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Aligning Kentucky's Tax Code for Growth

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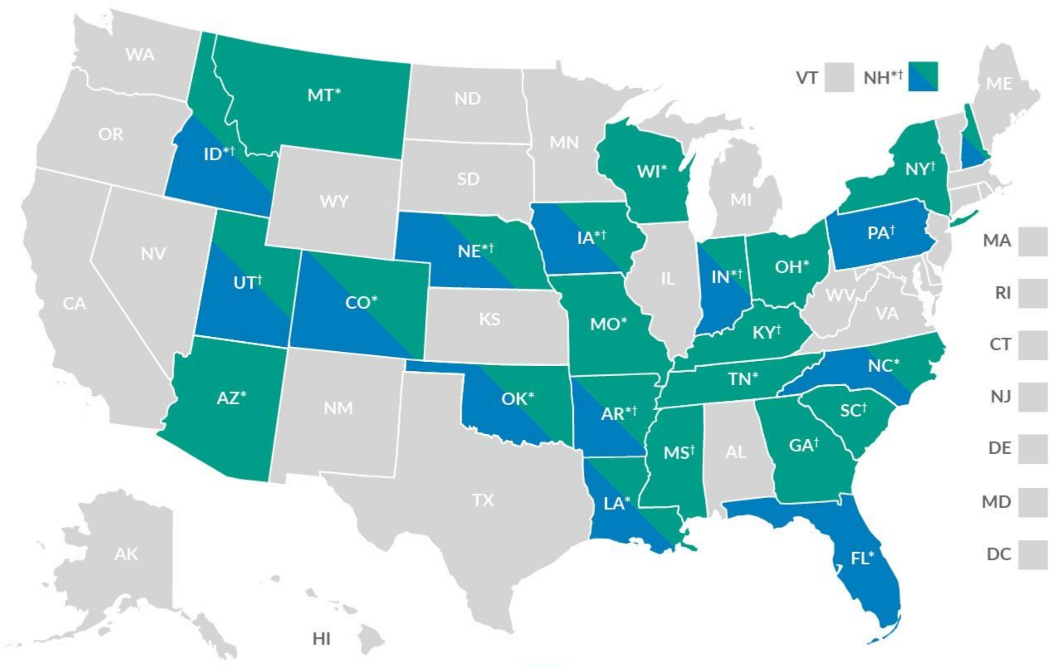
The Income Tax Landscape is Growing More Competitive

Income Tax Rate Reductions Enacted or Implemented in 2021 and 2022

As of July 13, 2022



- Individual Income Tax Reduction
- Corporate Income Tax Reduction
- * Rate reduction enacted/implemented in 2021
- † Rate reduction enacted/implemented in 2022

Note: In Florida, a corporate income tax rate reduction was automatically triggered for 2021 only. Colorado's Taxpayer's Bill of Rights (TABOR) triggered a temporary individual and corporate income tax rate reduction for 2021. New Hampshire does not tax wage and salary income, but its tax on individual interests and dividends income is phasing out over time. Tennessee's tax on interests and dividends income, the Hall Tax, was eliminated effective January 1, 2021.

Source: Tax Foundation.

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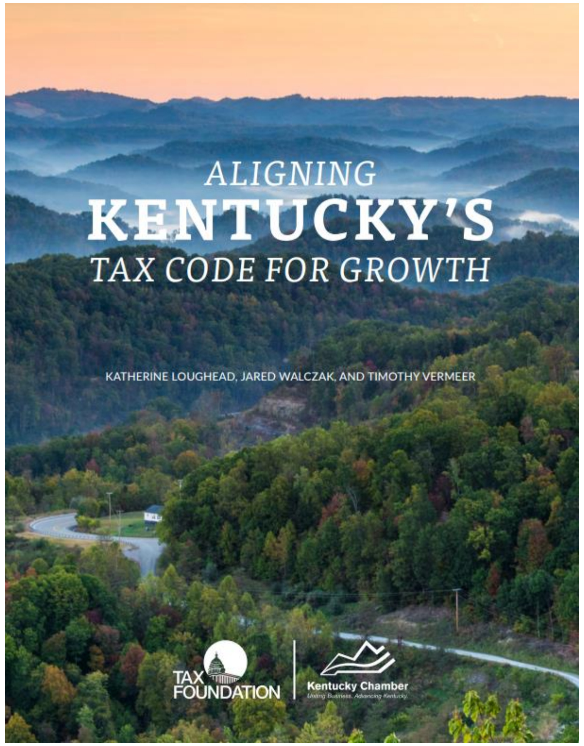
Fourteen States Have, Or Are Implementing, Flat Income Taxes

