AGRICULTURAL TAX RESOURCE GUIDE

Farm Bureau is a voluntary organization of farm families and their allies dedicated to serving as the voice of agriculture by identifying problems, developing solutions and taking actions which will improve net farm income, achieve better economic opportunities and enhance the quality of life for all.

INTRODUCTION

One of the major agenda items for the 2017 Kentucky General Assembly may be reforming Kentucky's tax code. A strong tax policy is of critical importance to the long-term viability of Kentucky agriculture.

It is important to know how Kentucky's revenue is derived. In FY 2015 Kentucky collected over $9.9 billion in tax revenue. Kentucky's state income tax generated 41% and the sales and use tax generated 33% of this $9.9 billion. All other taxes combined generated 26% of revenue including, property (6%), corporate income (5%), cigarette (2%), limited liability entity tax (2%), coal severance (2%), lottery (2%), and all other taxes (7%).

Each odd numbered year the Office of State Budget Director prepares a tax expenditure report. This report includes tax expenditures for the General Fund and the Road Fund. What are tax expenditures? Tax expenditures are provisions such as special exemptions, exclusions, deductions, credits, deferrals, and preferential rates in tax law that result in a loss of tax revenue. According to this report the grand total of all tax expenditures, excluding Tourism and Tax Increment Financing projects is estimated at $12.1 billion in FY 2016, $12.5 billion in FY 2017, and $13.1 billion in FY 2018. The biggest contributors to these totals are Individual Income Tax $5 billion, Sales and Use Tax $3.1 billion, excluded services $2.3 billion, Property Tax $714 million and agriculture $286 million.

Given the fact that Kentucky collected $9.9 billion in taxes in FY 2015 and the projected tax expenditures for FY 2016 is $12.1 billion, Kentucky's current tax code exempts more taxes than it actually collects.

The General Assembly will consider many different options during their tax reform discussion. They will more than likely consider items that are currently exempt from taxation, currently not being taxed such as services, and look at current deductions, exclusions and/or preferential tax rates.

PURPOSE

The purpose of this tax resource guide is to equip our membership with the information needed to discuss the importance of strong tax policy with members of the Kentucky General Assembly. To remain viable Kentucky agriculture must maintain the current sales and use tax exemptions as well as the provision of HB 44 as passed in 1979.

SALES AND USE TAX

The sales and use tax was first levied in its current form in 1960. The tax is collected on retail sales within the state, at a rate of 6 percent of the sales price. The use tax is imposed on the storage, use or other consumption of tangible property. For FY 2015, this tax generated $3.267 billion. Tax expenditures are estimated at $3.189 billion for FY 2016.

Currently, there are a number of tax exemptions for those involved in production agriculture in KRS 139.480. It is critical that we communicate to General Assembly members the importance of maintaining these exemptions. Below are a few key talking points:

- Each of Kentucky's seven surrounding states has laws that exempt agricultural inputs from their state sales tax.
- Removing Kentucky's current sales tax exemption would put Kentucky farmers at a competitive disadvantage.
- Would devastate farm equipment dealers.
- Farmers are unable to pass increased cost of production onto the market place.

While most agricultural inputs are exempt in Kentucky, when tax reform is considered by the Kentucky General Assembly it will provide an opportunity to exempt other agricultural inputs from Kentucky's sales and use tax. These items include:

- All inputs associated with equine farms;
- Livestock vaccines and medicine;
- Electricity, LP gas and natural gas;
- Sawdust and wood shavings utilized for poultry bedding;
- Trailers

KENTUCKY FARM BUREAU POLICY

- *We believe that a broad-base sales and use tax is the fairest plan for financing government, while maintaining current agricultural exemptions for all taxing jurisdictions.*
- *Agriculture cannot pass along its increases in production expenses; therefore to keep our agriculture community viable, we need to keep our Kentucky agriculture sales tax exemption intact.*
- *We recommend that all farm production items including veterinary medicine and vaccines, electricity, sawdust and wood shavings, all livestock and poultry bedding, LP gas, and natural gas be exempt from sales and use tax.*
- *We recommend removing the sales tax on bumper trailers for agricultural use.*

PROPERTY TAX

Kentucky has levied a property tax since becoming a Commonwealth on June 1, 1792. Property is assessed at its fair market value; rates vary depending upon the type of property. For FY 2015, property taxes generated $563.4 million. Tax expenditures are estimated at $714.3 million for FY 2016.

