

Kentucky Tax Developments: Fall 2022

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KEY CONTACTS

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I. 2022 LEGISLATIVE UPDATE

There are several notable tax developments from the Kentucky 2022 regular session, including House Bill 8 (“HB 8”), which passed over the Governor’s veto. HB 8 includes a proposal to reduce the individual income tax. Rather than reducing the individual income tax outright, HB 8 establishes a rate reduction evaluation, with any potential tax rate reduction beginning on January 1, 2023. Because Kentucky was able to reach the appropriate revenue threshold by September 5, 2022, the income tax rate will be reduced to 4.5% for the 2023 tax year.

HB 8 also continues to expand the sales tax base by imposing sales tax on more than thirty new services – especially significant are the taxation of marketing services and short term rentals of real property. Services to be taxed include cosmetic surgery services, marketing services, telemarketing services, photography and photo-finishing services, prewritten computer software access services, lobbying services, executive employee recruitment services, website design and development services, website hosting, certain repair services. Also, the exemption from sales and use tax for residential electricity, natural gas, fuels, water, and sewer services found in KRS 139.470(7) is amended to specify that these purchases are only exempt if they are “purchased and declared by the resident as used in his or her place of domicile.” HB 8 includes specific statutory definitions for only some of the additional services.

The Kentucky Department of Revenue has provided informal guidance in Kentucky Sales Tax Facts (June 2022) and Kentucky Sales Tax Facts (September 2022), which can be accessed at revenue.ky.gov/News/Publications/Pages/Sales-Tax-Facts.aspx.

Additional informal guidance may be found at TaxAnswers.ky.gov.

Also included in HB 8 is a tax amnesty program, available to all taxpayers from October 1 through November 29, 2022, though the Department has not publicly announced this on its website.

Many were closely watching House Bill 260 (“HB 260”), which would have significantly impacted property tax assessments in Kentucky, likely resulting in an increase in property taxes for small and large businesses alike. As introduced, HB 260 proposed expanding the requirements of the income approach for property valuation to include the value of long-term leases, including triple net leases; though these proposed modifications have since been removed from the bill. In its current form, HB 260 would mandate market segmentation of properties, amending the sales comparison approach for property valuation by requiring sales or rentals that look the same or similar and operate similarly to be considered comparable properties and prohibiting the use of vacant properties in comparable sales. Additionally, HB 260 establishes new requirements for the appraisal of real property, a dramatic shift from the current system, and limits tax representation to Kentucky licensed attorneys, CPAs, or real estate brokers. Though the bill passed the House, it did not advance out of committee for a final vote in the Senate. It remains to be seen whether a similar bill will be introduced in the 2023 legislative session.

There are likely to be a number of tax-related bills on the agenda for the 2023 legislative session, which begins January 3, 2023, including the bourbon barrel tax credit, continued sales tax modernization, and a continued review of the Limited Liability Entity Tax. Local tax modernization is also something to watch. Modernization of Kentucky’s tax code continues to be a focus of the General Assembly.

II. EXECUTIVE & ADMINISTRATIVE UPDATES

KDOR ISSUES SOFTWARE AS A SERVICE GUIDANCE

Cloud-based computing has increasingly become the go-to for individuals and businesses looking to securely store their data, files, photos, and more. Given the ever-evolving nature of this technology, questions often arise as to how the sales and use tax applies to transactions related to cloud-based software and ancillary services. In Private Letter Ruling KY-PLR-21-01 (“PLR”), the Kentucky Department of Revenue (“KDOR”) recently determined that an application provided as part of a Software as a Service model, also known as SaaS, was not subject to Kentucky sales tax.

The taxpayer requesting the ruling provides web-based service via a SaaS model, which involves its customers accessing prewritten computer software hosted online with no physical download or transfer. In the PLR, the Department confirms that such transactions are not subject to Kentucky sales and use tax because there is no transfer or sale of tangible personal property. This is in contrast to the purchase of prewritten computer software via physical copy, for example, on a CD or thumb drive, which involves the transfer of tangible personal property and which is thus taxable.

The taxpayer requested guidance regarding a subsequent free offer of a downloadable prewritten computer software application which enhanced the primary software’s usefulness, but which ultimately provides limited functionality. Specifically, the taxpayer requested a ruling as to whether this download would change the original exempt nature of the taxpayer’s SaaS product.

KDOR found that offering the prewritten computer software application as part of the taxpayer’s SaaS did not create a transaction subject to Kentucky sales and use tax. KDOR specified that the SaaS remained available online and that the application did not transform the transaction into one involving tangible personal property. KDOR also found that providing the application along with the SaaS did

not create a bundled transaction because the free software application was a *de minimis* part of the product the taxpayer provided to customers.

Because this guidance was issued in a private letter ruling, it is binding only to the specific taxpayer for which the ruling was issued. However, it may be instructive for similarly-situated taxpayers. It also illustrates the potential pitfalls to which such taxpayers may be exposed if they provide exempt SaaS products but offer additional ancillary products.

Notably, HB 8 extends the sales tax to prewritten computer software access services, effective January 1, 2023.

KENTUCKY GOVERNOR PROVIDES PROPERTY TAX RELIEF

Kentucky Governor Andy Beshear issued an executive order on February 16, 2022 intended to stop an increase in vehicle property taxes for 2022. Used car values in Kentucky have risen approximately 40% since last year, from \$8,006 to \$11,162. Under Governor Beshear's order, taxpayers will pay a similar amount of tax to what they paid in 2021, assuming they own the same vehicle in the same condition and in the same county. The relief will continue through the next two years. If a taxpayer has already paid their 2022 property tax on their vehicle, they will receive a refund from their county clerk.

Kentucky law generally requires the General Assembly to exempt all or part of the personal property tax applied to vehicles. The Senate issued Senate Joint Resolution 99 (R.S. 2022) earlier this year that stated that the Governor could also provide vehicle property tax relief. Following that joint resolution, Governor Beshear issued his executive order.

