KyPolicy
KENTUCKY CENTER FOR ECONOMIC POLICY
433 Chestnut Street Berea, KY 40403
859-756-4605 | www.kypolicy.org

March 17, 2021

Dear Governor Beshear:

I am writing to respectfully urge you to veto several pieces of recently-passed legislation — as well as prospective legislation that may arrive at your desk after the session's final two days — that would give away hundreds of millions of dollars in tax breaks from Kentucky's budget. These tax breaks will take money from schools, health, infrastructure and other vital public services and were passed without adequate public discussion or evidence of cost effectiveness. In addition, because of a provision of the American Rescue Plan, they put Kentucky at considerable risk of having to return aid money to the federal government that Kentucky so desperately needs in midst of a worldwide pandemic and historic recession.

Allowing hundreds of millions in tax breaks to become law puts Kentucky at considerable risk of owing back federal aid funds

The American Rescue Plan Act (ARPA) contains a strict provision against directly or indirectly using the $2.4 billion in aid Kentucky is set to receive for tax cuts. Specifically, the language for the State and Local Coronavirus Fiscal Recovery Funds says:

A State or territory shall not use the funds provided under this section or transferred pursuant to section 603(c)(4) [note: this refers to CARES Act funds] to either directly or indirectly offset a reduction in the net tax revenue of such State or territory resulting from a change in law, regulation, or administrative interpretation during the covered period that reduces any tax (by providing for a reduction in a rate, a rebate, a deduction, a credit, or otherwise) or delays the imposition of any tax or tax increase.

In the case of a violation, "the amount a state shall be required to repay shall be the lesser of—(1) the amount of the applicable reduction in net tax revenue attributable to such a violation; and (2) the amount of funds received by such State or territory" through ARPA or the CARES Act. Thus, passing net tax cuts will result in a state being forced to repay an equivalent amount of federal aid.

The state must certify a plan for use of the relief funds that complies with this restriction, and must provide periodic reports on use of the aid dollars as well as "all modifications to the State's or territory's tax revenue sources during the covered period." The "covered period" in the legislation has already begun — it started March 3, 2021 and ends when all the funds are spent or by December 31, 2024, whichever comes first. That means the tax cuts and tax credits from the 2021 Kentucky General Assembly described below would fall in the covered period.

Especially since Treasury has not yet issued guidance on how this provision will be interpreted in specific cases, it is prudent for Kentucky to avoid putting itself at risk of losing federal funds. Many states are pausing action on any tax changes until the specific rules of the provision and its implications are made clear. Just as we should exercise caution in deciding how to use the $2.4 billion in direct aid the state will receive before federal guidance is available, we should also exercise caution and avoid the enactment of tax cuts, credits and reductions that may reduce the funds available.

Kentucky's needs are tremendous due to the pandemic. Recent Census data show 1 in 8 parents say their kids aren't getting enough to eat because they can't afford it and 1 in 5 renters are behind on rent payments. Over 100,000 fewer Kentuckians are employed today than a year ago before the pandemic hit. We cannot afford to put at risk a single dollar of the $2.4 billion in aid that could otherwise help to meet Kentucky's many needs and prepare us for a more robust recovery.

KyPolicy
KENTUCKY CENTER FOR ECONOMIC POLICY
433 Chestnut Street Berea, KY 40403
859-756-4605 | www.kypolicy.org

Specific provisions of tax break legislation are highly problematic and expensive

In addition to the risk of forcing Kentucky to pay back federal aid, the specific new tax provisions that passed the General Assembly or that may pass in the final days are problematic in their own right. Specific bills we urge you to veto are as follows:

House Bill 249

HB 249 contains more than $175 million in tax breaks through large expansions of the film tax credit and the historic preservation tax credit. Neither of this expansions have a sunset date, meaning their annual cost of $175 million will exist in perpetuity, are very likely to be reached because the credits are refundable, and come "off the top" of the state budget before any money is allocated to schools or other public services.

HB 249 brings back the refundability of Kentucky's film tax credit at a cost of $75 million a year. The state had suspended its film tax credit and made it nonrefundable just a few years ago because of its ballooning costs. A refundable tax credit functions like a grant, because if a company has no state tax liability — as is often the case with out-of-state corporations — the Department of Revenue cuts them a check. In this program Kentucky would be paying movie and TV producers 30%-35% of their cost of production, and taking those tax dollars from the state's other needs.

Thirteen states have eliminated their film tax credits in recent years because of the overwhelming evidence such programs are not cost-effective. The jobs created for residents tend to be short-term, part-time and low wage; credits are often awarded to producers who would film in-state without the benefit; and their enormous costs do not come close to outweighing any benefit. Please see a comprehensive review of the literature of film tax credits here. The author of a recent study here concluded the states using these incentives "are not getting the return taxpayers deserve, pure and simple." Our analysis here provides more information.

