2023 Policy Priorities

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SALT parity

A part of the Tax Cuts and Jobs Act of 2017 sets a $10,000 cap on the amount of state and local taxes (SALT) paid that an individual can deduct when calculating their federal tax liability. This cap negatively impacts individuals, especially those that are shareholders, partners, or members of S corporations, partnerships, and limited liability companies, also known as pass-through entities (PTEs).

The taxes on business profits of PTEs are paid at the individual (shareholder/partner/member) level. As a result, a Kentucky business owner may experience increased federal income taxes and may be at a disadvantage compared to businesses operating in surrounding states that have adopted SALT reforms.

On November 9, 2020, through Notice 2020-75, the Internal Revenue Service announced support for state legislation that creates an entity-level state tax and thus partially restores the SALT deduction for federal income tax on SALT paid on the income from business operations. Since then, almost 30 states have enacted legislation to provide relief to main street businesses. That is, approximately 75 percent of states with an owner-level personal income tax on PTE income have enacted or proposed PTE taxes. Kentucky is in the 25 percent minority.

KyCPA supports legislative action that will allow pass-through entities to elect to pay state and local taxes on their business income at the entity level. By permitting the SALT deduction at the **entity level**, the individual owner may avoid the $10,000 SALT cap and have a reduction in their federal individual income tax liability. For companies that make this election, the reform will:

- Impose an entity-level tax at the state's individual income tax rate; and
- Allow PTE business owners the benefit of tax credits and taxes paid in other states that have adopted or will adopt these reforms.

Importantly, taxes paid to the General Fund **will not** be impacted. Savings achieved by this legislation will lower the federal tax liabilities of individual PTE owners. Thus, Kentucky PTE business owners will get a solution to the federal SALT cap at **no cost** to the state.

Department of Revenue

With several tax changes forthcoming from legislation enacted following the 2022 Regular Session, the Department of Revenue will be implementing various new tax regulations and administrative guidance. With employee recruitment and retention, a severe Department issue, efficiency, effective dates, and compliance will increasingly become a problem for Kentucky taxpayers, tax practitioners, and tax administrators. KyCPA will advocate for Department needs that will potentially encompass Society expertise, increased staffing, and additional appropriations to address this increasing problem for Kentucky taxpayers.

Guiding principles of sound tax policy

- **Clear administrative guidance:** Taxpayers and their advisors need clear and reliable guidance to efficiently remit their tax liabilities. The expansion of guidance minimizes the cost of tax administration and improves the state's cash flow by reducing errors and unnecessary disputes.
- **Certainty:** Continual change and lags in administrative guidance heighten taxpayer uncertainty and increase compliance burdens on Kentucky businesses and individuals. Reducing the frequency of rule changes and using consistent concepts and definitions is an important element of a sound and enforceable tax policy.
- **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.
- **Avoid double taxation (tax pyramiding):** 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.
- **KyCPA strongly opposes broadening the sales tax to professional services,** which would lead to tax pyramiding, administrative complexities, make Kentucky into a tax policy outlier, and adversely impact businesses and inhibit economic development in the Commonwealth.

KyCPA members socialized and received legislative updates from policymakers at the 2022 Day at the Capitol event in Frankfort.

Tax simplification

- **Kentucky's Internal Revenue Code Conformity:** Given the speed at which the Internal Revenue Code (IRC) is amended, and related Treasury guidance is being issued, adopting an updated conformity date to the IRC would benefit Kentucky taxpayers, tax practitioners, and tax administrators. IRC Conformity refers to the degree to which a state tax code conforms to the federal tax code and simplifies a state's implementation of its tax policy by using federal taxable income as a starting point for calculations.

- **Protect and enhance taxpayer rights:** The implementation of a fair tax code 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. Therefore, 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;
    - Continue to allow all disputed taxes to be appealed by taxpayers without the requirement of payment;

Tax simplification

- **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.