Subsequently, on March 10, 2022, Governor Beshear signed related legislation into law. The law exempts from the January 1 assessment dates for 2022 and 2023, the portion of taxes computed on any increase in a motor vehicle's valuation from

January 1, 2021. It also entitles taxpayers who paid the tax on any increase in their vehicle's valuation from 2021 to a refund of the tax overpayment. The law further requires the Department of Revenue and county clerks to establish procedures to enable taxpayers to receive refunds without making a written request and requires the refunds to be issued within 90 days of the effective date. The law took effect March 10, 2022.

KDOR ANNOUNCES DECREASE IN PROPERTY TAX RATE

On July 1, 2022, the Kentucky Department of Revenue announced it would be setting the 2022 real property tax rate at 11.5 cents per \$100 of assessed value, a decrease from the 2021 rate of 11.9 cents per \$100. The reduction of rate is the result of 7.36 percent estimated increase in revenue from real property assessments from 2021 to 2022; because the estimated increase in revenue is more than 4 percent, the 2021 rate must be reduced.

KENTUCKY TAX REGULATIONS

Regulation 103 KAR 43:340E, Excise Taxes on Gasoline and Special Fuels, freezes the average wholesale price and annual survey value of gasoline in June to prevent the state gas tax from increasing in July. By using the average wholesale price and annual survey value from the previous fiscal year, the freeze keeps the state gas tax at 26 cents per gallon and the state diesel tax at 23 cents per gallon. This freeze is anticipated to remain until the General Assembly reconvenes for the 2023 Regular Session in mid-January.

Electronic filing is here to stay. Regulation 103 KAR 1:160, Mandatory Electronic Filing And Payment Requirements, is a new tax regulation concerning electronic filing and electronic payment of income, sales and excise taxes implemented pursuant to KRS 131.250 and KRS 131.155 which also addresses penalties for noncompliance, and provides for waivers of electronic filing requirements.

Regulation 103 KAR 16:270, Apportionment; Receipts Factor, was amended to address, among

other things, the receipts factor in the context of financial institutions, which are subject to the corporate income tax, effective for tax years beginning on or after January 1, 2021.

As related by the Department in Kentucky Sales Tax Facts (May 2018), labor and installation charges are included in the definition of “gross receipts” subject to Kentucky sales tax and sales of extended warranty services covering tangible personal property that is taxable at retail to the warranty holder are subject to sales and use tax, as a result of 2018 HB 487, effective July 1, 2018. Regulation 103 KAR 27:150, Repairers and Reconditioners of Tangible Personal Property, and Regulation 103 KAR 27:230, Motor Vehicle Body Shops, interprets the application of sales and use tax to repairers and body shops concerning, among other things, charges for installing or applying taxable repair parts and extended warranty services.

For manufacturers, it should be highlighted that Regulation 103 KAR 30:120, Machinery for New and Expanded Industry, was amended to address, among other things, exempt charges for labor or services to apply, install, repair, or maintain tangible personal property directly used in manufacturing or industrial processing. And, Regulation 103 KAR 30:140, Energy and Energy-Producing Fuels, implements amendments to KRS 139.480(3) in 2019 HB 354 which authorizes a manufacturer or industrial processor with tolling operations at a plant facility that meet certain criteria to exclude the cost of tangible personal property from the toller’s cost of production in computing its sales tax exemption for energy costs exceeding 3% of its cost of production.

Regulation 103 KAR 26:131, Landscaping Services, is a new regulation that addresses the application of sales and use tax to landscaping services. These became subject to Kentucky sales and use tax, effective July 1, 2018 pursuant to 2018 HB 487.

Regulation 103 KAR 26:100, Industrial Laundry and Linen Supply Services, amends a longstanding regulation concerning the Department’s interpretation of the application of sales and use tax

to transactions involving industrial laundry and linen supply services; these services became subject to sales tax as a result of amendments effective July 1, 2018 to KRS 139.200(2) in HB 487. This Regulation merits a close read.

KRS 139.481, enacted effective January 1, 2021, requires farmers to apply for an Agriculture Exemption Number for use on exemption certificates that farmers must present to retailers when making sales tax exempt purchases. However, the amendments to Regulation 103 KAR 30:091, Sales to Farmers, do not appear to address KRS 139.481.

Curiously, for those who remember the Department’s tax policies and revenue circulars, Regulation 103 KAR 16:352, Corporation Income Taxes Policies and Circulars, was amended to identify additional Revenue Policies and Revenue Circulars that have been rescinded.

III. KENTUCKY TAXES & COVID-19: CONTINUED CHANGES AND TRENDS TO WATCH

Like many states and the federal government, Kentucky continues to respond to the impact of the Coronavirus pandemic. In 2020, Kentucky extended tax filing and payment deadlines, paused collection activity, and provided other relief. In addition, many of KDOR’s programs and services were altered or interrupted as a result of government office closures and health and safety mandates. While many of these services have now been restored and collections have resumed, following are updates concerning the continuing impact of Covid-19 on Kentucky tax law.

A. NEXUS AND TELECOMMUTING

The Covid-19 Pandemic brought about many changes, including where a business's employees work. For employers employing Kentucky residents and/or nonresidents who reside in states with which Kentucky has a reciprocal agreement, they will not need to change their current withholding practices during the period when these employees are working from home. Requirements for withholding of tax in either case remain unchanged by restrictions related to the Covid-19 pandemic and resulting emergency procedures. KDOR will continue reviewing Kentucky income tax nexus determinations on a case-by-case basis, though companies should continue to keep in mind federal Public Law 86-272, which prohibits states from imposing income tax on a business's income derived from interstate commerce if the business has only limited business activity in the state.

B. KENTUCKY ADOPTS FEDERAL TREATMENT OF PPP INCOME AND EXPENSES

In 2021 HB 278, the Kentucky General Assembly allowed for the same treatment of forgiven, covered PPP loans, deductions attributable to those loans, and tax attributes associated with the loans as allowed under P.L. No. 116-260, sec. 276 and 278. IRS Notice stated Loan Forgiveness Income Exempt and expenses deductible. Most notably, forgiven PPP loans not taxed and expenses paid with forgiven loans are deductible.

