

Kentucky Tax Alert

A REVENUE PUBLICATION FOR THE TAX PROFESSIONAL

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NOTE: This 2014 legislative summary presents only general information concerning the major tax provisions the General Assembly has enacted and does not represent a complete analysis or specific interpretations of the law changes. The Department of Revenue (DOR) will provide more specific information as it implements these changes. Full text of enacted bills is available on the legislative home page, www.lrc.ky.gov

A REVIEW OF TAX LAW CHANGES

Enacted by the 2014 Regular Session of the General Assembly.

CORPORATION TAX

Endow Kentucky Tax Credit—For fiscal years beginning on or after July 1, 2016, House Bill (HB) 208 amends KRS 141.438 to increase the total amount of tax credit that may be awarded from \$500,000 to \$1 million for each fiscal year.

Small Business Tax Credit Program—HB 301 amends KRS 154.60-010 and 154.60-020 to simplify and streamline the provisions of the Small Business Tax Credit Program which is administered by the Kentucky Economic Development Finance Authority (KEDFA). Some key definitions in the law were amended, including "small business" which is now defined in KRS 154.60-010(7) as: "any business entity organized for profit, including a sole proprietorship, partnership, corporation, limited liability company, joint venture, association, or cooperative, that has 50 or fewer full-time employees at the time it applies."

The small business tax credit program changes are effective July 15, 2014. The maximum credit amount for each small business for each year remains at \$25,000 and the total credit allowed for each fiscal year remains at \$3 million. Nothing in the Act affects the DOR's administration and compliance of the tax credit.

Kentucky Jobs Retention Act—Effective July 15, 2014, HB 396 amends KRS 154.25.010 to include as eligible companies those that are engaged in household appliance, or household appliance parts or supplies manufacturing.

Eligible companies must agree to undertake a jobs retention project resulting in the employment of a minimum of 1,000 full-time workers in Kentucky. The taxpayer must also invest at least \$100 million for new manufacturing equipment and the construction or modification of facilities to house the new equipment.

A taxpayer may recover, through credits, up to 50 percent of the investment and construction costs. A supplemental project may be approved, which may increase the recovery

percentage to 75 percent. The annual credit is equal to the lesser of the project costs that the taxpayer has not yet recovered under the agreement or 100 percent of tax liability attributable to the project, plus up to 5 percent of wages withheld from employees whose jobs were preserved or created by the project.

Internal Revenue Code Update—HB 445 updates the Internal Revenue Code (IRC) reference date from Dec. 31, 2006, to Dec. 31, 2013, for purposes of computing corporation and personal income tax. However, taxpayers who placed property into service after Sept. 10, 2001, are required to compute Kentucky depreciation under IRC Section 168 and the expense deduction under IRC Section 179 according to the provision in effect on Dec. 31, 2001. Therefore, taxpayers must continue to adjust Federal taxable income to Kentucky taxable income. The Code update applies to taxable years beginning on or after Jan. 1, 2014.

Distilled Spirits Tax Credit—HB 445 created a nonrefundable and nontransferable credit that may be claimed by income taxpayers who pay Kentucky property tax on distilled spirits. If the taxpayer is a pass-through entity, such as a partnership or limited liability company classified as a partnership for Kentucky income tax purposes, the taxpayer may apply the credit against the LLET and pass the credit through to its members, partners, or shareholders in the same proportion as the distributive share of income or loss is passed through.

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Credit amount: The distilled spirits credit is equal to:

- 20 percent of the property tax assessed and timely paid for taxable years beginning on or after Jan. 1, 2015;
- 40 percent of the property tax assessed and timely paid for taxable years beginning on or after Jan. 1, 2016;
- 60 percent of the property tax assessed and timely paid for taxable years beginning on or after Jan. 1, 2017;
- 80 percent of the property tax assessed and timely paid for taxable years beginning on or after Jan. 1, 2018; and
- 100 percent of the property tax assessed and timely paid for taxable years beginning on or after Jan. 1, 2019.

Taxpayers computing the credit cannot include delinquent taxes, interest, fees, or penalties paid to Kentucky.

The amount of the credit is contingent on the costs associated with the following capital improvements at the premises of the distiller:

- construction, replacement, or remodeling of warehouses or facilities;
- purchases of barrels and pallets used for the storage and aging of distilled spirits in maturing warehouses;
- acquisition, construction, or installation of equipment for the use in the manufacture, bottling, or shipment of distilled spirits;
- addition or replacement of access roads or parking facilities; and
- construction, replacement, or remodeling of facilities to market or promote tourism, including but not limited to a visitor's center.

