KY CPA
Kentucky Society
Certified Public Accountants

2022 Legislative Issues

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What's inside

OVERVIEW OF 2022 LEGISLATIVE ISSUES

Tax reform

Support additional changes to our state and local tax codes that increase fairness and simplicity, avoid double taxation and make Kentucky a more competitive place to do business.

Updated Internal Revenue Code (IRC) conformity

Support an update to Kentucky's IRC conformity date to keep the state current with the most recent IRC changes.

LLET (Cost of goods sold)

Repeal the limited liability entity tax (LLET). If retained, clarify the ambiguous cost of goods sold (COGS) definition to make it simple, fair, and easy for businesses and tax preparers to comply.

Taxpayer rights

Support additional transparency, efficiency, and equity in the administration of our tax code.

Sales tax on professional services

Strongly oppose broadening the sales tax to professional services, which would adversely affect Kentucky businesses and inhibit economic development.

Professional licensing

Oppose calls to eliminate or weaken professional licensing. As lawmakers debate the extent of licensing needed for many jobs, the health, safety, and welfare of the public must be considered.

Remote work

Accommodate businesses employing remote workers and workers working remotely by providing a means for businesses to file a multijurisdictional return for occupational licenses taxes based on net profits and wages.

Pension reform

Support any additional changes to our state's public pension system that keep the promises owed to retirees, pay down our unfunded liability, improve our bond rating and minimize taxpayer risk.

Audit firm rotation

Oppose mandatory audit firm or partner rotation policies, whereby private companies or governments are required to rotate audit firms or partners within a specified time period.

Vendor compensation

Support a reasonable increase in vendor compensation that will adequately reimburse retailers and sellers of taxable services for collecting the state sales tax.

SPGE oversight

Require new or proposed increases in ad valorem taxes and fees by special purpose governmental entities (SPGEs) be approved by the fiscal court or city council where the entity resides.

Ban the Box

Oppose "Ban the Box" and similar legislation that place unnecessary hiring constraints on CPA firms, which are charged with handling sensitive client financial information.

Cybersecurity

Monitor cybersecurity legislation to ensure it strikes an appropriate balance between consumer protection and the compliance burden on businesses.

2021 Kentucky State Tax Conference: Tax Reform Panel
Starting from right to left:

- Mark A. Loyd, ESQ., CPA, Partner and Co-Leader, Tax National Practice Group of Dentons Bingham Greenebaum LLP and KyCPA Tax Committee Chair as moderator;
- Russ Woodward with Capital Link Consultants;
- Shelby W. Somervell, VP of Government Affairs and Communications for Greater Louisville Inc.;
- P. Anthony Allen, Government Affairs Director for KyCPA; and
- Charles Aull, Senior Policy Analyst with the Kentucky Chamber of Commerce.

GUIDING PRINCIPLES FOR STATE AND LOCAL TAXATION

The power to tax is the power to control public and private behavior. It is one of the essential powers of federal, state and local governments. When tax statutes and regulations embody sound, clear tax policy, everyone benefits: corporate and individual taxpayers can predict the tax consequences of their actions, government officials can predict revenue with more accuracy, and administrators can produce clear rules and collect taxes easily.

Conversely, when tax policies are complex, vague, contradictory, or unpredictable, everyone loses: taxpayers get confused and inadvertently may fail to pay taxes owed; revenue streams are less predictable; and administrators can't produce clear regulations or collect taxes easily.

KyCPA recommends Kentucky tax policy be based on the following principles:

Clear administrative guidance

Kentucky should strive to be a model of state tax administration. Given the dynamics of tax laws and everyone's interest in full compliance, taxpayers (and their advisors, such as CPAs) need clear and reliable guidance. We applaud the legislature for passing **HB 245** in 2017, which has led the Department of Revenue to issue more tax guidance. Ultimately, the expansion of guidance minimizes the cost of tax administration and improves the state's cash flow by minimizing errors and unnecessary disputes. We urge the Department of Revenue to issue additional guidance on tax changes that have occurred in the last few years.

Certainty

Continual change and lags in administrative guidance heighten taxpayer uncertainty. Reducing the frequency of rule changes and using consistent concepts and definitions is an important element of a sound and enforceable tax policy.

Equity, fairness, and neutrality

Not only must state tax law be fair, but the public must perceive it as being fair. Narrow or targeted exemptions from state taxes create perceptions of favoritism and unfairness. Kentucky should avoid taxes that apply only to a small group of taxpayers or are unevenly enforced. Constitutional principles and social equity demand that similarly situated taxpayers be taxed the same.

