Kentucky Tax Bills Kicking Off the 2023 Legislative Session

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Kentucky saw significant movement towards tax reform during the 2022 regular legislative session. Whether it was the phase out of the individual income tax and sales tax base expansion that passed last spring, or the push for local tax reform, which did not ultimately pass but saw legitimate traction, the Kentucky General Assembly made clear last year its intent to push Kentucky towards further substantive tax reform. It appears with the start of the 2023 Regular Session this week, this year may bring more important tax developments in Kentucky.

The 2023 Regular Session kicked off this week with several tax related bills already introduced. Below is a list of tax related bills to keep an eye on this session:

- **House Bill 1 – Lowering Individual Income Tax Rate** – As expected based on our discussions in prior articles, H.B. 1 proposes reducing the individual income tax rate to 4.5% beginning in 2023 and 4% beginning in 2024. This is a requirement of the phase out provisions passed last year that in order for the individual income rate to be reduced, the state must meet various revenue benchmarks, and the General Assembly must approve the reductions. Based on the surplus of revenue reported last year, H.B. 1 simply follows through with the protocol for rate reduction resulting from the state meeting its revenue triggers last year.
- **House Bill 44 – Marketing Services Exempt From Sales Tax** – As discussed above, during the 2022 regular session, in an attempt to offset the proposed individual income tax phase out and shift from production to consumption taxation, the General Assembly expanded the Kentucky sales tax to include over 30 new services – one such service was "marketing services," making Kentucky an outlier in states that tax such services. However, H.B. 44 introduced by Representative Ken Fleming (R-District 48) would exempt marketing services from the imposition of sales tax. There are likely to be other bills, or

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an amendment to H.B. 44 exempting or narrowing the taxation of other services, including taxation of access to SaaS, holding of conventions, etc.

- **House Bill 37 – Authorizing Pass-Through Entities To Pay Income Tax on Entity Level** – In Kentucky, pass-through entities, such as LLCs and partnerships, that are subject to the corporation income tax pass such tax liability through to the entity's respective owners, be it members, partners, or shareholders. This proposed amendment to KRS Chapter 141 would allow a pass-through entity to elect to pay the tax on the entity level rather than pass through such liability to its owners. While the bill appears to be fairly consistent with other states that allow for such a pass-through entity election, what is less clear is the credit authorized for income tax paid by owners of a pass-through entity in other states. Currently, Kentucky resident owners of a pass-through entity can apply tax paid on the entity's income in other states as a credit against the owner's Kentucky income tax liability. While the bill adds a subsection providing that owners of an entity that elects to pay tax on the entity level may still receive a credit, it indicates that the entity must be assessed and pay income tax on the entity level in other states. This may pose some logistical issues for some taxpayers.
- **House Bill 123 – Limited Liability Entity Tax Threshold** – This bill proposes creating a threshold for the limited liability entity tax (LLET) filing requirement. The LLET is generally understood to be a detriment to growing business in Kentucky, and the proposed repeal of same is a common recommended tax reform proposal. But, H.B. 123 would instead simply protect entities doing business in Kentucky with gross receipts less than $100,000 from paying the LLET to at least provide some relief to the LLET.
- **House Bill 45 – Creation of Tax Expenditure and Economic Development Incentive Review Board** – The General Assembly appropriates and creates various economic incentives used to entice business development in the Commonwealth, but such programs are administered exclusively by the Kentucky Cabinet for Economic

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Development and its governing body the Kentucky Economic Development Finance Authority with assistance from other various agencies such as the Kentucky Department of Revenue. This bill proposes the creation of an Expenditure and Incentive Review Board that would "review, analyze, provide oversight, and make recommendations to the General Assembly" regarding the state's existing tax expenditures and economic development incentives as well as any expenditures or incentives created in the future. The Board would be comprised of members of the General Assembly and would meet monthly in between sessions beginning in August 2023. The goal of the Board would be to provide a comprehensive analysis of each tax expenditure and economic development incentive such as the number of taxpayers affected by the programs, the goals of the programs, revenue impact of the programs, research any issues associated with the programs, create standardized reporting requirements for agencies administering the programs to use, and creation of other various streamlined procedures. It can be assumed that this legislation is an attempt to create a more standardized incentive program and to increase General Assembly oversight of the various programs.

This is not the first time such legislation has appeared before the General Assembly. Last year, during the 2022 regular session, Rep. Fleming introduced a practically identical bill that did not move out of committee. As the state announced record breaking economic incentive deals in 2022 (such as BlueOval SK's $5.2 billion battery plant facilities), this bill may see more traction this year than it did last year.

As the General Assembly does not reconvene until February 7, it is expected that several more tax-related legislation may be introduced at that time. Given that it is a "short" (30-day) legislative session this year, and the General Assembly leadership vocalizing that they want a more traditional short session (i.e., only a few priority bills pass) after the craziness of 2021 from the pandemic, it is likely that only a few will get passed, such as the income tax reductions with other tax bills to be set up for movement in the

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longer 2024 legislative session. However, much more will be known when we get closer to the February reconvening period.

For more information on Kentucky tax developments this session, follow Frost Brown Todd's Tax Law Defined Blog.

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