

# CFG PLANNING ESTIMATES

(AN UPDATE ON TAX REFORM AND FY19 FINAL REVENUE)

GREG HARKENRIDER  
DEPUTY EXECUTIVE DIRECTOR  
AUGUST 9, 2019

Office of State Budget Director

## General Fund Update and Legislative Changes

(Since December 15, 2017)

2

- General Fund revenues exceeded official estimates by \$119.8 million in FY18 (undershot the base for biennial estimates)
- The General Assembly passed tax reform in 2018, with follow-up reform in 2019
- The 2018 legislation increased the CFG estimate for FY19 by a total of \$192.3 million
- General Fund revenues exceeded the revised official estimates by \$194.5 million in FY19
- The 2018 and 2019 legislation increased the official estimate for FY20 by a total of \$172.0 million

## Summary Display of Official Estimates

(General Fund, Millions \$)

3

	<u>FY 2018</u>	<u>FY 2019</u>	<u>FY2020</u>
CFG December Estimate	\$10,718.4	\$11,005.9	\$11,290.0
Legislative Impacts	\$0	\$192.3	\$172.0
Official Estimate	\$10,718.4	\$11,198.2	\$11,462.0
Actual Receipts	\$10,838.2	\$11,392.7	
Difference (from Official)	+\$119.8	+\$194.5	

## Assessment of Current Situation

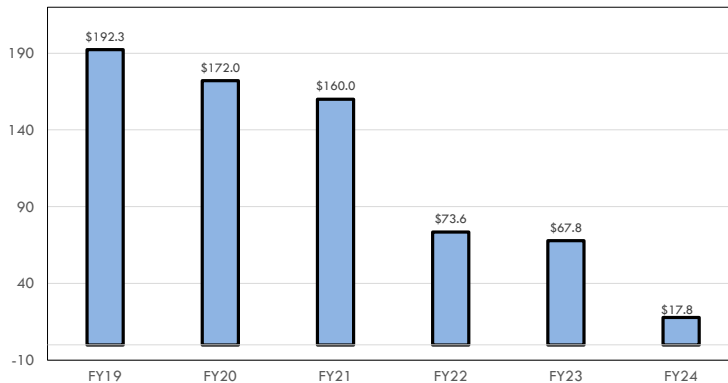
4

- Beginning the process of revising FY20 and projecting the next biennium and beyond
  - ▣ August planning estimates include the current fiscal year and the next four fiscal years
  - ▣ Two more opportunities to estimate FY20-FY22 in October and December
- Dependent Variables with non-static history of tax policy
  - ▣ Transform data to analyze policy-neutral data series
  - ▣ Sales tax, Individual Income, Corporate Income, Cigarette tax, Other taxes
  - ▣ Add back tax impacts after projecting policy-neutral data
- Difficult to disentangle tax data to isolate fiscal impacts

## Tax Impacts from 2018 and 2019

(Millions \$)

5



## FY19 General Fund Summary

6

- General Fund total: \$11,392.7 million
- General Fund nominal growth: \$554.5 million
- General Fund percentage growth: 5.1%
- Needed growth: 3.3%
- Revenue in Excess of Official Estimate: \$194.5 million

## Composition of the 2019 Variation

7

FY19 General Fund Revenues Compared to Official Estimate (million \$)				
	Actual	Estimate	Diff (\$)	Diff (%)
Sales and Use	3,937.6	3,907.6	30.0	0.8%
Individual Income	4,544.7	4,531.2	13.5	0.3%
Corporation Income	556.0	573.0	-17.0	-3.0%
LLET	206.7	200.2	6.5	3.2%
Coal Severance	92.9	77.9	15.0	19.3%
Cigarette Tax	353.5	321.0	32.5	10.1%
Property	647.0	620.7	26.3	4.2%
Lottery	263.9	249.0	14.9	6.0%
Other	790.4	717.6	72.8	10.1%
<b>TOTAL</b>	<b>11,392.7</b>	<b>11,198.2</b>	<b>194.5</b>	<b>1.7%</b>

