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Kentucky Issues New Tax Regulations – Part 2

The Importance of Tax Regulations and its Critical Role After Kentucky's Recent Tax Reform

As discussed in my previous blog post: [Kentucky Issues New Tax Regulations – Part 1](#), Regulations have a critical role in the world of tax and can be both helpful and harmful to taxpayers in several instances. The importance of Regulations is even more evident after there has been tax reform efforts at the Federal, state and/or local levels.

Kentucky is the perfect example of this after it recently passed substantial tax reform legislation in 2018 and 2019, and is now slowly rolling out its view of the new tax laws through the repeal, creation and amending of dozens of Administrative Regulations. This post will look more closely at many of the recent Regulations the Kentucky Department of Revenue ("Department") released to the public as a result of this tax reform and their likely effect on the business community.

One must pay close attention to the details of these Regulations not only for a general understanding of the new laws, but also to make sure new interpretations of old tax laws aren't thrown in too and become the law before anyone notices or objects to same.

Although the Department worked with representatives from our firm, and other Kentucky tax professionals and organizations, in crafting these regulatory changes, the Department ultimately has the final say on the proposed language. Given its importance to the implementation of Kentucky's new tax code, we take a deeper look at what has been proposed thus far.

Effect of Amended Regulations to Kentucky's Tax Reform

As background, the Kentucky General Assembly passed sweeping tax legislation in early 2018 which affected both corporate and

individual taxpayers on many levels. While an in-depth review of Kentucky tax reform can be found in my prior blog post [Kentucky Tax Reform – Big Changes for the Business Community](#), there is no question that 2018 H.B. 487^[1] made the most significant changes to Kentucky's tax structure in nearly a century that have already had massive effects on the business community – both negative and positive.

And to follow-up HB 487, the General Assembly once again passed significant tax changes in 2019 via H.B. 354^[2] and H.B. 458^[3] – primarily to fix the unintended extension of sales tax to nonprofits and tax pyramiding resulting from its expanded tax on services in 2018, but also making major modifications to its new mandatory combined/unitary reporting structure and other important business tax changes.

While the Department did a commendable job of initially providing informal guidance on the new laws in 2018 through its creation of a tax reform website^[4], the business community and us tax professionals know that the major policy changes and interpretations of the new statutes will come out in formally promulgated regulations which were first rolled out through monthly filings with the Legislative Research Commission ("LRC") in August and September 2018.

These first two rounds of regulatory changes proposed by the Department were its first attempt at clarification and clean-up after HB 487. For example, in August 2018, the Department proposed the full repeal of regulations related to the statute of limitations for assessments^[5], and regulations concerning coal-related taxable income, calculation of gross income for corporations and pass-throughs and expense deductions under Sections 168 and 179 of the Internal Revenue Code ("Code"), Kentucky's DPAD, and the deductibility of certain other state taxes in computing income tax ^[6] due to the Department's assertion that the authorizing statutes for such regulations either contain sufficient guidance on their own or the regulations have become irrelevant. The Department also repealed and consolidated many tax incentive program regulations into one regulation (103 KAR 18:180)^[7], as well as added various statutory citation and reference updates to several tax credit and

individual income tax-related regulations.

Further, in September 2018, the Department filed several other new regulations to: provide employers with needed guidance and procedures for new withholding-related changes to Kentucky's tax code^[8]; update estimated tax thresholds for short tax years^[9]; make updates to the Kentucky new markets and Endow Kentucky tax credit programs^[10]; add new statutory references for Kentucky residency definitions and standards for both corporate and individual taxpayers^[11]; and provide additional guidance on what income by nonresident estates, trusts and beneficiaries is subject to Kentucky income tax.^[12]

The Department's most recent rounds of proposed Regulations in October, November and December 2018, however, covered much meatier corporate income tax and policy issues, including: (i) business and nonbusiness income^[13]; (ii) income tax apportionment factors and market based sourcing after Kentucky adopted single sales factor (SSF) apportionment effective January 1, 2019^[14]; (iii) Kentucky corporate income tax nexus standards^[15]; (iv) additional details related to alternative apportionment requests and separate accounting for same after statutory changes made to KRS 141.120 in 2018^[16]; and (v) Kentucky's updated NOL rules under the new combined reporting regime^[17].

For example, significant changes were made to the apportionable income Regulation (103 KAR 16:060) which not only made technical changes therein (e.g., replacing terms business and nonbusiness income with the broader apportionable and non-apportionable terms) but also provided several, detailed examples of types of income and transactions which may constitute apportionable income for a multistate corporation.

But by far the most substantive and important changes made were to 103 KAR 16:270 – the income sourcing Regulation after Kentucky adopted both SSF apportionment and market based sourcing (replacing the cost of production methodology) – expanding the Regulation to 50-plus pages of guidance and several detailed examples applying Kentucky's new sourcing rules to different circumstances, activities and property, including sales of real property, tangible property, various services, intangible property,

and special rules for certain transportation and regulated industries.

