New Mandatory Electronic Filing in Kentucky – Benefit or Burden?

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In the wake of the COVID-19 pandemic, many businesses and government agencies have made changes to adapt to remote working and electronic communications – the Kentucky Department of Revenue (KDOR) is no different in this regard. Considering that KDOR and many other government agencies have struggled to remain in the office following executive stay-in-place orders and spikes in COVID-19 cases, it should not come as a surprise that KDOR is looking to find new ways to maintain remote and electronic work even beyond the pandemic.

On January 13, 2020, KDOR proposed 103 KAR 1:160 (the "Regulation"), effective for tax returns due on or after January 1, 2021, setting forth mandatory electronic filing and payment requirements for taxpayers.

In the first section of the Regulation, KDOR provides that all tax returns, reports, schedules, and statements shall be filed electronically with the department. Further, the Regulation provides that any fee payments also must be made electronically. The Regulation goes on to provide that this mandate applies to individual income taxes, corporate income taxes, limited liability pass-through entities taxes (LLET), employer income tax withholdings, general sales and use taxes as well as sales and excise taxes for tobacco producers, license fees and applications, commercial mobile radio service (CMRS) fees, gas and special fuels excise taxes, multichannel video programming and communications services excise taxes, transient room taxes, tire fees, and utility gross receipts license taxes. Thus, the Regulation's mandate is far-reaching in the taxpayers it affects.

Pursuant to previous statutory authority, KDOR was able to impose electronic filing mandates, but it was only statutorily required for certain types of taxes. Now, following the pandemic, KDOR has expanded this requirement.

Further, the Regulation imposes penalties for failing to comply with the mandate. Section 5 of the Regulation provides that "any person,

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taxpayer, or tax preparer who fails or refuses to comply with the requirements of this administrative regulation shall…pay applicable penalties." However, just as with other penalties imposed by KDOR, pursuant to the Uniform Penalty Act, if the taxpayer is able to show its failure to comply was based on reasonable cause, such penalties will be waived. This provision could pose problems for taxpayers, as theoretically a taxpayer could timely and correctly mail a tax return with payment and still receive penalties from KDOR for not submitting such filings electronically pursuant to the Regulation.

While this Regulation requires electronic filing for all taxpayers, it does allow for any taxpayer to request an advance waiver. However, the qualifications for the waiver are not specified, and are at the discretion of KDOR. Further, the Regulation does not provide whether the waiver can be applied to all taxes for all subsequent years or whether the waiver is limited.

KDOR cites the need to "enhance agency efficiency" as the purpose for the Regulation, and this regulation likely does so. However, the ultimate effect on KDOR is likely to be minimal while taxpayers will be burdened.

First, many taxpayers are already utilizing online filing where it is available, particularly in the business tax context. Many individuals also use various methods of electronic filing. Thus, it is unclear how many new taxpayers will be brought into the electronic filing fold.

Further, in its regulatory impact analysis of the Regulation, KDOR provides that some taxpayers may be required to pay nominal filing fees to software vendors depending on the software used by the taxpayer. While this may not be burdensome for many, it could be for small businesses or low-income individuals and the elderly.

More burdensome than software fees, however, is the problem of access. As Kentuckians have learned through observation of remote learning efforts for Kentucky schoolchildren, many Kentuckians don't have access to the internet or even a computer in some cases. While these individuals could pay for a third party to file for them, or go to a library and use public access computers, many people will struggle with this as well.

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The Regulation was filed with the Legislative Research Commission on January 14, 2021 and is subject to a public hearing on March 25, 2021 at 10 a.m. The Legislative Research Commission is also accepting written comments to the Regulation prior to the public hearing, if any taxpayers wish to raise questions or concerns.

We will continue to follow and report on this issue. For more information, visit Frost Brown Todd's Tax Law Defined Blog.

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