State	Flat as of
Massachusetts	Always (Est. in 1917)
Indiana	Always (Est. in 1965)
Michigan	Always (Est. in 1967)
Illinois	Always (Est. in 1969)
Pennsylvania	Always (Est. in 1971)
Colorado	1987
Utah	2007
North Carolina	2014
Kentucky	2019
Mississippi	Forthcoming: 2023
Arizona	Forthcoming: 2024
Georgia	Forthcoming: 2024
Iowa	Forthcoming: 2026
Idaho	Forthcoming: 2023

Next Steps for Pro-Growth Tax Modernization in Kentucky



1) Repeal the Limited Liability Entity Tax (LLET).
2) Improve tax treatment of business investment expenses under IRC § 179 and 168(k).
3) Shift away from local occupational license and net profit taxes.
4) Repeal the inventory tax (or improve the inventory tax credit).
5) Reduce reliance on tangible personal property (TPP) taxes.

Repeal the Limited Liability Entity Tax (LLET)

- As a gross receipts-based minimum tax, the LLET guarantees businesses pay a tax on their receipts even when they are not profitable.

- This tax is burdensome to startups, low-margin businesses, and companies experiencing losses.

- Since businesses that are sufficiently profitable can claim LLET taxes paid above $175 per year as a credit against their corporate or individual income tax liability, the LLET creates extra compliance costs while generating a negligible amount of additional revenue from profitable businesses.

Improve Tax Treatment of Business Investment Expenses Under IRC § 179 and 168(k)

Section 179

- Kentucky allows only $100,000 in qualifying investment expenses to be deducted in the year incurred.
- Kentucky is one of only 11 states and DC allowing less than $1 million in qualifying expenses to be deducted.
- All of Kentucky’s neighboring states except Indiana have a $1 million expensing allowance.

Section 168(k)

- Eighteen states allow full expensing for investments in qualifying machinery and equipment. Two other states offer bonus depreciation short of full expensing.
- Kentucky should consider conforming to the federal bonus depreciation allowance or offering its own permanent bonus depreciation allowance.

Shift Away from Local Occupational License and Net Profit Taxes

Local Individual Income Tax Effective Rates

Aggregate Local Income Tax Collections as a Percentage of State AGI

State	Average Effective Rate
Maryland	2.4%
Ohio	1.6%
New York	1.6%
Kentucky	1.4%
Pennsylvania	1.2%
Indiana	0.5%
Missouri	0.2%
Michigan	0.2%
Iowa	0.1%
Alabama	0.1%

Notes: Delaware, Kansas, and New Jersey have local income tax authority that is too limited to result in effective rates that round above zero percent. Oregon has recently implemented local income taxation in the Portland metro area that will show up in future data releases. Some Colorado and West Virginia jurisdictions have flat dollar-denominated wage taxes of up to a few dollars per week.

Sources: U.S. Census Bureau; Internal Revenue Service; Tax Foundation calculations.

Frankfort's Corporate Income Tax Rate Is High Nationally

Frankfort, KY vs. the Highest Combined State and City Rates Outside Kentucky

City or State	Combined CIT Rate
New York, NY	16.10%
New Jersey	11.50%
Pennsylvania	9.99%
Iowa	9.80%
Minnesota	9.80%
Illinois	9.50%
Alaska	9.40%
Maine	8.93%
California	8.84%
Delaware	8.70%
Vermont	8.50%
Maryland	8.25%
District of Columbia	8.25%
Frankfort, KY	8.00%
(tied with LA and MA)	

Source: Tax Foundation research.

