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Kentucky: Second bill enacted under comprehensive tax legislative package

Two bills affecting the taxation of businesses in Kentucky were enacted in March and April 2019.

The governor on March 26, 2019, signed into law House Bill 354—legislation that makes numerous changes to Kentucky's tax laws that affect businesses. Many of these changes were in response to the major tax reforms enacted last year in Kentucky. Read an initial report about House Bill 354 in ***TaxNewsFlash***.

A few days later, on April 9, 2019, the governor signed House Bill 458—legislation that includes some of the same changes in House Bill 354, but that also further revises Kentucky's tax laws.

The following discussion provides information about the tax changes initially made by House Bill 354 and then, if applicable, about subsequent revisions made by House Bill 458. In this report, if there is no reference to House Bill 458 that is an indication there were no changes to the measures enacted under House Bill 354.

Revised taxation of financial institutions, savings and loan institutions

Under current law, every financial institution regularly engaged in business in Kentucky is subject to an annual bank franchise tax.

House Bill 354

House bill 354 revised the law to make financial institutions subject to corporate income tax beginning January 1, 2021. Also, the bank franchise tax was to continue to apply until 2022—thus allowing a one-year transition from the bank franchise tax to the corporation income and limited liability entity taxes. During this transition period, financial institutions were to 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 required 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
- Receipts from a financial institution's investment assets and activity, and trading assets and activity

House Bill 458

House Bill 458 eliminates the transition period and provides that effective January 1, 2021, all financial institutions are subject to corporate income tax and limited liability entity tax (rather than the bank franchise tax).

House Bill 458 also provides that effective January 1, 2021, the corporate income and limited liability entity tax applies to savings and loan institutions in lieu of the savings and loans tax. Any financial institution or savings and loan institution operating on a fiscal year basis must file a short-year corporate income and limited liability entity tax return and pay any tax due for the period beginning January 1, 2021, through the end of the financial institution's normal fiscal year. The Department of Revenue is specifically authorized to issue guidance on filing the short-year return.

House Bill 458 provides that "financial institutions shall be subject to all applicable local government franchise taxes imposed under Section 11 of this Act." Section 11 of House Bill 458 addresses the local franchise tax measured by deposits that is imposed on financial institutions by counties, cities, and urban-county governments. The local deposits tax is in lieu of all other local taxes, except for real estate transfer taxes, real and tangible property taxes, and taxes levied on users of utility services.

Combined reporting changes

House Bill 354

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 revised the consolidated group election period to 48 months.

Composition of combined group

House Bill 354

House Bill 354 clarifies certain aspects of the combined reporting law, including 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 Kentucky 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 458

House Bill 458 further explains the rule (described immediately above) by providing that if a non-U.S. corporation is included in the combined group, to the extent that the non-U.S. corporation's income is excluded from U.S. taxation under a comprehensive income tax treaty, the income or loss is not includible in the combined group's net income or loss. Similarly, the member's expenses or apportionment factors attributable to the treaty-exempt income are excluded from the combined report.

House Bill 354

House Bill 354 clarified that only members incorporated or formed in the United States 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 was amended to clarify that the combined report is filed on a water's-edge basis.

Under Kentucky law, rather than listing specific countries that are deemed to be "tax havens," there are factors to consider in determining whether a jurisdiction is a tax haven. House Bill 354 confirmed that a "tax haven" does not include a jurisdiction that has entered into a comprehensive income tax treaty with the United States, which the Secretary of the U.S. Treasury has determined is satisfactory for purposes of IRC section 1(h)(11)(C)(i)(II).

Computation of combined group members taxable income or loss

Each taxpayer member of the combined group is responsible for tax based on its taxable income or loss apportioned or allocated to Kentucky. A taxpayer member's taxable income or loss apportioned to Kentucky includes the taxpayer member's net operating loss carryover.

House Bill 458

House Bill 458 adopts extensive provisions addressing the computation of a group member's net operating loss (NOL) carryover. These provisions confirm that an NOL carryover incurred by a taxpayer member of the group in a tax year after which a unitary combined return has been filed may be shared with other taxpayer members of the group, assuming the other taxpayer members were members of the group in the year the loss was incurred.

If the NOL carryover was from a pre-tax reform year or from a year in which the member incurring the loss was not a taxable member of the combined group, the loss can be shared but cannot reduce any other taxpayer member's Kentucky apportioned taxable income by more than 50% in any tax year.

If the taxpayer member is deducting its own NOL carryover from a pre-tax reform year or from a year in which it was not a taxable group member, the only limit that applies is the general 80% limit under IRC section 172 (which Kentucky has adopted).

New deferred tax deduction

House Bill 458

House Bill 458 adopts a new deduction for publicly traded companies if the adoption of combined reporting results in: (1) an increase to the members' net deferred tax liabilities; (2) an aggregate decrease to the members' net deferred tax assets; or (3) an aggregate change from a net deferred tax asset to a net deferred tax liability. Only publicly traded companies—including affiliated corporations participating in the filing of the company's financial statements prepared in accordance with accounting principles generally accepted in the United States as of January 1, 2019—are eligible for this deduction.

The deduction is equal to 1/10 of the amount necessary to offset the financial statement impact. To claim the deduction, per House Bill 458 and Kentucky **Revenue Procedure 19-02** [PDF 414 KB] (issued April 11, 2019), taxpayers must file a statement (Schedule DTD) with the Department on or before July 1, 2019. There are no extensions available for filing this schedule. No adjustments to the calculated deductions are permitted as a result of subsequent events.

Combined groups may start claiming the deduction for tax years beginning on or after January 1, 2024. The deduction claimed may not be greater than the combined group's Kentucky entire net income. Any unused deduction may be carried forward to a future tax year until fully used.

Corporate return filing extension extended

Going forward, corporations may 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 estimated tax provisions for corporate income tax and limited liability entity tax

House Bill 354

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 passthrough 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 (IRC) 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 IRC as in effect on December 31, 2017.

Section 179 expensing

House Bill 354

Currently, the IRC section 179 deduction that is allowed is tied to the IRC as of December 31, 2001. Under House Bill 354, for property placed in service on or after January 1, 2020, the expense deduction allowed under IRC section 179 is tied to the IRC as in effect on December 31, 2003.

Time to respond to limited liability entity tax assessment

House Bill 354

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

Excise tax changes

House Bill 354

Under Kentucky law, the multichannel video programming excise tax is imposed at a rate of 3% of 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 specifically to include "video streaming services." For these purposes, the term "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

In 2018, 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: (1) 200 transactions; or (2) over $100,000 of gross receipts.

House Bill 354

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

Specifically, a marketplace provider that makes retail sales on its own behalf or that 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, in any sales combination exceeding $100,000 or 200 or more separate transactions in the immediately preceding calendar year or current calendar year must register for a sales-and-use-tax permit number and report and remit the tax due on the marketplace provider's sales. The marketplace provider must also register 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.

House Bill 458

A change under the revised law is that a service provider of a taxable service may accept a resale certificate or an exemption certificate from the purchaser.

Other changes

House Bill 354

House Bill 354 reduces the personal property tax rate applicable to certain types of qualified heavy equipment that is held as inventory.

House Bill 354 also prohibits the Department of Revenue from disclosing certain taxpayer requests for guidance, private letter rulings, and alternative apportionment requests, and it provides that these documents are not subject to Kentucky'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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