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Is Kentucky's Tax Reform Dead On Arrival?

[House Bill 487](#) [1] in its final form was introduced as a committee substitute, debated and voted out of the Kentucky House of Representatives[2] and the Kentucky Senate[3] on Saturday, April 14, 2018, the last day of the General Assembly's 2018 regular session.[4] Becoming law without the signature of Kentucky Gov. Matt Bevin by expiration of the 10-day veto window,[5] as an "emergency" bill, many of its provisions became effective on April 27, 2018.[6] Some provisions were effective retroactive to Jan. 1, 2017,[7] while all of the tax reform's provisions concerning sales and use tax, became effective on July 1, 2018.[8]

Kentucky's [generations-long effort at tax reform](#) and with it the significant changes [HB 487](#) made — such as a flat 5 percent income tax rate, movement to single-sales factor and market-sourcing standards, adoption of sales tax on many services and admissions and also adoption of mandatory combined reporting (unitary) — were huge. And all moved ahead smartly for two months, positively and with certainty that, until several weeks ago and after a Kentucky trial court issued an opinion and order in a challenge brought by Kentucky's attorney general concerning another landmark bill, [Senate Bill 151](#). [9]

In [Commonwealth ex. rel. Beshear v. Bevin, et al.](#), the so-called pension bill challenge, the trial court declared SB 151 unconstitutional on its face for two violations of long-standing constitutional provisions governing the enactment of legislation. It is this finding which has placed HB 487 in jeopardy today and with it several bills which collectively comprise the 2018–2020 budget.[10]

The Franklin circuit court in *Beshear v. Bevin*, above, ruled that the Kentucky Constitution's requirement that a bill must be read in full three times before it may be voted on, was violated.[11] [Section 46](#) of the Kentucky Constitution has read as follows since Sept. 28, 1891:

No bill shall be considered for final passage unless the same has been reported by a committee and printed for the use of

the members. Every bill shall be read at length on three different days in each House, but the second and third readings may be dispensed with by a majority of all the members elected to the House in which the bill is pending. But whenever a committee refuses or fails to report a bill submitted to it in a reasonable time, the same may be called up by any member, and be considered in the same manner it would have been considered if it had been reported. No bill shall become a law unless, on its final passage, it receives the votes of at least two-fifths of the members elected to each House, and a majority of the members voting, the vote to be taken by yeas and nays and entered in the journal: Provided, any act or resolution for the appropriation of money or the creation of debt shall, on its final passage, receive the votes of a majority of all the members elected to each House.

Under a decades-old legislative tactic, the pension bill text added via a committee substitute motion on March 29, 2018, was not read three times.[12] That is SB 151 had been read three times, but when read was actually entitled “An act relating to the local provision of wastewater services.” On the last day of the 60-day legislative session, an amendment to what was then an eleven-page sewer bill was offered and effectuated, the result being a 291-page history making pension reform bill, which was then voted on by the House[13] and the Senate.[14] The governor subsequently signed the pension bill, SB 151.[15]

In its review, the Franklin circuit court took exception with this legislative maneuvering, notwithstanding that this tactic has purportedly been used hundreds of times by the legislature.[16] It did so in the face of a visible and active media effort to highlight the many pieces of recent legislation that would be constitutionally suspect if the court found SB 151 violated Section 46 of the Kentucky Constitution and its three readings rule. Notwithstanding the media firestorm, it seemed no one ever mentioned HB 487 or the budget bill — the new revenue source for biennial budget purposes being HB 487. One could conclude that if HB 487 violates Section 46 of the Constitution, then it is unconstitutional and thus void ab initio, as the court found when reviewing SB 151.[17] And if HB 487 is void ab initio, then the budget bills are unconstitutional as

they, mathematically, are not balanced, which violates [Kentucky Constitution Section 171](#), requiring revenue to be sufficient to defray the estimated expenses of the commonwealth.

A read of the court's historical analysis is worthwhile here. The Franklin circuit court stated as follows in finding that the pension bill violated Section 46 of the Constitution:

This case presents two primary issues under Section 46 of the Kentucky Constitution, which sets forth explicit requirements for the enactment of legislation. First, Section 46 requires that each bill must be printed and "read at length on three different days in each House." Thus, this case presents the question of whether legislation can be expedited through the General Assembly through the method of completely deleting one piece of legislation that has been through the process and received its required readings, eliminating every word of the original bill and substituting an entirely new bill on a different subject as a "committee substitute," then bringing the new bill to a vote without the three readings, which would otherwise be required under Section 46 of the Kentucky Constitution if the new bill had been proposed on its own merits. The principle is well established that "the General Assembly cannot do by indirection what it cannot do directly because of constitutional restrictions." *Commonwealth v. O'Harrar*, 262 S.W.2d 385, 389 (Ky. 1953). Here, could the legislature do indirectly what Section 46 of the Constitution forbids it from doing directly?