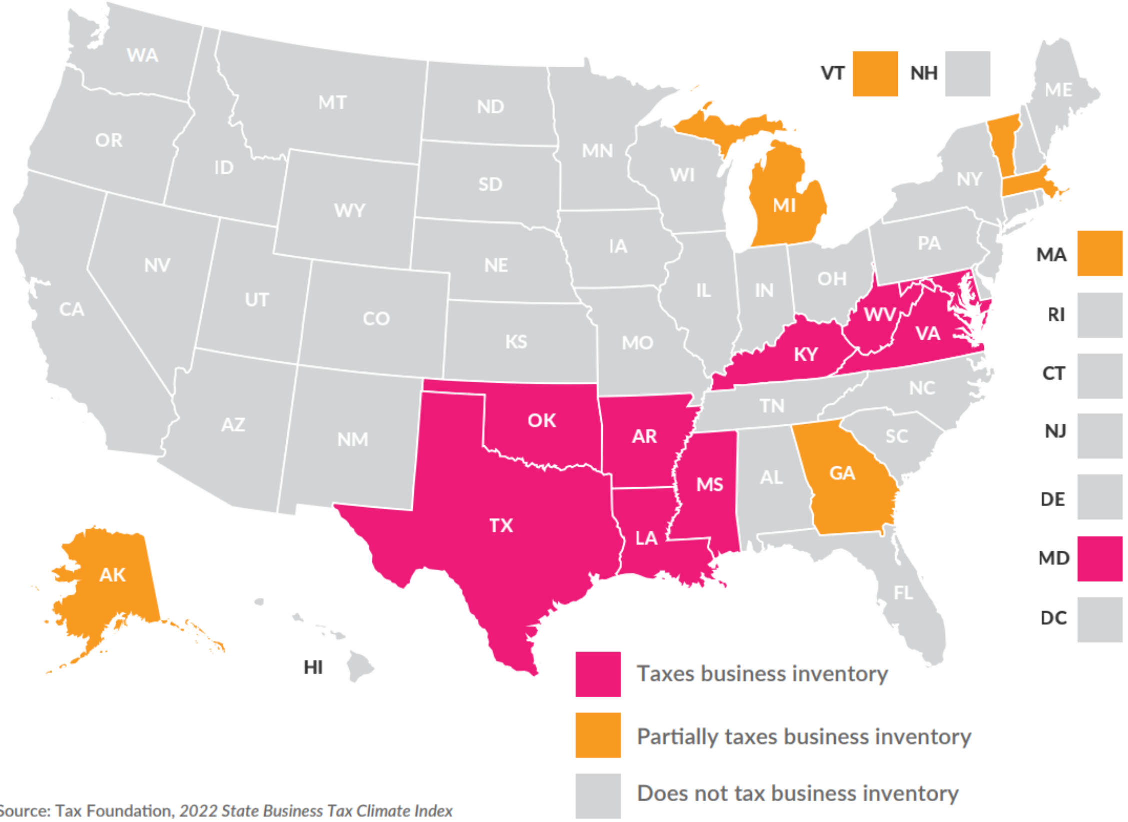
Shift Away from Local Occupational License and Net Profit Taxes (cont.)

- Kentucky is one of only eight states taxing both personal and business income at the municipal level.
- Amending the constitution to allow a local option sales tax would give municipalities more flexibility to move away from local income taxes.
- Compared to local income taxes, local real property taxes and retail sales taxes are less economically harmful, more stable, and less complex to administer and comply with.
- The state could consider permitting a one-time property tax rate adjustment in excess of current limits so local governments can shift away from local income taxation.

Repeal the Inventory Tax (Or Improve the Inventory Tax Credit)

State Taxation of Business Inventory

Property Taxes on Business Inventory (as of July 1, 2021)



Source: Tax Foundation, *2022 State Business Tax Climate Index*

- Kentucky is one of only 14 states taxing some or all business inventory.
- Take-up of the inventory tax credit has been much lower than expected.
- Because the credit is nonrefundable and cannot be carried forward, it only benefits inventory taxpayers who also have income tax liability in a given year.
- Even better than making the credit refundable would be repealing the inventory tax altogether to relieve the tax *and* compliance burdens.

Reduce Reliance on Tangible Personal Property (TPP) Taxes

- Create a tangible personal property (TPP) tax *de minimis* exemption.

- Any TPP tax *de minimis* exemption should be both a payment threshold *and* a filing threshold. This will reduce TPP taxes for all taxpayers while reducing compliance burdens by ensuring those with a minimal amount of otherwise taxable TPP no longer need to file and pay.

- The *de minimis* exemption should be indexed for inflation, and it could be statutorily increased over time to eventually phase out TPP taxes altogether.

Questions?

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