While policymakers should regularly evaluate tax exemptions, deductions and credits for their effectiveness, they should not confuse "tax expenditures" (i.e., the cost to the state) for "tax loopholes." Many broad-based tax expenditures common in other states (such as exempting most services from the sales tax) should be considered differently from narrow tax expenditures that favor certain economic activity.

KyCPA strongly opposes broadening the sales tax to professional services, which would adversely affect Kentucky businesses and inhibit economic development. There are several key policy reasons that distinguish professional services from the other types of services that are now taxable as a result of HB 487.

Border pressure – Over half of Kentucky's population lives in a border county, resulting in intense competition with our seven border states. Higher taxes affect individual and business decisions. It would be easy for individuals to purchase services across borders (or online) to lower costs, and for professional service firms to move their business location to attract clients. There's a reason only three states broadly tax professional services (all of which are less subject to border pressure), while other states, including Florida and Michigan, repealed such a tax shortly after implementation. On the other hand, most of the services now subject to sales tax in Kentucky have been taxed in many other states for extended periods of time.

Tax pyramiding – Sound tax policy dictates that a sales tax be administered at the final point of sale, but a majority of professional services are business-to-business transactions. By taxing inputs, goods or services, the price of the final product becomes more expensive; taxes are assessed multiple times as the goods or services come to market, increasing costs and yielding higher prices for consumers. This "tax on a tax" lacks transparency and hurts both consumers and businesses.

Complexity – While a goal of tax reform must be simplicity, implementing and collecting a tax on professional services would be extremely complicated. Tracking where services are performed and determining nexus would be challenging for employees, businesses, and the Department of Revenue.

Avoid double taxation and pyramiding of taxes

As previously noted, Kentucky should enact and retain tax laws that apply only one level of tax to a transaction or taxpayer. For the most part, Kentucky law appropriately exempts inventory purchased for resale. Sales tax is imposed only when the ultimate consumer buys the inventory. However, Kentucky must modernize its sales tax exemptions related to manufacturing, as certain exemptions have eroded because the tax code has not kept pace with technological advances.

Simplification and economy of collection

Simplification should be a high priority to minimize the costs of the Department of Revenue and local governments and businesses, including costs associated with collecting taxes, examining returns and resolving disputes. The current local tax system, where all 120 counties, hundreds of cities and numerous school districts have different rules and filing requirements, is increasingly burdensome as businesses become more mobile. Although the uniform occupational license tax statute (HB 277 in 2012) has eased some compliance problems, additional standardization and consolidated collection mechanisms should be considered.

Economic growth

Tax policy should not divert government or business resources from productive activities into excessive and non-productive compliance costs. Kentucky tax policy should be formulated to make the state a welcoming place to do business for existing and new businesses. The commonwealth should continue to recognize that sales and use, income, and other taxes have economic development implications, and many existing Kentucky businesses often compete with businesses across state lines. Coherent tax policy encourages economic development, the creation of jobs and the enhancement of Kentuckians' well-being.

Predictability

Kentucky should enact tax laws only prospectively to give the Department of Revenue, practitioners, software vendors, businesses and individuals enough time to prepare for changes. Retroactive tax laws should be prohibited – and tax laws should provide for clear, bright-line rules whenever possible. Additionally, prospective changes should provide a sufficient amount of time for taxpayers to understand the changes and take the necessary actions needed to comply with said changes. For example, recent changes to provide corporate taxpayers with a Deferred Tax Deduction were welcomed by the business community. However, only a few months were provided to perform the necessary complex calculations before reporting was due to the Department of Revenue.

Uniformity with other jurisdictions and federal procedures

Kentucky should strive to adopt uniform laws and compliance procedures that conform to federal procedures and those of other states. Specifically, we note two areas that can add excessive incremental burdens to Kentucky's current system:

- Because the starting point in calculating Kentucky's income tax is the federal income tax return, lags in adapting to the Internal Revenue Code (IRC) as it changes cause interpretative, administrative and compliance problems. As it did last year, Kentucky should annually update its reference to the Internal Revenue Code (IRC) or adopt a "rolling" IRC conformity whereby future IRC changes are automatically adopted without future Kentucky legislative action needed.
- Due to revenue considerations, Kentucky does not conform with IRC Section 179 and Section 168 (the election to expense certain qualifying equipment and bonus depreciation on certain qualifying equipment), which creates problematic differences between federal and Kentucky depreciation calculations. These and other depreciation differences cause businesses to make separate – and sometimes massively different – depreciation calculations for federal and Kentucky income tax purposes.

