



March 11, 2022

The Honorable Jason Petrie
Chair, House Committee on Appropriations &
Revenue
702 Capital Avenue, Annex Room 392
Frankfort, KY 40601

The Honorable Christian McDaniel
Chair, Senate Committee on Appropriations &
Revenue
702 Capital Avenue, Annex Room 203
Frankfort, KY 40601

Chairs Petrie and McDaniel:

The S Corporation Association has been engaged in a national effort to enact SALT Parity legislation since 2018, and we have drafted and/or actively supported the enactment of SALT Parity bills in a majority of states to date. We also worked with the Treasury Department to recognize the validity of the SALT Parity bills, laying the groundwork for Notice 2020-75.

With that with history in mind, we have several friendly suggestions for amendments to Section 16 of your year-end revenue bill, including the following:

- The draft appears to be limited to individual taxpayers and excludes trusts and other forms of ownership. This would prevent many family businesses from making the election and is a total outlier compared to the vast majority of states adopting our reform. Suggested language to address this issue is attached.
- The 5 percent reduction in the tax credit appears to be designed to raise revenue for the state, rather than to correlate the credit with the taxes owed by the business owners? Of the 30 states that have enacted SALT Parity legislation, only three have attempted haircuts to raise revenue – California, Massachusetts, and Connecticut. The Massachusetts Governor opposed the haircut and vetoed the bill, only to be overridden, while in Connecticut they are now attempting to undo the haircut because of its unpopularity.

Pass-through businesses are the backbone of Kentucky's economy – they represent the majority of businesses and they employ the majority of workers. SALT Parity will help these businesses by reducing their federal tax burden without reducing tax collections the state.

The provision has the potential to be a win-win for the state and its business owners. We strongly encourage you to consider these suggested changes, and appreciate all the hard work that has gone into crafting this legislation.

Sincerely,

A handwritten signature in blue ink, appearing to read 'Brian Reardon', with a stylized, cursive script.

Brian Reardon
President
S Corporation Association

Additional Comments –

1. Pages 74 to 75 of current bill (See attached):
 - a. The “in lieu of” change is necessary, because the taxes can't be paid “on behalf of” the ultimate owners. That would defeat the whole purpose of making this an entity-level tax that is deductible, rather than an individual-level tax that is not.
 - b. The “ultimate” partner, member, or shareholder of the pass-through entity change is needed, because there are numerous non-individual shareholders that should be eligible for this treatment. For example, grantor trusts, qualified subchapter S trusts, electing small business trusts, decedent's estates and bankruptcy estates are all eligible to be S corporation shareholders, and the election should be available for income allocable to them. See item 2. below also.
 - c. The 100% change is only fair. It certainly appears that state income tax is grossed up in determining taxable income at the state level.
2. Insert on page 91 of current bill: (37)

“Ultimate partner, member, or shareholder of the pass-through entity” means the direct or indirect partner, member, or shareholder that would be subject to tax on the income passed through from the pass-through entity; and
3. Kentucky should allow credit for entity-level taxes in other states, just as those states allow credit for Kentucky's entity-level taxes. Insert at the end of current Section 141.070 (1) of the Kentucky statutes:

“For purposes of the foregoing provision, the ultimate partner, member, or shareholder of a pass-through entity shall be treated as being liable for income tax paid to another state by the pass-through entity.”

- (c) The exemption provided in this subsection shall not apply to a person that is also engaged in the business of selling tangible personal property, digital property, or services included in KRS 139.200(2)(a) to (f).

➔ SECTION 16. A NEW SECTION OF KRS CHAPTER 141 IS CREATED TO READ AS FOLLOWS:

(1) For taxable years beginning on or after January 1, 2022, a pass-through entity may elect to pay the tax liability at the entity level, utilizing the tax rate computation under Section 22 of this Act, ^{in lieu} ~~on behalf of the~~ ^{ultimate} individual partner, member, or shareholder of the pass-through entity.

(2) The election shall be:

(a) Made on a form prescribed by the department;

(b) Made by the:

1. Fifteenth day of the fourth month upon the close of the taxable year;

or

2. Fifteenth day of the tenth month upon the close of the taxable year, if the return is filed under KRS 141.170;

(c) Made only upon the consent of all partners, members, or shareholders holding more than fifty percent (50%) ownership in the pass-through entity; and

(d) Binding upon all individual partners, members, or shareholders of the pass-through entity.

(3) For taxable years beginning on or after January 1, 2022, there shall be allowed a pass-through entity tax credit which shall be:

(a) Equal to ^{one hundred 100%} ~~ninety-five percent (95%)~~ of the tax paid by the pass-through entity ^{in lieu} ~~on behalf of the~~ ^{ultimate} individual partner, member, or shareholder of the pass-through entity;

(b) Claimed against the tax imposed under Section 22 of this Act on a return

ultimate
filed by the individual partner, member, or shareholder of the pass-through entity, with the ordering of credits as provided in Section 18 of this Act;

(c) Nonrefundable;

ultimate
(d) Based on the pro rata share of the individual partner's, member's, or shareholder's income from the pass-through entity.