C. KDOR RESUMES COLLECTIONS

KDOR's Division of Collections resumed collection activity on June 11, 2021. Collection action was previously suspended due to the COVID-19 emergency. The Department encourages those who owe a balance to contact the Department. Taxpayers may see increased collection activity as COVID-19 backlogs are resolved on both state and federal levels.

All of KDOR's Coronavirus updates can be found at revenue.ky.gov/Pages/2019NovelCoronavirus.aspx.

IV. SELECT CASE UPDATES

Dept. of Rev., Finance and Administration Cabinet v. Marathon Pipe Line, LLC, No. 2021-CA-0626-MR (Ky. App. May 13, 2022), discretionary review filed, 2022-SC-0233 (June 14, 2022)

Marathon Pipe Line, LLC (Marathon) is a public service corporation (PSC) that owns or leases thousands of miles of pipeline throughout the United States, including a 265-mile long tract from Owensboro to a Catlettsburg refinery located in an activated Foreign Trade Zone (FTZ).

At issue in this case is whether the pipeline was real property or tangible personal property; tangible personal property located in an FTZ is taxed at a very favorable rate. The Department of Revenue, Finance and Administration Cabinet, Commonwealth of Kentucky (the Department) assessed the pipeline as real property, at \$242 million in 2014, \$225 million in 2015, and \$240 million in 2016. Marathon protested and asserted the pipeline was taxable as tangible personal property with values of \$120 million, \$106 million, and \$106 million respectively. Marathon appealed to the Kentucky Claims Commission, now the Kentucky Board of Tax Appeals (KBTA/KCC). KBTA/KCC bifurcated the appeal and concluded that the pipeline is tangible personal. The Franklin Circuit Court affirmed KBTA/KCC's finding that Marathon's pipeline is tangible personal property. The Department appealed to the Court of Appeals.

Because it was an appeal from an administrative agency, the Kentucky Court of Appeals reviewed the case under the clearly erroneous standard. The Department cites *Cumberland Pipe Line Co. v. Lewis*, 17 F.2d 167 (E.D. Ky. 1926), which held that a similar pipeline was real property, and 103 KAR 8:090 which states that a transmission pipeline is real property. However, the Court of Appeals agreed with KBTA/KCC and the circuit court, on the rationale that the pipeline was: not annexed to the realty as it is moveable; not adapted to the use or purpose of the land above it; and intended by the parties to be moved and not a permanent accession to the land.

Furthermore, the Court of Appeals found that the Department's treatment of pipelines was not uniform, evidenced by its classification of MarkWest Energy's pipeline as tangible personal property. The court also noted that 103 KAR 8:090 indicates that a transmission line should be classified as real property, but another type of pipeline used to transport crude oil (a gathering line) should be classified as personal property. As for the ad valorem tax, the court found no error in KBTA/KCC's adoption of Marathon's numbers as the final order specified how KBTA/KCC found Marathon's expert testimony more persuasive than the Department's.

The Department has filed a motion seeking discretionary review from the Kentucky Supreme Court.

Century Aluminum of Ky. v. Dep't of Revenue, No. 19-CI-00424 (Franklin Cir. Ct. Feb. 3, 2020), affirmed 2020-CA-0301-MR (Ky. App. July 9, 2021), discretionary review granted, 2021-SC-0300 (Ky. Feb. 16, 2022) – Sales Tax – Manufacturing Supplies Exemption

On February 16, 2022, the Kentucky Supreme Court granted discretionary review in *Century Aluminum of Ky. v. Dep't of Revenue* and will take up review of Kentucky's manufacturing supplies exemption. Briefing has concluded and oral argument has been held as the parties await a final decision.

The case concerns the manufacturing supplies exemption from sales tax and certain items which were worn out during the manufacturing process. The Court of Appeals relied upon an exception from the supplies exemption, i.e., "Supplies' does not include repair, replacement, or spare parts of any kind..." and "The exemption ... does not include repair, replacement, or spare parts" to uphold the decision of the circuit court and find that the items were subject to Kentucky sales and use tax.

Century Aluminum argued that the items were not subject to Kentucky sales and use tax as tangible personal property for direct use in manufacturing or industrial processing and that the Department

failed to distinguish between supplies and parts intended to be used up in the manufacturing process and supplies and parts which wear out and are subject to replacement. The Kentucky Claims Commission (now KBTA) ("KCC/KBTA") held for Century Aluminum and adopted Century Aluminum's four-part test which compares the useful life of the item at issue when the machine or equipment it allegedly maintains is operating with and without the introduction of the product being manufactured. If there is a difference in the useful life of the item, then the item is being consumed in the manufacturing process; if not, then the item is a repair or replacement part.

The Department appealed the Final Order of the KCC/KBTA to the Franklin Circuit Court, which rejected this test, stating that it "ignores the fact that all tangible personal property used in the manufacturing process wears down or is used up" and that it would "exempt nearly all tangible personal property used in the manufacturing process from the sales and use tax, which is clearly not the intent [of the exemption]." Rather, the Court concluded that "the proper test is whether the items are introduced into the manufacturing process to maintain, restore, mend, or repair a machine or equipment, or whether the items...are used up or consumed as a consequence of their involvement in the manufacturing process."

The Court of Appeals agreed with the circuit court's rejection of Century Aluminum's proposed four-part test, finding that the Legislature intended for certain items in the manufacturing process to be tax-exempt and for other items, like the subject parts, to be taxable.

Notably, the Kentucky Association of Manufacturers, joined by the Kentucky Chamber of Commerce filed an amicus brief in support of Century Aluminum. Consistent with the taxpayer, amici argue, "Indeed, all text in the manufacturing supplies exemption and repair, replacement, or spare parts exception should be given effect, and the legislature's objective to encourage manufacturing by providing

the exemption must be effectuated... [and] [p] yramiding should be avoided....” *Amici* go on to argue, “The text ‘parts’ in the exception itself should be construed to limit its application to ‘parts’ and not literally ‘any tangible personal property.’”

The authors’ law firm represents *amici* in this action.

