Kentucky: Lawmakers override governor's veto, pass tax overhaul

David M. Kall | Thursday, April 26, 2018

On April 13, 2018, lawmakers overrode Kentucky's Gov. Matt Bevin's veto of two pieces of legislation, House Bill 200, the budget legislation, and House Bill 366, the tax reform initiative. In so doing, they put into action what the *Washington Post* characterized as the "biggest overhaul in a decade."

The governor doubled down on his opposition in an op-ed that he wrote the day after the override, accusing the legislature of "continu[ing] Kentucky's dangerous fiscal habits by making promises to our citizens that we already know we cannot keep. Have we not learned our lesson? These tax and budget bills suggest that we have not."

As has been widely reported, the tax reforms accomplish the following, among other things:

- Apply Kentucky's 6 percent sales tax to 17 services, ranging from veterinary, landscaping, janitorial, and industrial laundry services, to play, concert, sporting even, movie and bowling alley admissions, to usage of fitness and rec centers and overnight trailer campgrounds.
- Increase the cigarette tax by 50 cents per pack, to $1.10 per pack, and impose a 15 percent tax on electronic cigarettes.
- Cut the individual income tax rate to a flat 5 percent tax. Currently, there are three brackets: 5 percent for single and married-filing-jointly taxpayers earning less than $8,000; 5.8 percent for those earning between $8,000 and $75,000; and 6 percent for earnings above $75,000.

- Cut the corporate tax rate to a flat 5 percent. Now, the rate is 4 percent for income less than $50,000; 5 percent for income between $50,000- $100,000; and 6 percent for income above $100,000.
- Cut some tax deductions, such as those for medical expenses, medical insurance, paid taxes and investment income.

Gov. Bevins justified his veto on the grounds that giving in to the “emotion and hysteria” would have been the wrong thing to do. He pointed to the state’s $60 billion pension liability, broken education-finance system, and the ongoing imposition of onerous tax burdens “on the backs of hard working Kentuckians,” as critical problems with the legislation.

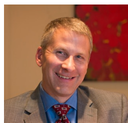
In addition, he expressed concerns about the “unintended consequences of these rushed bills,” such as a depleted emergency fund and the resulting deprivation of “critically needed reserve[s]…should Kentucky experience a natural disaster or downturn in the economy,” and the fact that “[c]redit rating agencies will frown on this. That will hurt Kentucky.”

With respect to the budget, the governor’s objections were more specific in his veto letter. He contended that the revenue analysis was faulty, “miss[ing] the mark by at least $50 million,” and spending nearly $600 million without either reducing expenditures or “adequately identifying revenue sources for the proposed spending.” He was also unhappy that it does not account for “known costs and…eliminate[s] any chance Kentucky has to maintain a positive balance” in the reserve fund.

In his veto message of HB 366, the tax reform initiative, Gov. Bevins was slightly less harsh. He conceded that it “contains some positive elements,” such as moving toward a consumption based approach, and reducing income tax rates modestly. Nevertheless, it “leaves in place several extremely bad taxes that harm Kentucky’s competitiveness.” He further opined that the new taxes on services will hurt small businesses disproportionately, fail to address inequities that favor government over free enterprise, add complexity, and will not meet revenue projections due to a $50 million shortfall over the biennium.

On the other hand, the Tax Foundation was delighted. In its 2018 Business Climate Index, the group ranked Kentucky at No. 33, a rank that has barely changed since 2015. In 2015, 2016 and 2017, the ranks were 31, 32, and 33, respectively. The new investment-friendly reforms will enable the Bluegrass State to leapfrog over 15 others, into the number 18 position, mostly because they broaden the tax base and lower rates, thus making a good start in correcting inequities in the sales tax scheme.

Even so, the Tax Foundation recognized that “[t]here is still work to be done.” The group disapproves of Kentucky’s “antiquated” Limited Liability Entity Tax. Also, Kentucky “is one of only six states to levy an inheritance tax, and its use of a tax credit to phase out the inventory tax is a problematic mechanism.”



David M. Kall

Team member bio