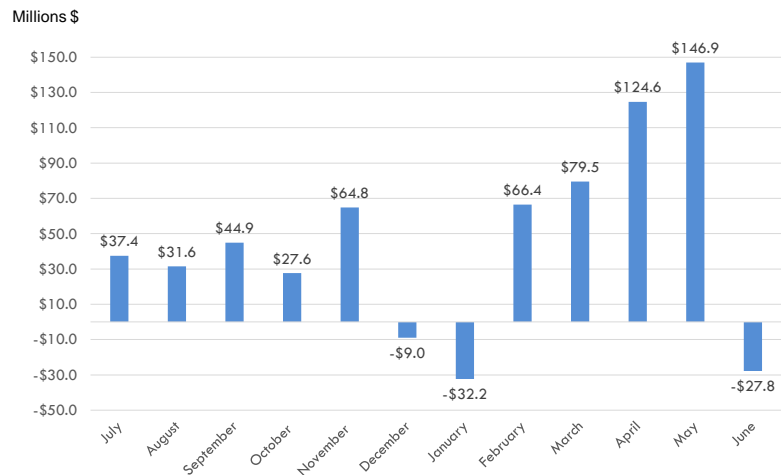
## Explanation of + \$194.5 million in FY19

8

- We exceeded the estimate by \$119.8 million in FY18 (unanticipated base from 2018)
  - ▣ That lowered the growth needed to hit the FY19 estimate
  - ▣ Implies that the economy was better than projected in December, 2017
- Tax reform added another source of variation
  - ▣ Hard to disentangle tax reform impacts from economic growth
  - ▣ Certain tax changes we know were different than estimated (example: cigarette tax)
  - ▣ All indications point to accurate tax estimates in aggregate
- Very strong fourth quarter of FY19
  - ▣ Some of the largest positive elements of the 2018 tax reform were back loaded into the fourth quarter, plus non-recurring receipts

## Revenue Growth Throughout FY19 (Millions \$)

9



## Road Fund Since December 15, 2017

10

- Road Fund revenues exceeded official estimates by \$7.7 million in FY18
- Small legislative impacts in the Road Fund
  - ▣ Handicap Placards (HB81, 2018 RS)
  - ▣ Compliance to 2005 REAL ID Act (rollout is underway)
- Road Fund revenues exceeded official estimates by \$59.5 million in FY19
  - ▣ Forecast was originally very flat for FY19
  - ▣ Motor Vehicle Usage continues to exceed expectations
  - ▣ Motor Fuels consumption continues to grow
  - ▣ Income from Investments spiked in 2019

## Road Fund Summary Display

(Millions \$)

11

	<u>FY 2018</u>	<u>FY 2019</u>	<u>FY2020</u>
CFG December Estimate	\$1,503.3	\$1,505.3	\$1,508.5
Legislative Impacts	\$0	\$1.25	\$1.25
Official Estimate	\$1,503.3	\$1,506.6	\$1,509.8
Actual Receipts	\$1,511.0	\$1,566.1	
Difference (from Official)	+\$7.7	+\$59.5	

## Composition of the 2019 Variation

(Actual Road Fund Revenue minus Enacted Estimates)

12

\$ millions				
	FY19		Difference	
	Actual	Estimate	\$	%
Motor Fuels	773.2	759.2	14.0	1.9
Motor Vehicle Usage	514.5	494.0	20.5	4.2
Motor Vehicle License	120.9	116.5	4.5	3.8
Motor Vehicle Operators	16.6	16.7	-0.1	-0.4
Weight Distance	83.7	82.1	1.6	2.0
Income on Investments	11.9	3.1	8.8	284.6
Other	45.1	35.0	10.1	29.0
<b>Total</b>	<b>1,566.1</b>	<b>1,506.6</b>	<b>59.5</b>	<b>4.0</b>

# TAX LAW CHANGES

(HB 487, 2018 RS; HB 354, 2019 RS; HB 458, 2019 RS)