Louisville/Jefferson County Metro Revenue Commission v. Ventas, Inc., No. 19-CI-000899 (Jefferson Cir. Ct. Feb. 8, 2021), affirmed, No. 2021-CA-0235-MR (Ky. App. Feb. 11, 2022)

Ventas, Inc. (“Ventas”) is a national healthcare real estate investment trust (“REIT”) that transacts business in multiple jurisdictions, but is headquartered in Louisville, Kentucky. In 2019, Ventas filed a declaration of rights action seeking an order that it is entitled a variance from the standard apportionment formula used by Metro Revenue in calculating occupational license tax. Metro Revenue moved to dismiss the case on the grounds of sovereign immunity, mootness, and ripeness. The Jefferson Circuit Court denied the motion, and Metro Revenue appealed the sovereign immunity issue alone to the Kentucky Court of Appeals.

The Court of Appeals affirmed the Circuit Court, holding that the Revenue Commission was not entitled to sovereign immunity in a declaratory judgment action: “...the Revenue Commission [contends] that a refund claim is implicit in the declaratory judgment action filed by Ventas and that a refund ‘presents a harm to state or government resources that implicates sovereign immunity.’ However, the only claim presented in the complaint filed by Ventas is one for declaratory judgment....it simply asked the circuit court to decide whether it was entitled to relief in the form of an alternative and equitable apportionment. Consequently, the declaratory judgment action did not impinge upon the Revenue Commission’s governmental immunity.”

The original declaratory judgment complaint (which has since been amended) is proceeding at the Circuit Court.

The authors’ law firm represents the taxpayer in this action.

LWAGLVKY 1, LLC, et al. c/o Walgreen Co. v. Jefferson Co. PVA, et al., No. K19-S-88, 207-210 (Ky. Bd. Tax App. Aug. 25, 2021), on appeal 21-CI-005434 (Jefferson Cir. Co. Sept. 24, 2021) – Property Tax

The KBTA issued its Final Order in *LWAGLVKY 1, LLC, et al. c/o Walgreen Co. v. Jefferson County PVA*, No. K19-S-88, 207-210 (Ky. Bd. Tax App. Aug. 25, 2021) concerning the assessment value of 15 properties leased by Walgreens throughout the Louisville Metro Area. Walgreens obtained fee simple appraisals for each property, using local market conditions and market rent, and argued that the fee simple appraisals represented the fair cash values for the properties under Kentucky law. PVA put forth evidence of a leased fee valuation for each property, using above-market contract rent and national sales, arguing that the value of the leased fee represented the properties’ fair cash value for ad valorem tax purposes. The KBTA held that, through its presentation of evidence, Walgreens overcame the presumption in favor of the PVA’s valuation. The KBTA found in favor of Walgreens for the two Walgreens-owned properties, but sided with the PVA on the 13 properties with leases. The KBTA made no findings concerning Walgreens’ constitutional claims that the PVA’s assessments violate uniformity and equal protection when PVA’s assessments were double or more than those of comparable retail properties in the county. Walgreens appealed the KBTA’s order concerning the 13 leased properties and the constitutional claims to Jefferson Circuit Court, where the case has been briefed and is awaiting review.

The authors’ law firm represents the taxpayer in this action.

Kroger Ltd. P’ship I v. Scott Cnty. Prop’y Valuation Adm’r, et al, No. 2019-CA-01133-MR (Ky. App. July 17, 2020); remanded, Kroger Ltd. Partnership I v. Tim Jenkins, Scott Cty. Property Valuation Admr., K15-S-30 (Ky. Bd. Tax. App. May 28, 2021) – Property Tax

In a case involving the valuation of a big box grocery store, the Court of Appeals recently reversed the decision of the Scott County Circuit Court in *Kroger Ltd. P’ship I v. Scott Cnty. Prop’y Valuation Adm’r*, holding that “Based upon [the Court of Appeals’] review of the properties relied upon by the PVA to determine comparable sales, we must agree with Kroger that the evidence it presented to counter the PVA’s assessment compels a finding that the Property was overvalued.”

The Property - which Kroger owns in fee simple - is located in Georgetown, Kentucky. It is 12.18 acres with a 130,600 square foot retail building of which just 1200 square feet, less than 1%, is leased to tenants other than Kroger, i.e., 99% *non-leased*. Kroger owns and operates a Kroger grocery store on the property. As the Court explained, “For the tax year of 2015, the PVA assessed the value of the Property at \$15.2 million. Kroger sought review of the PVA’s assessment ...Kroger asserted that the Property’s fair cash value as of January 1, 2015, was \$6.6 million based upon an appraisal report from May 2014.” Kroger appealed to the BAA, which adjusted the PVA’s assessment slightly, to \$14.094 million. Kroger again appealed, and after a hearing at which an expert appraiser testified for Kroger, the KBTA and Scott Circuit Court each upheld the BAA’s valuation. Kroger appealed to the Court of Appeals, asserting that this valuation was not based on substantial evidence.

The Court of Appeals ultimately agreed with Kroger. As the Court explained, “Kroger’s expert relied upon both the comparable sales approach and the income approach to reach his opinion on the valuation of the Property at \$6.7 million.” The Court continued, “the properties the PVA relied upon were subject to leases, unlike the Property in this case. Kroger points out that a lease has its own value...and additional information is needed to value properties

with leases....Because the PVA did not introduce any evidence of this type to apply the necessary adjustments, Kroger argues that the valuation was erroneous.”

The Court went on to hold “Based upon our review of the properties relied upon by the PVA to determine comparable sales, we must agree with Kroger that the evidence it presented to counter the PVA’s assessment compels a finding that the Property was overvalued.” The Court explained that, “As [Kroger’s expert] testified before the Board, each of the property sales the PVA relied upon were not comparable to the Property in this case. They were subject to leases or were parts of other specific transactions, such as being part of a portfolio sale or a 1031 exchange, or were not a big box store. Therefore, these sales could not provide a basis for the PVA’s assessment, and the circuit court erred in affirming the Board’s final order.” The Court “also [agreed] with Kroger that the statement of value by Kroger’s consultant in 2013 cannot be substantial evidence of its fair cash value as of January 1, 2015, two years later.”