Virtual Capitol Hill visit with Senator Rand Paul including:

- KyCPA Board of Directors Chair Eric D. Scott, CPA, Managing Director of Tax Services for Ernst & Young;
- Board of Directors Chair-Elect Jim Stevison, CPA, Partner with Strothman & Company;
- Darlene Zibart KyCPA Chief Executive Officer; and
- members of KyCPA's Board of Directors, Tax, and PAC Committees.

ADOPT AN UPDATED CONFORMITY DATE TO THE IRC

Given the recent speed at which the Internal Revenue Code (IRC) is being changed and the related Treasury guidance is being issued, adopting an updated conformity date to the IRC would be beneficial for Kentucky taxpayers, tax practitioners, and tax administrators. Most IRC changes take place during the interim when the General Assembly is not in session to legislatively act, which results in uncertainty regarding Kentucky's conformity and/or non-conformity to certain changes and issued regulatory guidance. While adopting rolling conformity to the IRC may not be feasible for Kentucky, keeping our IRC conformity date as current as possible provides clarity around the current IRC in effect for Kentucky as opposed to a historical version of the IRC that might require a re-computation of a taxpayer's federal return just for their Kentucky return.

REPEAL OR SIMPLIFY THE LIMITED LIABILITY ENTITY TAX

The cost of goods sold (COGS) definition used to calculate Kentucky's limited liability entity tax (LLET) must be modified to increase compliance and fairness. The LLET applies to all entities that offer limited liability to its owners (e.g. corporations, S corporations, limited partnerships, limited liability corporations, etc.). To determine the amount of tax owed, the business pays either a minimum fee ($175) or the lower of two alternative calculations based on the amount of gross receipts or gross profits.

The LLET is a unique tax that KyCPA believes should be repealed. However, if the LLET is retained, KyCPA supports legislation to align Kentucky's LLET COGS definition with that of the COGS definition for federal and Kentucky income tax purposes. By bringing Kentucky in line with the federal and its own income tax definition for COGS, it will both enhance compliance by businesses and improve enforcement by the state.

PROTECT AND ENHANCE TAXPAYER RIGHTS

While continuing to reform our tax code should be a priority for our state legislature, the fair administration of our tax code also plays a significant role in the commonwealth's economic development efforts. Not only do businesses want to locate, invest and expand in states that have competitive tax rates, but perhaps equally important, they want reasonable assurances that our tax laws will be enforced transparently, efficiently, consistently and equitably.

Recognizing the importance of tax administration, the Council on State Taxation (COST) publishes a scorecard, "The Best and Worst of State Tax Administration," every three years. According to COST, its focus is on the "states' adoption of procedural practices that impact the fairness of states' laws and regulations for state administration and appeal of tax matters." In the 2019 report, Kentucky's score raised from a C- to a B-.

The Department of Revenue and the legislature have in recent years engaged in constructive dialogue with tax practitioners to improve tax policies and administration, including several changes in HB 487 and HB 354. KyCPA supports the following additional modifications to improve our tax administrative ranking:

- Return to a balanced interest rate on taxes owed to and by the commonwealth;
- Streamline the tax appeals process by allowing taxpayers to appeal directly to the Court of Appeals (or Kentucky Supreme Court), bypassing the circuit court, for tax cases, other than real property cases;
- Allow the Department of Revenue to waive interest assessments, consistent with its existing ability to waive penalties;
- Equalize assessment and refund periods for tangible personal property taxes;
- Extend the statute of limitations for filing a constitutional challenge from two to four years; and
- Continue to allow all disputed taxes to be appealed by taxpayers without the requirement of payment.

OPPOSE ELIMINATING PROFESSIONAL LICENSING

Oppose calls to eliminate or weaken professional licensing. CPAs play a vital role in upholding the integrity of the global financial system. As lawmakers debate the extent of licensing needed for many jobs, the health, safety, and welfare of the public must be considered. Licensing is about more than entry into a profession. Licensing boards provide the systems for ongoing education for professionals—critical in professions that must stay current with complicated and changing codes—and the means for enforcing standards and sanctioning bad actors. Weakening licensing would diminish the ability of the licensing boards to establish, verify, and enforce necessary expertise; leaving consumers left on their own to evaluate qualifications and performance for highly complex, technical professions without the specialized knowledge needed to do so. Weakening licensing would create an unfavorable business climate in Kentucky, causing businesses in the Commonwealth to suffer. KyCPA strongly opposes any calls to eliminate or weaken professional licensing in Kentucky.

