BOURBON BARREL TAXATION TASK FORCE

Minutes of the 3rd Meeting
of the 2022 Interim

September 1, 2022

Call to Order and Roll Call

The 3rd meeting of the Bourbon Barrel Taxation Task Force was held on Thursday, September 1, 2022, at 10:00 AM, in Room 169 of the Capitol Annex. Representative Chad McCoy, Chair, called the meeting to order, and the secretary called the roll.

Present were:

Members: Senator Robert Stivers, Co-Chair; Representative Chad McCoy, Co-Chair; Senators Jimmy Higdon and Christian McDaniel; Representatives Jennifer Decker, Thomas Huff, and Cherlynn Stevenson.

Guests: Timothy J. Eifler, Stoll Keenon Ogden PLLC; Jerry Summers, Judge-Executive, Bullitt County; Jim Henderson, Executive Director, Kentucky Association of Counties (KACO); and Kayla Carter, KACO.

LRC Staff: Jennifer Hays, Sarah Watts, Hunter Branham, and Lexi Bensberg.

Discussion of Industrial Revenue Bonds

Timothy Eifler, Stoll Keenon Ogden PLLC, presented a general overview of Industrial Revenue Bonds in the context of their usage as a mechanism to obtain a state and local property tax abatement.

Mr. Eifler testified that an Industrial Revenue Bond (IRB) is essentially a loan with an obligation to repay. Statutes were enacted and bonds were first authorized in 1946 and may be issued by specific governmental entities to finance projects. These statutes provide requirements and guidelines for what type of assets can be financed through IRBs. The tax exemption at the local level is automatic once an IRB is issued for a project, but a project must apply to the Kentucky Economic Development Finance Authority (KEDFA) to receive a lower state tax rate. The evaluation criteria for this application includes variables such as amount on project capital investment, county unemployment rate, size and percentage of the abated tax, and estimated tax revenues among other things. If KEDFA approves the application, the state property tax rate for the Project is reduced to $0.015 per $100 of fair cash value.

IRBs act as a locally administered economic development incentive, with specific cities or counties having authority over whether to issue an IRB to a project that is planning to locate in its jurisdiction. IRBs are an alternative method to finance capital assets of a project that allows the project to obtain a state and local property tax abatement on those assets while the IRB is outstanding.

The leasehold interest in a project is exempt from local property tax. However, it must be approved by KEDFA to receive the reduced state rate of $0.015 per $100 of fair cash value.

Mr. Eifler explained that to obtain this tax abatement, the IRB must be structured specifically so that the title to the assets is held by the city or county during the bond's term (up to 40 years). Those assets are leased to the company by the city or county, and the IRBs are issued to pay the cost of those assets. The company's lease payments are used to repay the debt during the term of the bond. With the city or county acting as a conduit, projects that receive an IRB shall be exempt from taxation to the same extent as other public property used for public purposes during the term of the bond.

Due to this structure, the city or county is a conduit and the city or county is not obligated to levy a tax to repay the IRB if there is a default on the loan. Via statute and case law, an IRB is not considered a debt of the city or county for purposes of the limits on the city or county's ability to borrow.

KRS confirms that the purpose of an IRB is to promote economic development of the Commonwealth and to encourage the increase and retention of industry in the state. IRBs can finance the cost of any industrial building, as defined by KRS. There are 15 categories in the legal definition, though they are primarily used in manufacturing projects. Under Kentucky law, distilleries are considered to be manufacturers.

Mr. Eifler testified that the first step in the process of issuing an IRB is the adoption of a bond inducement resolution by the city or county's legislative body that will specify details of the project and the bond being issued. Once the project is constructed, the city or county will adopt the bond ordinance, which authorizes the issuance of the bond and specifies details such as amount and repayment term. Upon repayment of the bond, the lease terminates. The issuer transfers the project title to the company for a previously agreed upon nominal payment, and the property tax abatement ends.

In the context of distilleries, the barrels that hold the liquid can be financed through an IRB because the barrels are a depreciable asset.

Mr. Eifler testified that the issuer of the IRB may require payments in lieu of taxes (PILOT) to local taxing districts that may be impacted by the project's tax exemption.

These payments are negotiated amounts that the company contractually agrees to pay during the term of the IRB.

In response to a comment from Co-Chair Stivers, Mr. Eifler testified that if an IRB is issued to a company to expand a preexisting project, the added value provided by the expansion will be exempt from local property tax.

In response to a question from Senator Higdon, Mr. Eifler testified that the maximum duration of an IRB increased from 30 to 40 years. There is no guaranteed escape clause, but one could be negotiated into the terms of an IRB.

In response to a question from Senator Higdon, Mr. Eifler testified that KEDFA will agree to the state tax property rate reduction if there is an agreement for a full school PILOT. If the company is required to make a PILOT payment to another district, KEDFA would require the company to enter into a PILOT agreement with the state to match it.

In response to a question from Senator McDaniel, Mr. Eifler testified that South Carolina and Georgia have very similar IRB structures. He continued that KEDFA, under KRS, can issue conduit bonds. He also testified that he was unaware of any previous defaults on IRBs. When underwriters consider IRBs, they understand that the sole source of repayment is the revenue stream of the company. The city or county does not offer any collateral for repayment. If a company were to default on an IRB, it should not impact that city or county's ability to borrow in the future.