Accordingly, the Court reversed the Circuit Court and remanded the case, and the KBTA issued its order valuing the property at Kroger’s value of \$6.6 million on May 28, 2021.

The authors’ law firm represents the taxpayer in this action.

October_, 2022

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CSBrand-100270- SALT Insights for COST-Kentucky-01 — 03/10/2022





KENTUCKY DEPARTMENT OF REVENUE



Kentucky *Sales Tax Facts*

In this edition, the Department of Revenue (DOR) provides summary information on recent legislative changes affecting sales and excise tax administration. Unless otherwise noted, the effective date of these changes is January 1, 2023. Because of the breadth and scope of these law changes, DOR will provide more detailed explanation and guidance in future publications and online postings. You may contact us with questions at DOR.WebResponseSalesTax@ky.gov or call (502) 564-5170.

2022 Sales and Excise Tax Legislation Overview (HB 8, HB 659, SB 121)

House Bill 8

HB 8 expands the sales and use tax base to include a number of new services effective January 1, 2023. Where new service definitions are provided, the definition and statutory reference are listed together.

The \$6,000 de minimis threshold found in KRS 139.470(23) applies to otherwise taxable services. Any provider of new taxable services that exceeds \$6,000 in gross receipts in 2021 or 2022 must be registered for the collection of the sales and use tax beginning on January 1, 2023.

Inside This Issue...

Legislation Overview—

House Bill 8	2-5
Other Excise	
Tax Changes	
in HB 8 and	
HB 659	6
Sunset of Temporary	
Suspension on	
Motion Picture	
Refund Credit	6
Senate Bill 121	7

House Bill 8, continued

The following services are affected by the legislative change:

◆ (q) **Photography and photo finishing services.**

KRS 139.010(30) defines “photography and photofinishing services” to mean “(a) 1. *The taking, developing, or printing of an original photograph, or* 2. *Image editing including shadow removal, tone adjustments, vertical and horizontal alignment and cropping, composite image creation, formatting, watermarking, printing, and delivery of an original photograph in the form of tangible personal property, digital property, or other media.* (b) *Photography and photofinishing services does not include photography services necessary for medical or dental health.*”

◆ (r) **Marketing services.**

KRS 139.010(22) defines “marketing services” to mean “developing marketing objectives and policies, sales forecasting, new product developing and pricing, licensing, and franchise planning.”

◆ (s) **Telemarketing services.**

KRS 139.010(47) defines “telemarketing services” to mean “services provided via telephone, facsimile, electronic mail, or other modes of communications to another person, which are unsolicited by that person, for the purposes of:

- (a) 1. *Promoting products or services;*
 2. *Taking orders; or*
 3. *Providing information or assistance regarding the products or services; or*
- (b) *Soliciting contributions.*”

◆ (t) **Public opinion and research polling services.**

◆ (u) **Lobbying services.**

◆ (v) **Executive employee recruitment services.**

◆ (w) **Website design and development services.**

◆ (x) **Website hosting services.**

◆ (y) **Facsimile transmission services** (currently taxable as communication services under KRS 139.195).

◆ (z) **Private mailroom services**, including:

1. Presorting mail and packages by postal code;
2. Address barcoding;
3. Tracking;
4. Delivery to postal service; and
5. Private mailbox rentals.



The new services enacted by HB 8 are subject to both sales tax under KRS 139.200 and use tax under KRS 139.310.



House Bill 8, continued

- ◆ (aa) **Bodyguard services.**
- ◆ (ab) **Residential and nonresidential security system monitoring services.**
- ◆ (ac) **Private investigation services.**
- ◆ (ad) **Process server services.**
- ◆ (ae) **Repossession of tangible personal property services.**
- ◆ (af) **Personal background check services.**
- ◆ (ag) **Parking services;**
 1. Including:
 - a. Valet services; and
 - b. The use of parking lots and parking structures; but
 2. Excluding any parking services at an educational institution.
- ◆ (ah) **Road and travel services provided by automobile clubs as defined in KRS 281.010.**
- ◆ (ai) **Condominium time-share exchange services.**
- ◆ (aj) **Rental of space for meetings, conventions, short-term business uses, entertainment events, weddings, banquets, parties, and other short-term social events.**
- ◆ (ak) **Social event planning and coordination services.**
- ◆ (al) **Leisure, recreational, and athletic instructional services.**
- ◆ (am) **Recreational camp tuition and fees.**
- ◆ (an) **Personal fitness training services.**
- ◆ (ao) **Massage services, except when medically necessary.**
- ◆ (ap) **Cosmetic surgery services.**

KRS 139.010(5)(a) defines “cosmetic surgery services” to mean “*modifications to all areas of the head, neck and body to enhance appearance through surgical and medical techniques. (b) Cosmetic surgery services does not include reconstruction of facial and body defects due to birth disorders, trauma, burns, or disease.*”
- ◆ (aq) **Body modification services,** including tattooing, piercing, scarification, branding, tongue splitting, transdermal and subdermal implants, ear pointing, teeth pointing, and any other modifications that are not necessary for medical or dental health.



House Bill 8, continued

- ◆ (ar) **Testing services**, except testing for medical, educational, or veterinary reasons. However, small animal veterinarian testing services became taxable in 2018 under HB 487.
- ◆ (as) **Interior decorating and design services.**
- ◆ (at) **Household moving services.**
- ◆ (au) **Specialized design services**, including the design of clothing, costumes, fashion, furs, jewelry, shoes, textiles, and lighting.
- ◆ (av) **Lapidary services**, including cutting, polishing, and engraving precious stones.
- ◆ (aw) **Labor and services to repair or maintain commercial refrigeration equipment and systems when no tangible personal property is sold in that transaction including service calls and trip charges.**
- ◆ (ax) **Labor to repair or alter apparel, footwear, watches, or jewelry when no tangible personal property is sold in that transaction.**
- ◆ (ay) **Prewritten computer software access services.**

