Kentucky Tax Talk: Budget Focus Cools Tax Reform Efforts

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Authors:

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

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Over the last several years, the Kentucky General Assembly has made some huge shifts to the Kentucky tax landscape.

From beginning a phase out of the individual income tax and expanding the sales and use tax base to include over 30 new services in 2022, to phasing out the historically controversial Kentucky bourbon barrel tax in 2023, the Kentucky Legislature has made its intentions to shift the state from reliance on production taxes to reliance on consumption taxes clear.

With such huge initiatives put forth in recent years, some speculated whether the General Assembly would continue to use its Republican supermajority to make more significant tax reform initiatives in 2024. While some large concepts, such as local tax reform, were introduced, the General Assembly largely tabled any significant tax reform movement in 2024.

Rather than focusing on major tax initiatives, the General Assembly's attention was focused on establishing the state's two-year budget.

H.B. 8, the so-called revenue bill and part of the budget, morphed from an 11-page bill when introduced, into a 124-page bill when favorably voted out of the Kentucky House of Representatives 73-11 on March 25, and finally into a 198-page bill when passed by the Kentucky Senate 87-9 on March 28.

While two sections of the bill were vetoed by Kentucky's governor, the General Assembly simply sent the bill on to the Kentucky secretary of state for enrollment; it did not seek to override the governor's veto because the General Assembly asserts that it is not a budget bill.

While the revenue bill did not include any large tax reforms, there were still several items of note. First, the General Assembly has again legislated for a tax amnesty program in Kentucky; this was one

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of the sections that the governor attempted to veto in H.B. 8.

For context, in 2022 the General Assembly passed legislation amending Kentucky Revised Statutes Chapter 131 to require the Kentucky Department of Revenue to procure independent third-party administration of a tax amnesty program to occur that fall.

As a part of tax amnesty, the state agreed to waive all penalties and 50% interest for taxpayers with certain outstanding Kentucky tax liability, including liabilities under protest. The 2022 legislation provided that should the department fail to procure third-party administration of the amnesty program in 2022, it was required to administer the program itself, as had been done for prior amnesties, in the Fall of 2023.

Despite the 2022 statutory mandate, however, the department failed to procure a third-party administrator in 2022 or to administer the program itself in 2023.

The department's reasoning for ignoring the statutory mandate then, and similarly for the governor's attempted veto recently, was that the General Assembly had not appropriated any funds for the department to pay for procurement or perform the internal steps to administer the program itself.

The department argued that without additional funds for its administration, Kentucky could not have an amnesty program.

Despite the previous standoff between the Department of Revenue and the General Assembly, this year, H.B. 8 again legislates an amnesty program.

With the same substantive standards and parameters as the 2022 legislation, H.B. 8 provides that the department must procure a third party to administer an amnesty program now to occur this fall. Should the department be unable to procure a third party, the law mandates that it administer the amnesty program internally during fall 2025.

The last Kentucky amnesty program occurred in 2012. Historically, amnesty has proven to provide significant revenue for the state. Thus, given the various general fund revenue requirements needed to continue reductions in the state's individual income tax, it makes

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sense that the General Assembly wants to push amnesty in 2024 or 2025.

However, it appears that the Legislature again failed to appropriate any additional funds needed by the Department of Revenue for administration of an amnesty program, or penalties should the department fail to support the program. Thus, it appears passage of this new legislation may simply result in a continuation of the existing standoff between the department and General Assembly on tax amnesty.

Another portion of H.B. 8 that was passed by the General Assembly, line-item vetoed by the governor, then passed on to the secretary of state for enactment is a sales tax exemption for gold bullion — typically in gold and silver bar form.

The policy behind the legislation is that gold bullion has become increasingly more accessible for investment and that Kentucky generally does not impose sales tax on other investments such as stocks.

The governor vetoed this portion of the revenue bill, arguing that if a person can afford to purchase gold, they can afford to pay sales tax on it. Rather than view the purchase as an investment, the governor classified it as collectible goods, which are otherwise taxed in the commonwealth.

As with amnesty, despite the governor's veto, the General Assembly still submitted the provision for enrollment with the secretary of state. But unlike the amnesty program, the exemption will automatically go into effect as of Aug. 1, 2024. This matter may end up being litigated.

Other noteworthy portions of H.B. 8 include:

- Delaying availability of the deduction legislated to mitigate the negative impact on corporate taxpayers of the state's move to mandatory unitary/elected consolidated filing, adopted in 2019 and set to be available starting January 2024, to January 2026;
- Continuing Kentucky's push for more tax transparency, requiring the Department of Revenue to publish on its website

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all administrative writings, redacted as necessary — such as final rulings, manuals, private letter rulings, technical advice memoranda, etc. — within 120 days of issuance or finalization, which is consistent with most other states that already publish such writings; and

- Modifying the methodology for one of the fiscal triggers currently required for Kentucky's ability to reduce, and eventually eliminate, the state's individual income tax through a series of controlled rate reductions.

