Kentucky

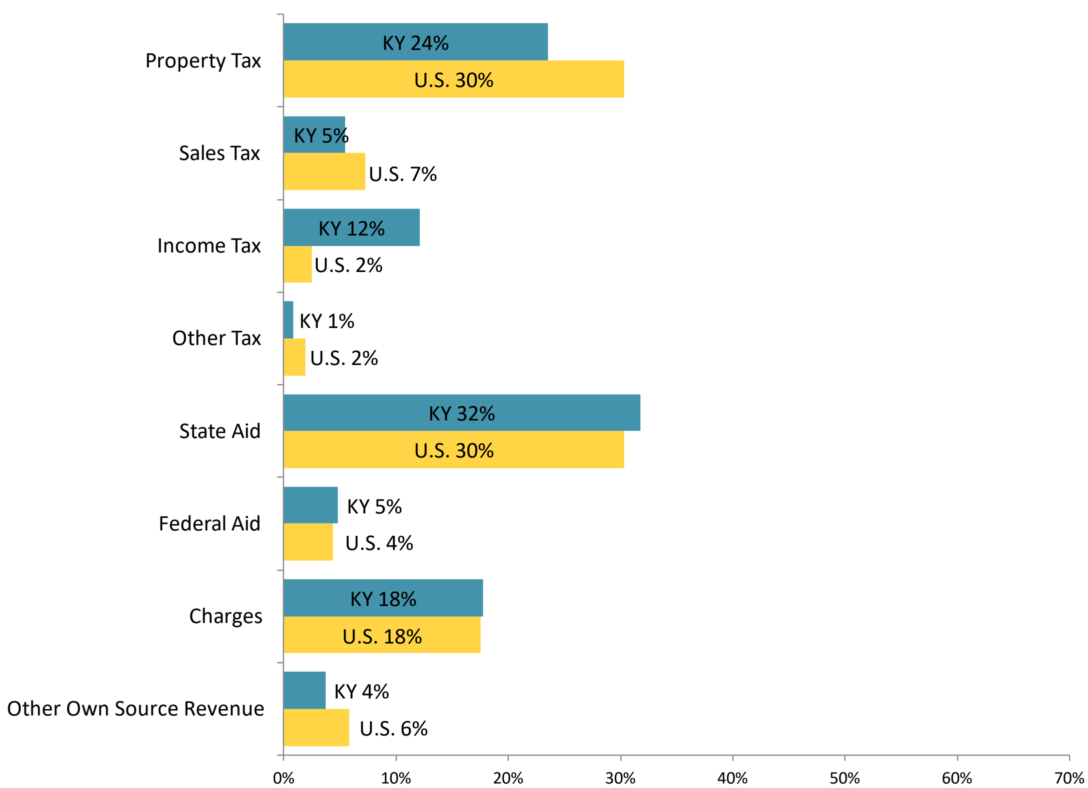
Highlights

Kentucky has a highly centralized system of government. Kentucky localities are less reliant on the property tax than localities in many other states (figure KY-1) because some cities are allowed to levy occupational license taxes and because property taxes are highly regulated. Occupational license taxes are also called occupational income taxes and are generally classified as local income taxes by the U.S. Census Bureau (CBER 2023, 256).

The state taxes personal property and relies more heavily on personal property taxation than do most other states. Kentucky is one of nine states still taxing most business inventories, though in 2018 it enacted an inventory tax credit which provides a credit equal to 100 percent of qualifying inventory taxes (Cammenga 2021; Kentucky Department of Revenue, Inventory Tax Credit).

The Commonwealth of Kentucky uses a detailed system of property tax classification with over 20 different classes of property. Ten of those property classes are taxed by local governments (Significant Features of the Property Tax).

Figure KY-1
Sources of Local General Revenue, Kentucky and U.S., 2020



Source: U.S. Census via Significant Features of the Property Tax

Property Tax Reliance

Kentucky ranks among the lowest 10 states in terms of per capita property taxes, property tax as a percentage of personal income, and as a percentage of state and local revenue (table KY-1).

