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STATE AND LOCAL TAX FORUM

Expanding Sales Tax to Services – A Kentucky Case Study and Policy Analysis

Paul J. Hartman ~ SALT Forum

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SPEAKERS

Michael Mazerov
Senior Fellow
Center on Budget & Policy Priorities
1275 First Street, NE, Suite 1200
Washington, D.C. 20002
Telephone: 202.408.1080
Email: mmazerov@cbpp.org

Fred Nicely
Senior Tax Counsel
Council on State Taxation
122 C Street, NW, Suite 330
Washington, D.C. 20001-2109
Telephone: 202.484.5213
Email: FNicely@cost.org

Richard A. Dobson
Executive Director
Office of Sales & Excise Taxes
Kentucky Department of Revenue
501 High Street, Station 50
Frankfort, KY 40602
Telephone: 502.562.5523
Email: Richard.Dobson@ky.gov

Moderator:
Mark F. Sommer
Partner
Frost Brown Todd LLP
400 West Market Street, Suite 3200
Louisville, KY 40202
Telephone: 502.779.8150
Email: msommer@fbtlaw.com

Today's Discussion

- The Kentucky Services Tax Revisited
- Policy Viewpoints Against The Kentucky Services Tax
- Policy Viewpoints on Services Tax From Business

OVERVIEW

- Kentucky's sales and use tax, enacted in 1960, is the staple of tax revenue to the Commonwealth. Commencing in 2018, the Kentucky Legislature began a policy shift to taxing services, which continues to date.

- This shift is occurring simultaneous with a decrease in the tax rates imposed for individual income tax, which now stands at 4.0% (for 2024); Legislation is in place for further reductions should various revenue/expense metrics be met.

The Sales Tax Base

- Prior to 2018, Kentucky imposed more of a "traditional" sales and use tax on sales and use of tangible personal property
- Only a handful of services were subject to Kentucky sales and use tax:
  - ❖ Accommodations less than 30 days
  - ❖ Sewer Services (Non-residential)
  - ❖ Admissions (Non-participatory)
  - ❖ Communications Services (Telecommunications & Ancillary Services)
  - ❖ Distribution, transmission, or transportation services for natural gas (Non-residential)

2018 HB 487 –
12 New categories of Taxable Services – KRS 139.200

Effective July 1, 2018, charges for the provision of the following services became subject to sales tax:

- Landscaping services - including but not limited to lawn care and maintenance services; tree trimming, pruning or removal services; landscape design and installation services; and snow plowing and removal services
- Janitorial services - including but not limited to residential and commercial cleaning services, and carpet, upholstery, and window cleaning services
- Small animal veterinary services - excluding veterinary services for equine, cattle, swine, sheep, goats, llamas, alpacas, ratite birds, buffalo, and cervids
- Pet care services - including but not limited to grooming and boarding services, pet sitting services, and obedience training services
- Industrial laundry - including but not limited to industrial uniform supply services, protective apparel supply services, and industrial mat and rug supply services

- Non-coin-operated Laundry and dry-cleaning services
- Linen supply services - including but not limited to table and bed linen supply services and non-industrial uniform supply services
- Indoor skin tanning services - including but not limited to tanning booth or tanning bed services and spray tanning services
- Non–medical diet and weight reducing services
- Limousine services - if a driver is provided
- Extended warranty services - to cover tangible personal property or digital property that is taxable at retail to the warranty holder
- Participatory Admissions- the privilege of participating in an event or activity

Reduction of Individual Income Tax Rate

HB 8 enacted in 2022 established individual income tax rate for tax year 2023 at 4.5%

- Conditions for possible .5% tax rate reductions each year
  - ❖ Budget Reserve Trust Fund balance at the end of a fiscal year must be at least 10% of receipts
  - ❖ General Fund receipts must be greater that the sum of appropriations plus the value of a 1% individual income tax rate
- HB 1 enacted in 2023 lowered the individual income tax rate for tax year 2024 to 4%
- In August 2023, the office of the State Budget Director notified the legislature that the threshold requirements of HB 8 were not met to trigger consideration of another .5% rate decrease for tax year 2025.

Income Tax Cuts – Sales and Use Tax Receipts

- Per H.B. 8, the Kentucky Legislature in 2022 put in place major legislation to reduce, and over time, eliminate the individual income tax.
- With carefully crafted budgetary receipts and expense "triggers," the rate has decreased to 4.0% effective as of January 1, 2024.
- During recent years, fiscal year sales and use tax receipts have increased as follows:

2017	2018	2019	2020	2021	2022	2023
$3.485B	$3.606B	$3.938B	$4.071B	$4.561B	$5.063B	$5.576B

Sales and Use Tax Receipts Forecasts: 2024 = $5.788B; 2025 = $5.991B; 2026 = $6.208B

Major Expansion of the Sales Tax Base recently occurred. Per 2022 HB 8 and 2023 HB 360, 34 New Services Now Subject to Sales and Use Tax:

- Photography and photo finishing services
- ~~**Marketing services**~~*
- Telemarketing services - means services provided via telephone, facsimile, electronic mail, **text messages***, or other modes of communications
- Public opinion and research polling services
- Lobbying services - **new definition adopting the DOR FAQ definition with added cites of KRS 11A.201 and KRS 6.611 for executive and legislative branch lobbying. Clarified these services include local and federal activities as well.***
- Executive employee recruitment services - **new definition indicating an executive employee is a senior-level manager. These services may include conducting interviews and contract negotiations. DOR will also continue to use the concept of highly compensated employee under IRC Section 414(q)(2).***
- Web site design and development services
- Web site hosting services
- Facsimile transmission services
- Private mailroom services - including:
  Presorting mail and packages by postal code; Address barcoding; Tracking; Delivery to postal service; Private mailbox rentals

* HB 360 changes retroactive to 1/1/2023

- Bodyguard services
- Residential and nonresidential security system monitoring services - **excluding separately stated onsite security guard services***
- Private investigation services
- Process server services
- Repossession of tangible personal property services
- Personal background check services
- Parking services - including:

  Valet services; and the use of parking lots and parking structures; excluding any parking services at an educational institution
- Road and travel services provided by automobile clubs as defined in KRS 281.010
- Condominium time-share exchange services
- Rental of space for meetings, conventions, short-term business uses, entertainment events, weddings, banquets, parties, and other short-term social events - **does not apply to subleases and sub-rents to exhibitors or others if tax is paid on the initial rental of the space by the primary lessee***
- Social event planning and coordination services
- Leisure, recreational, and athletic instructional services - **does not apply to certain non-profit civic and other nonprofit organizations under KRS 139.498***
- Recreational camp tuition and fees

* HB 360 changes retroactive to 1/1/2023

- Personal fitness training services
- Massage services - except when medically necessary
- Cosmetic surgery services - **clarification added to exclude surgery services that are medically necessary***
- 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
- **Laboratory** testing services - except testing for medical, educational, or veterinary reasons, **with new exclusion for government related testing requirements***
- Interior decorating and design services
- Household moving services
- Specialized design services - including the design of clothing, costumes, fashion, furs, jewelry, shoes, textiles, and lighting
- Lapidary services - including cutting, polishing, and engraving precious stones
- 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
- Labor to repair or alter apparel, footwear, watches, or jewelry - when no tangible personal property is sold in that transaction
- Prewritten computer software access services - **added to the definition of extended warranty services, storage, and use***
- Expanded definition of extended warranty services - now includes real property and exempt tangible personal property

* HB 360 changes retroactive to 1/1/2023

KY Services Sales Tax Implementation/Policy Considerations

- Resale exemption for the sale of services.
- Double impact to certain industry sectors (*e.g.*, industrial cleaning).
- Limited statutory definitions for new taxable service categories.
- Overlap of terms used with tax imposition (*e.g.*, admissions vs. recreational instructional services).
- Exemptions for services parallel to exemptions available for tangible personal and digital property.
- Sourcing challenges for new types of service transaction scenarios.
- B2B Issues

Overarching Policy Points

- Single biggest structural flaw of state sales taxes in nearly all states is very spotty coverage of services
- Some recent progress, but way too slow
- Why tax services?
  - Improve sales tax fairness
  - Substantial immediate revenue potential
  - Long-term fiscal sustainability/elasticity
- "Horizontal" equity principle: similar tax treatment of similarly-situated taxpayers
- Failure to tax services unfair to people who simply prefer to spend their money on goods
- Many untaxed services are close substitutes for taxable goods
  - Lawnmower taxed; lawn service exempt
  - Software purchase taxed; software subscription exempt

Does Taxing Services Reduce Sales Tax Regressivity?

- "Conventional wisdom says yes, but best (old, limited) empirical evidence says no
- Why? Lower-income people must spend significant share of their incomes on services (hair cuts, car repairs, plumbing repairs)
- Sales tax could be extended to services primarily bought by affluent, but would generate relatively little revenue
- Broad expansion to services coupled with completely offsetting rate cut will not make sales tax itself significantly more or less regressive
- But generating net additional revenue from sales tax through base expansion will increase regressivity of overall tax system because of greater reliance on inherently regressive tax
- Therefore, any significant increase in net sales tax revenue from taxing services should be significantly offset for low-income people, e.g., via expanded EITC or refundable sales tax credit
- Services absolutely shouldn't be taxed to finance income tax cuts – precisely what Kentucky did

Policy Point ~ Revenue & Fiscal Impact

- Revenue potential from comprehensive expansion to household services is substantial (even minus health care, childcare, education, and residential rentals, which shouldn't – and realistically won't – be taxed)
- States like Kentucky, with virtually no taxation of services prior to 2018, could probably boost sales tax revenue 25%-35% if household services (excluding those above) were taxed comprehensively
- That revenue could be used for public investments or to finance sales tax rate cuts
- Household consumption shifting from goods to services (despite contrary experience early in pandemic)
- Results:
  - ❖ failure of sales tax revenue to grow as rapidly as cost of services sales tax is supposed to pay for
  - ❖ steady increase in sales tax rates to compensate
- Need to mitigate this past and future erosion is arguably most important reason to expand base to include more services

Policy Point ‑ Tax Which Services?

- Services that are primarily business-to-business (e.g., payroll processing) should not be targeted for new taxes
- Focus on untaxed household purchases (e.g., personal trainers)
- Services frequently sold to both households and businesses (e.g., auto repair) should be taxed
  - ❖ Substantial evasion potential given large number of self-employed people who could claim personal consumption (telephone, car repair, hotels) was for business purpose
  - ❖ Unreasonable burden on seller/government to police eligibility for business purchase exemption

Policy Point ~ B2B Services

- Policy principles: sales tax is supposed to be tax on final consumption
- Passthrough: tax on inputs passed-through to purchasers, increasing regressivity
- Politics: fierce business opposition
- Pyramiding: double-taxation of business inputs

Example:

- Sales tax rate is 10%
- Business buys $500 of taxable services
- Has $50 sales tax expense ($500 * 10%)
- Has $350 in labor costs
- Business charges $1000 for its service to:
  - recover $50 in sales tax costs
  - recover $850 in services and labor expenses
  - obtain $100 profit
- Customers charged $100 on invoices ($1000*10%) plus $50 in hidden tax on services, *i.e.*, 15% sales tax, not 10%

Problems with Pyramiding

- No transparency; part of tax is hidden in price
- Increased regressivity: hidden tax in price of items that were exempted to mitigate regressivity (e.g., sales tax on supermarket's electricity hidden in price of groceries)
- Sellers may lose business to competitors in other states where price is cheaper because inputs are tax-exempt
- Creates incentive to provide services in-house with employees (e.g., janitorial) rather than outsource to more efficient suppliers (many of which would likely be small businesses)

Extent of Pyramiding Is Exaggerated

- Substantial portions of final household consumption are not subject to sales tax; e.g., food for home consumption, residential rentals, health care, airfares, Internet access, private school/college tuitions
- If business purchases to provide those goods/services are subject to tax but final consumption isn't, there's no pyramiding
- Likewise, if sales taxes on such inputs are passed through to consumer in sales price of tax-exempt item (e.g., sales tax imposed on janitorial service in rental apt. bldg.), those taxes effectively are an appropriate tax only on final consumption (notwithstanding transparency and regressivity issues)

What yields a "good" consumption (a/k/a sales and use) tax?

