Deloitte.

**External Multistate Tax Alert**
April 27, 2018

# Enacted Kentucky legislation provides for IRC conformity update, apportionment changes, and flat 5% tax rate

## Overview

On April 13, 2018, Kentucky legislators voted to override Governor Matt Bevin's veto of House Bill 366 (H.B. 366).[1] H.B. 366 includes the following significant modifications to Kentucky tax law:

- For tax years beginning on or after January 1, 2018, updates conformity to the Internal Revenue Code (IRC) as in effect on December 31, 2017 for both corporate and individual taxpayers, while continuing to decouple from federal depreciation provisions.
- Implementation of a flat 5% tax rate on corporations and individuals effective for tax years beginning on or after January 1, 2018.
- Adoption of a single sales factor apportionment formula and market-based sourcing provisions effective for tax years beginning on or after January 1, 2018.
- Adoption of economic nexus requirements for remote retailers for sales and use tax purposes.
- Expansion of the sales and use tax base to certain enumerated services.

This tax alert summarizes the significant provisions of the tax amendments provided by H.B. 366 and provides some taxpayer considerations.[2]

## Conformity to the Internal Revenue Code as of December 31, 2017

Effective for tax years beginning on or after January 1, 2018, H.B. 366 amends Kentucky's income tax provisions for conformity to the IRC that was in effect on December 31, 2017.[3] However, Kentucky will continue to decouple from federal depreciation provisions, including the full expensing deduction allowed for federal purposes under IRC Sec. 168(k).[4]

## Implementation of a flat 5% tax rate for both individuals and corporations

For taxable years beginning on or after January 1, 2007 and before January 1, 2018, the tax rate imposed on corporations was a graduated scale ranging from 4% to 6% based upon the amount of taxable net income.[5] Effective January 1, 2018, H.B. 366 levies a flat corporate tax rate of five percent upon corporate taxpayers.[6]

For taxable years beginning after December 31, 2004 and before January 1, 2018, the tax rate imposed on individuals was a graduated scale ranging from 2% to 6% based upon the amount of taxable net income.[7] Effective January 1, 2018, H.B. 366 levies a flat tax rate of 5% upon individual taxpayers.[8]

---

[1] 2018 Regular Session (H.B. 366). A copy of the adopted law is accessible here.
[2] As of the date of this alert, pending legislation (Kentucky House Bill 487) is under consideration that, if enacted, would provide for mandatory combined reporting beginning in 2019.
[3] H.B. 366, Sec. 53(14).
[4] H.B. 366, Sec. 56(1)(h).
[5] H.B. 366, Sec. 58(3).
[6] H.B. 366, Sec. 58(2).
[7] H.B. 366, Sec. 57(2).
[8] H.B. 366, Sec. 57(2).

## Adoption of SSF and market-based apportionment provisions for business entities

Effective for tax years beginning on or after January 1, 2018, for entities apportioning income to Kentucky, H.B.366 requires entities to use a single sales factor apportionment formula as opposed to the previous three factor apportionment formula with double-weighted sales.[9]

In addition, H.B. 366 implements a market-based sourcing approach for the sales factor for taxable years beginning on or after January 1, 2018.[10] H.B. 366 provides market-based sourcing rules for various types of sales including sales of intangible properties and services, but generally, sales are sourced to Kentucky if the market for those sales is located in Kentucky.[11] A throw-out rule will apply to the denominator of the sales factor if the business is not taxable in the state where the sales are assigned or if the state of assignment cannot be reasonably determined using market-based sourcing.[12]

H.B, 366 further excludes receipts from treasury functions from the sales factor for tax years beginning on or after January 1, 2018,[13] changes apportionment provisions for specific industries to reflect the single sales factor method,[14] and clarifies that alternative apportionment methods may be available to or be required for certain industries or taxpayers provided that the party petitioning for alternative apportionment proves by clear and convincing evidence that the statutory apportionment does not fairly represent the taxpayer's business in the state and the alternative proposal is reasonable.[15]