Recapture provisions: The distilled spirits credit is subject to recapture if the capital improvement associated with the credit is sold or otherwise disposed of prior to the exhaustion of the useful life of the asset for Kentucky depreciation purposes. The amount of recapture is prorated if only a portion of the capital improvements are sold or disposed of by the taxpayer.

New Markets Development Program Tax Credit—Under the provisions of HB 445, the annual statewide cap for the new markets development program credit, which is available to investors in long-term debt securities issued by a qualified community development entity for financing businesses in Kentucky low-income communities, is increased from \$5 million to \$10 million.

Refundable performance fee: A qualified community development entity that seeks to have an equity investment or long-term debt security certified as a qualified equity investment and eligible for the New Markets Development Program tax credit must, as part of the application, pay a refundable performance fee in an amount equal to 0.5 percent of the amount of the equity investment or long-term debt security for which the entity is seeking certification, up to a

maximum of \$500,000. The performance fee is refundable, at the written request of the entity, if the certification application is denied or the amount of the investment that is certified is less than requested. An application must also include a \$1,000 nonrefundable application fee.

Recapture provisions: Any portion of the New Markets Development Program tax credit may be recaptured if the qualified community development entity fails to invest at least 100 percent of the purchase price of the equity securities in businesses located in Kentucky low-income communities within 12 months of the issuance of the securities and fails to maintain the level of investment until the last credit allowance date. The recapture threshold for tax years before 2014 was 85 percent of the purchase price of the securities and the time allowed for the investment threshold was 24 months. In addition to credit recapture, the application performance fee is subject to forfeiture for failure to meet the investment requirements. However, there is a 90-day cure period.

The DOR anticipates accepting applications for the credit beginning July 15, 2014. Applications received prior to July 15, 2014 will be considered as being received on July 15, 2014. The application for the credit is available on DOR's website.

Certified Rehabilitation Credit—Effective for taxable years beginning on or after Jan. 1, 2014, HB 445 allows a taxpayer to claim an income tax or LLET credit for completing a certified rehabilitation to a certified historic structure that is located (1) within the jurisdiction of a consolidated local government or urban-county government, and (2) within one-half mile of a tax increment financing development area that has received at least preliminary approval. The minimum investment is \$15 million and rehabilitation of the structure must begin before July 1, 2015. The total approved credit is available over a four-year period.

Credit amount: The refundable and transferable historic structure rehabilitation credit, which is limited to the first \$30 million of qualified rehabilitation expenses, is equal to:

- 30 percent of the qualified rehabilitation expenses in the case of owner-occupied residential property; and
- 20 percent of the qualified rehabilitation expenses in the case of all other property.

The maximum credit that may be claimed in a taxable year is 25 percent of the total approved credit; however, the total statewide credit is not subject to an annual cap.

Application procedures: A taxpayer seeking the Kentucky historic structure rehabilitation credit must file an application for a preliminary determination of maximum credit eligibility. An application for a final determination of credit must be submitted by the taxpayer upon completion of the project. Both applications must be filed with the Kentucky Heritage Council.

Film Production Incentives—HB 445 eliminated the Jan. 1, 2015, expiration date for the film industry tax credit. All other requirements remain the same.

Tax Increment Financing (TIF)—HB 542 amends KRS 154.30-060 to expand the parameters for certain projects in consolidated local governments to qualify as mixed use projects. Mixed use means a project within any consolidated local government if the project includes at least three of the qualified uses, one of which must be at least 20 percent of the total finished square footage of the proposed project or represent 20 percent of the total capital investment, and the other uses must jointly comprise at least 20 percent of the total finished square footage of the proposed project or 20 percent of the total capital investment. This provision is effective July 14, 2014.

Kentucky Industrial Revitalization Act—Effective Aug. 1, 2014, Senate Bill (SB) 74 amends KRS 154.26-010 to allow companies with approved economic revitalization projects qualifying for incentives under the Kentucky Industrial Revitalization Act (KIRA) to undertake supplemental projects during or within 24 months following the term of the initial project and to qualify for additional incentives.