Table KY-1
Selected Kentucky Property Tax Statistics, 2020[1]

	Kentucky	U.S. Average	Rank (of 51) *1 is highest*
Per capita property tax	$908	$1,810	*46*
Property tax percentage of personal income	1.9%	3.1%	*45*
Total property tax as percentage of state-local revenue	9.2%	16.6%	*46*
Median owner-occupied home value[2]	$147,100	$229,800	*47*
Median real estate taxes paid for owner-occupied home[2]	$1,252	$2,551	*43*
Effective tax rate, median owner-occupied home[3]	0.9%	1.1%	*29*

Sources: U.S. Census via Significant Features of the Property Tax, American Community Survey

[1] All revenue numbers in this table include the state government as well as local governments.

[2] The statistics for median owner-occupied home value and median real estate taxes paid for owner-occupied home are five-year average statistics for years 2016–2020.

[3] Calculated as the median real estate tax paid on owner-occupied homes as a percent of the median owner-occupied home value.

Administration and Assessment

In Kentucky, property taxes are levied both by the state government and by cities, counties, school districts, and special districts.

Each of the 120 Kentucky counties elects a property valuation administrator (PVA) to conduct its property tax assessment (table KY-2). Cities may use the county valuation administrator assessment but must pay a fee to do so. Section 172 of the Kentucky Constitution requires all property to be assessed at the fair cash value, defined as “the price a property would bring at a fair and voluntary sale between a willing buyer and a willing seller, with neither party under duress, given a reasonable amount of time on the market.”

The state system of property tax classification employs over 20 categories, most of which are classes of personal property. While many classes established by the state are exempt from local taxation, 10 property classes are taxed by local governments to some extent. For example, county, city, and school district governments all set local rates for residential, agricultural, and commercial land and improvements (Kentucky Department of Revenue 2022).

Limits on Property Taxation

Kentucky has long adopted a *Truth in Taxation* approach to increases in property tax revenue due to increases in taxable value. Truth in Taxation imposes procedural requirements for revenue increases even without an increase in the tax rate. Revenue increases due to new construction are not subject to these requirements. In Kentucky, increases in revenue of less than 4 percent, without regard to new construction, require public notice of the increase. A proposed tax rate that would raise revenue by more than 4 percent, again without regard to new construction, must be approved by the voters (Significant Features of the Property Tax).

In addition, Section 157 of the Kentucky Constitution imposes a property tax rate cap that restricts county rates to $0.50 per $100 and city rates to $0.75 to $1.50 per $100 depending on the city size: cities with a population greater than 15,000 are capped at $1.50, and cities with less than 10,000 in population are capped at $0.75. All other cities are capped at $1.00. However, few places exceed these rates because of the constraints imposed by HB 44.

Property Tax Relief and Incentives

Kentucky offers a homestead exemption to seniors or people who are “totally and permanently” disabled. The exemption reduces the assessment by the amount by which it exceeds the value of the property in the first year the owner qualified and received relief, up to a maximum exemption of $46,350 in 2023 and 2024. The state reimburses counties for associated tax loss (Significant Features of the Property Tax).

According to Section 172A of the Kentucky Constitution, agricultural and horticulture land must be assessed at the property’s use value, which is determined by the income-producing ability of the land and comparable sales of agricultural land (American Farmland Trust 2004).

Kentucky has a few property tax incentives for economic development, including an exemption for new or relocating manufacturing establishments and tax increment finance. Kentucky authorizes local governments to freeze assessed values for qualifying residential or commercial property for up to five years for repair, rehabilitation, or restoration. Structures must be at least 25 years old to qualify (Significant Features of the Property Tax).

Kentucky also offers a tax credit against the distilled spirits ad valorem tax or “bourbon barrel tax.” The credit offsets property taxes paid on barrels of aging bourbon. The credit, which is claimed on the state income tax return, must be used for capital improvements related to producing, storing, shipping, or marketing of distilled spirits (Ky. Rev. Stat. Stat. Ann. § 141.389). Kentucky enacted legislation to phase out the so-called “bourbon tax” between 2026 and 2043 (Schreiner and The Associated Press 2023; Significant Features of the Property Tax). Under the 2023 legislation, the credit will be replaced after 2024 as described under recent developments.

