

Kentucky Tax Talk: What 3 Bills Show About Governor's Plans

By Mark Sommer, Daniel Mudd and Elizabeth Mosley

Following the November Kentucky gubernatorial election, and the start of a new administration, the new year brought to the commonwealth several tax concerns to monitor: Is Gov. Andy Beshear going to continue to pursue his campaign promises of increasing tax revenue through gaming and other methods? Is the Republican-controlled Legislature going to support any of Beshear's proposals?



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Alternatively, will the Legislature continue to initiate more expansive tax reforms following two important tax legislation years in 2018 and 2019?[1] Will the Kentucky Department of Revenue continue to focus on increased guidance and transparency, as it did under the prior administration, or instead seek increased audits and enforcement?

Now that the commonwealth is approximately three months into Beshear's first term, as well as halfway through the 2020 legislative session, some of these topics have been addressed. There have been three noteworthy legislative tax proposals in the past few months.



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First, early this year H.B. 261 was filed in efforts to clean up some of the changes implemented in 2019. Second, in January Beshear announced his 2020-2022 budget plan, surprising many with certain tax reform proposals. Third, and most recently, H.B. 416 was introduced on Feb. 14, and seeks to do many of the things proposed by Beshear's budget plan and potentially roll back changes made in 2018 and 2019.

Tax Clean-Up Bill

On Jan. 15, Kentucky Appropriations and Revenue Chairman Steven Rudy introduced a technical clean-up bill, H.B. 261, in efforts to alleviate some confusion caused by changes made in 2019. The bill addresses minor issues such as incorrect statute references. It also addresses larger concerns related to needed technical guidance for significant 2019 tax reform changes, including additional clarity on marketplace facilitator requirements and mandatory unitary combined income tax reporting.



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H.B. 261 clarifies some minor changes made in 2019, such as Kentucky's estimated tax penalty to clarify that the penalty is not an addition to tax, but is still considered a penalty, and thus no interest shall accrue on the amount of said penalty being assessed by the revenue department.

The bill expands administrative discretion given to the revenue department in a variety of fields. It removes the statutory list of items required to be electronically filed. Instead, it places discretion with the Department of Revenue to determine which returns, reports or statements must be electronically filed. H.B. 261 also amends the requirement that the sheriff mail H.B. 44 with each property tax bill, but will now allow the revenue department to display this information on its public website. Lastly, the revenue department must notify motor fuel dealers of the average wholesale price of gasoline on an annual basis instead of quarterly to match the 2015 change from quarterly to annual ability to adjust the rate of the

same.

Next, H.B. 261 clarifies recent changes to the sales and use tax following the U.S. Supreme Court's decision in *South Dakota v. Wayfair*. Kentucky now requires marketplace facilitators, as retailers, to collect and remit state sales tax on behalf of smaller remote sellers using the facilitator's platforms and/or resources. H.B. 261 provides some logistical information for collecting and remitting these taxes. Similar to what other states have enacted, it provides that no later than 60 days after the threshold for sales or transactions is exceeded the marketplace provider must register and collect the tax from the consumer by the first day of the calendar month.

H.B. 261 also addresses some prior confusion in relation to business income tax reporting. In 2019, the commonwealth moved from nexus consolidated to mandatory unitary combined reporting (with elective U.S. consolidation). This change caused some confusion in relation to the limited liability entity tax, or LLET, as it also uses the term "combined group" but with a different meaning. Because of the change to combined reporting for income tax purposes, many taxpayers wondered if this would also change the meaning of the term for LLET purposes.

H.B. 261 clarifies that a consolidated group is allowed to file a single LLET return even if filing a consolidated income tax return, but that a combined group is not able to file a single LLET return because each taxpayer is a separate tax-paying entity.

Lastly, the bill amends Kentucky Revised Statutes Section 141.201 to clarify which corporations may or may not be included in a consolidated return. H.B. 261 states that by electing to file a consolidated return, the affiliated group is voluntarily subjecting each member of the affiliated group to the commonwealth for tax purposes.

This change likely relates to the Kentucky Court of Appeals' decision in *Department of Revenue v. AT&T Corp.* finding that the statute was ambiguous as to which subsidiaries of a company are considered part of the affiliated group for Kentucky tax purposes.

Beshear's Budget Address

As stated in our December Law360 article "A New Governor's New Tax Ideas," Beshear recently announced his much-anticipated 2020-2022 proposed budget for the commonwealth. While campaigning, he pushed to increase tax revenue through legalizing casinos, online and sports betting, taxing vapor products, and also legalizing marijuana.