Principles of a Good Consumption Tax

- Primarily applies to final household consumption/exempts business inputs
- Uniform (harmonized) tax base
- Fair and efficient sales tax administration
- Centralized tax administration w/limited local jurisdictions

Big Picture ~ How much tax does business pay and how are tax receipts trending?

- U.S. FY 2021 State and Local Business Tax Burden – By Tax
- U.S. FY 2021 State and Local Tax Burden – Business vs. Households
- Volatility of State Tax Revenues vs. The Economy
- Trends in State Tax Revenue Since Covid-19
- National Trends in Total Tax Revenue and Variance in Same

National pressure building for sales tax expansion to services (or, Kentucky is leading the pack)

Expansion of Sales and Use Tax Base to Mitigate/Reduce/Eliminate Income Tax

- Services as a share of total personal consumption continue pace
- Per the NCSL (2/2023), at least 20 states have cut personal and/or corporate income tax rates since the start of 2021.
- This has reduced some state's revenues by hundreds of millions or, in several cases, billions of dollars, annually.
- Going into 2023, there was a continued push to cut income taxes:
  - Arkansas
  - Kentucky
  - Mississippi
  - Nebraska
  - North Dakota
  - Oklahoma
  - West Virginia

Policy Point ~ Expanding sales and use tax base would be less onerous if the states had more uniformity, or would it?

Expansion of the States' Sales Tax Base Necessitates an Efficient and Fair Sales Tax System

- While the U.S. Supreme Court overturned the longstanding *Quill* precedent in the *Wayfair* case, **attaining a level of sales tax simplification and uniformity that satisfies a constitutional "commerce clause" requirement should not be confused with constructing an efficient and fair modern-day sales tax system.**
- Three features the U.S. Supreme Court highlighted with South Dakota's law:
  - ❖ No retroactivity
  - ❖ Small seller exclusion
  - ❖ **State was a member of the Streamlined Sales & Use Tax Agreement (SSUTA)**
- Will more states join the SSUTA now?

Policy Point ~ the major impediment to sales and use tax modernization: avoiding sales taxes on business inputs

The Fly in the Ointment - Taxing Business Inputs

- This structural flaw of state sales tax systems — the widespread taxation of business purchases (excluding resale) — is of long-standing origin.
- The pyramiding of sales tax at multiple stages of the supply chain creates a number of distortions because it affects business choices of input purchases, location of jobs and investments, and organization of business structures.
- A well-designed broad-based consumption tax on household goods and services can provide an efficient way to raise revenue for government with a minimal impact on economic growth.

However, the cascading of taxes on business inputs can undermine this advantage and penalize both domestic business investment and the competitiveness of U.S. exports.

The Expert's Perspective: Historical Condemnation of the Sales Taxation of Business Inputs

- "In the establishment of the structure of a sales tax, it is highly desirable to confine the tax so far as possible to the sale of consumption goods, since the taxation of producers' goods is not only contrary to the intent and philosophy of the tax, but gives rise to undesirable effects, especially in countries in which maintenance of a high level of investment is important." John F. Due, Sales Taxation (1957)
- "A sensible sales tax would… exempt all sales to business." Charles E. McLure, Hoover Institution, Stanford University, "Understanding the Nuttiness of State Tax Policy," National Tax Journal (September 2005).
- An ideal retail sales tax "…should apply only to consumption expenditures, and thus not to savings or to purchases for use in production." John L. Mikesell, "Reversing 85 Years of Bad State Retail Sales Tax Policy," State Tax Notes, (Feb. 4, 2019).

Report on Imposing Sales Taxes on Business Inputs

- **"The Impact of Imposing Sales Taxes on Business Inputs,"** EY, STRI/COST report issued May 2019
- Despite a complex system of exemptions intended to exclude specific categories of business input purchases from the sales tax base, most state sales tax systems fall short of the goal of taxing only household consumption because they impose significant taxes on business-to-business transactions
- ***State sales taxation of business purchases accounted for 42% of total state and local sales taxes in 2020***
- National (percentages) of SALT imposed on business inputs

Source: Total State and Local Business Taxes: State-by-State Estimates for Fiscal Year 2021, study prepared by Ernst & Young LLP for the State Tax Research Institute and the Council On State Taxation (Release TBD)

Policy Point: Iowa's Exemption for Business Purchases of Software and Digital Products

- Iowa provides the broadest exemption for business purchases of digital commerce.
- Iowa provides a statutory exemption that covers specified digital products, prewritten computer software, and some enumerated services furnished to a commercial enterprise for use exclusively by the enterprise.
  - ❖ Included in the "enumerated services" are information services, custom software, and SaaS.
- "Commercial enterprise" is broadly defined to include: (1) businesses and manufacturers operating for profit; (2) insurance companies (for-profit and nonprofit); (3) financial institutions (for-profit and nonprofit); (4) professions and occupations; and (5) public utilities.
- As summarized by the Iowa Department of Revenue in a guidance document, specified digital products, prewritten computer software, information services, and SaaS are exempt "when purchased by a commercial enterprise and used exclusively by or furnished to that commercial enterprise."
  - ❖ Furthermore, to qualify for "use exclusively by the commercial enterprise," the use for noncommercial purposes must not be more than de minimis.

Expansion of Tax Base to Services – Manufacturing and Resale Exemptions Need Reviewed/Modified

- Resale exemptions for business inputs are tailored towards buying and selling TPP and need modified to address digital products that are not resold in exactly the same form – *e.g.*, two digital products merged together
- Services – exemptions for inputs (equipment) are often not considered
- Manufacturing exemptions can have limited application the production of digital products, often dependent on the classification of the digital product as TPP
- Consideration of exemptions to the sale of tangible personal property versus digital products
  - ❖ Purchase physical item that is digitized, *e.g.*, a poster – exemptions should include content, materials, equipment, consumables, software, packaging equipment
  - ❖ Purchase of two different digital products and resold as merged product – resulting merged product for sale could be subject to tax, but seller's purchase of the two products should be exempt (resale and/or manufacturing)

Policy Point ~ Sweeping sales tax base broadening legislation without explicitly exempting business inputs

Recently Enacted Sales and Use Tax Base Expansion

- Over the last three decades, states have repeatedly sought to extend the sales tax base to cover a wide range of services.
  - ❖ Bolstered by the issue of remote seller collection being settled by *Wayfair* in 2018
- **North Carolina** (2017) with an emphasis on taxing services delivered by sellers with an existing sales tax obligations.
- **Kentucky** (2022) added to the sales and use tax on many services with goal to reduce the State's personal income tax rate.
- **Many states** have expanded the sales tax base to include newly digitized goods and services that were previously taxed as tangible personal property (movies, books, audio, etc. – *e.g.*, "specified digital products") .

Failed Attempts at Sweeping Sales and Use Tax Base Broadening Legislation

The state and local political landscape is littered with examples of states that failed to enact (or sustain) major sales tax base expansion even with significant gubernatorial or legislative support.

- Florida (1987)
- Massachusetts (1991)
- Michigan (2007)
- Nebraska (2013)
- Ohio (2013)
- Louisiana (2013)
- Minnesota (2013)
- Pennsylvania (2015)
- Maine (2015)
- Utah (2019)
- Connecticut (2019)
- South Carolina (2019)
- Maryland (2020)
- Nebraska (2020)

The Political Difficulty with Sweeping Sales Tax Base Broadening Legislation

- Several factors are responsible for the failure of wide-scale sales tax base expansion, including the difficulty of enacting large-scale tax reform, the objection of impacted service providers, and general public resistance to new taxes.

- ***But certainly, the most important common factor has been the principled opposition from the business community***. Generally, the policy objections were not to the expansion and modernization of the sales tax base to include the growing services sector, but to doing so without limiting the base expansion to household purchases and exempting business inputs.

The "Catch 22" of Sales and Use Tax Base Expansion

- By now, this much is clear: the extension of the sales tax base to include business services is inconsistent with creating a more efficient and modern sales tax system.
- States that include business purchases in sales tax base expansion not only diverge from theoretical norms of an ideal sales tax system, but also risk near-certain defeat of comprehensive base-expansion legislation.
- **States should recognize that if their goal is to modernize and broaden the sales tax base, expansion to include more services purchased by households, but not businesses, is better than no reform at all.**
- An improved understanding of the extent and negative impact of sales taxes imposed on business inputs will enhance the potential for future sales tax reform to better comply with the principles of taxing final consumption of household goods and services while exempting intermediate business inputs.

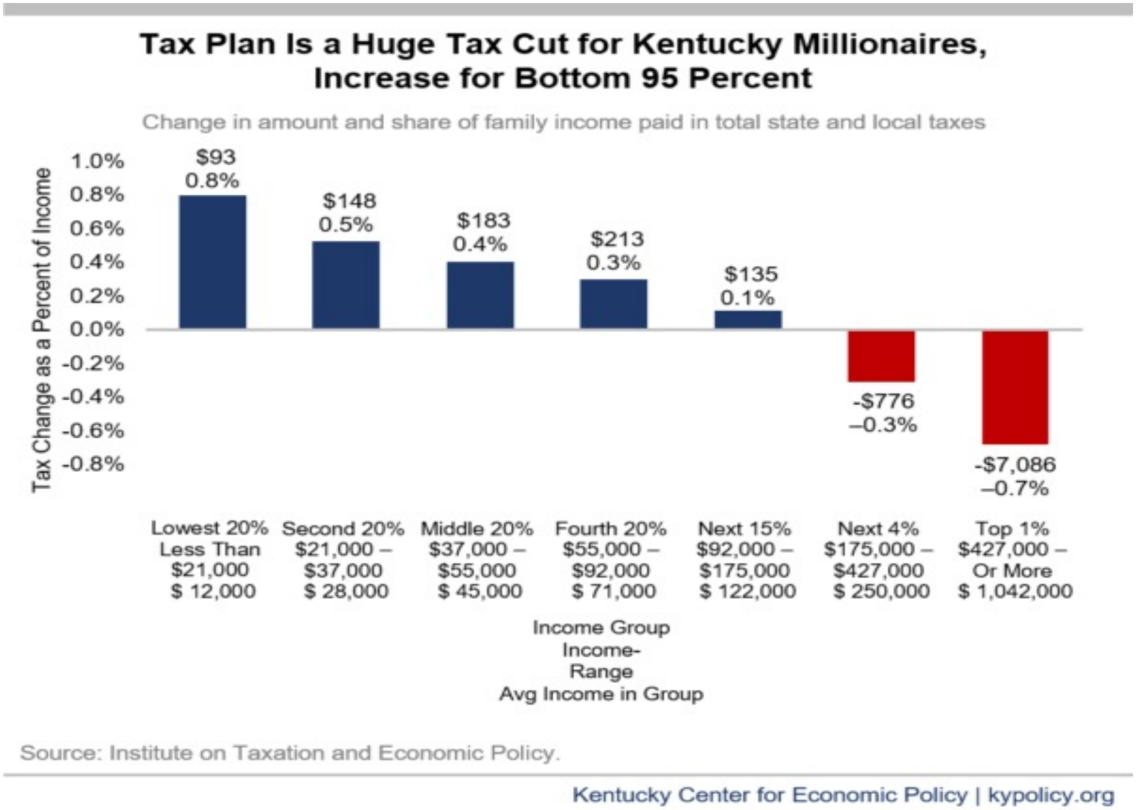
- Share of Services Purchased by Businesses and Personal Consumption
- Breadth of States' Manufacturing Equipment Exemption
- Breadth of States' Manufacturing Inputs Exemption
- "Double Taxation" (Inputs and Outputs) of Select Services
- Retail Industry Exemptions for Business Purchases of Electricity, POS, and Furniture/Fixtures
- Tax on Digital Software Accessed Remotely (SaaS)
- Multiple Points of Use (MPU) Apportionment with Digital B2B Purchases