KRS 139.010(33) defines “prewritten computer software access services” to mean *“the right of access to prewritten computer software where the object of the transaction is to use the prewritten computer software while possession of the prewritten computer software is maintained by the seller or a third party, wherever located, regardless of whether the charge for the access or use is on a per use, per user, per license, subscription, or some other basis.”*

In addition to the new services subject to sales and use tax, other changes within HB 8 are also effective on **January 1, 2023**, and include the following:

- ◆ KRS 139.260 is amended to allow all the newly taxable services (KRS 139.200(2)(g) through (ay)) **to be purchased for resale**. For example, a purchaser of taxable website design services who then resells the service to an end customer (in this instance, a web designer that subcontracts out to another entity to design a portion of the website), may issue a fully completed resale certificate to the entity that performed the service.
- ◆ **“Limousine services”** is removed from KRS 139.200 as a service subject to sales tax. Effective January 1, 2023, limousine service providers are under a new section of KRS Chapter 138 that imposes a 6% excise tax on car rental and ridesharing services.

House Bill 8, continued

- ◆ Effective January 1, 2023, “**extended warranty services**” in KRS 139.010(14) is amended to mean “*services provided through a service contract agreement between the contract provider and the purchaser where the purchaser agrees to pay compensation for the contract and the provider agrees to repair, replace, support, or maintain tangible personal property, digital property, or real property according to the terms of the contract, ~~if:~~*”

- ~~1. The service contract agreement is sold or purchased on or after July 1, 2018, and~~
- ~~2. The tangible personal property or digital property for which the service contract agreement is provided. Is subject to tax under this chapter or under KRS 138.460.”~~

The effect of this language change (deletions and additions) is to not only add extended warranty contracts for real property, but to also include all contracts for tangible personal property and digital property regardless of whether the property itself is taxable or exempt. For example, separately charged extended warranties purchased on exempt property such as farm equipment, machinery for new expanded industry and motor vehicles sold to certain out-of-state residents will no longer be exempt from sales and use tax. However, all entity-based exemptions are still valid so the purchase of an extended warranty contract by a tax-exempt purchaser, such as a 501(c)(3) charitable organization or a governmental entity, may still be exempt from the tax.

- ◆ An amendment to KRS 139.480 creates a new sales and use tax exemption for **drugs and over-the-counter drugs** “*that are purchased by a person regularly engaged in the business of farming and used in the treatment of cattle, sheep, goats, swine, poultry, ratite birds, llamas, alpacas, buffalo, aquatic organisms, or cervids.*” The terms “drug” and “over-the-counter drug” have the same meaning as defined in KRS 139.472(3).
- ◆ The exemptions from sales tax for **admissions to historical sites** found in KRS 139.200(2)(c)(2) and KRS 139.482 have been removed. However, these historical sites are typically non-profits whose sales of admissions remain exempt from the tax under KRS 139.498.
- ◆ The exemption from sales and use tax for residential electricity, natural gas, fuels, water, and sewer services found in KRS 139.470(7) is amended to specify that these purchases are only exempt if they are “***purchased and declared by the resident as used in his or her place of domicile.***” “Place of domicile” is further defined as “*the place where an individual has his or her legal, true, fixed, and permanent home and principal establishment, and to which, whenever the individual is absent, the individual has the intention of returning.*” DOR is developing further guidance for both consumers and utility providers on how to claim and document the residential utility exemption beginning for periods on or after January 1, 2023.
- ◆ KRS 139.730 is amended to require that “***any event coordinator of a festival or similar event shall provide the department with a list of vendors selling at the event any tangible property, digital property, or services***” subject to sales and use tax (effective July 14, 2022).

The amended definition for “extended warranty services” now includes extended warranty contracts for real property and all contracts for tangible personal property and digital property regardless of whether the property itself is taxable or exempt.

Other Excise Tax Changes in HB 8 and HB 659

- ◆ HB 8 amends KRS 142.400, effective January 1, 2023, to expand the 1% state transient room tax to include campgrounds and RV parks. In addition, the new language requires those facilitating the rental of accommodations to collect the room tax on their total charges for the rental of accommodations. Also, receipts from a customer for a continuous stay of 30 days or more are now exempted from the 1% transient room tax. These changes conform the transient room tax base more in line with the sales and use tax base. The new language included in KRS 142.400 also applies to the various local transient room taxes imposed and administered by various cities, counties and other municipal governments across the commonwealth.
- ◆ In addition to the current taxation of motor vehicle rentals under motor vehicle usage tax and U-Drive-IT provisions, a new section of KRS 138 establishes a 6% excise tax on the gross receipts of vehicle rentals, peer-to-peer car sharing rentals, ride share services, taxicab services, and limousine services, effective January 1, 2023. The 6% excise tax applies to any vehicle rental or service listed here that originates in Kentucky.
- ◆ A new section of KRS 138 establishes an excise tax on electric vehicle power, effective January 1, 2024 (HB 659). The initial rate is \$0.03 per kilowatt hour on the electric power distributed in this state by an electric vehicle power dealer. In addition, a \$0.03 per kilowatt hour surtax is established on power distributed by electric charging stations located on state property. Annually, the \$0.03 per kilowatt hour rate will be adjusted based on the annual percentage change of National Highway Construction Cost Index 2.0 with a maximum annual 5% increase or decrease and rounded to the nearest \$0.001%. The Department will send notification of the adjusted electric vehicle power tax rate for the next calendar year to all electric vehicle power dealers by December 11th each year. Receipts from this tax are for deposit into the Road Fund.

The bill also establishes an initial registration and annual renewal registration fee of \$120 for electric vehicle owners and \$60 for electric motorcycle and hybrid vehicle owners. Collections from electric vehicle and hybrid vehicle registration fees are evenly split between the General Fund and the Road Fund. These registration fees are subject to adjustment on the same schedule and in the same manner as the electric power excise tax rate adjustment.

- ◆ Effective for cigarette stamp purchases by licensed wholesalers on or after August 1, 2022, the compensation rate increases to \$0.015 on each 20 cigarettes (HB 659).