GREG HARKENRIDER  
DEPUTY EXECUTIVE DIRECTOR

AUGUST 09, 2019

Office of State Budget Director

## Fiscal Impact of 2018 Legislation

14

- There was no estimated score for FY18 due to the effective date of HB 487 of July 14th. However, there could have been some minor changes in FY18:
  - ▣ Withholding tables changed May 1<sup>st</sup>
  - ▣ Estimated income tax payments in June (FY18)
- FY19 fiscal impact was estimated to be +\$192.3 million
  - ▣ Sales Tax +\$208.2 million
  - ▣ Corporate income -\$27.6 million
  - ▣ Individual income -\$118.3 million
  - ▣ Tobacco Taxes +\$128.6 million
- FY20 fiscal impact was estimated to be +\$197.5 million
  - ▣ Sales Tax +\$277.7 million
  - ▣ Corporate income -\$71.9 million
  - ▣ Individual income -\$118.3 million
  - ▣ Tobacco Taxes +\$110 million

# Fiscal Impact of 2019 Legislation

15

- There was no official score for FY19 due to effective dates
- FY20 fiscal impact is -\$25.5 million
  - ▣ Sales and Excise Taxes -\$13.7 million
  - ▣ Corporate income -\$3.6 million
  - ▣ Individual income -\$13.7 million
  - ▣ Telecommunications Tax +\$5.5 million
- FY24 fiscal impact is -\$159.3 million
  - ▣ Sales and Excise Taxes -\$1.2 million
  - ▣ Corporate income -\$8.3 million
  - ▣ Individual income -\$26.0 million
  - ▣ Telecommunications Tax +\$6.0 million
  - ▣ LLET -\$1.3 million
  - ▣ Bank Franchise -\$124.0 million
  - ▣ Property Tax -\$4.4 million

# Estimated Fiscal Impacts of Legislative Changes

16

Total For All Tax Bills 2018 & 2019	Fiscal Impact (\$ million)				
	FY20	FY21	FY22	FY23	FY24
Sales Tax	\$ 264.3	\$ 274.6	\$ 275.8	\$ 276.3	\$ 276.8
Cigarette Tax	\$ 110.0	\$ 104.5	\$ 99.3	\$ 94.3	\$ 89.6
Individual Income Tax	\$ (132.0)	\$ (148.4)	\$ (144.3)	\$ (144.3)	\$ (144.3)
Corporate Income Tax	\$ (75.5)	\$ (71.0)	\$ (37.3)	\$ (36.5)	\$ (80.2)
LLET	\$ -	\$ (1.3)	\$ (1.3)	\$ (1.3)	\$ (1.3)
Bank Franchise Tax	\$ -	\$ -	\$ (120.0)	\$ (122.0)	\$ (124.0)
Telecomm Tax	\$ 5.5	\$ 6.0	\$ 6.0	\$ 6.0	\$ 6.0
Wine Wholesale	\$ (0.3)	\$ (0.3)	\$ (0.3)	\$ (0.3)	\$ (0.3)
Property Tax	\$ -	\$ (4.1)	\$ (4.2)	\$ (4.3)	\$ (4.4)
	<b>\$ 172.015</b>	<b>\$ 160.0</b>	<b>\$ 73.6</b>	<b>\$ 67.8</b>	<b>\$ 17.8</b>



## Road Map for Tax Reform

17

- Focus on the General Fund
- Highlight where we finally landed with tax reform rather than the path we took to get there
- Hit the major highlights
- Refer to handout in the packet for greater details
- Focus on items that carried fiscal impacts

## Basic Principles of HB 487, 2018 RS

18

- Lower Rates
  - ▣ Corporate Income
  - ▣ Individual Income
- Broader Base
  - ▣ Sales Tax
  - ▣ Individual Income Tax
  - ▣ Corporate Income Tax
  - ▣ Telecommunications Tax
- Shift from taxing income and production to taxing consumption
- Overall revenue positive

## Basic Principles of 2019 Tax Changes

19

- HB 354 began as a technical corrections bill to the 2018 tax reform
  - ▣ Unintended consequences of HB 487
  - ▣ Partial policy rollbacks
- Additional tax policy not addressed in 2018
- End result included modifications as well as new tax policy
- Overall revenue negative, partially offsetting 2018 changes

## Individual Income Tax

(Broadened the Base, Lowered the Top Rates)

