Kentucky Tax Talk: Budget Focuses on Pandemic Relief

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Authors:

Mark F. Sommer
Daniel G. Mudd
Elizabeth M. Ethington

The commonwealth's primary concerns have drastically changed since the start of the 2020 General Assembly's regular session in January. Whether it was newly elected Gov. Andy Beshear's anticipated plans for expanding gaming laws, the possibility of legalizing medical marijuana, or the 2020-2022 budget, most of these issues took a back seat in response to the COVID-19 pandemic.

On March 30, the governor signed S.B. 150 into law, providing support to individuals, businesses and health care providers in response to the spread of the coronavirus. While the Coronavirus Aid, Relief, and Economic Security, or CARES, Act was passed earlier this month, providing a variety of federal relief to individuals and businesses negatively affected by the virus, many state legislatures, including Kentucky's, chose to provide supplemental aid.

Some of the support provided in S.B. 150 includes: expanding eligibility for unemployment insurance benefits; allowing flexibility for telehealth services; authorizing local jurisdictions to extend filing and payment deadlines for local occupational license taxes; and instructing the Kentucky Department of Revenue to follow federal tax filing extension guidelines, to name a few.

In addition to legislation, the Kentucky DOR also made administrative changes in response to the pandemic — such as business and personal property tax filing and payment deadline extensions and requiring local counties to delay the annual real property tax appeal period from May to July.

While much of the Legislature's focus was on providing relief to Kentucky individuals and businesses affected by the pandemic, the General Assembly was still able to make some significant tax changes during the 2020 session.

First, H.B. 351 — while the bill was initially vetoed by Beshear, the House overrode the veto 57 to 32, and the Senate did the same with a 24 to 9 vote. H.B. 351 passed on the last day of the session. The

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original version of the bill was 24 pages, but by the time it was sent to the governor for signing, it contained 224 pages of tax changes. The original version of the bill covered primarily tobacco product tax expansion and other changes that were anticipated going into the session.

Yet, much of these anticipated changes did not make the cut in the final version of the bill, and the General Assembly instead adopted a wide variety of tax changes, many of which were not expected — especially considering the expansive tax reform enacted during the 2018 legislative session.

The final version of the bill added some very basic tax-related provisions, including:

- Requiring more transparency from local property value administrators;
- Changing the term "combined" to "affiliated" group for corporate income reporting to be more consistent with past income tax reform changes;
- Conforming to the new federal audit computations for partnership tax (which Beshear had vetoed as discussed further below);
- Creating a new tax credit program to incentivize farmers to sell to beginning farmers to help retain one of the state's most important industries;
- Providing some wins for Kentucky's bourbon and craft alcohol industry, such as:
    - Expanding the biodiesel production tax credit to renewable chemical production which could cover waste products from bourbon distilling and other processes (which Beshear had also vetoed);
    - Clarifying that Kentucky's sales tax exemption for machinery in new and expanded industry includes machinery directly used for most distilleries, wineries and breweries;
- Providing relief to the struggling coal industry in the form of a severance tax refund for those exporting; and

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- Subjecting vaping products to Kentucky's tobacco product tax at a rate of either 15% (similar to most other noncigarette tobacco products) for open vapor products typically bought at a vape shop or $1.50 per closed vapor cartridge, such as Juul cartridges (but the tobacco industry did withstand a push to also increase the tobacco tax on snuff and Snus).

While some of these changes are minor, expansion of tax incentives to sustain the farming industry and help to the bourbon and craft alcohol industry — both staples of the state's economy in need of aid due to the effects of COVID-19 — also help provide opportunity for new business in the state.

Some constitutional questions were raised as Beshear used a line item veto for H.B. 351; only in a budget bill can this occur.

The governor's reported contentions with the bill included discrepancies between the adoption of the new partnership level for tax assessments based on the new federal partnership audit rules and the current Kentucky laws governing partnership taxes; failure of the Legislature to provide how the new renewable chemical tax credit is calculated; and the belief that the language expanding the business machinery sales tax exemption is overly broad.