## New economic nexus requirements for remote retailers for sales and use tax purposes

H.B. 366 expands Kentucky's economic nexus provisions for sales and use tax purposes to include remote retailers who meet certain thresholds for transactions occurring on or after July 1, 2018.[16] All remote retailers selling tangible personal property or digital property to purchasers in the state must now collect and remit sales tax if they meet one the two following thresholds: (1) have sales in the state in two hundred or more separate transactions in the previous or current calendar year or (2) have gross receipts from sales to the state that exceed one hundred thousand dollars in the previous or current calendar year.[17]

## Expansion of sales tax base to include certain enumerated services

H.B. 366 also expands the 6% Kentucky sales and use tax base to include additional enumerated services for transactions occurring on or after July 1, 2018.[18] The following are some of the services upon which sales tax will now be levied: admission fees except those to racetracks, historical sites, and county fairs; landscaping services; janitorial and industrial laundry services; small animal veterinary services and pet care services; and extended warranty services.[19]

## Additional changes

This tax alert does not provide a comprehensive summary of all law changes provided in H.B. 366. Additional administrative and specialty tax amendments resulting from the enactment of H.B. 366 include the following:

- Increasing the deadline to notify the Kentucky Department of Revenue of federal audit changes from 30 days to 90 following the federal determination date.[20]
- Increasing the tax on cigarettes.[21]

---

[9] H.B. 366, Sec. 60(9)
[10] H.B. 366, Sec. 60(11)(a).
[11] H.B. 366, Sec. 60(11)(a).
[12] H.B. 366, Sec. 60(11)(a)(4)(b).
[13] H.B. 366, Sec. 78. Current law allows net gains from certain treasury transactions to be included in the sales factor.
[14] H.B. 366, Sec. 78.
[15] H.B. 366, Sec. 60(12). The Department will not bear the same burden of proof in imposing alternative apportionment if it can demonstrate that in any 2 of the prior 5 years, a taxpayer has used an apportionment method at variance with its apportionment method used for other tax years.
[16] H.B. 366, Sec. 42(2)(g); H.B. 366, Sec. 143.
[17] H.B. 366, Sec. 42(2)(g).
[18] H.B. 366, Sec. 37(2); H.B. 366, Sec. 143.
[19] H.B. 366, Sec. 37(2).
[20] H.B. 366, Sec. 114(4).
[21] H.B. 366, Sec. 27.

- Implementation of a credit for ad valorem taxes paid,[22] changes to film production credits,[23] and changes to personal and dependent credits for individuals.[24]
- Increasing the time to protest a tax assessment from 45 days to 60 days for assessment issued July 1, 2018 or later.[25]

### Considerations

H.B. 366 contains significant changes that may impact taxpayers doing business in Kentucky. Taxpayers should review the effects the new law may have on their state tax obligations in Kentucky with regard to the updated conformity to the IRC, apportionment factor changes, and the expanded sales and use tax nexus provisions. Taxpayers impacted by the enactment of H.B. 366 should consult with their Kentucky tax advisors for further assistance.

## Contacts:

If you have questions regarding H.B. 366 or other Kentucky tax matters, please contact any of the following Deloitte Tax professionals:

**Amber Rutherford**
**Senior Manager**
Deloitte Tax LLP, Nashville
+1 615 259 1830
amberrutherford@deloitte.com

**Brian Hickey**
**Managing Director**
Deloitte Tax LLP, Cincinnati
+1 513 784 7171
bhickey@deloitte.com

**Traci Cull**
**Senior Manager**
Deloitte Tax LLP, Cincinnati
+1 513 412 8362
tcull@deloitte.com

The authors of this alert would like to acknowledge the contributions of Adam Hines, Lela Norras, and Jason Gong to the drafting process. Adam Hines is a Manager in the Cincinnati Multistate Tax practice of Deloitte Tax LLP. Lela Norras is a Senior and Jason Gong is a Tax Consultant II working in the Atlanta Multistate Tax practice of Deloitte Tax LLP.

**For further information, visit our website at** www.deloitte.com

**Follow** @DeloitteTax



[22] H.B. 366, Sec. 115.
[23] H.B. 366, Sec. 62.
[24] H.B. 366, Sec. 57(3).
[25] H.B. 366, Sec. 106(1)(a)(2).