



2018 Kentucky Tax Changes House Bill 487





The Making of House Bill 487 SCS

- ▶ HB 487 SCS was enrolled after the HB 366 FCCR veto over-ride.
- ▶ HB 487 SCS has 162 sections; 30 sections contain differences from HB 366 FCCR
 - ▶ 14 new sections;
 - ▶ 9 policy changes;
 - ▶ 5 clarifying changes; and
 - ▶ 2 sections with conforming changes.
- ▶ Every component of HB 366 FCCR is included in HB 487 SCS
- ▶ HB 487, being the later-passed bill, should prevail for successful mergers in instances of policy changes between the bills.
- ▶ Ultimately the work of the statute reviser will determine the exact codification where conflicts exist.

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Fiscal Impact of House Bill 487 SCS

- ▶ There was no official score for FY18 due to the effective date of HB 487 being July 14th. However, there could be some minor changes in FY18:
 - ▶ Withholding tables changed May 1st
 - ▶ Estimated income tax payments in June (FY18)
- ▶ FY19 fiscal impact was +192.3 million
 - ▶ Sales Tax +\$208.2 million
 - ▶ Corporate Income -\$27.6 million
 - ▶ Individual Income -\$118.3 million
 - ▶ Tobacco Taxes +\$130 million
- ▶ FY20 fiscal impact was +197.5 million
 - ▶ Sales Tax +\$277.7 million
 - ▶ Corporate Income -\$71.9 million
 - ▶ Individual Income -\$118.3 million
 - ▶ Tobacco Taxes +\$110 million

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Implications for the State Budget Office

- ▶ In many cases, tax law changes created winners and losers.
- ▶ We don't hear from many winners.
- ▶ Altered the official revenue estimates by the scores in the previous slide.
- ▶ Will alter the process of revenue estimation going forward.
 - ▶ Most models assume a constant policy regime in the time series of numbers
 - ▶ Past may no longer be correlated with future observations
 - ▶ Hard to tease out the effects of tax changes from the monthly data
- ▶ Receipts may fluctuate as implementation issues get quickly resolved.



House Bill 487 Key Effective Dates

For tax years beginning on or after January 1, 2018

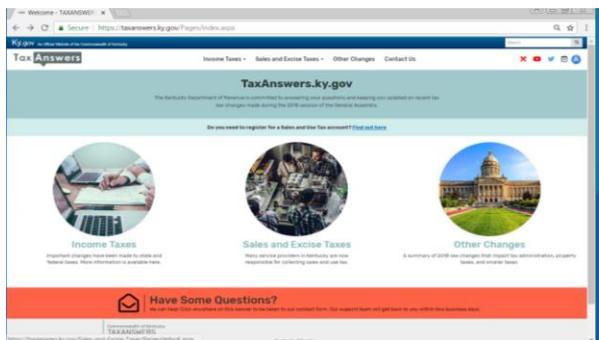
- Flat tax rate of 5% for individuals and corporations
- Elimination of many Individual Income Tax deductions
- IRC Conformity for Income Tax updated to December 31, 2017 including P.L. 115-97
- Single Sales Factor & Market Based Sourcing

Sales after July 1, 2018:

- Sales Tax on various services, participatory admissions, extended warranties, installation with purchase of tangible personal property
- Cigarette Tax Increase

For tax years beginning on or after January 1, 2019

- Unitary Combined & Elective Consolidated Group Filing





Implementation of House Bill 487

- The Department has or will issue guidance on the new tax law changes via:
- ▶ A new website, TaxAnswers.Ky.gov went live on May 30th.
 - ▶ Publishing and updating Frequently Asked Questions and Answers at TaxAnswers.ky.gov
 - ▶ Publishing Technical Advice Memorandum's on complex issues created by the changes
 - ▶ Filing Administrative Regulations that relate to the new tax law changes
 - ▶ Issuing Private Letter Rulings when requested by specific taxpayers
 - ▶ Participating in seminars to describe the changes. The Dept. of Revenue has made presentations to the Kentucky Society of CPAs; Council on State Taxation, Tax Executives Institute, the Kentucky Chamber, Finance & Administration Cabinet Executive Staff, and Dept. of Revenue Field Operations Staff.
 - ▶ Meeting with various industry groups impacted by the enacted changes.
 - ▶ Engaging in increased media exposure to distribute information about the changes.