None of the above listed changes were included in the governor's vetoes, and thus will not be subject to potential disputes between the executive and legislative branches.

In addition to the budget, the significant tax reform item the General Assembly considered tackling this session was local tax reform. Kentucky's Constitution limits the General Assembly's power to award taxing power to local jurisdictions.

In particular, local jurisdictions in Kentucky — such as cities, counties, school and fire districts, etc. — can only obtain revenue through ad valorem taxes, some limited excise taxes, and the Kentucky occupational license tax, or OLT, which is a license fee imposed on net profit and payroll earned in the jurisdiction.

As the OLT has become the primary source of revenue for many local jurisdictions, it has also proven to be a somewhat unreliable and restricting source, especially during and following the COVID-19 pandemic.

Because of these and other difficulties with the OLT, local tax reform has been a topic debated in the commonwealth for decades. As the problem is rooted in a constitutional limitation, in order to fix it, the reform legislation must pass the General Assembly, and Kentucky citizens must also approve a constitutional amendment at the next general election.

Periodically, there have been pushes for local tax reform, but in 2022 this initiative caught more traction than it had in a long time.

In 2022, the General Assembly introduced H.B. 475, which, unlike previous attempts to reform local taxation, did not set forth any

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specific methods for local tax reform, but instead proposed amending the state Constitution by authorizing the General Assembly to create and enable local tax changes. This would provide the General Assembly the power to explore other types of revenue streams for local jurisdictions without committing to a specific type, such as a local option sales tax.

Despite passage of the bill by the House 80-17, the bill did not make it out of the Senate Appropriations and Revenue Committee, and thus did not become law in 2022.

Two years later, similar to the amnesty program, the General Assembly took another bite of the exact same apple. H.B. 14, introduced on March 12, and its companion legislation, H.B. 724, introduced on March 21, adopted almost identical language as that in H.B. 475 in 2022.

H.B. 14 and H.B. 724 did not set forth a specific type of local tax reform, such as local-option sales tax, but instead proposed to amend the Constitution to authorize the General Assembly to create new taxing structures for local governments.

While the 2024 local tax reform legislation included the same broad constitutional amendment to provide flexibility to the General Assembly on this topic, both H.B. 14 and H.B. 724 limited the power of local jurisdictions to impose a local sales and use tax.

H.B. 14 set forth that, should the General Assembly authorize a local sales and use tax, the tax must have the same tax base and be administered in the same manner as the state-level sales and use tax. H.B. 724, after amending the applicable statutes to broaden the local jurisdictions' taxing power, also provided that the local jurisdiction may not impose a sales or use tax.

This sales tax limitation was presumably a response to some of the criticism received relating to the prior attempts to expand local tax. Some local jurisdictions fear that a local sales tax will create disparity between local jurisdictions and cause double taxation of their residents.

The 2024 limitation was likely an attempt to prevent any local jurisdiction from imposing a sales or use tax after expanding its

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power, before the General Assembly authorizes and prepares for the administration of same, thus expanding power but limiting its application without proper safeguards being in place.

However, despite the traction gained in 2022, this year's legislation did not pick up the same level of steam. Instead, like the local tax reform efforts made before it, H.B. 14 and H.B. 724 were left on the cutting room floor.

Another interesting piece of legislation, H.B. 122, which was initially designed to require the Department of Revenue to publish all administrative writings — later crafted into H.B. 8, as mentioned above — was transformed into a bill that, among other things, statutorily classifies mains, pipes, pipelines, and conduits used for heat, steam, water, sewage, natural or manufactured gas, or electricity, to or for the public, as real property.

Presumably in response to the department's May 2023 announced administrative position that all pipelines must be classified as tangible property, following the 2022 Kentucky Court of Appeals' decision in Department of Revenue v. Marathon Pipe Line LLC, this legislation seeks to statutorily prohibit the department from a reclassification. However, rather than doing so indefinitely, the legislation only applies to tax years 2024 and 2025.

This classification amendment was initially included in other legislation introduced by the House and was subsequently dropped from that legislation; interestingly, the Senate then added the language back in through an amendment to H.B. 122.

This bill was passed by the General Assembly and delivered to the governor on April 15, the last day of the regular session.

Other noteworthy pieces of tax legislation that were considered but ultimately left behind included the long sought after elimination of the limited liability entity tax, tax incentives for first-time home buyers and elimination of the inheritance tax.

While 2024 proved to be a relatively quiet session with regard to tax legislation, now that the budget has been negotiated, we believe several of the tax reform items that were considered may come to fruition in 2025.

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