In 1979, the Kentucky General Assembly passed HB 44 (KRS 132) which limits the amount of revenue the state can collect on annual real property taxes. Prior to the passage of HB 44, the state tax rate on real property was 31.5 cents for every $100 of assessed value. Since 1979, this rate has dropped to its current rate of 12.2 cents per $100 of assessed value. Although the tax rate has dropped over the years, the state continues to collect more tax revenue each year due to the increase of property values.

There has been legislation filed to freeze the state real property tax rate. Freezing the real property tax rate would allow property tax bills to rise beyond 4 percent per year.

- Freezing the states real property tax rate would be a tax increase.
- An increase in property tax is an increase tax on every citizen that owns property, not just agricultural land owners.

KENTUCKY FARM BUREAU POLICY

- *We strongly oppose freezing the state real property tax rate.*
- *We recommend that local officials' authority to increase revenue from property taxes be confined to 4 percent plus new growth. Any proposal to increase revenue more than that formula should automatically be decided by a voter referendum.*

AGRICULTURAL LAND ASSESSMENT

In 1969 the citizens of Kentucky voted on a referendum to change Section 172 of the constitution to grant the Kentucky Agricultural Land Assessment. The constitution allows agriculture and horticulture land to be assessed for taxation at its value for agricultural or horticulture use.

This is important because as land is taken from agriculture and put into residential and/or commercial development the overall assessment may go up dramatically. This assessment assures those that still want to farm can do so without being taxed unfairly simply because the area surrounding their farm is being developed.

Surrounding states' real property taxes vary greatly as do their agricultural land assessments.

KENTUCKY FARM BUREAU POLICY

- *We urge the Department of Revenue and county assessing authorities to comply with the principles of the Farmland Assessment Amendment and use new technology such as Global Positioning Systems (GPS) to obtain the most accurate surveying information.*

DEATH TAXES

First adopted in 1906, the inheritance tax is assessed against the value transferred from the estates of deceased Kentuckians. The tax rate and the amount subject to tax are based on the "class" of the beneficiary. For FY 2015, the inheritance tax generated $51 million, but the estate tax has been all but eliminated due to a federal law that disallowed the deduction for state estate taxes paid. Tax expenditures for this tax are estimated at $68.1 million for FY 2016.

Inheritance Tax: The Kentucky inheritance tax is a tax on a beneficiary's right to receive property from a decedent's estate; both the tax and exemptions are based on the relationship of the beneficiary to the decedent. All property belonging to a resident of Kentucky is subject to the tax except for real estate located in another state. Also, real estate and personal property located in Kentucky and owned by a nonresident is subject to being taxed.

If the inheritance tax is paid within nine months of the date of decedent's death, a 5 percent discount is allowed. However, if the beneficiary's net inheritance tax liability exceeds $5,000 and the return is filed timely, an election can be made to pay the tax in 10 equal annual installments. The first installment is due at the time the return is filed. The portion of the tax deferred is charged with interest at the rate established by law beginning 18 months after the date of death.

There are three classes of beneficiaries: Class A, Class B, and Class C.

Class A beneficiaries include: surviving spouse, parent, child, grandchild, brother, sister, half-brother, and half-sister. If the date of death is after June 30, 1998, all Class A beneficiaries are exempt from paying Kentucky inheritance tax.

Class B beneficiaries include: niece, nephew, half-niece, half-nephew, daughter-in-law, son-in-law, aunt, uncle, and great-grandchild. Class B beneficiaries receive a $1,000 exemption and the tax rate is 4 percent to 16 percent.

Class C beneficiaries include: all persons not included in Class A or Class B. Cousins are considered Class C beneficiaries. Class C beneficiaries receive a $500 exemption and the tax rate is 6 percent to 16 percent.

Estate Tax: The estate tax was enacted in 1936. This tax has seen several significant changes through the years. Since January 1, 2005, there has been no Kentucky estate tax. The American Taxpayer Relief Act was signed into law on January 2, 2013 and permanently extends the deduction for state estate taxes on the Federal Form 706. Before 2005, a credit was allowed against the federal estate tax for state estate, inheritance, legacy, or succession taxes.

The estate tax or "pick up tax" is a tax on the estate equal to the amount by which the credit for state death taxes allowable under the Federal estate tax law exceeds the Kentucky inheritance tax. The Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) repealed the state death tax credit for decedents dying after 2004 and replaced the credit with a deduction. Since state death taxes are no longer treated as a credit for federal estate taxes, there is no Kentucky estate tax.

KENTUCKY FARM BUREAU POLICY

- *We support the permanent repeal of Kentucky's estate and inheritance tax.*

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