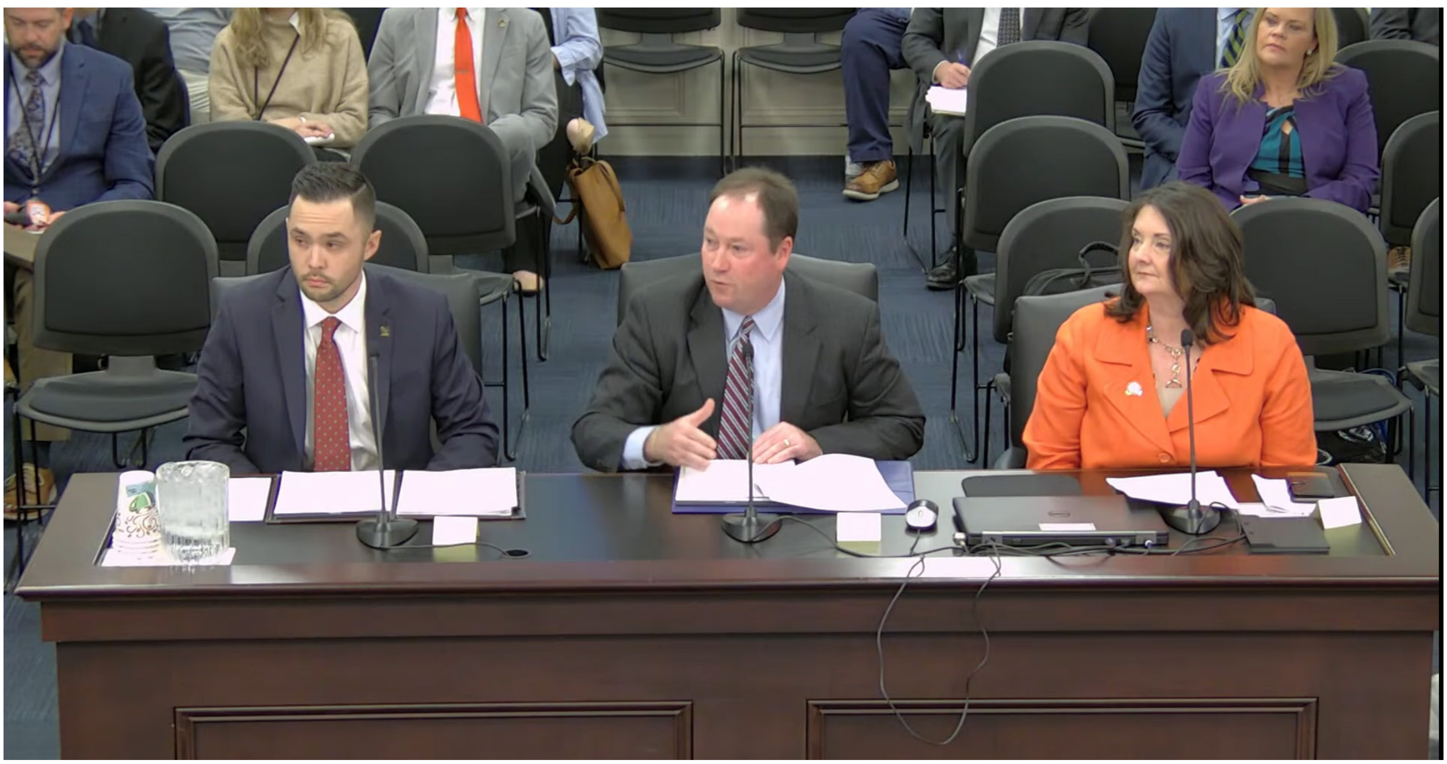
The LLET is a unique tax that **KyCPA believes should be repealed**. However, if the LLET is retained, KyCPA supports legislation to align Kentucky's LLET COGS definition with that of the COGS definition for federal and Kentucky income tax purposes. By bringing Kentucky in line with the federal and its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

- **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.

  KyCPA supports legislative action that will allow multi-jurisdictional entities and individuals to file local taxes with the Department of Revenue. Alternative standardization and consolidated collection mechanisms will ease the bureaucratic burden on multi-jurisdictional filers while allowing individual jurisdictional filers to continue remitting taxes to their local governments.

Professional licensing

CPAs play a vital role in upholding the integrity of the national 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 on their own to evaluate qualifications and performance for highly complex, technical professions without the specialized knowledge needed to do so. KyCPA strongly opposes any calls to eliminate or weaken professional licensing in Kentucky, which would create an unfavorable business climate in the Commonwealth.



P. Anthony Allen, KyCPA Government Affairs Director, Joe Donohue, Kentucky State Board of Accountancy Executive Director, and Representative Kim Banta, Kentucky's 63rd House District testifying 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 4,000 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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