20

- Abandoned progressive rates in favor of a flat 5% income tax rate
- Eliminated several itemized deductions
- Eliminated \$10 personal exemptions
- Lowered the exclusion of retirement income from \$41,100 to \$31,100
- Internal Revenue Code updated to December 31, 2017, and then December 31, 2018 -- as modified by KRS 141.010. The update adopted many provisions in the Tax Cuts and Jobs Act on the effective dates specified in that Act.
- Inventory Tax Credit – a non-refundable and non-transferable income tax (state and local) credit is allowed for property taxes timely paid on inventory. Phase-in begins for property assessed as of January 1, 2018. Can be taken against IIT, CIT, or LLET

# Individual Income Tax

(Continued)

21

- ▣ Restoration of certain itemized deductions
  - Investment interest deduction (IRC Section 163)
  - Gambling loss deduction (IRC Section 165 d )
- ▣ Relief for low-income households
  - “Income tax gap credit”
  - A small number of filers were harmed when the progressive rate structure from pre-2018 was changed to a flat rate structure
  - Enhanced family size tax credit
- ▣ Reclassification of heavy equipment rental inventory
  - Only NAICS codes 532310 and 532412
  - Eligible for inventory tax credit (IIT, CIT, LLET)

# Sales and Use Tax

(Broadened the Base)

22

- ▣ Admissions and Selected Services
  - ▣ Participatory admissions, membership fees
  - ▣ Transient Accommodations
  - ▣ Landscaping services
  - ▣ Janitorial services
  - ▣ Small animal veterinary services
  - ▣ Pet grooming and boarding services
  - ▣ Industrial laundry and linen supply services
  - ▣ Non-coin-operated laundry and dry cleaning services
  - ▣ Indoor tanning services
  - ▣ Non-medical diet and weight reducing services
  - ▣ Limousine services with a driver
  - ▣ Extended warranty services

# Sales and Use Tax

(Continued)

23

## □ Other Sales Tax base expansions

### □ Installation and Repair Services

- Gross receipts subject to sales tax will include installation/repair labor *associated with the sale* of taxable tangible personal property, digital property, or services. This labor component becomes taxable if part of a taxable retail sale.
- Charges for the installation of fixtures to real property or for labor to repair fixtures to real property are not part of gross receipts subject to sales tax. See 103 KAR 26:070 for more information on fixtures and building materials used in construction contracting.
- There is an exemption for charges for repair or installation labor for taxable tangible personal property *used directly within the manufacturing process*
- This law change does not affect contractors involved in building construction or repairs to real property.

# Sales and Use Tax – Online Retailers

24

## □ Nexus Expansion for Economic Presence for a Remote Retailer

- In anticipation of a favorable ruling in the Wayfair case
- If a retailer has \$100,000 in annual gross receipts or 200 separate transactions during the year, the retailer must collect Kentucky Tax
- Effective 2018

## □ Marketplace Providers

- Requires online sales platforms to collect and remit KY sales and use tax on transactions they facilitate for sales into the Commonwealth from third party sellers.
- Collection requirements apply based upon on the same economic standard as remote retailers (\$100,000 in gross receipts -- or -- 200 or more separate transactions from sales into KY annually).
- Effective July 1, 2019.

## Sales and Use Tax

(Continued)

25

- ▣ Non-profit organizations exemption
  - HB 487 taxed all admissions – effective July 1, 2018
  - HB 354 amended KRS 139.495 and created a new section to exempt all sales of admissions as well as fundraising event sales made by (501) (c) (3) charitable, religious and educational organizations, government, and all other nonprofit organizations – effective March 26, 2019
- ▣ Partial exemption for energy and energy-producing fuels -- KRS 139.480 (3) -- clarified
  - Grandfathered manufacturers and industrial processors with tolling operations in place as of July 1, 2018
  - Established specific criteria for tollers after July 1, 2018
- ▣ Sales-for-resale of new services
- ▣ De Minimis sales threshold (\$6,000) exclusion for new services