Sunset of Temporary Suspension on Motion Picture Refund Credit

KRS 139.538 suspended the acceptance of any new applications for the film refund credit until July 1, 2022. DOR will begin receiving new registration applications (Form 51A241) on or after July 1, 2022, for film productions that begin after that date. Registration applications must be filed with DOR before filming begins. Refund applications (Form 51A242) for the eligible sales tax rebate must be filed within 60 days of the completion of filming or production in the state.

Senate Bill 121

Senate Bill 121 was signed into law by Governor Beshear on March 30, 2022. This legislation had an emergency clause, so it became effective on that date.

SB 121 amends KRS 139.481, KRS 139.260, and KRS 139.270 to make changes related to the agriculture exemption license number program administered by DOR.

Previously, farmers had until July 1, 2022 to receive their agriculture exemption license number. **SB 121 amends KRS 139.481 to extend the deadline for farmers to obtain their agriculture exemption license number until January 1, 2023.**

KRS 139.481 requires a farmer to provide an agriculture exemption license number to the retailer at the time of purchase in order to exempt the purchase from sales and use tax. Any transaction claiming an agriculture exemption without an agriculture exemption license number is invalid for purchases on or after January 1, 2023.

All agriculture exemption license numbers will expire on December 31, 2026, and every four (4) years thereafter. If a person ceases to engage in an exempt farming activity, the agriculture exemption license number becomes invalid and the person has sixty (60) days to notify DOR.

KRS 139.260 and KRS 139.270 are amended to permit retailers to treat purchases as eligible for the agricultural exemptions by 1) accepting an agriculture exemption license number from a farmer without a certificate, or 2) receiving a Streamlined Sales and Use Tax Agreement Certificate of Exemption with the farmer's agriculture exemption license number included. If the farmer provides the retailer with the exemption license number and the retailer maintains information on items purchased linking each sale to the farm and address associated with agriculture exemption license number, the retailer will no longer be required to receive and maintain a fully completed exemption certificate. However, DOR still recommends, as a best practice for the benefit of all parties, that the farmer execute a fully completed exemption certificate. DOR will continue to provide access to the two Kentucky farm exemption certificates (Forms 51A158 and 51A159) along with the Streamlined Sales and Use Tax Agreement Certificate of Exemption (Form 51A260) for use as needed.



“All agriculture exemption license numbers will expire on December 31, 2026, and every four (4) years thereafter.”

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To submit additional questions or suggestions for future topics, please write to:

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**Andy Beshear, Governor
Commonwealth of Kentucky**

**Holly M. Johnson, Secretary
Finance and Administration Cabinet**

**Thomas B. Miller, Commissioner
Department of Revenue**





KENTUCKY DEPARTMENT OF REVENUE

Kentucky *Sales Tax Facts*



This edition covers several of the services included in House Bill (HB) 8 that become taxable as of January 1, 2023, in more detail than the summary coverage in the June 2022 edition. The taxation of these additional services creates significant changes to guidance previously given to businesses on how to handle both the sales and purchases of these services. Below are some highlights for these new tax treatments.

In addition, please consult TaxAnswers.ky.gov for periodic postings of FAQs developed in response to various questions the department has received regarding HB 8 implementation.

2022 Sales and Use Tax Legislation HB 8

Changes to Selected Industries

Photography and photo finishing services

Kentucky Regulation 103 KAR 27:120, Photographers, Photo Finishers and X-Ray Labs, interprets the sales and use tax law as it applies for periods prior to January 1, 2023. Photographers are treated as primarily engaged in the service of taking, developing, and printing original photographs and are consumers of tangible personal property used to perform this professional service. Additional prints sold by the photographer are taxable and materials which become an ingredient or component part of these additional prints are exempt for resale when purchased by the photographer.

Inside This Issue...

House Bill 8—Changes to Selected Industries

Photography & photo finishing services	1-2
Rental of space for meetings, conventions, etc.	2
Certain instructional, camp, and training services	2-3
Interior decorating & design services	3
Labor to repair or alter apparel, footwear, watches, etc.....	4
Labor & services to repair or maintain commercial refrigeration equipment	4
Extended warranty services	5



Photography and photo finishing services, continued

However, currently nontaxable charges listed below become taxable at the beginning of the new year:

- ◆ Charges for sitting fees.
- ◆ Charges for developing and printing original photographs.
- ◆ Charges for developing negatives.
- ◆ Charges for tinting or coloring pictures provided by the customer.

Effective for periods on or after January 1, 2023, KRS 139.010(30) defines “photography and photofinishing services” to mean

“(a) The taking, developing, or printing of an original photograph, or image editing including shadow removal, tone adjustments, vertical and horizontal alignment and cropping, composite image creation, formatting, watermarking printing, and delivery of an original photograph in the form of tangible personal property, digital property, or other media.

(b) ‘Photography and photofinishing services’ does not include photography services necessary for medical or dental health.”

In summary, photographers will become pure retailers and all charges by a photographer as defined in the statute above will become subject to sales and use tax. Examples of newly taxable photography services include wedding pictures, family portraits, athletic pictures, etc. However, videography charges are not included in the legislation as taxable photography services.

Rental of space for meetings, conventions, short-term business uses, entertainment events, weddings, banquets, parties, and other short-term social events

When the meaning of taxable admissions expanded in July 2018, the Department received inquiries from different businesses about whether general facility rentals were taxable. The answer then was no. However, starting on January 1, 2023, several of these types of charges become taxable. Below are just a few examples of the types of rental charges that will be subject to sales and use tax next year:

- ◆ Hotel conference and ballrooms
- ◆ Convention center space and related charges
- ◆ Picnic shelters and other recreational spaces
- ◆ Dining areas reserved for private parties

Certain Instructional, Camp, and Training Services

Many items excluded from the general admissions category in 2018 become taxable services enumerated in KRS 139.200 when sold on or after January 1, 2023. The Department previously issued guidance indicating that these charges were not subject to sales tax because they were educational in nature. The primary categories and examples of these **instructional, camp and training services** are listed below:

Examples of newly taxable photography services include wedding pictures, family portraits, athletic pictures, etc.