During the initial term of an agreement, or within 24 months after the expiration of the term an eligible company may apply for, and the authority may approve, a supplemental project when the applicant:

1. Has expended approved costs of at least \$50 million on an approved economic revitalization project;
2. Employs a minimum of 750 employees at the site of the economic revitalization project;
3. Agrees to incur at least \$10 million in additional eligible costs for improvements to a blast furnace that is located at the economic revitalization project, and that has burned at least one million tons of Kentucky coal during the initial term of the agreement; and
4. Is at risk of closure and carries a significant net loss carry forward for the last three tax years as certified by the approved company.

INDIVIDUAL INCOME TAX

Code Update—HB 445 updates the definition of “Internal Revenue Code” to mean the Internal Revenue Code (IRC) in effect on Dec. 31, 2013, exclusive of any amendments made to the IRC subsequent to that date, other than amendments that extend provisions in effect on Dec. 31, 2013, that would otherwise terminate, and as modified by KRS 141.0101.

The itemized deductions limitation established in 26 U.S.C. Sec. 68 shall be determined using the applicable amount from 26 U.S.C. Sec. 68 as it existed on Dec. 31, 2006. This means the method used to calculate the limitation on

itemized deductions used in 2013 applies equally to tax years 2014 and beyond. The applicable amount (as adjusted for inflation) for a taxable year beginning in calendar year 2013 is \$178,150 (\$89,075 in the case of a separate return by a married individual). The applicable amount (as adjusted for inflation) for taxable years beginning in calendar year 2014 is \$181,150 (\$90,575 in the case of a separate return by a married individual).

Depreciation calculations for Kentucky did not change. HB 445 provides, “For property placed in service after September 10, 2001, only the depreciation and expenses deductions allowed under Sections 168 and 179 of the Internal Revenue Code in effect on December 31, 2001, exclusive of any amendments made subsequent to that date, shall be allowed.” Therefore the taxpayer will continue to make adjustments on their tax returns for the differences in depreciation allowed for Federal taxable income and Kentucky taxable income.

Angel Investor Credit—Effective for taxable years beginning on or after Jan. 1, 2015, HB 445 makes available a nonrefundable personal income tax credit under the Kentucky angel investment credit program to individuals who invest a minimum of \$10,000 in certain Kentucky small businesses with high-growth potential that are engaged in knowledge-based activities, such as bioscience, environmental and energy technology, health and human development, information technology and communications, and materials science and advanced manufacturing, that will further the establishment or expansion of small businesses, create additional jobs, and foster the development of new products and technologies.

Eligibility: A small business is qualified to participate in the program if at the time it requests certification, the business:

- has a net worth of \$10 million or less or net income after federal income taxes for each of the two preceding fiscal years of \$3 million or less;
- is actively and principally engaged in a qualified activity within Kentucky, or will be actively and principally engaged in a qualified activity within the state after the receipt of a qualified investment by a qualified investor;
- has no more than 100 full-time employees;
- has more than 50 percent of its assets, operations, and employees located in Kentucky; and
- has at no time received an aggregate amount of qualified investments that has allowed qualified investors to receive more than \$1 million in angel investor credits.

Individual investors must demonstrate to the KEDFA that the investor:

- is an individual natural person;
- qualifies as an accredited investor under the U.S. Securities and Exchange Commission’s Regulation D as of the date the individual investor requests certification;

- does not hold a more than 20 percent ownership interest in, and is not employed by, the qualified small business prior to making the investment;
- is not the parent, spouse, or child of an individual who holds a more than 20 percent ownership interest in, or who is employed by, the qualified small business prior to making the investment; and
- seeks a financial return from the investment in the qualified small business.

The investment must be offered and executed in compliance with applicable state and federal securities laws and regulations. In addition, the investment must be exchanged for consideration in the form of an equity interest in the qualified small business.

Credit amount: The amount of Kentucky angel investment credit is equal to:

- 40 percent of the investment, if the principal place of business of the qualified small business is outside a designated enhanced county; or
- 50 percent of the amount of the investment, if the principal place of business of the qualified small business is in an enhanced incentive county (*i.e.*, certain counties that are designated as economically depressed).

The maximum annual credit that may be awarded to each angel investor is \$200,000. The maximum credit that can be claimed in any taxable year shall not exceed 50 percent of the total credit awarded or transferred to the taxpayer. The credit is subject to an annual cap of \$3 million that is available to all angel investors. The total amount of credits awarded under the angel investment program, together with credits awarded under the Kentucky Investment Fund Act, cannot exceed a lifetime cap of \$40 million.