* * *

As explained above, the three-readings requirement is designed to provide public notice of the contents of the legislation, the most fundamental requirement of any legislative process based on the consent of the governed. [T]his requirement is a fundamental safeguard for the right of all legislators to know what they are voting on and the right of the public to voice support or opposition to legislation before it is called for a vote, rights which are essential to democratic government.

* * *

Section 46 states, in part, “Every bill shall be read at length on three different days in each House, but the second and third readings may be dispensed with by a majority of all the members elected to the House in which the bill is pending.”

* * *

[T]he drafters of this provision were greatly concerned with “the fraudulent substitution of bills” that had so frequently occurred in the past and hoped to prevent similar abuses in the future. For example, Delegate Spalding stated that bills had been brought to the Speaker for signature “in batches of twenty, thirty, forty or fifty, and the Speaker would sign them without knowing what he was signing.” At other times, bills had passed both Houses and had been delivered to the Governor for signature within a single day. The drafters believed that this “hasty mode of legislation ought to be checked, not only in the interest of the people, but in the interest of the legislative body itself.” As a result, the drafters enacted Section 46 “to throw guards around hasty legislation, and render it impossible for ... bills to be railroaded through the Legislature.” Thus, the readings requirement of Section 46, when duly observed, invites “caution and deliberation in each house” during an open legislative process, ensuring that members of the legislature remain well-informed and know what they are voting for.

The wholesale changes in SB 151 rendered the first three readings in the Senate and two readings before the House meaningless. Reliance on those previous readings would have led the legislators to believe that they voted on a bill for the acquisition of wastewater services. However, instead of an eleven-page bill related to the acquisition of wastewater services, the General Assembly actually enacted a 291-page bill that altered the retirement plans of over 200,000 current employees and future hires and did so in such a way that legislative leaders recognized that the title of the bill had to be rewritten.[18]

A rather lucid, but plodding analysis by the court, one could conclude.

Applying the legislative facts of SB 151 to HB 487, one can see a cause for concern. Here is where the rub occurs — HB 487 was read three times, but was read as a half page “tax credit” bill and was entitled “An act relating to economic development and workforce development.”[19]

It was then gutted[20] by the House of Representatives and a committee substitute of over 417 pages was made, literally on the 60th and last day of the session, voted on and then moved over to the Senate for a concurrence vote.[21]

The legislative record,[22] which memorializes all legislative actions during a session, makes it clear that the same three reading rule applied by the Franklin circuit court in declaring the pension bill, SB 151, unconstitutional was violated in the legislation of HB 487. These facts are not disputable.

And so, as a result of *Beshear v. Bevin*, after less than two months, the landmark tax reform legislation now faces a possible constitutional attack. And since the legislature will not reconvene until Jan. 8, 2019, if HB 487 is struck down, serious constitutional and separation of powers issues are potentially raised due to the linkage of HB 487’s reported additional \$400 million net new revenue being the “balancer” of the biennial budget bills. For if the budget does not balance, it is likewise constitutionally suspect under Section 171 of the constitution. And that raises potential separation of power questions.

It has been a wild first half of 2018 in the commonwealth, and with legislative elections coming this November, including all 100 House seats up, the second half of 2018 may be even a rougher ride.

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[1] H.B. 487, 2018 Gen. Assemb., Reg. Sess., 2018 Ky. Laws 207 (2018), 2018 KY LEGIS 207 (Westlaw).

[2] <http://www.lrc.ky.gov/record/18RS/HB487.htm>

[3] Id.

[4] Id.

[5] Id.

[6] Note 1, supra at Sections 150–156.

[7] Id. at Section 153.

[8] Id. at Section 152.

[9] Commonwealth ex. rel. Beshear v. Bevin, et al., Civil Action Nos. 18–CI–379 and 18–CI–414 (Franklin Cir. Ct., Div. I), https://ag.ky.gov/pdf_news/20180620_Order.pdf.

[10] H.Bs. 201, 203, 204 and 265, 2018 Gen. Assemb., Reg. Sess.:

<https://osbd.ky.gov/Publications/Documents/Budget%20Documents/2018-2020%20Executive%20Budget%20Recommendation/Budget%20in%20Brief%20Final%20with%20Cover.pdf>

[11] Note 9, supra.

[12] Note 2, supra.

[13] <http://www.lrc.ky.gov/record/18RS/SB151.htm>

[14] Id.

[15] Id.

[16] <http://wfpl.org/judge-rules-Kentucky-pension-bill-unconstitutional-appeal-likely/>

[17] Note 9, supra at 29–31.

[18] Note 9, supra at pp. 5–6; 18–19; 21–22. Internal citations omitted throughout.

[19] Note 2, supra.

[20] Id.

[21] Id.

[22] Id.

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