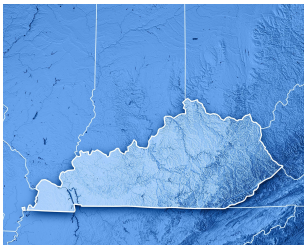

What's Next? The Individual Income Tax. Part Three – On Tax Policy, Is the Kentucky Governor Out Ahead of His Skis?

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Authors:

Mark F. Sommer
Elizabeth M. Ethington

We continue with our review of executive power and tax changes in part three of this series (check out part one and part two for a refresher). Kentucky levies an income tax on all income earned by Kentucky residents, as well as all income earned by nonresidents through Kentucky sources. The individual income tax rate is currently five percent of taxable net income.

Earlier this year, the state legislature passed House Bill 8 (H.B. 8), over Governor Beshear's veto. Under H.B. 8, any reduction in rate must be "triggered" by certain revenue levels. Every rate reduction will be 0.5 percent. The reduction is dependent on the amount of funds in the state's Budget Reserve Trust Fund, as well as the amount of general fund receipts that exceed appropriations in a fiscal year. Another safeguard put in place is that rate reductions will not occur automatically once revenue triggers are met; rather, any reductions will require review and approval by the General Assembly. If all goes as planned by the legislature, and the economy cooperates, the use of these triggers will likely lead to the phaseout of the individual income tax in its entirety over time. The legislature made it clear its intention is to lower the income tax rate, but to do so responsibly.

As discussed above, H.B. 8 provides various safeguards to prevent the same mistakes that happened with other states, such as Kansas years ago, that have unsuccessfully attempted similar income tax elimination initiatives without safeguards in place. Another safeguard put in place is the approval of the Department of Revenue. Pursuant to H.B. 8, before the rate reduction is even brought before the General Assembly, the legislature gives the executive branch, via the Department and the Office of State Budget Director, the power to approve, or to not approve, the reduction. H.B. 8 provides that beginning September 1, 2022, the

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Department, with assistance from the Office of State Budget Director "shall review the reduction conditions…and make a determination if the reduction conditions have been met," and if met, the Department shall report to the Appropriations and Revenue Committee of the General Assembly.

Given the executive branch's recent expansion of legislative-type power, both through executive orders and emergency administrative regulations discussed in our prior article, could the Governor order the Department of Revenue to reject the rate reduction and ensure the reduction is not passed along to the General Assembly even if the applicable financial and revenue metrics are met?

Although H.B. 8 allows the executive branch to review the fiscal situation to determine whether the conditions have been met, given our prior discussions on executive power in parts one and two, this legislation does not expand the powers of the Governor to control Kentucky taxation.

If the Governor chooses to do this, as in the Department and the Budget Office not recommending or approving a rate reduction where the fiscal metrics are met, it would essentially strip the General Assembly of its taxation power, in that it would make null and void the General Assembly's decision to phase out the individual income tax in Kentucky. As our prior blog post discusses, the legislature is in the best position to set policy and create laws in the Commonwealth. Circumventing the legislative process to pass sweeping tax policy changes not only violates the separation of power as articulated in Section 28 of the Kentucky Constitution, but it also puts the Commonwealth at risk of incurring irreparable financial harm.

It has been reported that at the conclusion of Kentucky's fiscal year on June 30, 2021, the state closed the year with its second highest surplus in its history of $1.1 billion. This revenue surplus was expected to meet the requirements set forth in H.B. 8 to trigger the first 0.5% rate reduction in 2023. It has been reported that for the first 0.5% rate decrease, the Department has reviewed and decided that the reduction conditions were met in fiscal year 2020-2021, which was expected based on the state's financial status this Spring

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when H.B. 8 was drafted and passed. However, as the executive branch, via the Department and Office of Budget Director must approve each rate reduction in future years, and considering the 2023 Kentucky Gubernatorial Election, the above discussions as to executive power and its affect on Kentucky taxes could become extremely poignant in years to come.

We will continue to follow the rate reduction events and continue to post more as developments ensue. For more information about your Kentucky taxes, visit out Tax Law Defined Blog. You can also read the first two articles in this three-part series:

- What are the Governor's Powers? Part One – On Tax Policy, Is the Kentucky Governor Out Ahead of his Skis?
- The Governor's Impact on Motor Vehicle and Fuel Taxes. Part Two – On Tax Policy, Is the Kentucky Governor Out Ahead of His Skis?

**Taylor Ecleberry contributed to this article as a summer associate at FBT. Taylor Ecleberry is not a licensed attorney.*

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