Now that Beshear is finalizing his administration, and the 2020 General Assembly legislative session is in full swing, his budget proposal deviates from what many expected following not only the governor's expressed tax priorities while campaigning, but also the general direction the commonwealth was moving in regards to tax reform.

First, Beshear's recently announced plan for expanding gaming laws differs from what he expressed while campaigning. Largely because of the Republican-controlled Senate's open distaste for legalized brick-and-mortar casinos, Beshear's January announcement is silent as to casinos. Instead, it focuses on expanding wagering on college sports, online gambling such as fantasy sports and online poker, and sports wagering at horse tracks, professional sports venues, and/or online platforms.

The next portion of Beshear's budget plan that surprised many is his intent to expand the LLET. This is a stark contrast from his predecessor, former Gov. Matt Bevin, who advocated

for years to eliminate the LLET to improve the economic and tax climate for corporate taxpayers in Kentucky. But, under Beshear's current proposal, the minimum LLET would not be eliminated. It would instead increase from \$175 to \$225 effective Jan. 1, to bring in additional revenue.

Not surprisingly, Beshear also proposed tax increases and additions for tobacco-related products. Following several other states' lead, the budget plan would impose a 10 cent tax per fluid milliliter for vaping products effective July 1, with the possibility of an additional floor tax.

Additionally, the proposed budget continues to raise the cigarette tax from \$1.10 per pack to \$1.20 per pack, implement a floor tax, increase the tax on moist snuff and chewing tobacco from 19 cents per unit to 38 cents per unit, and includes a 15% raise on the sales tax of other tobacco products' wholesale price. Tax increases targeted at tobacco products have been a continual trend, so this announcement, while not advocated in Beshear's campaign, was not surprising to most.

Another interesting addition to Beshear's budget proposal is increased funds for hiring staff and enforcement at the revenue department. According to his plan, the revenue department will be hiring up to 50 new full-time employees. In the previous administration, much of the revenue department's focus was towards guidance and communication on the front end through updated regulations, formalizing of guidance requests by taxpayers, and other informational materials as opposed to enforcement.

Beshear's budget announcement, coupled with the revenue department's policy shift, lead many to believe there will be an increased trend in both desk and field audits in the coming years. Such suspicions were confirmed during legislative committee meetings when the new budget director John Hicks explained this new focus on the record. This will likely mean increased compliance costs for businesses, as well as more tax litigation in the coming years.

New Comprehensive Tax Reform Bill

Lastly, on Feb. 14, H.B. 416 was introduced to the Appropriations and Revenue Committee. This Democrat-backed bill is labeled as a comprehensive tax bill intended to implement many of Beshear's budget proposals.

For example, the bill proposes to include vapor products in the definition of taxable tobacco products, increase the tax on tobacco products generally, including a floor stock tax, and impose surtax amounts on horse racing wagers to be put in the general fund.

In addition to providing legislative support for Beshear's budget plan, H.B. 416 also proposes more expansive tax reforms such as reversing several changes made in the 2018 and 2019 legislative session.

The bill proposes to increase the corporate income tax rate to 7% and lower the threshold amounts for tax owed, reinstate the three-factor apportionment formula and include a throwback rule, eliminate the deferred tax deduction, amend Kentucky Revised Statutes Section 141.201 to sunset the election for consolidated reporting, alter the filing requirement basis from waters-edge to world-wide, reduce the annual cap, sunset the new markets tax credit, and eliminate the cap on calculation of gross receipts.

Other changes proposed in the bill would freeze the state property tax rate and eliminate

the tax rate reduction for qualified heavy equipment, allow taxation of boat ramp fees, remove the exemption of gross receipts from the sale of semi-trailers and trailers, and impose an estate tax.

Apart from the inclusion of vaping products as taxable tobacco products, and the increased tax on tobacco products generally, it will likely be difficult for the more substantive provisions in H.B. 416 to pass because the Legislature is controlled by the Republican party, many of whom supported the 2018 and 2019 changes this bill seeks to reverse. The bill is still something that should be monitored closely.

While H.B. 261, Beshear's budget plan, and H.B. 416 have provided some tax changes, with roughly 30 days remaining in the legislative session, and the revenue department's expected uptick in enforcement, 2020 could still lead to big changes for the business and tax community in Kentucky. Stay tuned for more!

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