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Kentucky: Comprehensive tax legislation signed into law

The governor on March 26, 2019, signed House Bill 354—legislation that makes numerous changes to Kentucky's tax laws that affect businesses. Many of the changes are in response to the major tax reforms enacted in Kentucky last year.

Read **House Bill 354**

Revised taxation of financial institutions

Under current law, every financial institution regularly engaged in business in Kentucky is subject to an annual franchise tax. Beginning January 1, 2022, the bank franchise tax no longer applies to financial institutions, and beginning January 1, 2021, all financial institutions will be subject to the corporation income tax and the limited liability entity tax. During the one-year transition from the bank franchise tax to the corporation income and limited liability entity taxes, financial institutions will be allowed a refundable tax credit for income tax purposes equal to the amount of bank franchise tax paid for that one year.

House Bill 354 requires the Department of Revenue to promulgate corporate income tax regulations to address the sourcing of various types of receipts related to financial institutions, including but not limited to, interest, fees and penalties imposed in connection with loans, net gains from sales of loans, receipts from fees, interest, and penalties charged to credit card holders, net gains from sales of credit card receivables, merchant discount receipts, ATM fees, and receipts from a financial institution's investment assets and activity and trading assets and activity.

The definition of a "financial institution" that currently applies for purposes of the bank franchise tax has been incorporated into the "definitions" section of Kentucky's income tax code.

Combined reporting changes

Under legislation enacted last year, effective for tax years beginning on or after January 1, 2019, a unitary business group must file a unitary combined report or make an election to file a consolidated return with all affiliated group members regardless of whether those group members have Kentucky nexus. As originally enacted, the election period was 96 months.

House Bill 354 revises the consolidated group election period to 48 months, and also clarifies that a combined group will include only corporations, the voting stock of which is more-than 50% owned, directly or indirectly, by a common owner or owners. Previously, there was no specific stock ownership percentage for determining unity.

Under current law, the combined report includes the entire apportionment factors and income of any: (1) members incorporated or formed in the United States or formed under the laws of any state, the District of Columbia, or any territory or possession of the United States; and (2) members doing business in a "tax haven." Also included are a portion of the factors and income of a member that earns more than 20% of its income directly or indirectly from intangible property or service-related activities that are deductible against the apportionable income of the other members of the group. House Bill 354 clarifies that only members incorporated or formed in the U.S. that earn less than 80% of their income outside of the United States are included in the group. With this change, U.S. formed entities that earn substantial income from outside the United States will not be included in the combined group. Elsewhere in House Bill 354, the law has been amended to clarify that the combined report is filed on a water's-edge basis.

Currently, the law sets forth the criteria for determining a "tax haven," rather than a list of specific countries that are deemed to be tax havens. House Bill 354 confirms that a "tax haven" does not include a jurisdiction that has entered into a comprehensive income tax treaty with the United States, which the U.S. Secretary of the Treasury has determined is satisfactory for purposes of IRC section 1(h)(11)(C)(i)(II).

Extended corporate return filing extension

Going forward, corporations can request an extension of not more than seven months for filing income tax returns. Previously, the extension could not be more than six months.

Revised corporate extension provisions for corporate income tax and limited liability entity tax

House Bill 354 makes revisions to Kentucky's current rules for making estimated corporate and limited liability entity tax payments. For tax years beginning on or after January 1, 2019, every corporation and limited liability pass-through entity must make estimated payments if the entity's liability can reasonably be expected to exceed $5,000. Under House Bill 354, estimated tax payments generally are to be made at the same time and calculated in the same manner as estimated tax payments for federal income tax purposes under IRC section 6654.

IRC conformity

For tax years beginning on or after January 1, 2019, Kentucky adopts the Internal Revenue Code in effect on December 31, 2018. Last year, Kentucky updated its conformity post-federal tax reform; thus, for the 2018 tax year, Kentucky conformed to the Code as in effect on December 31, 2017.

Section 179 expensing

Currently, the IRC section 179 deduction that is allowed is tied to the Internal Revenue Code as of December 31, 2001. For property placed in services on or after January 1, 2020, the expense deduction allowed under IRC section 179 is tied to the Internal Revenue Code in effect on December 31, 2003.

Time to respond to limited liability entity tax assessment

When an assessment of limited liability entity tax is made against a pass-through entity, House Bill 354 clarifies that the owners of the pass-through entity have 180 days from the date of the assessment to file the required amended returns reporting the adjustments.

Excise tax changes

Under Kentucky law, the multichannel video programming excise tax is imposed at a 3% rate on the sales price charged for multichannel video programming services. Effective for transactions occurring on or after July 1, 2019, House Bill 354 amends the definition of "multichannel video programming service" to include live, scheduled, or on demand programming and to specifically include "video streaming services."

"Video streaming services" means programming that streams live events, movies, syndicated and television programming, or other audio-visual content over the Internet for viewing on a television or other electronic device with or without regard to a particular viewing schedule.

Sales and use tax changes

Last year, the definition of "retailer engaged in business" in Kentucky was amended to include remote retailers selling tangible personal property or digital property delivered or transferred electronically to a purchaser in Kentucky if the retailer met a threshold of over 200 Kentucky transactions or $100,000 of Kentucky gross receipts.

House Bill 354 extends the economic nexus provisions to marketplaces and adopts a comprehensive (an over two-page) definition of a "marketplace provider." In addition to including the activities commonly identified as defining a marketplace, the Kentucky definition specifically includes within the definition of marketplace provider a person that owns or operates digital distribution services and platforms as well as online portals and applications stores.

A marketplace provider that makes retail sales on its own behalf or facilitates retail sales of tangible personal property, digital property, or services that are delivered or transferred electronically to a purchaser in Kentucky for one or more marketplace retailers that exceeds $100,000 or 200 or more separate transactions in the immediately preceding calendar year or current calendar year must register to collect and remit sales tax. Specifically, the marketplace provider must register: (1) for a sales and use tax permit number to report and remit the tax due on the marketplace provider's own sales; and (2) for a separate sales and use tax permit number to report and remit the tax due on all of the sales it facilitates for one or more marketplace retailers. The requirement to register occurs the first day of the calendar month that begins no later than 30 days after either threshold is reached.

The marketplace provider must collect Kentucky tax on the entire sales price or purchase price paid by a purchaser on each retail sale subject to tax that is made on its own behalf or that is facilitated by the marketplace provider, regardless of whether the seller would have been required to collect the tax had the retail sale not been facilitated by the marketplace provider. The marketplace provider will be subject to audit on all sales made on its own behalf and on all sales facilitated by the marketplace provider. The marketplace retailer is relieved of all liability for the collection and remittance of the sales or use tax on sales facilitated by the marketplace provider. Finally, no class action may be brought against a marketplace provider on behalf of purchasers arising from or in any way related to an overpayment of tax collected by the marketplace.

House Bill 354 also makes certain changes to the types of admissions that are subject to sales and use tax, makes clarifying changes to the law in light of the sales tax base expansion enacted last year, and adopts a services tax exemption for sellers that derive less than $6,000 from sales of services per year.

One key change is that under the revised law, a service provider of a taxable service can accept a resale certificate or an exemption certificate from the purchaser.

Other changes

House Bill 354 also reduces the personal property tax rate applicable to certain types of qualified heavy equipment that is held as inventory. The legislation also prohibits the Department of Revenue from disclosing certain taxpayer requests for guidance, private letter rulings, and alternative apportionment requests and provides that these documents are not subject to the state's Open Records Act.

For more information about the sales and use tax changes, contact a KPMG State and Local Tax professional:

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