Big tax trends and issues

By Mark A. Loyd, Esq., CPA

From potential new laws, to administrative developments, to tax litigation, there is a lot going on with regard to Kentucky taxes.

Let's take a look at some of 2016's big developments and issues that are sure to continue into 2017.

Intensifying state attacks on Quill physical presence standard

Kentucky has been at the forefront of the state's efforts to overturn the Quill physical presence nexus requirement for states to require out-of-state remote vendors to collect sales tax. Kentucky is a member of the Streamlined Sales and Use Tax Agreement and has delegates on the Streamlined Sales Tax Governing Board. The focus of Streamlined is: state-level administration; uniform tax bases; simplification of rates; and simplification of compliance. Addressing these issues is thought to address the policy issues requiring the Quill physical presence nexus requirement, i.e., complexity requires maintaining the status quo under Quill.

Proposed federal legislation would overturn Quill. For example, the Marketplace Fairness Act of 2015, if enacted, would statutorily override Quill, so long as states simplify their sales tax schemes similar to the Streamlined initiative.

The United States Supreme Court appears open to revisiting Quill. Justice Kennedy, in his concurrence in Direct Marketing Association v. Brohl, 135 S.Ct. 1124, 1135 (2015), posits, "The legal system should find an appropriate case for this Court to reexamine Quill." States such as Alabama, South Dakota, and Tennessee, among others, are taking steps to try to require remote sellers without a physical presence in their states to collect sales tax. Most recently, the Colorado Department of Revenue has asked the Supreme Court, in its conditional cross-petition for certiorari filed on Oct. 3, 2016, "Should Quill be overturned?"

Entity-level partnership audits

Effective Jan. 1, 2018, federal income tax partnership audits will be conducted by the Internal Revenue Service at the partnership level as a result of Sec. 1101 of the Bipartisan Budget Act of 2015, except for small, simple partnerships that elect out and those that elect to put the liability on the partners. This raises questions for state tax audits. How will federal audit adjustments be reported? What about multi-state partnerships? At this point, there are more questions than answers.

Comprehensive Kentucky tax reform

One can anticipate a proposal to comprehensively reform Kentucky's tax structure, perhaps in a special session in 2017. This was portended in Governor Bevin's veto message for 2016 HB 19, "[a]s with numerous other proposed tax changes by the 2016 General Assembly, the tax credit proposed by House Bill 19 would be appropriate for debate and potential inclusion in a comprehensive tax reform proposal."

Based on his election platform on taxes, one can expect that a proposal for Kentucky tax reform may include: repealing the inheritance tax; decreasing personal and corporate income tax rates; simplifying the tax code; and significantly reducing tax expenditures.

It would seem that the big hurdle for tax reform is going to be the tax expenditures, which include such things as deductions, exemptions, credits, subject not taxed (e.g., services not subject to sales tax), etc.

New faces and changes at Kentucky Department of Revenue

Gov. Bevin appointed Dan Bork, CPA, a former tax executive at Lexmark, to be the revenue commissioner in December 2015. Commissioner Bork has already begun influencing the way the Department works at the highest levels. Melanie Bitzer is the new taxpayer ombudsman, which is again a statutory division of Revenue, provided for by the Kentucky Taxpayers' Bill of Rights. Revenue also has a new Office of Tax Policy and Regulation; Ken Meng, CPA, formerly with Ernst & Young LLP, is the executive director.

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More regulations and guidance

It is no secret that Kentucky taxpayers and their advisors want updated, necessary and appropriately tailored and specific guidance including examples from Revenue, in addition to the general information on Revenue's website and the Kentucky Tax Alert; guidance on which they can rely. It should be noted that Revenue has promulgated tax regulations, but generally, Revenue has not updated them since the mid-2000s, even though the tax statutes they pertain to have been amended. For example, there is no Limited Liability Entity Tax ("LLET") regulation, although there is one for the LLET's predecessor, the Alternative Minimum Calculation, 103 KAR 16:220. And CPAs and other tax practitioners have mourned Revenue's decision to stop publishing the "Blue Books" which included Revenue Policies and Circulars.

RED TAPE REDUCTION

That said, Revenue is working with KyCPA and the Kentucky Chamber to provide additional guidance to taxpayers. Also, in July 2016, Gov. Bevin announced the Red Tape Reduction Initiative. The Initiative's Web site, www.RedTapeReduction.com, allows anyone to report a regulation, stating "If you are aware of a regulation that you believe to be outdated, unnecessary or overly complex, let us know…" While this Initiative is going on, it would seem that Kentucky taxpayers will review regulations that are important to them and, if appropriate, request a review of those regulations.

The bottom line is that guidance is wanted, and we should be looking for it in the upcoming year.

Kentucky Claims Commission succeeds Kentucky Board of Tax Appeals

By Executive Order, Gov. Bevin merged the Kentucky Board of Tax Appeals with two other statutory boards that hear and decide disputes administratively, the Kentucky Board of Claims and the Kentucky Crime Victims Compensation Board, creating the Kentucky Claims Commission, effective Oct. 1, 2016. One would expect that the General Assembly will approve the Governor's reorganization as it typically approves Executive Branch reorganizations. It appears that the Kentucky Claims Commission will operate similarly to the KBTA as to tax matters. However, one could expect that the Commission will use hearing officers more extensively than the KBTA did in real property tax appeals and potentially in other tax cases as well.

Kentucky sales tax manufacturing exemption disputes

Progress Metal Reclamation Co. v. Dep't of Revenue, No. 2013-CA-001765 (Ky. App. Mar. 13, 2015), discretionary review denied, No. 2015-SC-000175 (Feb. 2, 2016) is just the latest example of disputes involving the sales tax manufacturing exemptions. In Progress Metal, the Kentucky Court of Appeals held that a hammer pin, used to hold a hammer in place on a rotor which turns and breaks up metal, was not an "industrial tool" pursuant to KRS 139.470(11) because it was actually a repair, replacement, or spare part, and therefore, was not exempt from sales and use tax. However, the Court also held that liquid oxygen used in a torch cutting process was an "industrial supply" pursuant to KRS 130.470(11), and therefore, was exempt from sales and use tax.

Exemptions from sales tax for manufacturers are important to prevent pyramiding of the sales tax. Disputes between Revenue and taxpayers, however, will continue.

Kentucky real property tax disputes

In a developing trend, there appears to be an increase in litigation involving real property tax disputes. One example is Wilgreens, LLC v. Fayette County Property Valuation Administrator, No. 2015-CA-000407 (Ky. App. Sept. 23, 2016), wherein the Kentucky Court of Appeals affirmed a finding that the value of a build-to-suit lease must be taken into consideration when assessing a property at its fair cash value. Another example is CPT Louisville I LLC v. Jefferson County PVA, Order No. K-24995, File No. K14-S-85, K15-S-278 (Ky. Bd. Tax App. January 8, 2016) in which the Kentucky Board of Tax Appeals entered a "directed verdict", finding that the recent sales price of a shopping mall was the best evidence of fair cash value in a real property tax appeal and rejecting an appraisal using the residual method.

"Yeah, well, you know, that's just, like, your opinion, man." - The Dude, The Big Lebowski (1998).

What are the big developments and issues in Kentucky? These are certainly in the running. Watch for these and other trends in the upcoming months and years.

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