Leisure, recreational, and athletic instructional services

Examples of services in this category include charges for youth to participate in Little League, golf or tennis lessons. Other examples include individualized training to increase skills in various recreational and sports disciplines.

Recreational camp tuition and fees

As the language implies, this category includes charges for camp enrollment that include recreational activities. All types of camp tuition and related charges will not become taxable. However, camps of all types, whether non-profit or for-profit, that include recreation as more than 10% of planned activities for participants will become taxable as of January 1, 2023.

Personal fitness training services

Again, these types of services were excluded from the expanded admissions that became taxable in 2018. However, instructor-led recreational classes or one-on-one instruction for swimming lessons, fitness classes, personal trainer exercise instruction, yoga lessons, riding lessons, golf lessons, baseball hitting lessons, etc. will be part of the expanded sales and use tax base.

There is a specific exemption for sales of admissions by nonprofit organizations under the provisions of KRS 139.495 and KRS 139.498, effective March 26, 2019. However, the sale of personal fitness training services or leisure, recreational, and athletic instructional services by these non-profit groups are taxable beginning on January 1, 2023.

Interior decorating and design services

Prior to January 1, 2023:

Interior decorators and designers have traditionally operated as contractors under Kentucky law (Kentucky Regulation 103 KAR 26:070). They have paid sales and use tax on all the tangible personal property they install as improvements to real property such as drapes, blinds, wallpaper, etc. They also did not collect sales and use tax on their service charges to their customers.

On and after January 1, 2023:

Interior decorators and designers will charge sales and use tax to their customers for their services. Because these services are subject to tax, the interior decorator or designer may issue a resale certificate for the purchase of the tangible personal property that transfers to the customer. Examples of these items include drapes, blinds, wallpaper, etc. purchased and installed in fulfillment of the interior decorating and design services provided. Please note that if the interior decorating and design provider performs a turn-key project and bills for all project charges, then all the charges for services performed are subject to the 6% Kentucky sales and use tax. For example, all the improvements to real property performed by or on behalf of the decorator and designer and billed to the customer are considered the retail sale of interior decoration and design services.



Labor to repair or alter apparel, footwear, watches, or jewelry when no tangible personal property is sold in that transaction

Prior to January 1, 2023:

In general, repair labor charges where the material used for repairs is less than 10% of the total charges are not treated as retail transactions. See Kentucky Regulation 103 KAR 27:150 for more information.

On and after January 1, 2023:

Transactions including only service charges to repair or alter apparel, footwear, watches, or jewelry are subject to sales and use tax. In addition, repair charges for apparel, footwear, watches, or jewelry where the material used for repairs is less than 10% of the total charges are also taxable because these transactions no longer qualify as a bundled transaction under the provisions of KRS 139.215. Both the materials used for repair or alteration and the labor charges are taxable so there is not a combination of taxable and nontaxable products in the transaction.

Labor and services to repair or maintain commercial refrigeration equipment and systems when no tangible personal property is sold in that transaction including service calls and trip charges.

“Services performed on commercial refrigeration equipment and systems” is another category of services becoming taxable as of January 1, 2023. Regardless of whether the commercial refrigeration equipment and systems are free standing or fixtures to real property, any charges to repair or perform maintenance on the units become subject to sales and use tax. Below are examples of charges that become taxable.

- ◆ If the service provider installs parts (even if the parts represent less than 10% of the total charge) while performing the repair or maintenance, both the material and labor charges are taxable. See section on apparel, footwear, watches, or jewelry for why the bundling rule in KRS 139.215 does not apply to this new category of taxable services.
- ◆ If the provider only performs labor to complete the repair or maintenance, then the labor only charges are still taxable.
- ◆ If the only charge is for the service call itself, then the service call charge for commercial refrigeration equipment and systems is still taxable.

This treatment of newly taxable services applies to repair and maintenance of commercial refrigeration equipment, but it does not apply to the sale and installation of new commercial refrigeration equipment. If the transaction is for an original installation, then the new provisions of HB 8 regarding commercial refrigeration do not apply. Instead, tax treatment will depend upon whether the equipment and system are fixtures to real property or remain free standing tangible personal property after installation. See Kentucky Regulation 103 KAR 26:070 for longstanding guidance on treatment of fixtures to real property.



Extended warranty services

Prior to January 1, 2023:

The definition of “Extended warranty services” applies only if:

1. The service contract agreement is sold or purchased on or after July 1, 2018; and
2. The tangible personal property or digital property for which the service contract agreement is provided is subject to tax under this chapter or under KRS 138.460.

Based on this language, if the tangible personal property or digital property sold is exempt from Kentucky sales tax then the exemption extends to the extended warranty.

On or after January 1, 2023:

The definition for taxable “extended warranty services” found in KRS 139.010 includes extended warranty services covering real property (in addition to the previously taxable extended warranty services covering tangible personal property and digital property). Also, language limiting the taxability of extended warranty service only to those contracts covering property subject to tax under KRS 139 or motor vehicle usage tax under KRS 138.460 has been removed. See chart below illustrating the impact of the expanded “extended warranty services” definition.

	Prior Treatment	New Treatment
Extended warranty on water heater	Exempt	Taxable
Extended warranty on garage door	Exempt	Taxable
Extended warranty on building roofing	Exempt	Taxable
Extended warranty on dishwasher	Exempt	Taxable
Extended warranty on farm tractor	Exempt	Taxable
Extended warranty on a semi-tractor and/or trailer	Exempt	Taxable

Extended warranty services “means services provided through a service contract agreement between the contract provider and the purchaser where the purchaser agrees to pay compensation for the contract and the provider agrees to repair, replace, support, or maintain tangible personal property, digital property, or real property according to the terms of the contract” (KRS 139.010(14)). Since the upfront charges for contracts to perform the extended warranty services are taxable, the service provider performing the extended warranty services may purchase the items used to complete the warranty services under a resale exemption without the payment of tax if the items are transferred to and remain with the customer.

All entity-based exemptions will still be valid so the purchase of an extended warranty by a tax-exempt purchaser, such as a charitable organization or a government entity, will still be exempt from sales and use tax.



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