HB 249 also dramatically expands the "historic preservation" tax break from a cap of $5 million a year to $100 million a year. This tax break is also refundable and thus provides the equivalent of a grant of 20%-30% of developers' costs in restoring property. There has been no evidence presented of this program's effectiveness, yet HB 249 expands the cost of the program twenty-fold. There is also a special tax credit to help offset $30 million of the cost of renovating the Seelbach Hotel, making the bill special legislation otherwise disallowed in the Kentucky Constitution through the tax code.

House Bill 230 and Senate Bill 255

HB 230 and SB 255 provide new tax breaks to cryptocurrency mining companies. These operations employ very few people while using massive amounts of energy, straining energy systems and potentially forcing expensive capacity upgrades that result in rate increases for consumers. They are also highly speculative and volatile financial operations with potentially short lifespans and little hope of sustainability for the few jobs involved.

Kentucky already has cryptocurrency operations in the state without these additional tax breaks, and no case was made as to why these are needed. HB 230 provides a sales tax exemption that would be far more generous than the one that already exists for energy-intensive manufacturers that employ far more people.

House Bill 413

433 Chestnut Street Berea, KY 40403
859-756-4605 | www.kypolicy.org

HB 413 would delay increases in the unemployment tax schedule and the taxable wage base that would otherwise go into effect for 2021 and 2022. This legislation has been presented as a business relief measure, but it will simply add more costs later. It provides the biggest benefit to the state's largest employers like Amazon that have actually expanded employment during the pandemic, rather than helping those struggling businesses that have laid off employees and would thus be paying less in unemployment taxes anyway.

The scheduled increases in unemployment taxes are small, amounting to 0.32% of total wages on average or 0.05% of average business sales, and the increase in the taxable wage base amounts to approximately $5 per employee per year. It is unlikely such changes would make or break a business, and delaying the increases would just mean higher payments later. Businesses have largely already collected their 2021 taxes through payroll deductions because the taxable wage base applies to the initial dollars earned in a calendar year, and suspending the tax increase for 2022 is premature given the expectations of a strong economy by that time. Our full analysis of HB 413 is here.

HB 413 may be especially problematic in regard to the ARPA provision because of the possibility of the state using ARPA funds to put into the trust fund and help pay down the federal loan, which also results in tax relief. In combination with HB 413, that means federal funds would be used to directly pay for tax reductions.

House Bill 563

HB 563 shifts $25 million a year from the state budget to unaccountable private entities to fund private schools and related services. Wealthy donors, who can actually profit off their donations of up to $1 million a year due to avoided capital gains taxes, would essentially be able to steer those public dollars to the communities, schools and type of students that they wish. Private school choice exists already, and nonprofit schools are already subsidized through their tax exemption. We shouldn't provide additional direct subsidies to these schools, which lack the same legal mandate to serve all students no matter where they live, and that often fail to protect students from discrimination based on special needs, LGBTQ status, race, religion, English language ability, and other differences. See our analysis of HB 563 here.

House Bill 372 (not yet passed)

Although HB 372 has not yet passed, we have concerns that it may yet move through the legislature in the final two days. HB 372 has a problematic "data center" tax break that would cost $15 million a year. In addition, it contains a last minute, poorly designed and enormously expensive tax break for at-home workers that would be a windfall for those who do not need for it for doing what they are doing already.

The bill would provide an income tax credit of up to $15,000 over 5 years for people who work at home for an out-of-state company in addition to a potential credit for property taxes paid. This credit will go overwhelmingly to people who are already living in Kentucky and already working from home — and remote work has increased dramatically during the pandemic. Especially as a state with much of its population at its borders, HB 372 could subsidize many of the 124,000 Kentucky workers who already have an out-of-state job for continuing to work at home. There are no minimum hours a week of remote work to qualify for the credit, nor a requirement that the credit offset the income tax from the remote job. It even creates a perverse incentive for in-state companies to move across the border, such as from northern Kentucky to Cincinnati, in order to increase their employees' tax benefits. It also puts Kentucky employers competing for the same employees at a disadvantage because they will have to pay significantly more than an out of state company to make up for the tax credits.

KyPolicy
KENTUCKY CENTER FOR ECONOMIC POLICY

433 Chestnut Street Berea, KY 40403
859-756-4605 | www.kypolicy.org

Because the tax break is designed as an income tax credit, it will not be available to people below the poverty line and will be largest for those who make more than $100,000 a year (the only people who make enough to qualify for the full $5,000 credit). The portion of the income tax credit refunding the property tax will be worth the most for those with the biggest and most valuable houses, and is totally unavailable for people who rent. This tax break will also only go to professionals whose jobs allow them to work at home. Essential workers including nurses and home care workers, retail and restaurant workers, and Kentuckians in other low-wage service jobs will be ineligible for the tax break. That latter group is disproportionately made up of workers of color and women.

We urge you to protect Kentucky's budget and take the fiscally responsible and prudent course in light of the American Rescue Plan and veto HB 249, HB 230, SB 255, HB 413, HB 563, and HB 372 (if needed).

Thank you for your consideration.

Sincerely,

Jason Bailey

Jason Bailey
Executive Director