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Expansion of the Sales Tax Base

Admissions and Services

- ▶ Participatory admissions, membership fees - Bowling centers; skating rinks; health spas; swimming pools; tennis courts; weight training facilities; fitness & recreational sports centers; golf courses, both public and private
- ▶ Transient Accommodations - Campsites, campgrounds, RV parks;
- ▶ Landscaping services (lawn care/maintenance; tree trimming, pruning or removal; landscape design and installation; landscape care/maintenance; snow plowing or removal services);
- ▶ Janitorial services - residential/commercial cleaning, carpet, upholstery, window cleaning;
- ▶ Small animal veterinary services, pet care (grooming, boarding, pet sitting, pet obedience training);
- ▶ Industrial laundry and linen supply services;
- ▶ Non-coin-operated laundry and dry cleaning services;
- ▶ Indoor tanning services;
- ▶ Non-medical diet and weight reducing services;
- ▶ Limousine services with a driver; and
- ▶ Extended warranty services sold on or after July 1, 2018 for tangible personal property or digital property that is taxable to the warranty holder.

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Expansion of the Sales Tax Base

Effective July 1, 2018

Installation Key Issues:

- ▶ Gross receipts subject to sales tax will include installation/repair labor associated with the sale of taxable tangible personal property, digital property, or services. This labor component becomes taxable if part of a taxable retail sale.
- ▶ Charges for the installation of fixtures to real property or for labor to repair fixtures to real property are not part of gross receipts subject to sales tax. See 103 KAR 26:070 for more information on fixtures and building materials used in construction contracting.
- ▶ There is an exemption for charges for repair or installation labor for taxable tangible personal property used directly within the manufacturing process
- ▶ This law change does not affect contractors involved in building construction or repairs to real property.

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Sales Tax Changes for Nonprofit Entities

- ▶ Due to the expanded definition of admissions in HB 487 and recent guidance from the Kentucky Supreme Court in the *Interstate Gas Supply* case, nonprofit 501(c)(3) groups must collect sales tax on their charges for all categories of taxable admissions for periods beginning July 1, 2018, forward.
- ▶ In its decision, the Supreme Court confirmed the Ky. Constitution Sec. 170 exemption for charitable institutions applied only to property taxes and not to excise taxes (sales and use tax).
- ▶ The only sales tax exemptions for 501(c)(3) charitable, educational and religious organizations are those explicitly listed in KRS Chapter 139.
- ▶ Sales tax law (KRS 139.497) provides an exemption for sales by elementary or secondary schools or by their nonprofit school-sponsored or school affiliated groups if the net proceeds from the sales are used solely for the benefit of the elementary or secondary school or its students.

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Application of Sales Tax on Affected Services on or after July 1, 2018

- ▶ If a payment is made prior to July 1, 2018 for a taxable services enacted under HB 487 and performed July 1, 2018 and thereafter, sales tax would not be due on that specific payment.
- ▶ If a taxable service enacted under HB 487 is performed prior to July 1, 2018 and payment is made for that service July 1, 2018 or thereafter, sales tax would not be due on that specific payment.
- ▶ If a taxable service enacted under HB 487 is performed July 1, 2018 and thereafter and payment is made for that service July 1, 2018 and thereafter, sales tax would be due and payable.

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Additional Sales Tax Changes

Effective July 1, 2018

- ▶ Nexus Expansion for Economic Presence for a Remote Retailer - \$100K/200K transactions threshold as in the Wayfair case
- ▶ Industrial processing - consistent use of terminology for Machinery for New & Expanded Industry and Industrial tools/supplies
- ▶ Clarification regarding cost of production for partial energy exemption related to tolling operations
- ▶ Elimination of pollution control exemption for sales & use tax
- ▶ Suspension of motion picture rebate until July 1, 2022

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Excise Tax Increases

- ▶ \$0.50 Cigarette tax increase, effective July 1, 2018;
- ▶ Cigarette floor stocks of \$0.50 with 3 installments (July 10, Aug 10, and Sep 10, 2018); and
- ▶ Motor Vehicle Tire Fee increased to \$2, part of gross receipts subject to sales tax.