## Cigarette Tax Increase

26

- ▣ \$0.50 Cigarette tax increase, effective July 1, 2018;
- ▣ Cigarette floor stocks of \$0.50 with 3 installments (July 10, Aug 10, and Sep 10, 2018)
- ▣ Estimated Fiscal Impact: \$128.6 million
  - ▣ Increase in Cigarette Tax -- \$122.4 million
  - ▣ Increase in floor stock tax -- \$15.9 million
  - ▣ Decrease in sales tax – (\$9.7 million)
- ▣ Actual Fiscal Impact: approximately \$165.0 million
  - ▣ Increase in Cigarette Tax – approximately \$146.9 million
  - ▣ Increase in floor stock tax -- \$21.3 million
  - ▣ Decrease in sales tax – (uncertain)

## Other Excise Tax Changes

27

### □ Video streaming services –

- ▣ HB 354 defines these services under the category of “multi-channel programming services” as “*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.*”
- ▣ Video streaming services provided to Kentucky customers are subject to the 3% excise tax (KRS 136.604) and the 2.4% gross revenues tax (KRS 136.616), collectively KY telecommunications taxes, as well as the utility gross receipts license tax (school tax) imposed at a local school district rate not to exceed 3% (KRS 160.614) billed on or after July 1, 2019.
- ▣ Base Preservation due to changing technology

## Kentucky Corporation Income Tax Changes

28

- Kentucky changed five areas of its corporation income tax law which will affect revenue collections:
  - ▣ Tax rates,
  - ▣ Apportionment of income and sourcing of sales,
  - ▣ IRC updates,
  - ▣ Group filing methods and NOL provisions, and
  - ▣ Tax credits.

## Corporation Income Tax Rates and Apportionment

29

- A flat 5% tax rate replaces the graduated rate brackets which ranged from 4% to 6%
- Income Apportionment
  - ▣ Replacing three-factor apportionment (double weighting of sales, property, and payroll)
  - ▣ New Law: Single factor apportionment (sales) with market based sales sourcing
  - ▣ Lowers tax burden for corporations that have substantial property and payroll in Kentucky
  - ▣ Determines Kentucky taxable income

## Sourcing Sales of Services and Intangibles

30

- Allocating receipts from services and sales of intangibles
- Moving from origin to destination-based sourcing
  - ▣ Cost-of-performance to market-based
- Sourced to Kentucky if the taxpayer's market for the sale is in Kentucky (destination-based).
  - ▣ Where is the service performed?
- Under previous tax law, receipts from sales were origin based.
  - ▣ State with the largest share of cost

## Federal Tax Changes

31

Kentucky updated its federal conformity date to December 31, 2017 (and later to December 31, 2018), and adopted the following changes in the Tax Cuts and Jobs Act (TCJA):

- ▣ Net Operating Losses limitations
- ▣ Net Interest Expense Limitations
- ▣ Repeal of the Domestic Production Activity Deduction
- ▣ Taxation of Foreign Derived Intangible Income

Kentucky did NOT adopt the following changes in the TCJA:

- ▣ Depreciation and Expensing
- ▣ Deduction for Qualified Business Income of Pass-Through Entities

## Group Filing Methods and NOL Provisions

32

- For tax years beginning on or after January 1, 2019
- Filing:
  - ▣ Unitary Combined Group filing required; *unless*
  - ▣ The group elects a 48 month same-as-federal consolidated group filing; *otherwise*
  - ▣ Separate entity filing if not part of a unitary or consolidated group
  - ▣ Benefit of this method?
    - Reduces or eliminates tax avoidance (“accounting games”)



## What is a unitary Group?

33

- "Unitary business" means a single economic enterprise that is made up either of separate parts of a single corporation or of a commonly controlled group of corporations that are sufficiently interdependent, integrated, and interrelated through their activities so as to provide a synergy and mutual benefit that produces a sharing or exchange of value among them and a significant flow of value to the separate parts. For purposes of this section, the term "unitary business" shall be broadly construed, to the extent permitted by the United States Constitution;
- KRS 141.202 (2) (f)

