

PASS-THROUGH ENTITY-LEVEL TAXATION IN KENTUCKY

INTERIM JOINT COMMITTEE ON APPROPRIATIONS AND REVENUE
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Office of State Budget Director

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Pass-Through Entity Tax Payments and Credits

2

- Payments of the PTET are specifically identified and separately reported by the Department of Revenue
- Payment of the PTET creates a dollar-for-dollar refundable tax credit for individual members or owners to use when settling their individual income tax liabilities
- The members or owners can recover credits in a number of ways:
 - ▣ Reduce quarterly individual income tax estimated payments
 - ▣ Lower withholding payments (especially the previously- required withholding for non-resident members or owners)
 - ▣ Apply the credit when the members, owners file Kentucky 740 income tax returns

CFG Estimates for the Payments and Credits

3

- CFG projected payments and credits for FY24, 25, & 26
- PTET retroactive to Tax Year 2022
- Difficult to predict with so little information
- When the estimate was prepared, there was only 4 months of PTET payment history, with \$187 million in 1st Quarter.
- For members and shareholders to achieve maximum federal benefit, there are certain deadlines
 - For timely-filed Tax Year 2023 returns, the assumption was made that the deadlines were in the first half of FY24
 - CFG assumption: Based on those filing deadlines, nearly all of the PTET payments would occur in the first half of FY24

CFG Estimates for the Payments and Credits

4

- **\$315.4 million pass-through entity tax payment estimates** for FY24, by quarter, were:
 - \$187.4/\$113.0/\$0/\$15 million for quarters 1-4
- The next step was to estimate the timing of when the members or owners would take advantage of the individual income tax credit
- After a discussion with the Department of Revenue, it was assumed that:
 - 80% would be in FY24
 - 20% would be in FY25

Official CFG Estimates of the Pass-Through Entity Tax

(Estimates as presented to the CFG on December 8, 2023; \$ millions)

5

- Net PTET payments equal gross payments less credits
- Official Estimates from the CFG for net PTET
 - ▣ FY24 +\$52.7 million net:
 - \$315.4 Payments
 - (\$262.7) Credits
 - ▣ FY25 (\$79.1 million) net:
 - \$236.6 Payments
 - (\$315.7) Credits
 - ▣ FY26 (\$14.0 million) net:
 - \$236.6 Payments,
 - (\$250.6) Credits

Actual FY24 Fiscal Impact of the Pass-Through Entity Tax

(PTET Payments, \$ million)

6

- PTET Payments were Underestimated for FY24

	<u>FY24 Estimated</u>	<u>FY24 Actual</u>	<u>Difference</u>
Quarter 1	\$ 187.4	\$ 187.4	\$ -
Quarter 2	\$ 113.0	\$ 192.7	\$ 79.7
Quarter 3	\$ -	\$ 186.1	\$ 186.1
Quarter 4	\$ 15.0	\$ 225.8	\$ 210.8
FY24 Total	\$ 315.4	\$ 791.9	\$ 476.5

- Clearly, the volume and timing assumed by the CFG varied substantially from actual taxpayer behavior

Actual FY24 Fiscal Impact of the Pass-Through Entity Tax (PTET Credits)

7

- **Very difficult to quantify the PTET Credits**
 - Of the 3 ways a taxpayer can recover their Credits, only one is reported – Form 740 – Individual Income Tax Return
 - **Line 31g on Form 740**, “Enter 2023 refundable pass-through entity tax credit from Form PTET-CR, line 9”. That information can be captured, but the net returns account on the receipts report includes other transactions
 - **Declaration Payments** will be lower due to the credit, but the effect of the PTET credit is unknown - how much lower?
 - **Nonresident withholding** will be lower due to the credit, but the effect of the PTET credit is unknown – how much lower?

Kentucky Form 740 Pass-Through Entity Tax Credit

30	Add lines 28 and 29, enter here.....	
31 a	Enter Kentucky income tax withheld as shown on enclosed Schedule KW-2	31a
b	Enter 2023 Kentucky estimated tax/extension payments	31b
c	Enter 2023 refundable certified rehabilitation credit	31c
d	Enter 2023 refundable entertainment incentive tax credit.....	31d
e	Enter 2023 refundable development area tax credit.....	31e
f	Enter 2023 refundable decontamination tax credit	31f
g	Enter 2023 refundable pass-through entity tax credit from Form PTET-CR, line 9	31g
h	For amended return ; enter amount paid with original return plus additional payment(s) made after it was filed.....	31h
32	Add lines 31(a) through 31(h).....	

Hypothetical Offsets to the FY24 Actual Entity-Level Tax

(\$ millions, FY23 adjusted downward to equalize rate at 4%)

	<u>FY24</u>	<u>FY23</u>	<u>Difference</u>
Net Returns	\$ (188.1)	\$ 93.8	\$ (281.9)
Declaration Payments	\$ 448.4	\$ 564.0	\$ (115.6)
Nonresident Withholding	\$ 90.7	\$ 199.1	\$ (108.5)