(4) The pass-through entity shall report to each individual partner, member, or shareholder the individual's proportionate share of the tax paid by the pass-through entity for the taxable year and for purposes of the pass-through entity tax credit created in subsection (3) of this section.

(5) The department shall prescribe forms and may promulgate administrative regulations as needed to administer this section.

➔ Section 17. KRS 141.206 is amended to read as follows:

(1) Every pass-through entity doing business in this state shall, on or before the fifteenth day of the fourth month following the close of its annual accounting period, file a copy of its federal tax return with the form prescribed and furnished by the department.

(2) (a) Pass-through entities shall calculate net income in the same manner as in the case of an individual under KRS 141.019 and the adjustment required under Sections 703(a) and 1363(b) of the Internal Revenue Code.

(b) Computation of net income under this section and the computation of the partner's, member's, or shareholder's distributive share shall be computed as nearly as practicable identical with those required for federal income tax purposes except to the extent required by differences between this chapter and the federal income tax law and regulations.

(3) Individuals, estates, trusts, or corporations doing business in this state as a partner, member, or shareholder in a pass-through entity shall be liable for income tax only in their individual, fiduciary, or corporate capacities, and no income tax shall be

1 defined in subsection (24) of this section;

2 (b) In the case of corporations that are taxable in this state and taxable in another
3 state, means "net income" as defined in subsection (24) of this section and as
4 allocated and apportioned under KRS 141.120;

5 (c) For homeowners' associations as defined in Section 528(c) of the Internal
6 Revenue Code, means "taxable income" as defined in Section 528(d) of the
7 Internal Revenue Code. Notwithstanding the provisions of subsection (21) of
8 this section, the Internal Revenue Code sections referred to in this paragraph
9 shall be those code sections in effect for the applicable tax year; and

10 (d) For a corporation that meets the requirements established under Section 856
11 of the Internal Revenue Code to be a real estate investment trust, means "real
12 estate investment trust taxable income" as defined in Section 857(b)(2) of the
13 Internal Revenue Code, except that a captive real estate investment trust shall
14 not be allowed any deduction for dividends paid;

15 (36) "Taxable year" means the calendar year or fiscal year ending during such calendar
16 year, upon the basis of which net income is computed, and in the case of a return
17 made for a fractional part of a year under the provisions of this chapter or under
18 administrative regulations prescribed by the commissioner, "taxable year" means
19 the period for which the return is made; and

20 (37) *"ultimate partner, member, or shareholder of the"* "Wages" has the same meaning as in Section 3401(a) of the Internal Revenue Code
21 and includes other income subject to withholding as provided in Section 3401(f)
22 and Section 3402(k), (o), (p), (q), and (s) of the Internal Revenue Code.

23 ➔ Section 20. KRS 141.019 is amended to read as follows:

24 In the case of taxpayers other than corporations:

25 (1) Adjusted gross income shall be calculated by subtracting from the gross income of
26 those taxpayers the deductions allowed individuals by Section 62 of the Internal
27 Revenue Code and adjusting as follows:

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141.070 Credits allowed individuals for tax paid to other states.

- (1) Whenever an individual who is a resident of this state has become liable for income tax to another state upon all or any part of his net income for the taxable year, derived from sources without this state and subject to taxation under this chapter, the amount of income tax payable by him under this chapter shall be credited on his return with the income tax so paid by him to the other state, upon his producing to the proper assessing officer satisfactory evidence of the fact of such payment, except that application of such credits shall not operate to reduce the tax payable under this chapter to an amount less than ~~would have been payable were the income from the other state ignored.~~ *→ See Insert in email*
- (2) An individual who is not a resident of this state shall not be liable for any income tax under KRS 141.020(4) if the laws of the state of which such individual was a resident at the time such income was earned in this state contained a reciprocal provision under which nonresidents were exempted from gross or net income taxes to such state, if the state of residence of such nonresident individual allowed a similar exemption to resident individuals of this state. The exemption authorized by this subsection shall in no manner preclude the Department of Revenue from requiring any information reports pursuant to KRS 141.150(2).
- (3) As used in this section, "state" means a state of the United States, the District of Columbia, the commonwealth of Puerto Rico, or any territory or possession of the United States.

Effective: April 27, 2018

History: Amended 2018 Ky. Acts ch. 207, sec. 118, effective April 27, 2018. -- Amended 2005 Ky. Acts ch. 85, sec. 478, effective June 20, 2005. -- Amended 1974 Ky. Acts ch. 163, sec. 3. -- Amended 1966 Ky. Acts ch. 255, sec. 138. -- Amended 1960 Ky. Acts ch. 5, Art. III, sec. 4. -- Amended 1958 Ky. Acts ch. 3, sec. 2. -- Created 1952 Ky. Acts ch. 194, sec. 3. -- Recodified 1942 Ky. Acts ch. 208, sec. 1, effective October 1, 1942, from Ky. Stat. secs. 4281b-15, 4281b-16.

Legislative Research Commission Note (4/27/2018). Pursuant to 2018 Ky. Acts ch. 207, sec. 153, the amendments made to this statute in that Act apply to taxable years beginning on or after January 1, 2018.