



Kentucky Society
Certified Public Accountants

LLET

Appropriations and Revenue Committee

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Background



- Limited liability entity tax (LLET) applies to all entities that offer limited liability to its owners
 - C corporations, S corporations, limited partnerships (LPs), limited liability corporations (LLCs), etc.
 - Type of “franchise” or “privilege” tax
- Became effective in 2007 tax year
- Replaced alternative minimum calculation (AMC) that was in effect during 2005 and 2006 tax years
 - AMC replaced business license tax

How it works

Two alternative calculations

- Gross receipts
- Gross profits
 - Gross receipts less cost of goods sold (i.e. costs incurred to produce and sell inventory)

	< \$3 million	\$3 – 6 million	> \$6 million
Gross receipts calculation	\$175	Varies	0.095%
Gross profits calculation	\$175	Varies	0.75%

How it works

- Approximately 92% of the roughly 170,000 entities that file the LLET pay the minimum tax (\$175)
 - Note: Thousands of entities in Kentucky have minimal to no activity; disregarded entities do not pay LLET
- Entities that pay more than the minimum tax
 - Typically, low-volume, high-margin businesses use the **gross receipts calculation** while high-volume, low-margin businesses use the **gross profits calculation**
 - Examples of high-volume, low-margin businesses – Contractors, gasoline retailers, auto dealers, manufacturers, etc.

Cost of goods sold



- Kentucky bases COGS definition on federal tax code, but with specific modifications – KRS 141.0401(1)(d)
- In early 2013, Kentucky began disallowing various deductions in the COGS calculation, resulting in significant assessments for some businesses.
- Kentucky disallows all costs except for direct materials and direct labor, costs that are normally understood to be COGS at the federal level
 - EX. Construction supervisor vs. laborer; depreciation expenses
- Disparate treatment of COGS at state and federal levels creates compliance burden and increases cost of doing business in Kentucky
 - Kentucky is an outlier

What's allowed?

Federal and KY income tax	KY LLET
Direct material costs	Direct material costs
Direct labor costs	Direct labor costs
Indirect labor costs	
Indirect material costs	
Management and supervisory compensation	
Cost recovery (Depreciation or amortization on equipment and facilities)	
Rent	
Insurance	
Utilities	
Repairs and maintenance	
Engineering and design costs	
Tools and equipment	
Quality control	
Bidding costs	
Pension and other related costs	
Employee benefit expenses	
Purchasing costs	
Handling costs	
Storage costs	
Depletion	
Taxes	
Spoilage	
Licensing and franchise costs	
Interest	
Capitalizable service costs	
Selling and distribution costs	

LLET income tax credit



- Limited liability entity owner receives a nonrefundable Kentucky personal income tax credit equal to the owner's proportionate ownership share, less the \$175 minimum
- Similarly, a corporation receives a nonrefundable corporate income tax credit, less the \$175 minimum
- Because the credit is nonrefundable, it benefits profitable companies while hurting low- to no-profit companies



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Revenue considerations

LLET	Gross (millions)	Net (millions)
FY12	\$214	\$80
FY13	\$246	\$82
FY14	\$199	\$84
FY15	\$224	
FY16	\$203	
FY17	\$245	
FY18	\$235*	

*Projected

Source: KY State Budget Office /
Dept. of Revenue

FY19 projection

- Gross: \$220 million
- Credits: \$135 million
 - \$125 million – corporate income
 - \$10 million – personal income
- **Net: \$85 million**
 - Approximately \$27 million from entities paying \$175
 - Approximately \$58 million from entities paying more than \$175

Who's paying the \$58 million?

Owners/businesses that ***cannot*** use the full LLET income tax credit

Surrounding states



How surrounding states tax business entities

(excluding the income tax)

- Indiana – No entity-level tax
- Ohio – Commercial activities tax (CAT) on gross receipts
- Tennessee – Franchise tax on net worth (no personal income tax)
- Virginia – No entity-level tax
- West Virginia – No entity-level tax
- Illinois – Personal property replacement tax on net income
- Missouri – No entity-level tax

Options

Repeal LLET

- Fixed tax considerations – If each entity paid...
 - \$175 - \$30 million
 - \$300 - \$51 million
 - \$500 - \$85 million

Fix COGS

- Mirror Kentucky's COGS definition with the federal definition
 - Projected revenue loss – \$12-20 million*
- Legislation with bipartisan support filed in 2014 (HB 136), 2015 (HB 331), 2016 (HB 292)

*Source: KY State Budget Office

Supporting organizations



KY Society of CPAs

Associated General Contractors of KY

Associated Builders and Contractors – IN/KY, OH Valley chapters

KY Association of Highway Contractors

Plantmix Asphalt Industry of KY

KY Crushed Stone Association

Home Builders Association of KY

NIFB – KY Chapter

KY Chamber of Commerce

Commerce Lexington

Greater Louisville Inc.

KY Retail Federation

KY Association of Manufacturers

KY Beverage Association

KY Thoroughbred Owners and Breeders

KY Trucking Association

KY Petroleum Marketers Association

KY Malt Beverage Council

Automotive Service Council of KY

KY Paint Council

KY Forest Industries Association

KY Auto & Truck Recyclers Association

KY Fire Sprinkler Contractors Association

KY Building Materials Association

KY Automobile Dealers Association

Independent Insurance Agents of KY