Income Tax to Be Eliminated in Kentucky?

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Authors:

Mark F. Sommer
Jennifer Y. Barber
Daniel G. Mudd
Rachael High Chamberlain
Elizabeth M. Ethington

Following the Tax Foundation and Kentucky Chamber of Commerce's report published this winter detailing several suggestions for tax reform in Kentucky, many have been anxiously awaiting to see what the General Assembly would propose during its 2022 Regular Session. As the session crossed its half-way mark this week with still no comprehensive tax reform legislation introduced by the Republican supermajority, some wondered if tax reform may again be tabled during this legislative session. However, the Kentucky House of Representatives silenced these rumors this morning and proposed House Bill 8, which would have significant effects on Kentucky taxpayers if enacted.

In particular, H.B. 8 takes a major step towards what the Commonwealth has been trending toward for years – a switch from reliance on production-based taxes to consumption-based taxes. There are several nuanced portions of the legislation that could have significant impacts for certain types of taxpayers, but in large part, the legislation's impact is twofold.

First, the legislation proposes to cut the individual income tax rate from 5% to 4% beginning January 1, 2023, with legislative text eventually eliminating the individual income tax all together. The legislation sets forth a phase-out plan that lowers the individual income tax rate over time if the state's general fund reaches certain revenue levels. Ultimately, the plan proposes the rate being lowered to zero once the general fund gross receipts exceed $20,500,000,000. This is significant. While many expected the General Assembly would propose lowering the individual income tax rate, as well as potentially the corporate income tax rate, this was a big move by the General Assembly to propose a complete phase-out of one with no changes made to the corporate income tax rate or the limited liability entity tax.

While the legislation proposes putting more money into individuals' hands through income tax rate reductions, it also proposes making up for lost revenue by greatly expanding the sales tax base, as the

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state began to do back in 2018. Although the General Assembly did not propose increasing the rate, as some speculated might be the case, it expanded the sales tax base to include a multitude of services. Some such services that the legislation proposes to subject to sales tax include:

- Photography
- Advertising and graphic design services
- Marketing services
- Telemarketing services
- Lobbying services
- Executive employee recruitment services
- Website design and development services
- Residential and nonresidential security system monitoring services
- Personal financial planning and investment management services
- Parking services
- Event rentals
- Social event planning and coordination services
- Pleasure watercraft docking, launching, and storage
- Cosmetic surgery
- Massage services (unless medically necessary)
- Personal fitness services
- Tattooing, piercing and other body modification services
- Interior decorating and design
- Moving services
- Commercial refrigerator repair services and
- Prewritten computer software access services

This is not an exhaustive list. While the legislation stipulates that the tax only applies to such service providers with gross receipts that are greater than $3,000 in a calendar year, the above expansion of the sales tax base touches a wide variety of consumption.

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Additionally, while it may not affect many individuals in the Commonwealth, the expansion of the sales tax to prewritten computer software access could impact a variety of tech-related businesses such as SaaS and Paas development/services, which could potentially impact the development of the tech industry in Kentucky.[1]

Other changes included in the bill are the imposition of a 6% excise tax on the rental of a shared vehicle by a peer-to-peer car sharing company, vehicle renting company, sales of transportation network company (such as Uber, Lyft, etc.) services, sales of taxicab services, and sales of limousine services, as well as the creation of a 3 cent per kilowatt hour excise tax on electric vehicle power. An annual fee was also added for owners of electric and hybrid vehicles related to battery disposal and remediation.

While the legislation does not cover much of what was included in the Tax Foundation's Report, it makes clear the General Assembly's intent is to move Kentucky in the direction that many other states have moved in focusing on an economy dependent on consumption, not production. Additionally, a number of other important tax proposals have been made so far this session, such as the local option sales tax constitutional amendment and a 2022 tax amnesty, which will further this goal and help fund the proposed changes. Many also speculate that a companion bill or other legislation concerning tax expenditures and credits may be next to drop.

We will continue to monitor this H.B. 8 as well as all other legislation affecting your Kentucky taxes. For more information, please reach out to the authors, Mark Sommer, Jennifer Barber, Daniel Mudd, Rachael Chamberlain, and Elizabeth Mosley. You can also visit our Tax Law Defined® Blog to read about the latest in federal, state and local tax administration.

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[1] See our other articles on how Kentucky has positioned itself to provide incentives for a developing tech industry:

- *Kentucky Releases Application for New Cryptomining Energy Exemption*

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- *Solar and SALT – Sunshine is Making Hay*
- *Kentucky Poised To Be National Cryptomining Leader With New Tax Legislation*
- *Kentucky DOR Provides Guidance for Taxation of Solar Energy Equipment*

Additional analysis of Kentucky tax administration and legislation can be found on our Tax Law Defined® Blog.

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