Four Takes on Kentucky's Shift

- Kentucky's 2018/2022 base expansion to services was a (very) partial "pay-for" for deep cuts in personal income taxes
- PIT had been 5.8% on incomes between $8,000 and $75,000 and 6% on higher incomes; has now been cut to flat 4% with triggers for future cuts based on irrational criteria that will allow permanent rate cuts based on temporary tax surpluses
- "Case study" in session title implies we are to draw lessons for other states.

Take #1:

- PIT cuts were overwhelming tilted to people with the highest incomes, have worsened regressivity of overall tax system, and have worsened racial inequality



"The 2018 General Assembly's tax shift from progressive income taxes to regressive sales taxes made Kentucky's tax system even more imbalanced. The new tax law was a cut for the richest 5 percent of Kentuckians — especially the top 1 percent, who received a cut of over $5,000 — and an increase for everyone else. Because of these changes, Kentucky now ranks 25th worst among states on ITEP's inequality index, which measures the effect of state tax systems on income inequality. Without those changes, Kentucky would have ranked 34th."

Kentuckians of Color More Concentrated in Lower-Income Groups

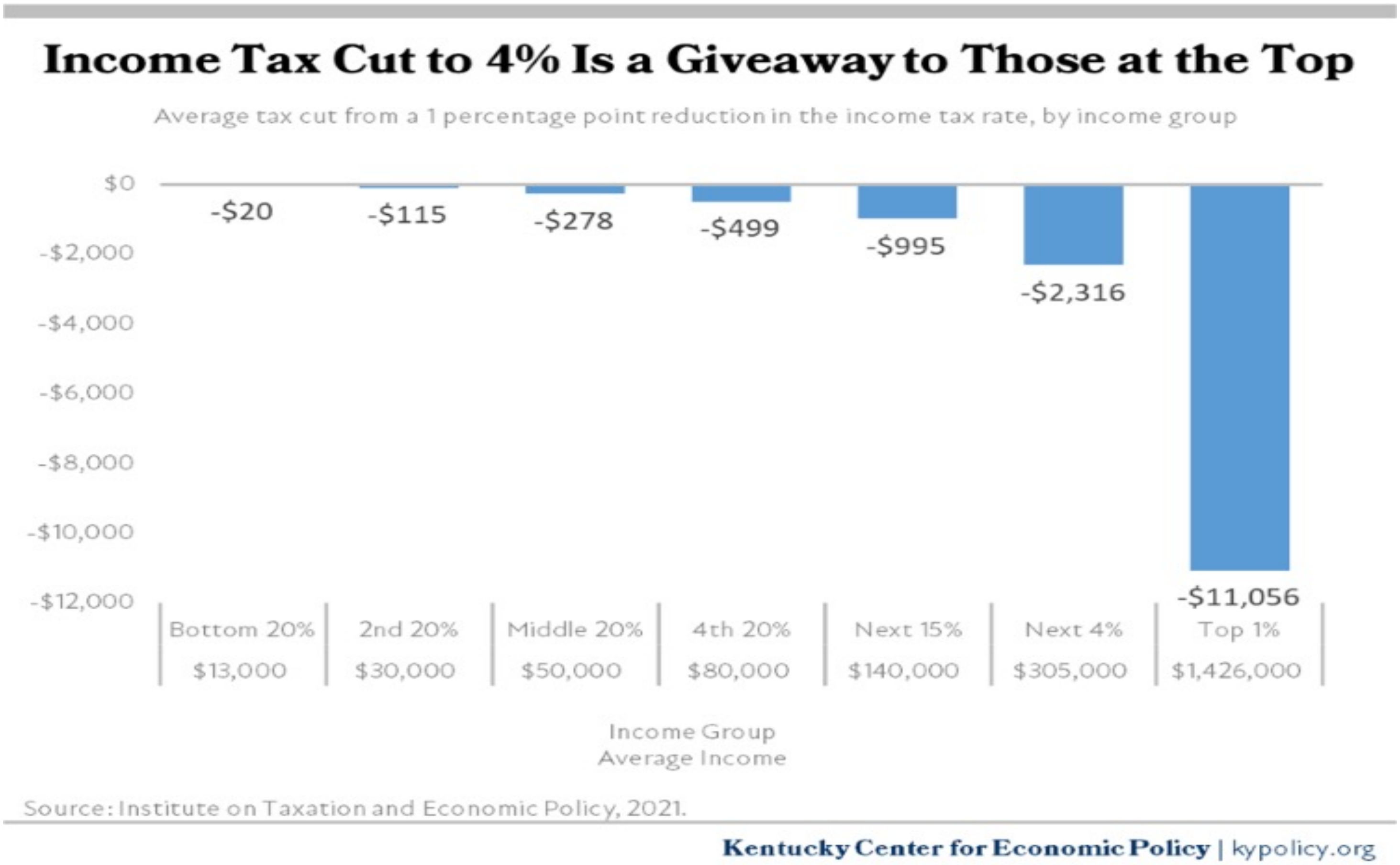
Distribution of each race through the income-based quintiles

	Lowest 20%	Second 20%	Middle 20%	Fourth 20%	Next 15%	Next 4%	Top 1%
Total	20%	20%	20%	20%	15%	4%	1%
White Non-Hispanic	19%	20%	20%	20%	16%	4%	1%
Hispanic	21%	27%	22%	20%	5%	3%	1%
Black	29%	23%	22%	14%	10%	2%	0%
American Indian/Alaska Native	20%	37%	15%	18%	5%	4%	N/A
Asian	12%	11%	16%	30%	18%	9%	4%
Other	20%	23%	17%	25%	11%	3%	1%

Source: Institute on Taxation and Economic Policy, May 2017.

Kentucky Center for Economic Policy | kypolicy.org

"More Kentuckians of color will face tax increases, and fewer will receive tax cuts, than white Kentuckians under HB 366; 39 percent of White Non-Hispanic Kentuckians are in the bottom two quintiles – groups facing a tax increase on average of 0.5 percent of income or higher – whereas 52 percent of Black and 48 percent of Hispanic Kentuckians are in these lower-income groups."


Income Tax Cut to 4% Is a Giveaway to Those at the Top
Average tax cut from a 1 percentage point reduction in the income tax rate, by income group
$0
-$2,000
-$4,000
-$6,000
-$8,000
-$10,000
-$12,000
-$20
-$115
-$278
-$499
-$995
-$2,316
-$11,056
Bottom 20% $13,000
2nd 20% $30,000
Middle 20% $50,000
4th 20% $80,000
Next 15% $140,000
Next 4% $305,000
Top 1% $1,426,000
Income Group
Average Income
Source: Institute on Taxation and Economic Policy, 2021.
Kentucky Center for Economic Policy | kypolicy.org

Take #2:

- Even in a state in which motivation for base expansion to services was ostensibly "switching from taxing income to taxing consumption" rather than just raising revenue, legislators didn't understand or care about violating the principle by significantly taxing such B2B services as
  - ❖ telemarketing
  - ❖ executive recruitment
  - ❖ web design/hosting
  - ❖ employee background checks
  - ❖ private mailroom services

- State Tax Notes: "The business community has extolled [2022] H.B. 8's income tax cut as key to attracting a larger workforce, one of the challenges facing the state."

Take #3:

Very unlikely, and certainly not cost-effective strategy. Cost of 1% rate cut is over $1 billion.

- ❖ Kentucky's net migration rate had been averaging -0.1% before tax cuts and +.1% since
- ❖ Kansas, New Mexico, and Ohio, three other states with weak economic performance that have cut income taxes deeply, saw no improvement in migration (see: Mazerov, "State Taxes Have a Minimal Impact on People's Interstate Moves," 8/23)

Take #4:

- Business representatives who supported or did not oppose Kentucky's 2018 and 2022 tax bills were not acting in the long-term interest of their companies
  - ❖ Business continuously seeks reductions of sales taxation of business inputs, but Kentucky instead significantly expanded this (and precedent has been set for future ones as income tax cuts increasingly bite)
  - ❖ Businesses pay a lot of property tax, and Kentucky property tax rates likely to rise over time as deep income tax cuts force cuts in state financial support for local schools

Take #4 (con't):

- Business representatives who supported or did not oppose Kentucky's 2018 and 2022 tax bills were not acting in the long-term interest of their companies
  - ❖ Kentucky has 5th-lowest level of college graduation and 9th-lowest level of high-school graduation among adult workforce.
  - ❖ It ranks 5th lowest in the share of its adult population that is employed.
  - ❖ It ranks highest in the share of adults with at 3 or more chronic health conditions like diabetes and heart disease.
- If workforce quality and availability are the issue for business, these problems require public investments, not counterproductive tax cuts.
- Sadly, business silence in similar situations in recent years in Arkansas, Mississippi, and West Virginia

QUESTIONS?

