COMMONWEALTH OF KENTUCKY STATE FISCAL NOTE STATEMENT
LEGISLATIVE RESEARCH COMMISSION
2016 REGULAR SESSION

CORRECTED 4/29/2016

MEASURE

2016 BR NUMBER **0923** **HOUSE** BILL NUMBER **292**

RESOLUTION NUMBER_____ AMENDMENT NUMBER _____

SUBJECT/TITLE An ACT relating to the limited liability entity tax.

SPONSOR Representative Yonts

NOTE SUMMARY

FISCAL ANALYSIS: ☒ IMPACT ☐ NO IMPACT ☐ INDETERMINABLE IMPACT

LEVEL(S) OF IMPACT: ☒ STATE ☐ LOCAL ☐ FEDERAL

BUDGET UNIT(S) IMPACT: _____

FUND(S) IMPACT: ☒ GENERAL ☐ ROAD ☐ FEDERAL ☐ RESTRICTED AGENCY _____ ☐ OTHER

FISCAL SUMMARY

FISCAL ESTIMATES	2015-2016	2016-2017	2017-2018	ANNUAL IMPACT AT FULL IMPLEMENTATION
REVENUES			($20 million) Minimum	($20 million) Minimum
EXPENDITURES				
NET EFFECT			($20 million) Minimum	($20 million) Minimum

( ) indicates a decrease/negative

MEASURE'S PURPOSE: To amend the definition of cost of goods sold for the limited liability entity tax (LLET).

PROVISIONS/MECHANICS: KRS 141.0401 is amended to change the definition of cost of goods sold for the LLET to mean the same amounts that are allowable as cost of goods sold pursuant to the Internal Revenue Code and any guidelines issued by the Internal Revenue Service, except that no costs shall be included in costs of goods sold for any activity other than manufacturing, producing, reselling, retailing, or wholesaling. Definitions for direct labor and bulk delivery costs are deleted because these terms were originally defined to differentiate Kentucky's definition from the federal definition. The new definition applies to taxable years beginning on or after January 1, 2016.

FISCAL EXPLANATION: The LLET contains two computations and tax is paid on the lower of the two. The gross receipts calculation is based on all Kentucky gross receipts, without any deduction from that amount, at a rate of $0.095 per $100 of Kentucky gross receipts. The gross profits calculation is based on Kentucky gross receipts, minus returns and allowances and cost of goods sold attributable to Kentucky gross receipts, at a rate of $0.75 per $100 of Kentucky gross profits. A minimum tax of $175 applies to all entities.

This negative fiscal impact represents the minimum estimate of the potential impact when considering the taxpayers that may take an additional deduction related to cost of goods sold. There is a possibility that the increased deduction may allow taxpayers to shift to the gross profits calculation from the gross receipts calculation. The impact related to any shift in the current tax payment structure is indeterminable.

In 2012, there were approximately 175,000 taxpayers that filed the limited liability entity tax. Of the total number of taxpayers, approximately 93% pay the minimum tax of $175. This proposal will not impact these smaller taxpayers.

When considering the returns of those taxpayers paying more than the minimum tax (approximately 12,250 returns), less than 2% of those returns deduct a costs of goods sold on the Kentucky LLET return that is equal to the federal cost of goods sold deduction. If enacted, 98% of these taxpayers (about 12,000 of the 12,250) may be able to increase the amount of deduction taken and reduce the tax being paid.

By allowing a higher deduction for cost of goods sold, taxpayers may also be able to reduce gross profits to qualify for the reduced tax due allowed for small businesses or the minimum tax due. If gross profits are below $3 million, the minimum tax of $175 is due. If gross profits are between $3 million and $6 million, a reduced rate is allowed to minimize the tax due.

Receipts for FY 15 for the LLET equaled $ 223.8 million.

DATA SOURCE(S): **OSBD, DOR**
PREPARER: **Jennifer Hays** **NOTE NUMBER**: **125** **REVIEW**: **JRS** **DATE**: **4/26/2016**