Nevertheless, the Legislature overrode the governor's veto and the bill moved forward.

Additionally, the General Assembly was entrusted with creating the 2020-2022 budget during this legislative session. Typically, the Legislature would have constructed a two-year budget, but with the uncertainty of the economic climate in response to the COVID-19 pandemic, in the 11th hour, the General Assembly instead adopted a one-year budget and will revisit the issue during the 2021 regular session.

While the governor attempted to veto several portions of the budget, H.B. 352, providing the executive branch budget, as well as the bills containing the judicial branch, legislative branch and the state's highway plan passed on April 15, creating $11.3 billion in general fund spending.

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The budget includes fully funded teachers pensions, but no increases in teachers' salaries or per pupil base funding (SEEK Program), as was earlier advertised by lawmakers; an increased budget for medical services in county jails; $47.5 million in bonds to assist in the construction of new schools; and funding for the Road Plan with highway projects listed as a priority through 2026.

While it is not the ideal budget for lawmakers and many of the promises made by Beshear and other legislators going into the session were not delivered, many have expressed that the budget is the product of a bipartisan effort to do what needs to be done and equip the commonwealth for the next year of uncertainty.

It is hard to predict whether some of the anticipated budget changes for this year will be implemented next year as the economic needs of the state continue to change as the governor's stay-in-place orders remain in effect. A special session later this year does not appear to be out of the question to deal with the budget and continuing issues due to the pandemic.

Local jurisdictions' taxing power was another focus of the 2020 legislative session.

S.B. 5 creates a new section of Kentucky Revised Statutes Chapter 65A that requires special purpose governmental entities wishing to levy or increase ad valorem taxes to request permission to do so from its governing or appointing body. This requirement does not apply to an air board, fire protection district or ambulance taxing district.

The bill was vetoed by Beshear, but the Senate overrode the veto, passing the bill 27 to 7 and the House did the same in a 56 to 30 vote. The governor's reason for vetoing the bill was that it would hinder the special purpose governmental entities because the entities are created to be flexible and move rapidly to address community challenges.

Another bill, H.B. 475, proposed expanding of local taxing power, did not pass this session but will likely be revisited in the next. The bill was introduced at the end of February, proposing an amendment to the Kentucky Constitution granting the General Assembly the power to authorize any county, city, town, or other municipality to asses

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and collect local taxes.

This would have given the General Assembly the flexibility to authorize local tax expansion, which is currently not allowed by the state Constitution. The push for local option sales taxes has gained support over the years, so with the growing need for funding to local governments, this bill may be of much more importance next session.

Local government revenue continues to severely suffer in response to the COVID-19 pandemic. Moving forward it is anticipated that expansion of local governments' power to both increase current tax rates and implement new forms of taxation will be not just a topic of interest, but a matter of necessity.

How the coronavirus pandemic will continue to shape the health and economy of the commonwealth is uncertain, but the General Assembly must continue to work to provide both temporary and long-term relief.

Several of the changes made this session, such as the COVID-19 relief bill and expanded credits and incentives for various industries, are helpful in the short term, but because Kentucky's economy is greatly dependent on manufacturing and other industrial jobs hit hard by government ordered shutdowns, it may struggle to bounce back from the unprecedented pandemic more than other states with more tech- and data-related economies.

Moving forward, the General Assembly will be faced with the difficult task of aiding both the suffering state and local taxing agencies while also providing aid to struggling industries and getting Kentucky citizens back to work.

For more information, contact Mark Sommer, Daniel Mudd, Elizabeth Mosley, or any member of Frost Brown Todd's Tax Practice.

***Note:** This article was originally published by Law360 (April 28, 2020)*

To provide guidance and support to clients as this global public-health crisis unfolds, Frost Brown Todd has created a Coronavirus Response Team. Our

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attorneys are on hand to answer your questions and provide guidance on how to proactively prepare for and manage any coronavirus-related threats to your business operations and workforce.

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