APPENDIX OF CHARTS

- Frequently Asked Questions – HB 8 & HB 360
- U.S. FY 2021 State and Local Business Tax Burden Study
- FY 2021 State and Local Business Tax Burden Study
- State Tax Revenues are More Volatile Than the Economy
- Trends in State Tax Revenues Since the Pandemic
- Current Trends in Total Tax Revenues: Large Variation Across States
- Services as a Share of Total Personal Consumption Expenditures, 1929 – 2017
- Will More State Join the SSUTA? SSUTA State Score Better on COST's Sales Tax Systems Scorecard
- State and Local Sales Taxes Imposed on Business Inputs

Appendix of Charts – Cont'd

- Tax on Business Purchases of Select Software and Digital Products
- Share of Services Purchased by Businesses and Personal Consumption, 2016
- Breadth of States' Manufacturing Equipment Exemption
- Breadth of States' Manufacturing Inputs Exemption
- Double Taxation (Inputs and Outputs) of Select Services
- Retail Industry Exemptions for Business Purchases of Electricity, POS, and Furniture/Fixtures
- Tax on Digital Software Accessed Remotely (SaaS)
- Multiple Point of Use (MPU) Apportionment with Digital B2B Purchases

Frequently Asked Questions – HB 8 & HB 360

Sales Tax

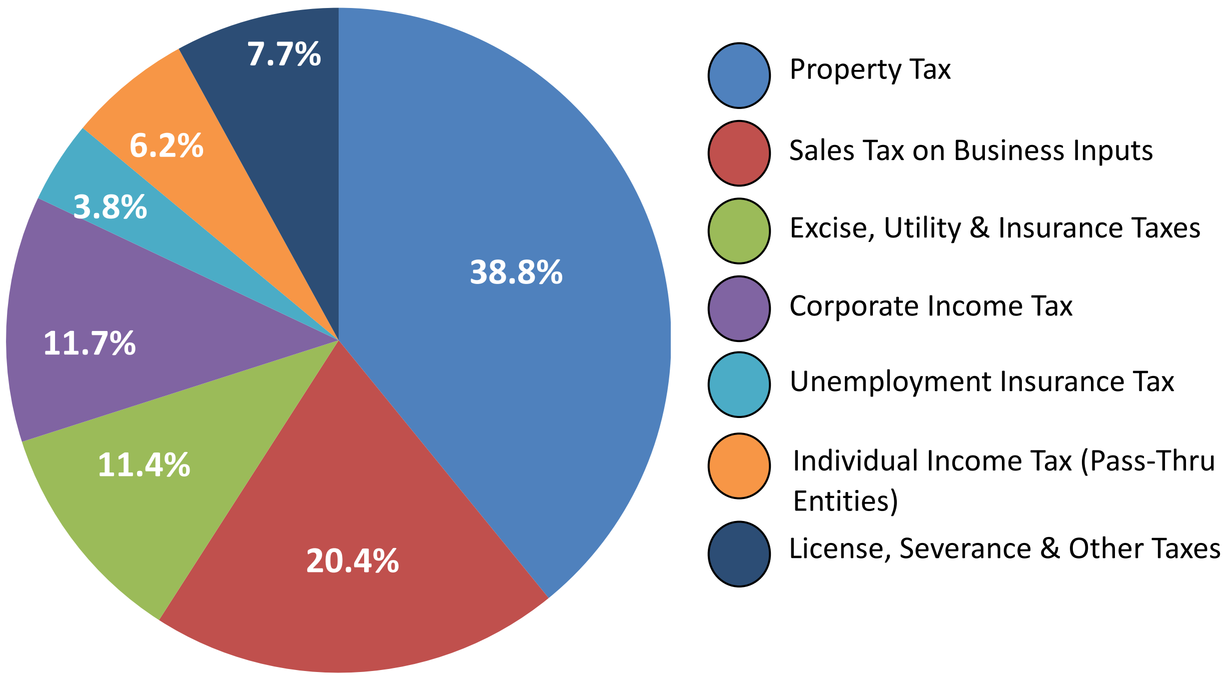
- Cosmetic Surgery Procedures (11/21/22)
- Employer Recruitment Services (12/29/22)
- Lobbying Services (12/19/22)
- Marketing Services (4/27/23)
- Massage Services (12/15/22)
- Parking Services
- Photography and Photo Finishing Services (11/21/22)
- Recreation and Fitness (1/20/23)
- Recreational Vehicles (6/29/23)
- Rental Space (4/23)
- Residential Utility Exemption Changes (12/20/22)
- Sourcing Guidelines (6/29/23)
- Testing Services (4/6/23)

Excise Tax

- Motor Vehicle Rental/Ride Share Excise Tax
- Recreational Vehicles - Clerk and Consumer Guidance (7/11/23)
- Sports Wagering Excise Tax (9/12/23)
- Transient Room Tax

https://taxanswers.ky.gov/Sales-and-Excise-Taxes/Pages/default.aspx

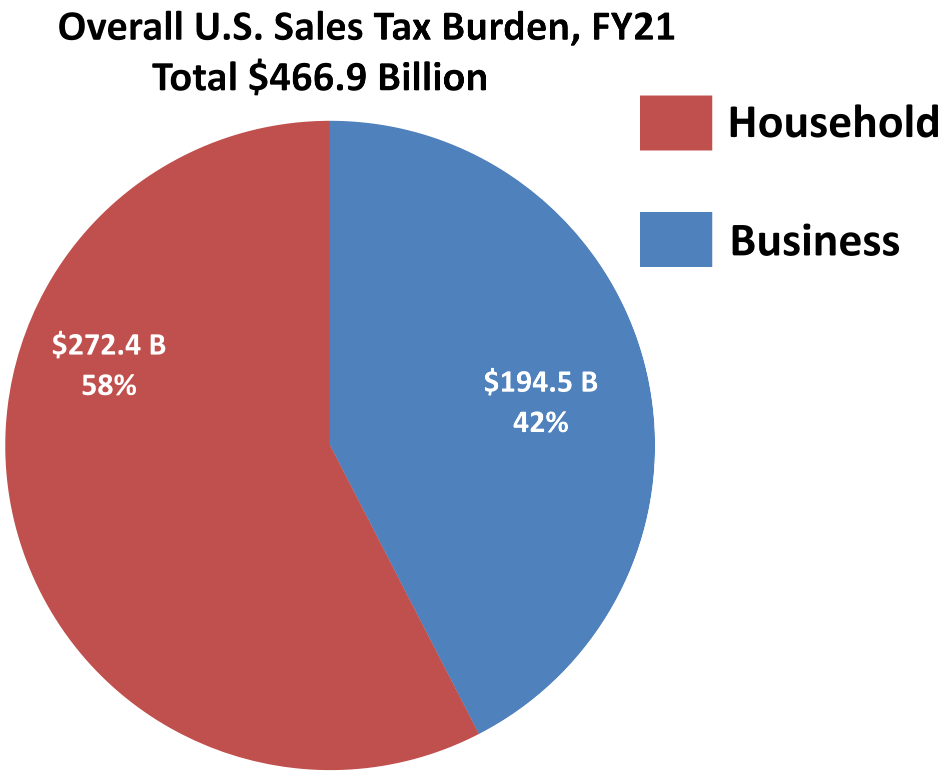
U.S. FY 2021 State and Local Business Tax Burden Study

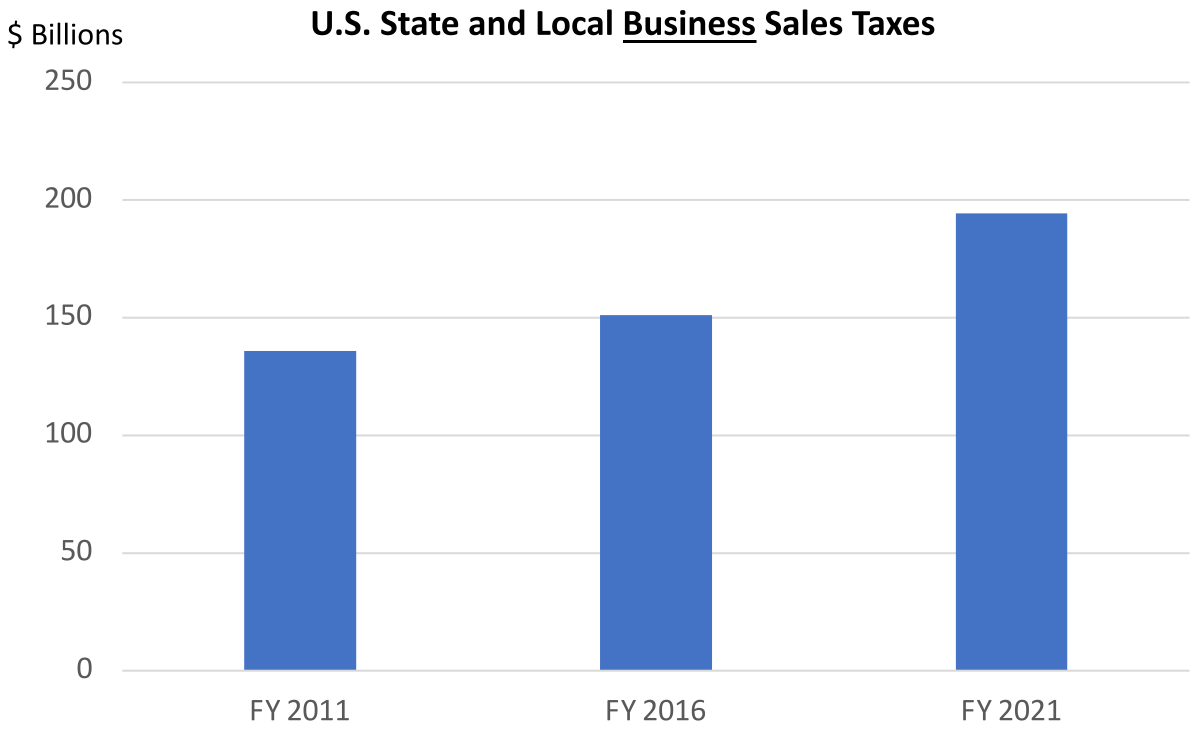


How Much Do Businesses Pay?

- Businesses paid more than $951 Billion in U.S. state and local taxes in FY21, an increase of 13.6% from FY20
- State business taxes increased by 17% and local business taxes grew by 10.2%
- Corporate income tax revenue increased by 53.3% in FY21.
- In FY21, business tax revenue accounted for 43.6% of all state and local tax revenue
- Remarkably, the business share of SALT nationally has been within approximately 1% of 44% since FY03