While all of these new and amended Regulations are not yet final^[18], one thing is for sure – the Department will continue rolling out new regulations and other guidance over the next several months on other important subjects, including any changes resulting from the 2019 tax reform, such as the Department’s recent guidance on the new deferred tax deduction enacted in 2019 for public companies to help offset the effects of combined reporting.^[19]

And these regulations, of course, will not clarify or expound upon every single issue related to or arising from Kentucky tax reform, and therefore the new formal process Kentucky implemented in 2017 for requesting and receiving official guidance from the Department (e.g., private letter rulings, TAMs, etc.) has already proved to be a useful tool for us in helping clients obtain needed guidance for their particular activities. This ability to provide binding guidance, as well as the Department’s authority to finally include useful examples in Regulations and guidance, were all brought about in 2017 via important amendments to KRS 131.130, which have proved to be instrumental to making Kentucky a more business and taxpayer-friendly state, at least in terms of having more guidance and transparency.^[20]

Only time will tell what the full effect of these new Regulations will be on the business community, and any additional changes to come after the 2019 tax reform, but it is just another example of how critical Regulations are to tax administration, and for taxpayers and tax professionals to constantly be on top of the details and impact of same.

Attorneys at Frost Brown Todd continuously monitor Kentucky’s recent tax reform efforts and its effects on businesses. Should you have questions or would like additional information about these changes, contact [Daniel Mudd](#) or any attorney in [Frost Brown Todd’s Tax Law team](#).

^[1] 2018 H.B. 487 is available at <https://apps.legislature.ky.gov/record/18rs/HB487.html#HCS1>.

[2] 2019 H.B. 354 is available at <https://apps.legislature.ky.gov/record/19rs/hb354.html>.

[3] 2019 H.B. 458 is available at <https://apps.legislature.ky.gov/recorddocuments/bill/19RS/hb458/bill.pdf>

[4] The Department's press release and link to website is available at <https://revenue.ky.gov/News/Pages/TaxAnswers.ky.gov-to-Provide-Information-on-HB-487.aspx>.

[5] See 103 KAR 15:041 (repealing 103 KAR 15:040 and 103 KAR 15:090, eff. Dec. 7, 2018).

[6] See 103 KAR 16:011 (repealing 103 KAR 16:010, 103 KAR 16:210, 103 KAR 310 & 103 KAR 16:360, eff. Dec. 7, 2018).

[7] See 103 KAR 18:191 (repealing 103 KAR 18:190, 103 KAR 18:200, 103 KAR 18:210, and 103 KAR 18:220, eff. Dec. 7, 2018).

[8] See 103 KAR 18:050, 103 KAR 10:050E (filed as an "emergency" regulation, i.e., effective immediately, given the importance and short timeframe involved with these issues, eff. Jan. 4, 2019), 103 KAR 18:110, 103 KAR 18:120 & 103 KAR 18:150 (eff. Jan. 4, 2019).

[9] See 103 KAR 15:060 (eff. Jan. 4, 2019).

[10] See 103 KAR 15:180 & 15:195 (eff. Jan. 4, 2019).

[11] See 103 KAR 17:010, 17:020 & 17:060 (eff. Jan. 4, 2019).

[12] See 103 KAR 19:010.

[13] See 103 KAR 16:060 (eff. Feb. 1, 2019).

[14] See 103 KAR 16:290 (property factor, eff. Feb. 1, 2019); 103 KAR 16:340 (apportionment under the completed contract method of accounting, eff. Feb. 2, 2019); 103 KAR 16:270 (sales factor, eff. May 3, 2019); 103 KAR 16:151 (eff. May 3, 2019, repealing multiple, special apportionment/allocation regulations for various industries, including telephone companies [103 KAR 16:100], pipeline companies [103 KAR 16:110], trucklines, buslines and airlines [103 KAR 16:120], railroad companies [103 KAR 16:130], barge lines [103 KAR 16:145], and financial organizations and loan companies [103 KAR 16:150] after Kentucky's three-factor formula was eliminated).

[15] See 103 KAR 16:240 (publicly confirming the Department's believed internal, administrative position that Public Law 86-272's nexus/solicitation protections for income tax purposes does *not* apply to Kentucky limited liability entity tax ("LLET"), eff. Feb. 1, 2019).

[16] See 103 KAR 16:330 (eff. Feb. 1, 2019).

[17] See 103 KAR 16:250 (eff. Apr. 5, 2019).

[18] A full list of the new Regulations which have recently become effective can be found on the Department's website here: <https://finance.ky.gov/services/legalsvcs/Pages/FACfiledRegs.aspx> (last viewed May 16, 2019).

[19] See KY-RP-19-02 (Apr. 11, 2019), *available at* <https://revenue.ky.gov/TaxProfessionals/PublishingImages/Pages/Guidance/KY-RP-19-02%20%28Final%20Official%20Version%29.pdf>.

[20] This is despite the attempt to thwart such tax transparency via a last minute add to 2019 H.B. 354 (by unnamed sources) to prohibit the Department from producing relevant tax guidance through an open records request (e.g., final rulings, private letter rulings, alternative apportionment requests, etc.) which thankfully was later repealed by 2019 H.B. 458 once legislators became fully aware of its effect. We believe this effort has now backfired on those wanting to prevent transparency as the General Assembly has now specifically enacted legislation (H.B. 458) to confirm such disclosure is permitted going forward.

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