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Income Tax Changes

- ▶ Flat tax rate of 5% for individuals and corporations, beginning on and after 1/1/18
- ▶ Federal conformity provisions were updated to December 31, 2017. The update adopted many provisions in the Tax Cuts and Jobs Act on the effective dates specified in that Act.
- ▶ HB 487 did not amend the depreciation differences between Kentucky income tax law and federal income tax law.
- ▶ The Corporation Income Apportionment Factor was changed to Single Sales Factor with Market Based Sourcing, beginning on and after 1/1/18.
- ▶ Mandatory Unitary Combined or Elective Consolidated Group Filing is effective for tax years beginning on or after 1/1/19.

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Federal Tax Reform

Income Tax - Public Law 115-97

- **Kentucky Adopted:**
 - Net Operating Losses (IRC Sec. 172)
 - Net Interest Expense Limitation (IRC Sec. 163(j))
 - Repeal of Domestic Production Activity Deduction (IRC Sec. 199)
 - Foreign Derived Intangible Income (FDII) (IRC Sec. 250)
 - Repeal of Moving Expense Deduction & Corresponding Reimbursement Exclusion (IRC Sec. 132 & 217)
 - Repeal of Deduction for Alimony Payments and Inclusion of Alimony Received in Taxable Income for post-2018 Divorce Agreements (IRC Sec. 215 & 61)
- **Kentucky Decoupled:**
 - Full Depreciation Expensing (IRC Sec. 168(k))
 - Deduction for Qualified Business Income of Pass-through Entities (IRC Sec. 199A)

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Additional Corporation Income Tax Changes

- **Mandatory Nexus Consolidated** continues for tax years beginning before January 1, 2019
 - The 50% net operating loss (NOL) limitation is *eliminated* along with mandatory nexus consolidated filing for tax years beginning on or after January 1, 2019
- Adopt the 80% federal NOL limitation under IRC Sec. 172(a) for NOL generated after January 1, 2018
- Adopt federal unlimited carryforward of unused NOL
- Kentucky does not allow a NOLD carryback for tax years beginning on or after January 1, 2005

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2018 KY Legislative Session

Apportionment

For tax years beginning on or after January 1, 2018:

- **Single Sales Factor**
- **Market Based Sales Sourcing**
 - Receipts from services and the sale of intangibles are in Kentucky if the taxpayer's market for the sales is in Kentucky.
 - Sale, rental, lease or license of real property if the property is in KY
 - Rental, lease or license of tangible property if and to the extent the property is in KY
 - Sale of service to the extent the service is delivered in KY
 - Intangible property to the extent it is used in KY
 - Throw-out rule for receipts attributable to intangible property if the taxpayer is not taxable in the state to which the receipts are assigned, or the state of assignment is indeterminable

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2018 KY Legislative Session

Apportionment

For tax years beginning on or after January 1, 2018:

- **Three factor apportionment retained for companies in the business of providing:**
 1. Communications service as defined in KRS 136.602;
 2. Cable service as defined in KRS 136.602; or
 3. Internet access as defined in 47 U.S.C. sec. 151.
- **Special Apportionment**
 - Passenger Airlines & Qualified Air Freight Forwarders
- **Alternative Apportionment**
 - Taxpayer must prove by clear and convincing evidence that the apportionment requirements do not fairly represent the extent of the taxpayer's activity in Kentucky

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2018 KY Legislative Session

Corporation and Pass Through Entity Taxes

For tax years beginning on or after January 1, 2019:

- **Corporation Tax Filing:**
 - Unitary Combined Group filing required; **unless**
 - The group elects a 96 month same-as-federal consolidated group filing; **otherwise**
 - Separate entity filing if not part of a unitary or consolidated group
- **E-filing required for separate corporation and pass-through entity returns with federal gross receipts exceeding \$1,000,000**