FY 2021 State and Local Business Tax Burden Study

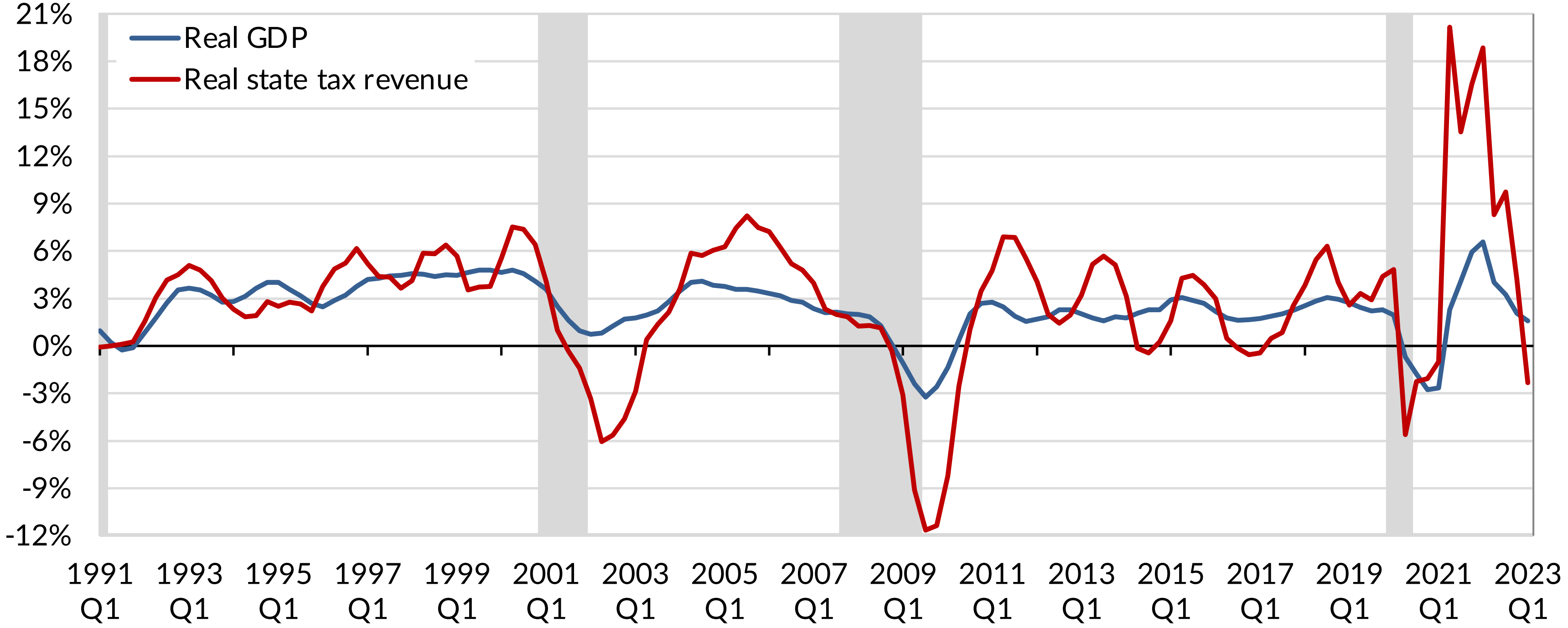




Source: Total State and Local Business Taxes: State-by-State Estimates for Fiscal Year 2021, study prepared by Ernst & Young LLP for the State Tax Research Institute and the Council On State Taxation.

State tax revenues are more volatile than the economy

Year-over-year change in real state taxes and real GDP, 4-quarter moving averages



Source: Tax Policy Center 9/2023

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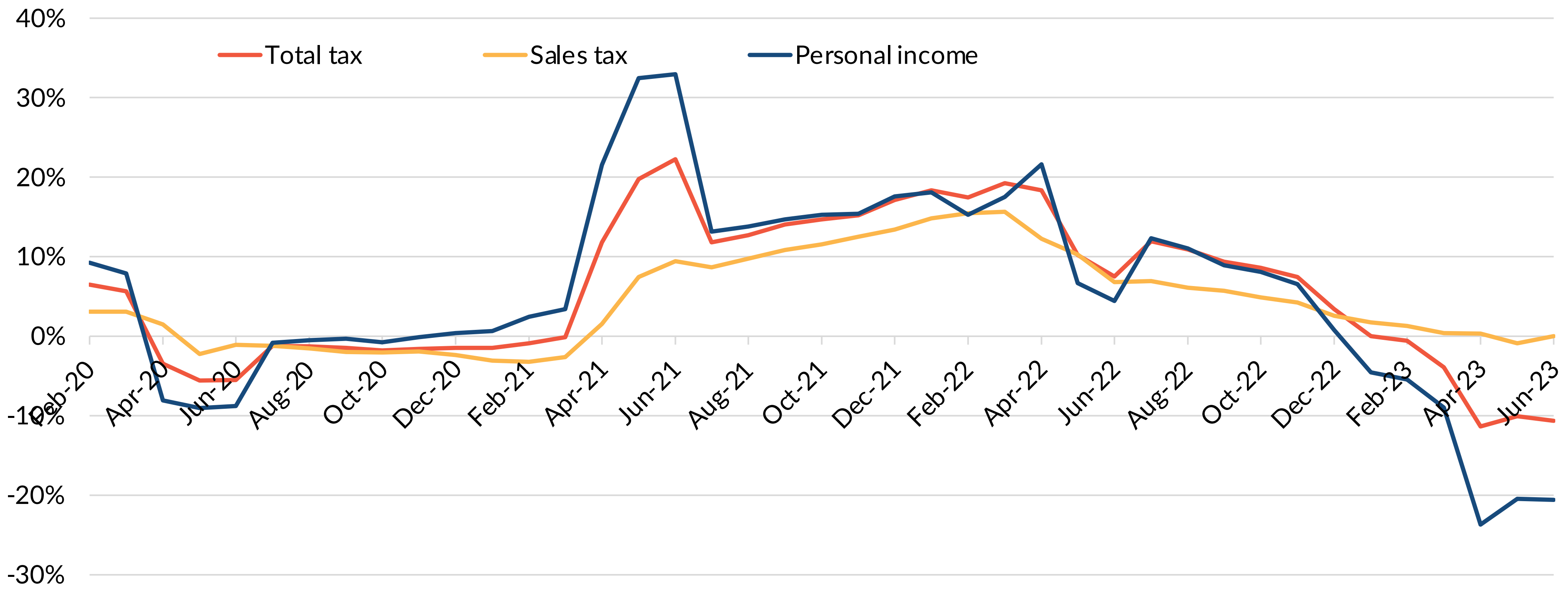
Trends in state tax revenues since the pandemic

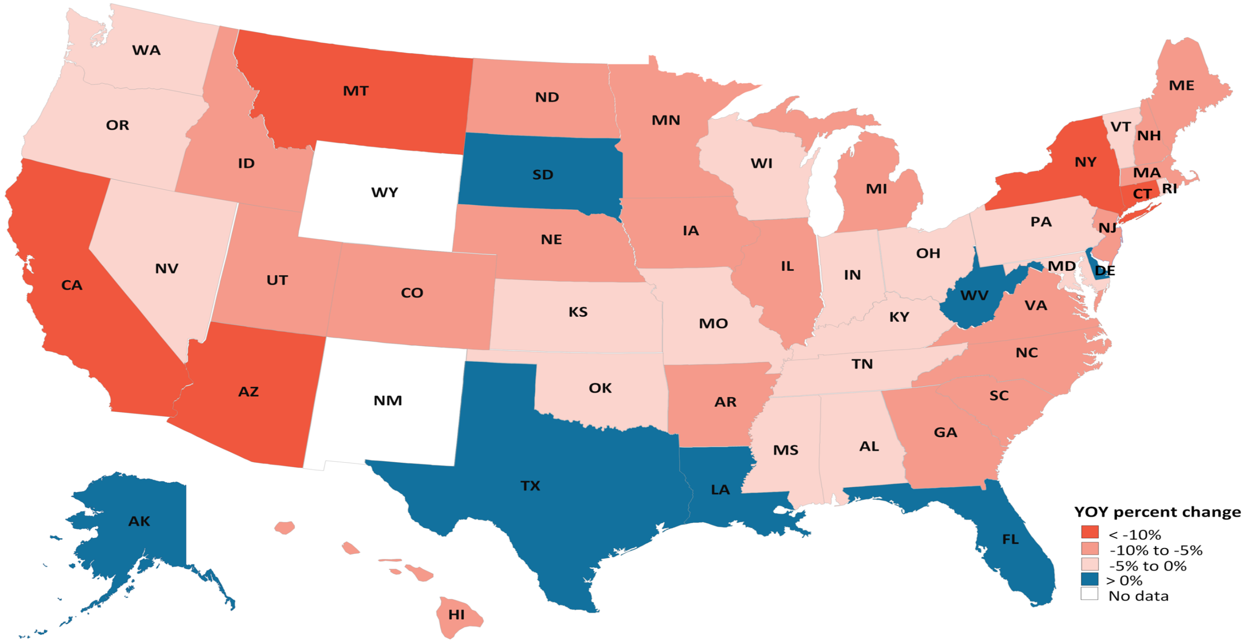


Percent change in inflation-adjusted state tax revenues
Year-over-year percent change, 12-month moving averages

Current trends in total tax revenues: Large variation across states

Percent change in inflation-adjusted state tax revenues

July 2022-June 2023 vs July 2021-June 2022, inflation-adjusted percent change



Notes: Complete data is still not available for New Mexico and Wyoming.
https://www.urban.org/policy-centers/cross-center-initiatives/state-and-local-finance-initiative/projects/state-tax-and-economic-review

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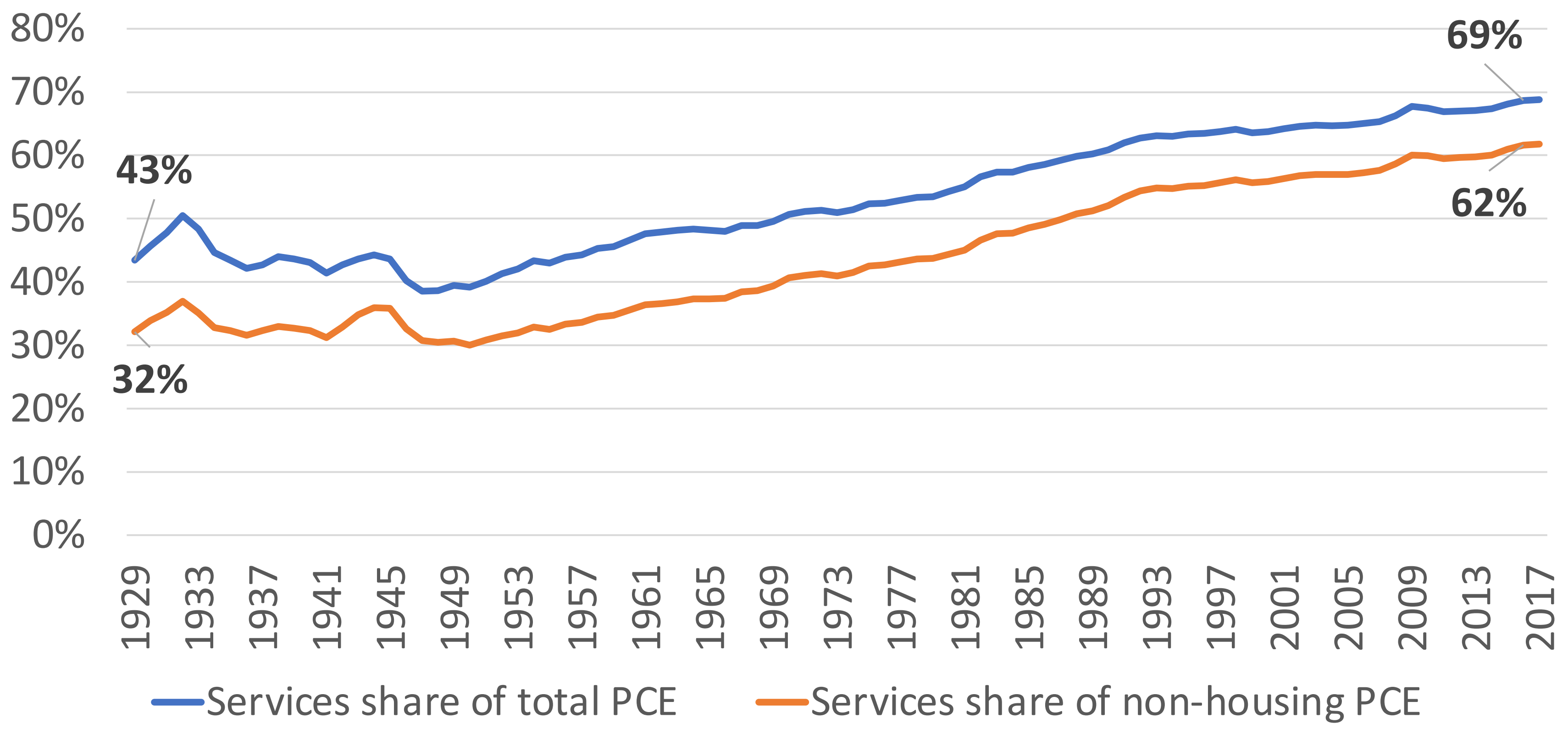
Services as a Share of Total Personal Consumption Expenditures, 1929 – 2017