## Clarifying Provisions for Unitary Filing

34

- Modifications to HB 487
  - 50% voting stock for common ownership (not included in HB 487, goes to commonly controlled)
  - Further definition of "tax haven" to exclude jurisdictions that have entered into a comprehensive income tax treaty with the US
  - Combined report to be filed on a "waters-edge" basis
  - Combined report considers eliminating entries (transaction between members within a unitary group are eliminated)
  - Include corporations that earn less than 80% of income from sources outside the US
  - Changed election period from 96 months to 48 months

# Modifications to HB 487

(Continued)

35

## □ Further Corporation Income Tax changes

- Sharing of NOL's (but not tax credits) across members of group
- Deferred tax deduction for unitary filers
  - Applications with Schedule DTD due July 1, 2019
  - 125 schedule DTD claiming a total tax impact of \$444.8 million
  - Claimed over a 10-year period beginning in 2024
- IRC §179 expense deduction increased to \$100,000 for Kentucky in 2020 (New Tax Policy)
  - Property placed into service 9/10/01 - 12/31/19
    - Use 12/31/01 IRC (\$25,000 § 179 max)
  - Property placed into service on or after 1/1/20
    - Use 12/31/03 IRC (\$100,000 § 179 max)

□ [Taxanswers.Ky.Gov](https://taxanswers.ky.gov)

# Other Tax Changes

36

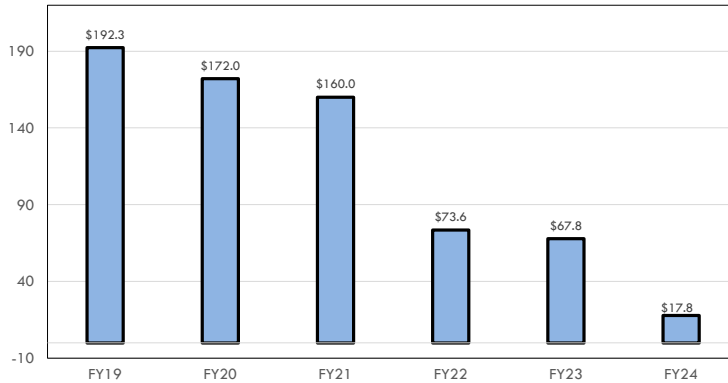
## □ New Tax Policy

- Repeal of the Bank Franchise Tax (January 1, 2021)
- Imposition of CIT and LLET on financial institutions
- Heavy Equipment Leasing Property and Tax Credit
- Enhancements to *major* recycling credit program
  - 400 employees at the project location (previously 750)
  - Credit for 25% of the installed cost of the equipment (previously 50%)
  - 30 year life (previously 10)
  - Credit may offset up to 75% of each tax liability for all years available (previously 50%)

## Tax Impacts from 2018 and 2019

(Millions \$)

37



## Net Fiscal Impact of Tax Policy 2018, 2019

38

Total For All Tax Bills 2018 & 2019	Fiscal Impact (\$ million)				
	FY20	FY21	FY22	FY23	FY24
Sales Tax	\$ 264.3	\$ 274.6	\$ 275.8	\$ 276.3	\$ 276.8
Cigarette Tax	\$ 110.0	\$ 104.5	\$ 99.3	\$ 94.3	\$ 89.6
Personal Income Tax	\$ (132.0)	\$ (148.4)	\$ (144.3)	\$ (144.3)	\$ (144.3)
Corporate Income Tax	\$ (75.5)	\$ (71.0)	\$ (37.3)	\$ (36.5)	\$ (80.2)
LLET	\$ -	\$ (1.3)	\$ (1.3)	\$ (1.3)	\$ (1.3)
Bank Franchise Tax	\$ -	\$ -	\$ (120.0)	\$ (122.0)	\$ (124.0)
Telecomm Tax	\$ 5.5	\$ 6.0	\$ 6.0	\$ 6.0	\$ 6.0
Wine Wholesale	\$ (0.3)	\$ (0.3)	\$ (0.3)	\$ (0.3)	\$ (0.3)
Property Tax	\$ -	\$ (4.1)	\$ (4.2)	\$ (4.3)	\$ (4.4)
	<b>\$ 172.015</b>	<b>\$ 160.0</b>	<b>\$ 73.6</b>	<b>\$ 67.8</b>	<b>\$ 17.8</b>