Carryforward provisions: Unused Kentucky angel investment credits may be carried forward for up to 15 years.

Forfeiture provisions: The angel investment must be made no later than the earlier of:

- 60 days, including weekends and holidays, following the date of credit approval; or
- Dec. 31 of the calendar year of credit approval.

The angel investor must provide proof of the investment to the KEDFA within 20 days, including weekends and holidays, of making the investment. If the investor either fails to make the investment prior to the deadline or fails to provide the required proof of the investment, the award of credit approval is null and void.

Transfer provisions: An angel investment credit may be transferred by a qualified investor to any individual taxpayer who also meets investor qualification requirements. Written notice of the transfer must be provided to the DOR.

Reporting requirements: A qualified small business that has received a qualified investment must file an annual report with the KEDFA by Feb. 1 of the calendar year following the year in which a credit was awarded and each of the four years thereafter. The report must demonstrate that the business continues to meet the original small business qualification requirements. In addition, the report must include the following information:

- new jobs created;
- increased sales or other economic activity conducted;
- the degree of other private investment attracted; and
- any other information requested by the KEDFA.

Recapture provisions: If the business fails to submit a report during any year or fails to satisfy the small business qualification requirements during the reporting period, the full amount or any portion of the credit is subject to recapture by the DOR from the qualified investor that received the credit award or any taxpayer receiving the credit through a valid transfer.

Additional Tax Credits—The following credits were enacted in the 2014 Regular Session of the General Assembly for individual income tax and corporate taxes: (see explanation of credits in the corporation tax section.)

Certified Rehabilitation credit,

Distilled Spirits income tax credit,

New Markets Development Program income tax credit, and
Film Industry tax credit.

Local History Trust Fund—Effective for taxable years beginning Jan. 1, 2015, HB 445 provides that any taxpayer required to file a return under KRS 141.180 who is entitled to an income tax refund and who desires to contribute to the local history trust fund may designate an amount, not to exceed the amount of the refund, to be paid to the trust fund. Look for the check-off box for local history trust fund on the 2015 individual income tax return.

SALES AND AND USE TAX

Automated Business Record Falsification Devices—Effective July 15, 2014, HB 69 made it illegal to own, operate, or distribute an automated business record falsification device in Kentucky. Possession of these devices is a Class D felony and the device is considered to be contraband subject seizure and forfeiture to the Commonwealth. These devices are sometimes referred to as “zappers”, and are used to avoid sales tax by altering or deleting sales transactions within a retailer’s point of sales software. The DOR will work with law enforcement agencies to administer this change.

Blast Furnace Exemption—SB 74 amended the sales and use tax exemption language for blast furnaces provided in KRS 139.480(21). The previous exemption was applicable through June 30, 1994. The law change provides that the

new exemption will apply to the construction, rebuilding, modification or expansion of a blast furnace or any of its component or appurtenant equipment or structures effective for sales made on and after July 1, 2016. The extended blast furnace exemption is only for supplemental projects approved under the Kentucky Industrial Revitalization Act as amended by SB 74.

Exemption for Federally Chartered Corporations—Sales tax will not apply to sales of tangible personal property made by a federally chartered corporation at the corporation's annual national convention held in the Commonwealth. The exemption applies to sales of tangible personal property made on or after Oct. 1, 2014, but before Dec. 31, 2021. A "federally chartered corporation" is a corporation chartered under Title 36 of the United States Code. HB 488 enacted this exemption.

Tourism Development Act Tax Incentives—HB 493 lowered the eligibility threshold for investments to qualify for tourism attraction projects in enhanced incentive counties. The minimum threshold for eligible costs in enhanced incentive counties was reduced from \$1 million to \$500,000 for new applications received on or after Aug. 1, 2014, and before May 2, 2018. In addition, the sales tax incentive potential is increased from a maximum of 25 percent to 30 percent of approved costs for these new projects. KRS 148.853(3) was amended to include tourism attraction projects located in an enhanced incentive county as eligible for a sales tax incentive allowed to an approved company for a ten-year period.

UTILITY GROSS RECEIPTS LICENSE TAX

Effective July 15, 2014, HB 170 made several changes to the utility gross receipts license tax to clarify the determination of the correct tax due and how refunds are administered. This tax is commonly referred to as "school tax". HB 170 clarifies how energy direct pay holders compute their school tax liability when qualifying for the partial tax exemption on their energy purchases. The energy direct pay holder must pay school tax directly to the DOR for energy purchases that do not exceed a 3 percent cost of production threshold. The statute of limitations for refunds of school tax was clarified and a 30-day appeal period to circuit court for denied refunds was established.