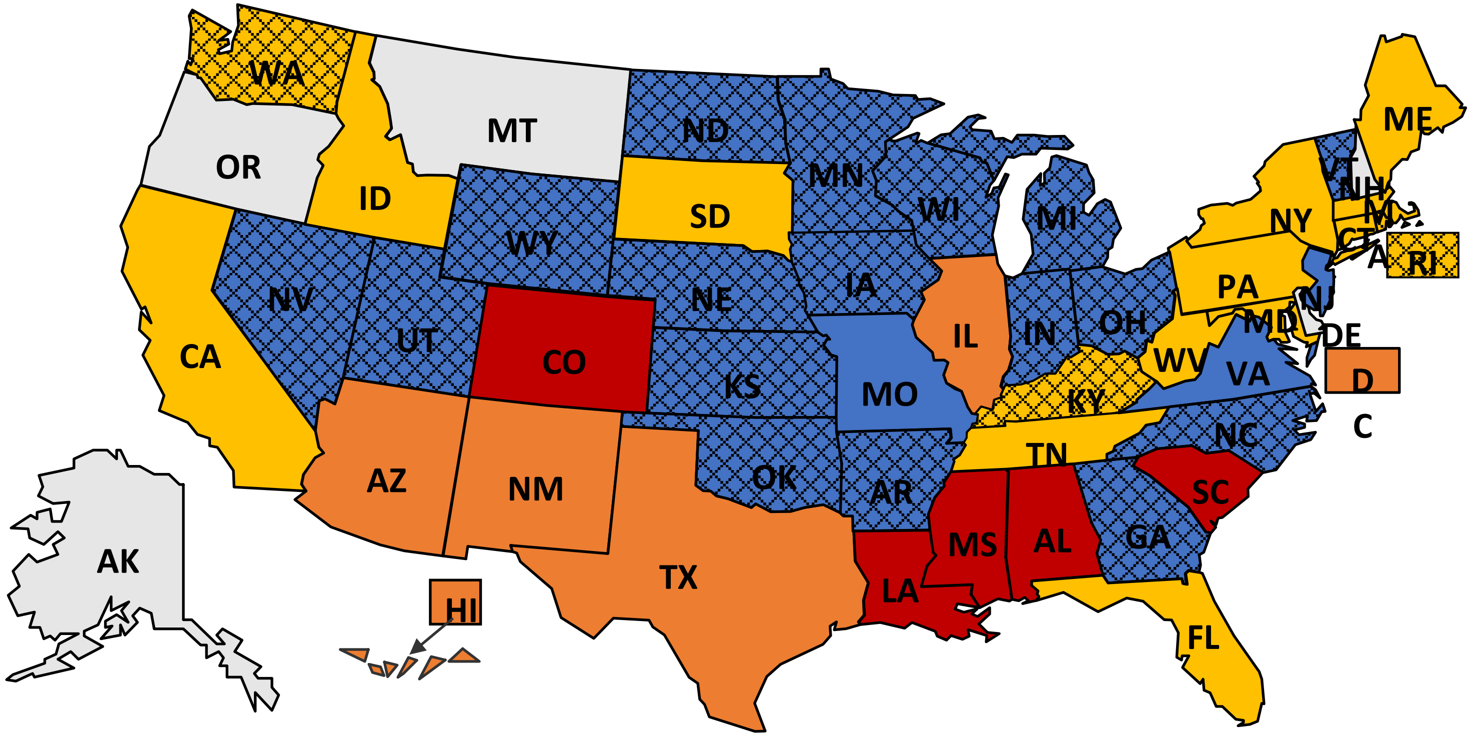
The Impact of Imposing Sales Taxes on Business Inputs, study prepared by Ernst & Young LLP for the State Tax Research Institute and the Council On State Taxation (June 2019)

Will More States Join the SSUTA?
SSUTA States Score Better on COST's Sales Tax Systems Scorecard

State is a full member of the Streamlined Sales and Use Tax Agreement (SSUTA)

Full Member & Associate Member Represent 35.7% of U.S. Population

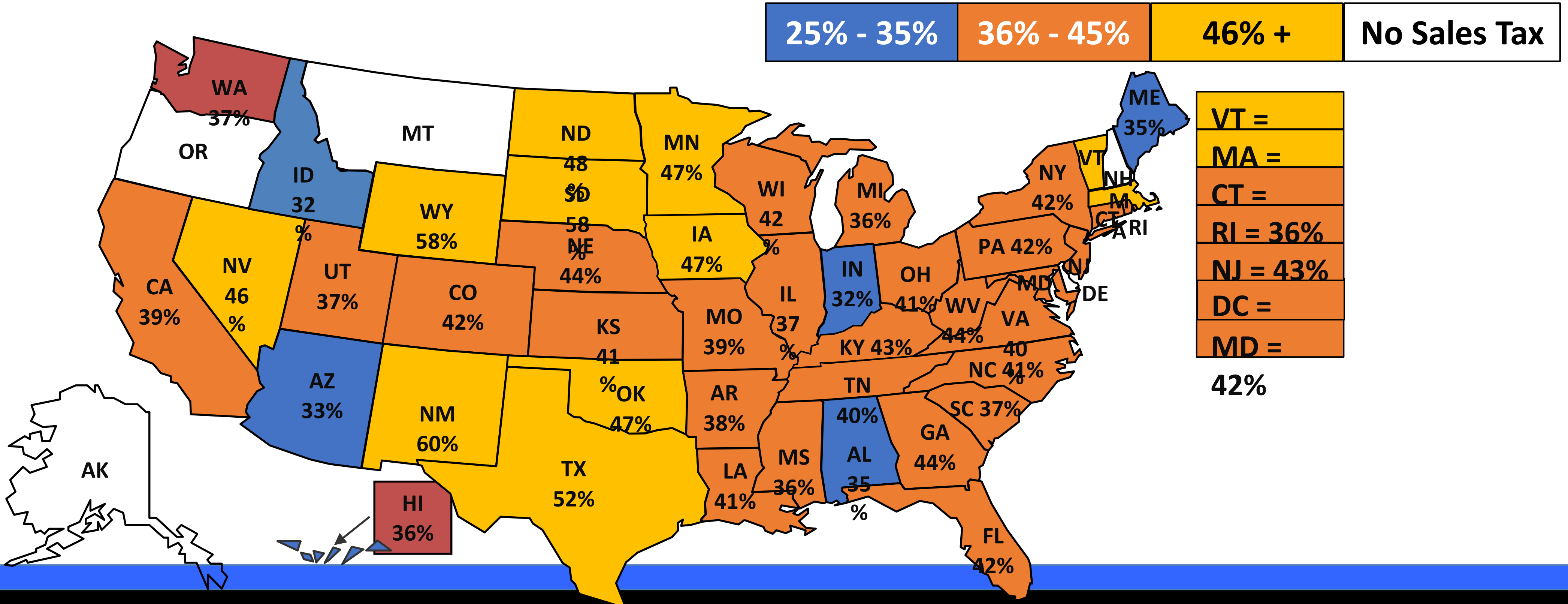
Overall Sales Tax Scorecard Grades					
N/A	0-12	13-20	21-26	27-29	30+
N/A	A	B	C	D	F



Note: Because Alaska has no statewide sales tax, its was not given an overall grade

State and Local Sales Taxes Imposed on Business Inputs

Business Inputs Share of Total Sales Tax Collected

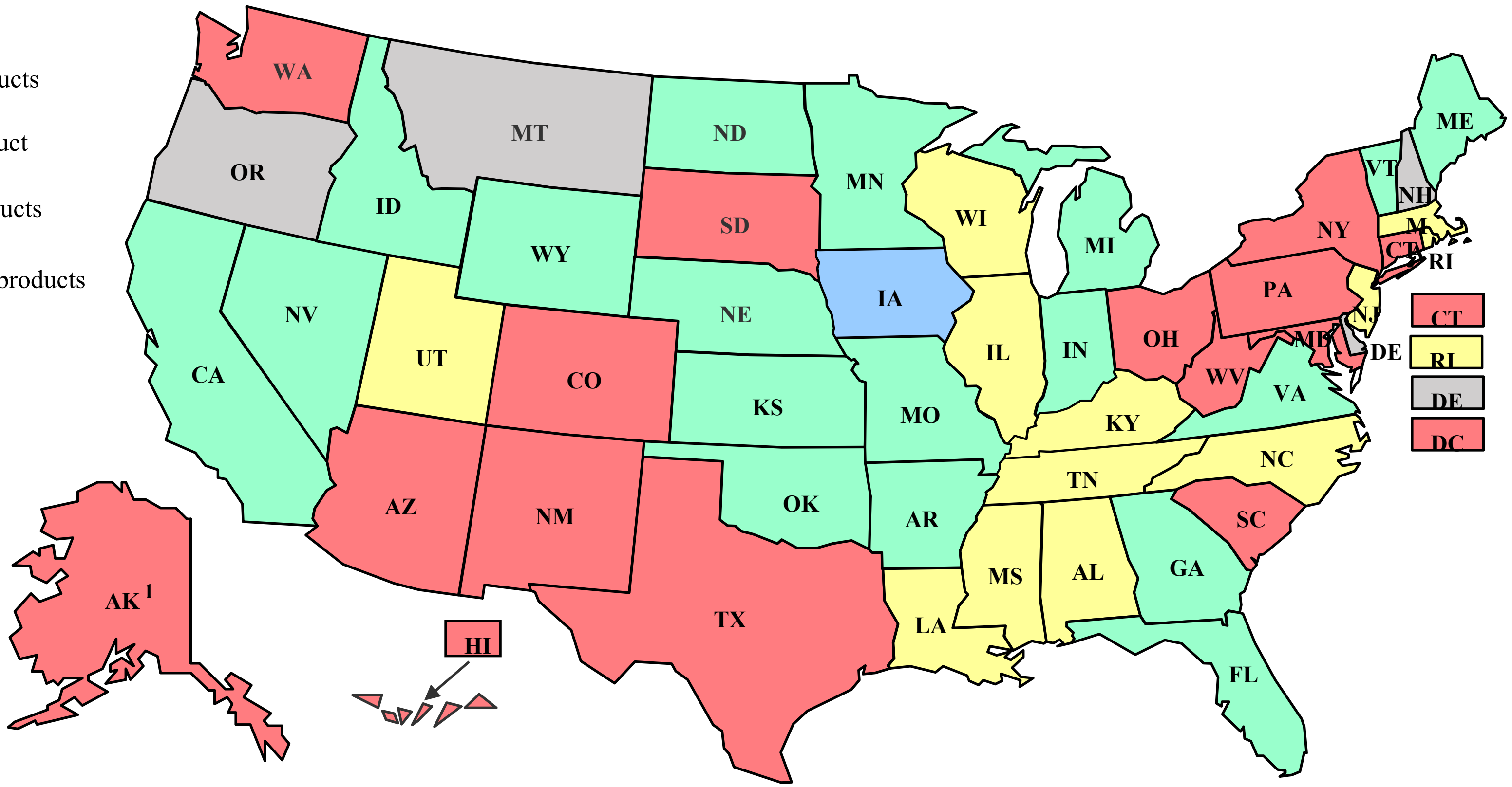


Tax on Business Purchases of Select Software and Digital Products

Three Select Software/Digital Products Tax Types:

- **Software (canned or custom)**
- **Data Processing/Info Services**
- **Software as a Service (SaaS)**

0 select products
1 select product
2 select products
All 3 select products
No sales tax



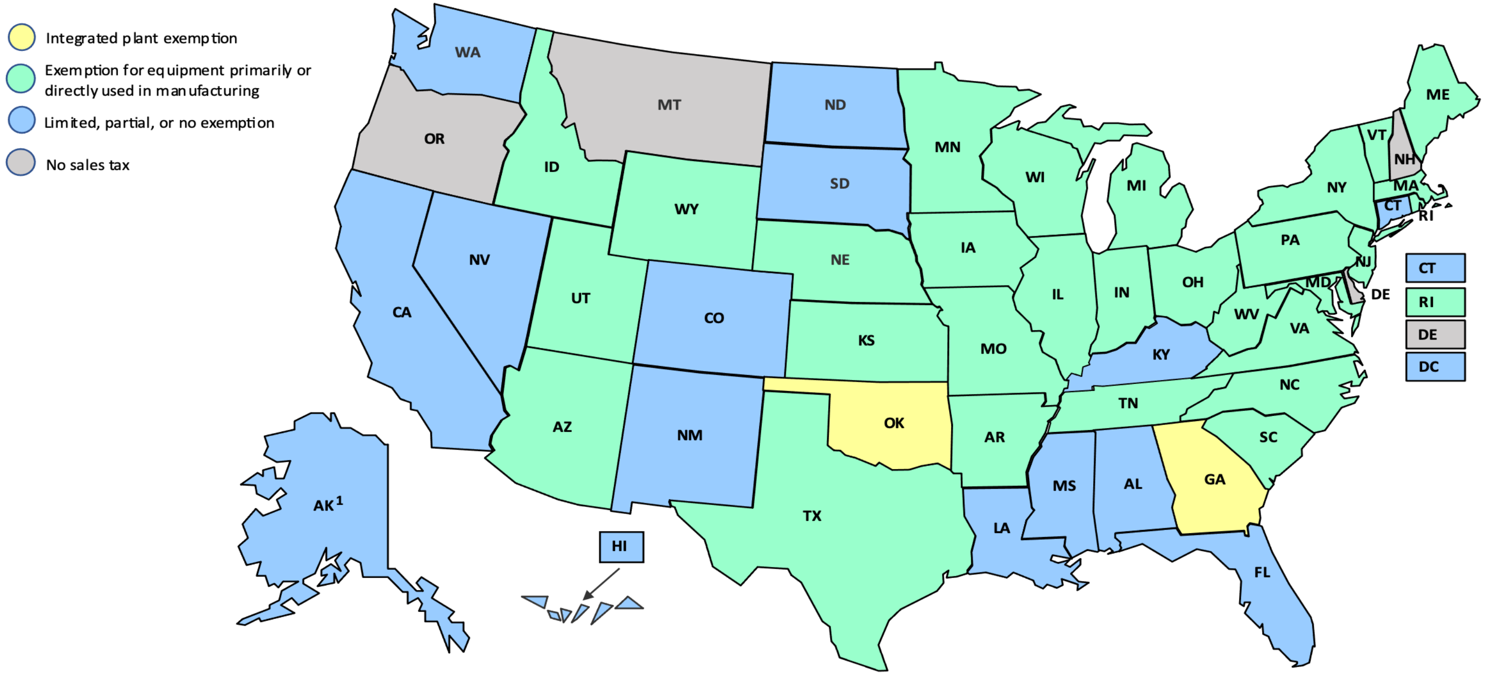
Disclaimer: *This information should be used for general guidance and not relied upon for compliance.*
Source: *Council On State Taxation (COST)*
[1] Data is based on local municipalities since Alaska does not have a state-wide sales tax
[2] Data includes local jurisdictions even if the state's base may not include some of these products

Share of Services Purchased by Businesses and Personal Consumption, 2016

Industry	Business share	Personal consumption share
Administrative and support services	93%	7%
Broadcasting and telecommunications	50%	50%
Computer systems design and related services	100%	0%
Data processing, internet publishing, and other information services	77%	23%
Federal Reserve banks, credit intermediation, and related activities	67%	33%
Food services and drinking places	23%	77%
Insurance carriers and related activities	67%	33%
Legal services	68%	32%
Management of companies and enterprises	100%	0%
Publishing industries, except internet (includes software)	37%	63%
Rental and leasing services and lessors of intangible assets	73%	27%
Securities, commodity contracts, and investments	54%	46%
Waste management and remediation services	78%	22%

Bureau of Economic Analysis, 2016

Breadth of States' Manufacturing Equipment Exemption



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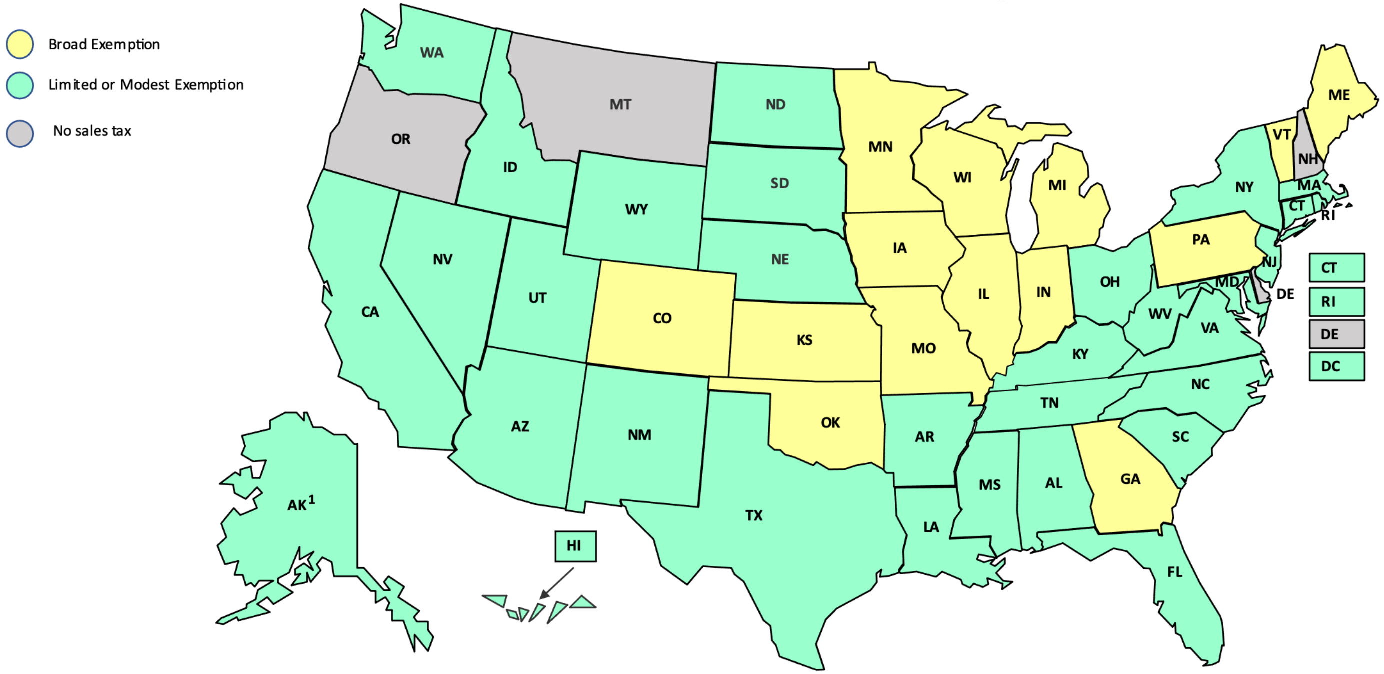
Source: Council On State Taxation (COST)
[1]AK - Data is based on local municipalities since Alaska does not have a state-wide sales tax

Breadth of States' Manufacturing Inputs Exemption



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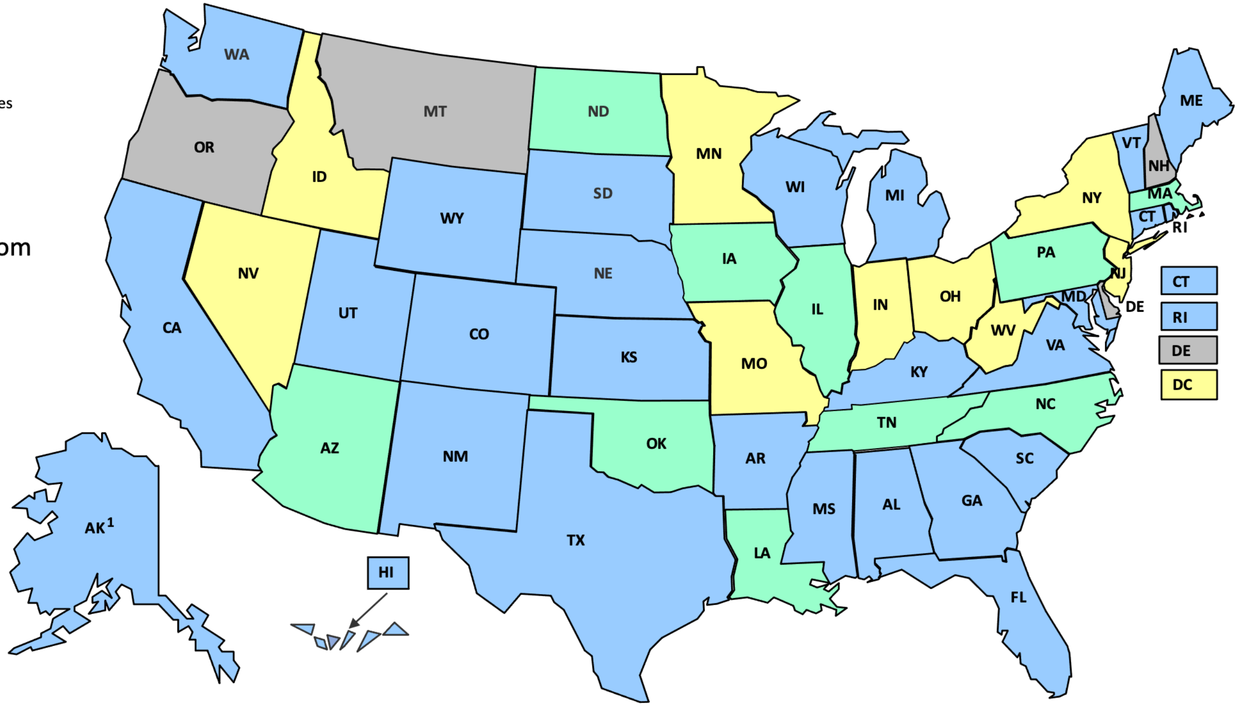
Source: Council On State Taxation (COST)
[1] AK - Data is based on local municipalities since Alaska does not have a state-wide sales tax