MONITOR PUBLIC PENSION REFORM

In 2018, the legislature passed significant reforms to the state's pension systems, including KyCPA-supported changes that moved to level-dollar amortization and shifted the benefit structure for new state employees to more closely reflect the private sector. Most importantly, the legislature has now made it a priority to fully fund the systems and did so in the last state budget plan. KyCPA supports any additional pension reform proposals that keep the promises owed to retirees, pay down our unfunded liability, improve our bond rating and minimize taxpayer risk.

OPPOSE MANDATORY AUDIT FIRM ROTATION

The overarching goal of the auditing profession is to ensure that quality audits are performed by qualified firms. Rotation of audit firms has been a widely discussed topic among both the public and private sector for many years. KyCPA strongly opposes mandatory audit firm or partner rotation policies, whereby private companies or governmental entities (such as school boards, fire districts, cities, counties, etc.) are required to rotate audit firms or partners within a specified time period (usually 3-5 years).

Study after study has concluded that although the rationale behind mandatory auditor rotation may have good intentions (e.g., a "fresh set of eyes"), it is fundamentally flawed. Audit failures are three times more likely in the first two years of an audit because of its steep learning curve. Therefore, there's a positive correlation between auditor tenure and auditor competence. The American Institute of CPAs (AICPA) has found that automatic audit firm rotation results in increased audit failures, increased start-up costs, increased difficulties in timely reporting, loss of institutional knowledge, and reduced incentives to improve efficiency and audit quality.

INCREASE SALES TAX VENDOR COMPENSATION

In 2013, through a last-minute agreement to pay for public pension reforms, the legislature drastically reduced the maximum amount of vendor compensation to collect the state sales tax, from $1500 to $50 per reporting period. Though technological advancements have made collection easier, this reduction has forced Kentucky retailers and sellers to spend their own resources to collect a tax on behalf of the state. It is vitally important that retailers have the resources needed to invest in technology and seek advice on sales tax rules to ensure proper compliance. KyCPA supports a reasonable increase in vendor compensation that will adequately reimburse retailers and sellers for collecting and remitting the tax.

REQUIRE VOTE FOR SPGE FEES

In 2013, KyCPA supported reforms to increase transparency and accountability for special taxing districts (now called special purpose governmental entities, or SPGEs). As a result, legislation was passed to require SPGEs to electronically file administrative information, budget-to-actual data and audit certification in a publicly-accessible database. It also lowered the threshold for mandatory annual audits and attestation engagements, though KyCPA did not entirely agree on the new threshold limits.

To build upon these reforms, KyCPA also supports a requirement that new or proposed increases in ad valorem taxes and fees by SPGEs be approved by the fiscal court or city council where the entity resides.

OPPOSE "BAN THE BOX" AND SIMILAR LEGISLATION

In recent years, civil rights and ex-offenders advocates have filed legislation commonly referred to as "Ban the Box." These proposals generally prohibit an employer from including a check box on a job application that asks candidates if they have criminal records. Other proposals prohibit employers from asking for a candidate's credit history.

While the goal of these proposals is laudable, to give reformed ex-offenders an opportunity to show their qualifications without discrimination, the concept poses unique challenges for CPAs and CPA firms – where trust, confidentiality and handling of sensitive financial materials are cornerstones of the CPA-client relationship. To ensure CPA firms can make informed hiring decisions, KyCPA opposes "Ban the Box" and similar legislation that does not include an exemption for CPA firms. The Society also cautions the legislature from expanding the number of class D felonies eligible for expungement under the expungement law passed in 2016.

MONITOR

CYBERSECURITY LEGISLATION

Protecting consumer data and sensitive information is a rising priority across the country. During the 2019 session, at least 43 states and Puerto Rico introduced or considered close to 300 bills that deal significantly with cybersecurity. Thirty-one states enacted cybersecurity-related legislation in 2019. Kentucky already has a security breach notification law, and attempts have been made in recent sessions to strengthen this law.

Cybersecurity legislation often has a direct impact on CPA firms, who hold personal information related to their clients. While KyCPA supports efforts to protect consumer data, legislation should carefully strike a balance between consumer protection and the compliance burden on businesses.

KyCPA Chief Executive Officer Darlene Zibart and Government Affairs Director P. Anthony Allen join Representative Kim Banta, House District 63, for a hearing on House Bill 275, CPA Licensure.

Kentucky Society of Certified Public Accountants

Founded in 1924, the Kentucky Society of Certified Public Accountants (KyCPA) is a statewide, nonprofit professional organization serving nearly 4,500 CPAs in public accounting firms, business, industry, government and education. KyCPA supports all CPAs in Kentucky with timely information, outstanding educational opportunities, career development, helpful resources, the promotion of high ethical standards and public advocacy on behalf of the profession and the public good.

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