In response to a question from Chair McCoy, Mr. Eifler testified that the bourbon barrel tax is usually still being collected if a distillery has an IRB agreement. Mr. Eifler explained that it benefits a city/county to enter into an IRB agreement because it offers an incentive for economic development in their jurisdiction. He also testified that if the bourbon barrel tax disappeared there would be no breach of existing IRB contracts.

In response to a question from Senator McDaniel, Mr. Eifler testified that the IRB is a loan and that the interest on the loan is treated as ordinary income. There is no prohibition on an affiliate of the project company from purchasing the IRB debt, and this process is common on property tax abatement bonds.

In response to a question from Representative Decker, Mr. Eifler testified that it is not unusual to have a PILOT agreement written into the contract of an IRB.

Discussion of County Concerns

Jerry Summers, Judge-Executive, Bullitt County; Jim Henderson, Executive Director and Kayla Carter, Kentucky Association of Counties, testified to the concerns facing counties if the Bourbon Barrel Tax were to be abolished.

Mr. Summers testified that the Bullitt County barrel tax revenue is expected to double by 2026. The revenue from the tax provides funding for multiple local districts. Bullitt County does not have an occupational tax or a licensing fee, so it would be difficult to compensate for the lack of revenue if the tax were to be abolished.

Mr. Summers testified that counties have issues $2.5 billion in IRBs since 2012. These IRBs were issued based on the expectation of future revenue growth from the bourbon barrel tax.

In response to a question from Senator McDaniel, Mr. Summers stated that he would provide the document with the annual unrealized property tax revenue by county at a later date. Mr. Summers clarified that his administration has not issued any IRBs, but historically there was an expectation of a revenue stream via the bourbon barrel tax from these projects.

In response to a question from Chair McCoy, Mr. Henderson testified that the interest is to maintain and grow the bourbon industry's interest in residing in Kentucky. The barrel tax is often a reason that a city or county would consider issuing an IRB to a distiller interested in locating in their jurisdiction.

Mr. Henderson testified that the 2021 barrel tax revenue provided over $1.1 million to the Nelson county fiscal court. The 2021 barrel tax revenue provided over $300,000 to the Marion county fiscal court. These counties issued millions of dollars in IRBs to distillers.

Henry County does not currently have a high dependence on revenues from the bourbon barrel tax. However, it recently sold 40 acres of the county industrial park at a discounted rate, with the expectation of a return on investment through the barrel tax. Once current projects are completed, it is expected that there will be a 20 percent increase in fiscal court tax revenue.

Mr. Henderson testified that many smaller counties are heavily reliant on revenues from local property taxes to fund local districts, but forego this revenue by issuing IRBs with the expectation that the bourbon barrel tax would account for a portion of lost revenue. If the bourbon barrel tax were to be abolished, it would put a large hole in the budgets of many counties. It is uncertain how that hole would be filled.

Mr. Henderson also discussed the correlation between tangible property tax and real property tax rates. He expressed concern about the decrease in personal property tax having a bearing on the real property tax rate, due to the convoluted relationship between the two.

Senator Higdon commented that in 2014, the General Assembly eliminated the ad valorem tax by way of tax credits. The local governments would receive their tax revenue, but then the companies would receive a tax credit on the state return for local taxes paid to local tax districts.

Senator McDaniel commented that the General Assembly made a generous contribution to the bourbon industry in 2014. He acknowledged that the Commonwealth’s budget reserve trust fund cannot act as a solution to the issue at hand, as the state must find solutions to state workforce wage and pension liabilities.

In response to a question from Representative Decker, Mr. Henderson testified that the escape clause in the IRB issued within the representative’s district, which voids the contract if the bourbon barrel tax is abolished, is not common and likely was only negotiated because of the current discussion in the legislature to abolish the tax.

In response to a question from Co-Chair Stivers, Mr. Summers testified that a bourbon barrel costs around $200. However, the rate at which the barrel is taxed differs by county. Mr. Summers agreed that any solution to a hole in revenue created by the abolishment of the bourbon barrel tax would have to vary based on the preexisting tax structure in each county.

In response to a question from Co-Chair Stivers, Ms. Carter testified that the liquid in the barrels is taxed at the tangible rate set by each county. She also stated that most of the IRBs that she has seen in Kentucky have had a 30-year repayment term.

In response to a question from Chair McCoy, Mr. Henderson testified that the graphs included in the KACo presentation were designed to showcase the financial impact of the barrel tax, but that the $230,000 impact to the Nelson County sheriff’s office is included in the other tax revenues listed. Also, Mr. Henderson testified that his office does not typically set tax policy. However, if the barrel tax were to be abolished the expectation that was set when the local government agreed to the IRB should continue to be filled. How this fulfillment would happen, once again, would vary by county based on tax structure.

Chair McCoy commented that this conversation is not being heard at the local level because new distilleries are not choosing to locate within the state. Chair McCoy announced that he will not be attending the fourth meeting of the Bourbon Barrel Task Force and that Co-Chair Stivers will be chairing the meeting.

Seeing no other questions or comments, Chair McCoy adjourned the meeting at 11:50 a.m.