MISCELLANEOUS TAX CHANGES

Alcoholic Beverage Tax Rates—Effective July 1, 2015, the following alcoholic beverage tax rates apply to wholesalers of wine and beer: 10.75 percent for wholesale sales made on or after July 1, 2015, and before June 1, 2016; 10.5 percent for wholesale sales made on or after June 1, 2016, and before June 1, 2017; 10.25 percent for wholesale sales made on or after June 1, 2017, and before June 1, 2018; and 10 percent for wholesale sales made on or after June 1, 2018. The rate changes were enacted in 2014 HB 445.

Horse Racing Taxes—Effective Aug. 1, 2014, an excise tax will be imposed on all advance deposit account wagering licensees at a rate of 0.5 percent of all amounts wagered through the licensees by Kentucky residents. Beginning on April 1, 2014, a 1.5 percent tax is imposed on tracks conducting pari-mutuel wagering on historical horse races in Kentucky. The enacted provisions relating to historical horse racing have a retroactive effect to Sept. 1, 2011. The racing tax changes were enacted in 2014 HB 445.

Waste Tire Fee—The sunset date for the \$1 per tire waste tire fee was changed from June 30, 2014 to June 30, 2016.



SALES and USE TAX Administrative Issues

Filing Update: IVR Sales and Use Tax Filings

The DOR will no longer offer the IVR (Interactive Voice Response) sales and use tax zero return filings via the telephone. This service ended on June 30, 2014. Zero returns filed with the department-issued PIN via the telephone will no longer be accepted after the May returns due by June 20, 2014. Any June returns, either monthly or quarterly, must be filed either by paper or online via KY E-Tax. Please see below for directions on how to register and electronically file the Kentucky sales and use tax return via KY E-Tax. This electronic filing option is a convenient alternative to the IVR filing method.

TO REGISTER FOR ONLINE FILING:

1. Go to the DOR homepage www.revenue.ky.gov
2. Click on the blue state of Kentucky in the middle of the page labeled "KY E-Tax".
3. Click on "Sales and Use Tax Returns" under the heading E-Filing.
4. Click on "Registration Information for New Users".
5. Scroll to the bottom of the page and select "Click here to register for KY E-Tax".
6. Enter the information for the account Administrator and select "Continue".
7. Create a user id and password.



You will receive a registration confirmation informing you that the online account will be available within three business days after submitting the registration.

Instructions for Filing an Online Return after Registration

TO FILE A SALES AND USE TAX RETURN ONLINE:

1. Go to the DOR homepage *www.revenue.ky.gov*
2. Click on the blue state in the middle of the page labeled “KY E-Tax”.
3. Click on “Sales and Use Tax Returns” under the heading E-Filing.
4. Click on the blue state of Kentucky at the top of the page labeled “KY E-Tax Logon”.
5. Enter your sales tax account number, user id and password to logon to your account.
6. Click on the period highlighted in blue for the return you are filing.

Online Consumer Use Tax Filing and Payment Now Available

Consumer use tax account holders may now file their returns via KY E-Tax. This new feature was recently implemented to provide a quicker and more efficient way for use tax account holders to file. Please see the instructions above on how to register and then file your use tax returns via KY E-tax.

STATE PROPERTY TAX RATE UNCHANGED FOR 2014

Rate is 12.2 cents per \$100 assessed value; same for last two years

The DOR has set the 2014 State Real Property Tax Rate at 12.2 cents per \$100 of assessed value. Kentucky Revised Statute 132.020 requires the DOR to set the real property rate no later than July 1 of each year.

This rate is based on the revenue generated from the increase in taxable real property assessments from 2013 to 2014. If the revenue increase is more than 4 percent after the exclusion of new property added to the tax roll during 2014, then the prior year rate must be reduced. Because the assessment increase for 2014 is estimated at 1.57 percent, the state rate will remain the same as the 2013 rate, 12.2 cents per \$100 of assessed value.

All of the revenue generated from the state property tax rate will go into the state’s General Fund.

Kentucky Tax Alert comments and suggestions should be addressed to the Office of Income Taxation/Training Branch, Finance Cabinet, Department of Revenue, Frankfort, Kentucky, (502) 564-0937.

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