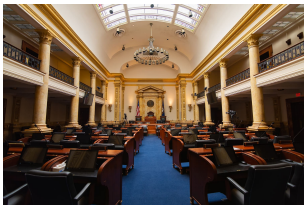

Kentucky Tax Talk: General Assembly Makes Strides to Assist Businesses During the 2021 Legislative Session

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Authors:

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

In our December and February Kentucky Tax Talk articles, we covered what to watch for going into the 2021 Kentucky legislative session in relation to the Commonwealth's taxes. Some hot button issues such as needed legislative approval of the newly reorganized Kentucky Board of Tax Appeals and addressing the Kentucky Supreme Court's recent decision striking down historical horse racing as a form of legal parti-mutuel betting were expected to face scrutiny. However, with a shorter than normal session, and a priority on passing a rare, one-year COVID-focused 2021 budget, major changes to Kentucky's tax code or structure were not expected.

Instead, the General Assembly used several tax initiatives to provide immediate assistance to struggling businesses and expand new industries in a post-pandemic world.

Business Expansion in the Bluegrass – Cryptocurrency, Historic Rehabilitation Tax Credit, Incentive Program Expansion

Several pieces of legislation were passed to expand new and existing industries in Kentucky. One such industry is cryptocurrency mining. While Kentucky is physically located in an optimal location for this industry based on its easy access to and relatively low cost of energy, Kentucky's tax statutes have not been designed in a way that allowed this industry to capitalize on. H.B. 230 and S.B. 255 were signed into law by Governor Andy Beshear to address this issue and allow this industry to expand in the Commonwealth. H.B. 130 provides a sales and use tax exemption at both the state and local level for energy purchased and consumed in the commercial mining of cryptocurrency. S.B. 255 enhances a state tax incentive program allowing sales tax refunds for equipment used to construct, retrofit, or upgrade a cryptocurrency mining facility in addition to potential income tax and wage assessment incentives. These bills are expected to provide an opportunity for Kentucky to enhance

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and diversify its manufacturing industry to include new and developing technology and capitalize on its ability to provide energy for such operations.

S.B. 162 also expands and amends a variety of other tax incentives governed by the Kentucky Cabinet for Economic Development encouraging businesses to relocate and expand in Kentucky. Some of the more substantive changes made by S.B. 162 include modifying the most used incentive program, the Kentucky Business Investment (KBI) program, by expanding the qualifying activities, as well as sunsetting the income tax credit related to the Kentucky Industrial Revitalization Act (KIRA) and modifying various portions of the Kentucky Reinvestment Act (KRA).

Two other pieces of legislation could have major effects on expanding industries in the Commonwealth. First, the Historic Rehabilitation Tax Credit (HTC) was expanded by increasing its cap to $100 million from $5 million for certified historic structures. To benefit from this increase, applications must be submitted on or after April 30, 2022. As many properties struggle to maintain value through the pandemic, this could provide an opportunity to rejuvenate and expand existing structures.

Another technology-based tax incentive bill (H.B. 372) was designed to provide substantial state and local tax incentives for large data center developments. Even though it passed both chambers of the General Assembly, Gov. Beshear ultimately vetoed it on April 9; however, similar legislation is likely to be revisited during next year's regular session, or potentially during a special session later this year. The General Assembly made clear it intends to encourage the development of the technology and advanced-manufacturing industries in Kentucky.

COVID-19 Recovery Relief – PPP Loan Business Expense Deductions and Out-Of-State Business Tax Protections

While the General Assembly made strides incentivizing new and expanding industries, it also provided additional and immediate COVID-19 assistance to all businesses. During the spring 2020 legislative session, the General Assembly passed S.B. 150 providing

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a variety of immediate relief to taxpayers from filing and payment deadline extensions to expanding eligibility for unemployment. Since that time, the federal government passed two additional stimulus packages providing ongoing aid; however, it has been unclear how much of this aid would be mimicked by states.

One example was the deductibility of business expenses paid for using federal Paycheck Protection Program (PPP) loan funds. In the December Consolidated Appropriations Act (CAA), Congress clarified that taxpayers that used PPP funds to cover business expenses could still deduct these expenses as per usual on their federal income tax returns; however, the Kentucky Department of Revenue (Department) issued guidance that it would not allow these deductions on state income tax returns unless authorized by the General Assembly.[1]

In response, the General Assembly amended the Kentucky income tax statutes via H.B. 278 explicitly allowing businesses to deduct normal and ordinary business expenses paid with PPP loans on Kentucky income tax returns. As many Kentucky businesses are still struggling to maintain operations, this legislation will allow businesses to better maintain cash flow as they will not be expected to essentially pay back business expenses covered by PPP loans.

Another enacted bill attempts to encourage continued pandemic relief. H.B. 84 authorizes protection for out-of-state businesses performing emergency-related work while Kentucky remains in a state of emergency from both state income tax liability as well as the local occupational license tax. The type of work the out-of-state business must be performing includes, "repairing, renovating, installing, building, or rendering services that are essential to the restoration of critical infrastructure that has been damaged, impaired, or destroyed by a declared state disaster or emergency." To qualify for the tax filing obligation protection from a tax filing, the business must have no other nexus-creating activity in the state such as property or other business activities.

Despite the tax changes to assist Kentucky residents through the pandemic, its silence on some issues has left room for uncertainty

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moving forward. One troublesome area is the taxability of unemployment compensation. While the federal government and several other states explicitly provided that unemployment payments are not considered taxable income, on April 1, the Department issued a statement that "all unemployment compensation earned as a Kentucky resident is subject to Kentucky income tax." So, as of now, Kentuckians that have received unemployment compensation will be expected to pay state income tax on those funds.

Kentucky Board of Tax Appeals Reorganization

Another important tax-related legislative development relates to Gov. Beshear's fall 2020 reorganization of the Public Protection Cabinet, which abolished the Kentucky Claims Commission (KCC) responsible for hearing tax proceedings and reinstating the Kentucky Board of Tax Appeals (KBTA). Each executive branch reorganization is statutorily required to be approved by the General Assembly. Through S.B. 162, the General Assembly maintained the general KBTA structure, however, it now requires that the chairperson, as well as another member of the KBTA, be an attorney (with the chairperson having the qualifications of a circuit court judge), with at least one member of the three having a background in tax. Additionally, the General Assembly abolished the bond requirement reinstatement by the Governor's executive order, preventing Kentucky from being considered a "pay-to-play" state for tax appeals. S.B. 162 also made clear that all *local* tax matters are now within the purview of the KBTA, rather than to a circuit court which may not often hear tax cases.

While the General Assembly upheld the Governor's KBTA reinstatement to some extent, it also took legislative steps to prevent such widespread executive reorganization in the future. H.B. 5, enacted despite the Governor's veto, curtails a governor's ability to reorganize Executive Cabinet agencies and boards via Executive Order while the General Assembly is out of session. This will have a large effect on future administrations as it is often common for new governors to reorganize executive agencies after taking office.

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While this legislative session turned into a whirlwind of vetoes, overrides, amendments, and more, it is anticipated that the 2022 legislative session will pick up many items that were left on the table at the conclusion of the 2021 session, including bills that propose wholesale removal and changes to popular tax exemptions as well as potentially detrimental changes to how real property is valued for property tax purposes.

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[1] https://revenue.ky.gov/News/Pages/Unemployment-Benefits-Fully-Taxable-on-Kentucky-Returns–.aspx

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