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2018 KY Legislative Session

Tax Credits

• **Inventory Tax Credit**

- Nonrefundable and nontransferable credit against income and limited liability entity tax for ad valorem (property) tax **timely paid on inventory on or after January 1, 2018**
 - Phased in: 25% in 2018; 50% in 2019; 75% in 2020; and 100% in 2021 and thereafter

• **Film Tax Credit**

- Refundable for applications approved prior to the enactment (**April 27, 2018**) and made nonrefundable and nontransferable for applications approved thereafter
- Annual cap on approvals of \$100 million for 2018 and thereafter
- Commercials no longer qualify for the credit

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2018 KY Legislative Session

- **HB 366** was a tax and revenue measure that passed via veto override on April 13, 2018.
- The bill repealed several economic development tax incentives.
- However, House Bill 487 rescinded the repeal of those economic development incentives including the Kentucky Jobs Retention Act (KJRA) and Incentives for Energy Independence Act (IEIA).
- House Bill 487 passed the General Assembly on April 14, 2018 and became law on **April 27, 2018**.
- Thus, the passage of House Bill 487 means the KJRA and IEIA incentive programs stay in place.

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2018 KY Legislative Session

House Bill 557 - Tax Incentives

- Enacted multiple changes to various economic development incentive programs.
- Little used programs were repealed, including the Kentucky Environmental Stewardship Act.
- Other programs were sunset, including the Incentives for Energy Independence Act (IEIA), *effective August 1, 2018*.
- Several technical changes were made to improve program administration for the approved companies and Cabinet for Economic Development.

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2018 KY Legislative Session

Individual Income Tax - Itemized Deductions

For tax years beginning on or after January 1, 2018:

- **Maintained deductions for:**
 - Home mortgage interest, points, and qualified mortgage insurance premiums
 - Charitable contributions, and
 - Some miscellaneous deductions
 - Amortizable premium on taxable bonds (IRC Sec. 171)
 - Federal estate tax on income in respect of a decedent (IRC Sec. 691)
 - Repayments of more than \$3,000 under a claim of right (IRC Sec. 1341)
 - Unrecovered investment in an annuity (IRC Sec. 72)
 - Loss from other activities from Schedule K-1 (Form 1065-B), box 2
- **Several Itemized Deductions Eliminated**
 - Investment interest (IRC Sec. 163)
 - Taxes (IRC Sec. 164)
 - Casualty or theft losses and gambling losses (IRC Sec. 165)
 - Medical and dental care expenses (IRC Sec. 213)
 - Moving Expenses (IRC Sec. 217)
 - Other miscellaneous deductions subject to the 2% of AGI limitation (IRC Sec. 67)

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Individual Income Tax

For tax years beginning on or after January 1, 2018:

- Pension exclusion decreased to \$31,110 (previously \$41,110)
- \$10 personal tax credits for taxpayers and dependents eliminated
 - Retained credits for over age 65, blind, and Kentucky National Guard Members
- **Itemized Deductions:** The dollar limit cap (Pease Limitation) was eliminated for high income taxpayers

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2018 KY Legislative Session

Property Tax Changes

- Clarifies that prewritten computer software is subject to state and local ad valorem tax **beginning on January 1, 2019.**
- “Prewritten computer software” is defined to be the same as the sales tax definition.

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LEGISLATIVE UPDATES

Tax Administrative Changes

- **KRS 131.110** was amended to increase the time to submit a protest to 60 days, applicable to notices of tax due **issued on or after July 1, 2018.**
- **KRS 131.081** was amended to prohibit the Department from entering into a contingent fee contract for audits, collections or legal services if the service performed is contingent upon the amount of tax, interest, fee, or penalty assessed against or collected from the taxpayer.
- **KRS 49.250** was amended to eliminate the requirement that payment of the tax due or posting of a supersedeas bond be made to appeal an order sustaining a tax assessment.
- **KRS 141.210** was amended to increase the time frame for notifying Kentucky of a federal audit final determination from 30 to 180 days.

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THANK YOU!



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