Double Taxation (Inputs and Outputs) of Select Services

No double taxation
Double taxes one industry
Double taxes two or three industries
No sales tax

<u>Select Service Industries</u>
- Wired and Wireless Telecom
- Cable
- Electric and Gas



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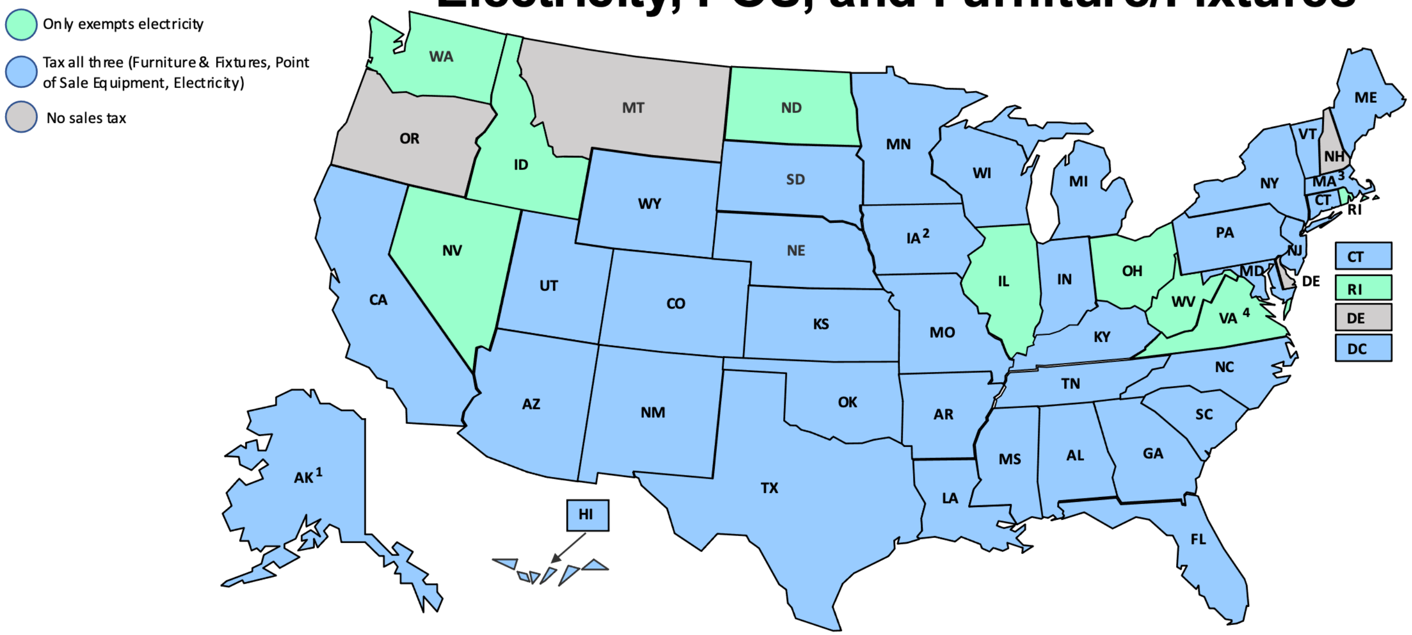
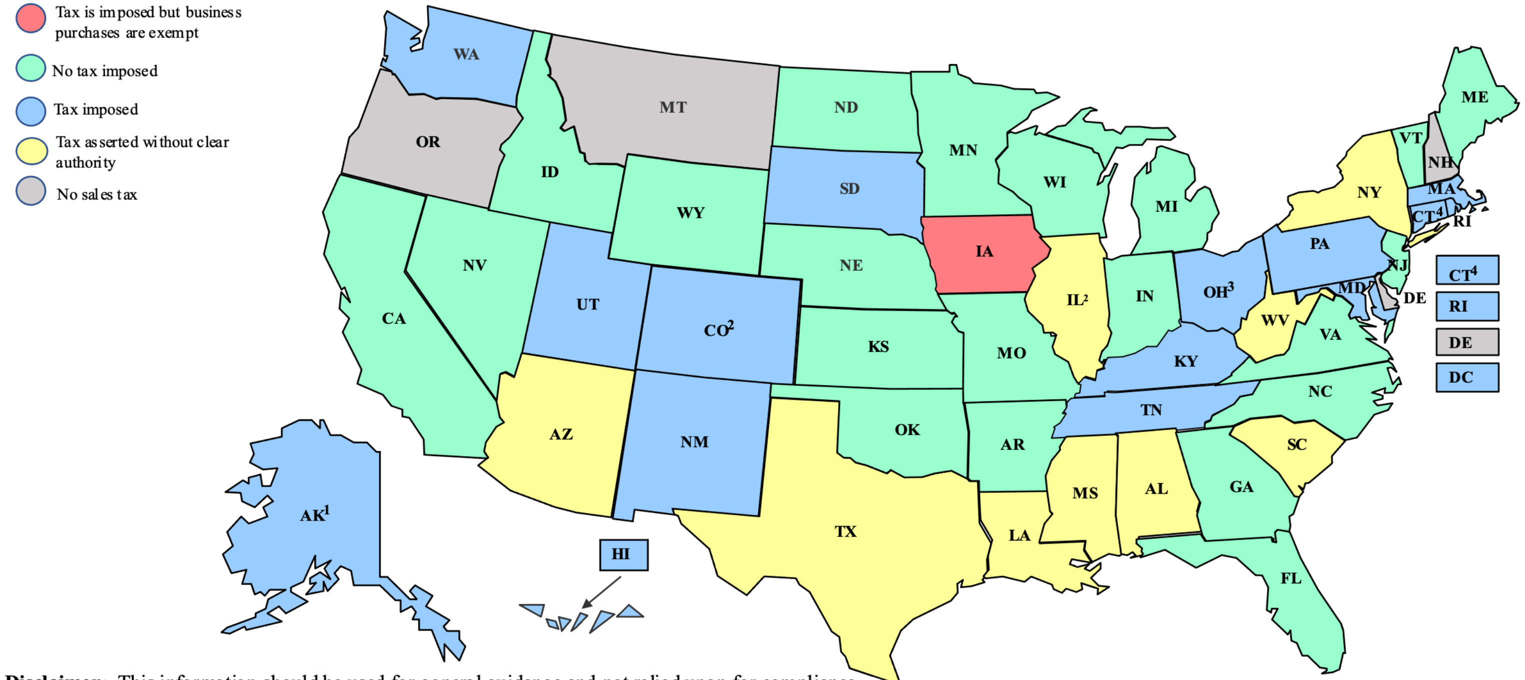
Source: Council On State Taxation (COST)
[1] AK - Data is based on local municipalities since Alaska does not have a state-wide sales tax

Retail Industry Exemptions for Business Purchases of Electricity, POS, and Furniture/Fixtures



Disclaimer*:* This information should be used for general guidance and not relied upon for compliance.
Source: Council On State Taxation (COST)
[1] AK - Data is based on local municipalities since Alaska does not have a state-wide sales tax
[2] IA - Electricity is exempt for restaurants
[3] MA - Electricity may be exempt for certain small businesses
[4] VA - Electricity is subject to separate electricity consumption tax

Tax on Digital Software Accessed Remotely (SaaS)



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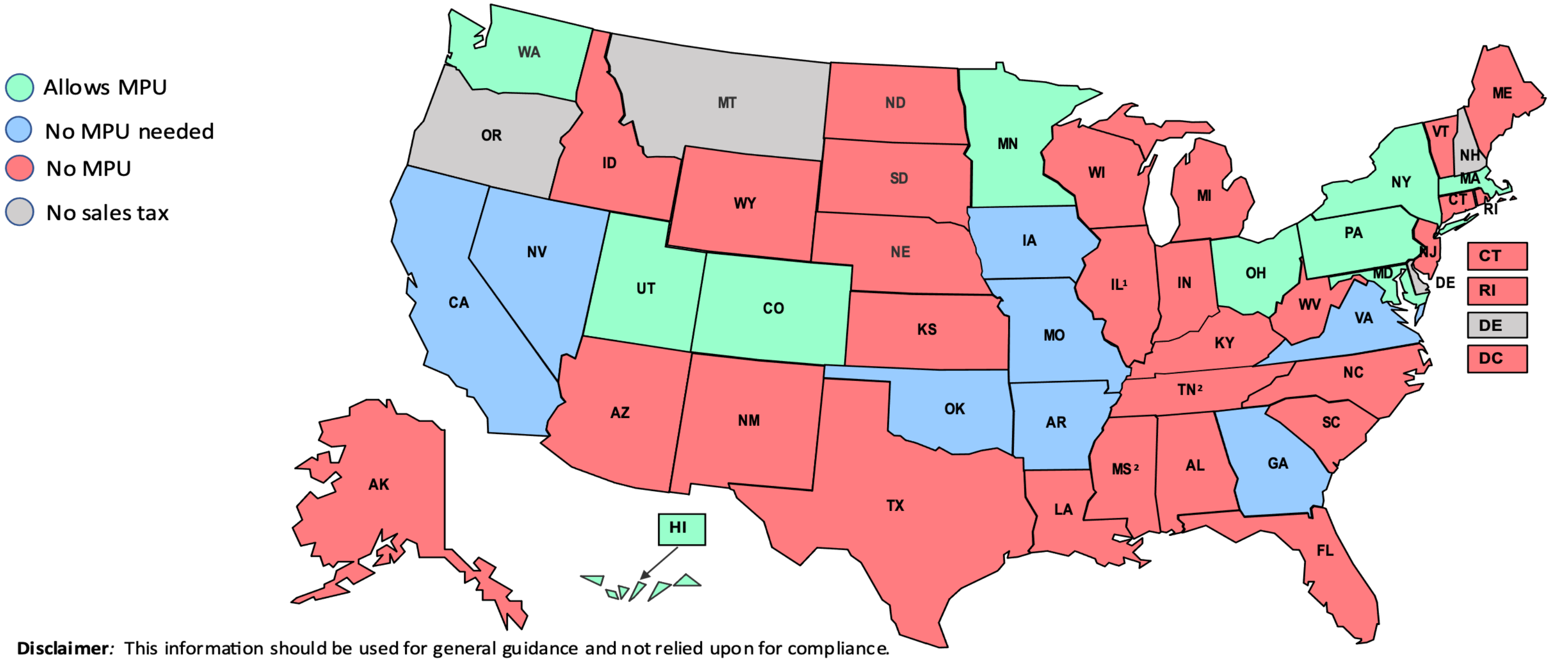
Source: Council On State Taxation (COST)

[1] AK - Data is based on local municipalities since Alaska does not have a state-wide sales tax
[2] CO/IL - State does not impose a tax, but tax may be imposed by some localities
[3] OH - Tax only applies to businesses
[4] CT - Electronically delivered software is taxed at a 1% rate for businesses

Multiple Points of Use (MPU) Apportionment with Digital B2B Purchases



Disclaimer: *This information should be used for general guidance and not relied upon for compliance.*
Source: Council On State Taxation (COST)
[1] IL - MPU allowed in Chicago
[2] TN - MPU is allowed for SaaS.
[3] MS – MPU may be allowed on case-by-case basis