Table KY-2
Kentucky Property Tax Features, 2021

Feature	Kentucky	Count for 50 states plus DC
Statewide classification of real property	Yes	25
Assessment of property primarily by county	No	31
Limits on property tax rates or levies	Yes	45
Limits on the rate of growth of assessed value	No	17
Circuit breaker property tax relief program	No	31

Sources: Significant Features of the Property Tax

Key Property Tax History

Following statehood, Kentucky established a property tax that originally provided over 80 percent of state government revenue. Prior to 1965, the majority of real and personal property was assessed well below market values, and most taxing jurisdictions set tax rates near the Section 157 constitutional limits. However, in *Russman v. Luckett* (1965) the Court of Appeals ruled that real property must be assessed at 100 percent of its real market value (Legislative Research Commission 2016).

The court ruling created worries of large assessment increases without an assurance that tax rates would be reduced. Thus, a 1965 special session enacted a law requiring local tax authorities to roll back tax rates to a rate which results in approximately the same amount of revenue that was raised in the preceding year. Increases in revenue were allowed if due to growth in the assessed tax base or if new properties were added to the base (Fayette Urban County Government 2013; Legislative Research Commission 2016). This was the first step toward Truth in Taxation in Kentucky.

However, in the 1970s, high inflation rates resulted in substantial increases in assessed values. Tax rates remained relatively constant in this period, but the new 4 percent rate limitation discussed above was introduced to address tax increases due to rising values rather than higher tax rates(Fayette Urban County Government 2013; Legislative Research Commission 2016).

Historically, Kentucky has had substantial inequities in revenue-raising capacity across the state. In *Rose v. Council for Better Education* (1989), the Kentucky Supreme Court declared the system of public education unconstitutional. In response to the court, the Kentucky Education Reform Act (KERA) attempted to equalize revenue generated at a specific tax rate across districts. Districts are required to put forth a minimum amount of funding equal to 0.30 percent of assessed property value, and the state then grants each district the difference between a calculated guaranteed level of funding and the required local contribution (Clark 2003).

However, despite KERA and the requirement for full value assessment, the tax base in eastern Kentucky, in particular, remains problematic. Every two years the state sends professional appraisers to each county to randomly check assessments against fair market value. Many counties in eastern Kentucky fall below the required assessments, which often results from a lack of property sales in these counties, pressures to keep assessments low due to high poverty rates, and property tax appeals in which owners argue that the value of the property was damaged due to coal mining. In addition, many of these eastern counties have a substantially higher share of disabled or elderly residents than the average county, which results in a depleted tax base from use of the homestead exemption (Cheves 2015).

Recent Developments

Although Kentucky is one of fewer than 10 states that tax inventory, the legislature passed an inventory tax credit effective for the 2018 tax year. The non-refundable, non-transferable credit may be claimed against individual or corporate or LLC entity taxes. The credit was phased in between 2018 and 2021, by 25 percent per year. In the 2021 tax year, eligible taxpayers could claim a 100 percent credit for qualifying inventory taxes (KRS 141.408; Pierzchalski 2018).

In 2022, Kentucky enacted a two year freeze on vehicle assessed values in response to rising used car values. House Bill 6 reset vehicle values to January 1, 2021 values for the purposes of taxation in 2022 and 2023.

In 2023, Kentucky enacted an entity-level tax to shield owners of pass-through businesses from the effect of the cap on the federal income tax deduction for state and local taxes by offering credits against personal income taxes for entity-level taxes paid (House Bill 360 of 2023) (Chamberlain 2023). Kentucky is one of 36 states that have adopted entity level tax workarounds since the enactment of the cap on SALT deductions under the Tax Cuts and Jobs Act of 2017 (AICPA 2023).

Kentucky is home to almost all of the world's bourbon inventory, and its unique state and local personal property tax on "Bourbon Barrels"—actually on the value of the distilled spirits in the barrels—has long been controversial. In 2023, the industry achieved a longstanding goal when the state passed legislation to phase out the tax over 20 years (2023 Ky. Act Ch. 95, HB 5). The 2023 state tax rate was $.05 for every $100 of spirits; school districts and local governments set their own rates. In 2020, over 10 million barrels of bourbon aged in bonded warehouses in the state, and revenues from the "barrel tax" totaled over $27.8 million, with $18.2 million going to school districts, $7.9 million to cities and counties, and $1.7 million to the state (Coomes and Kornstein 2022). These payments served as a credit against state income taxes; although no new credits will be offered after 2023, taxpayers may waive accumulated unclaimed credits and receive either a property tax credit for the assessed value of up to 25,000 barrels per year or a sales and use tax credit for investing in communities with low or moderate income populations (Chamberlain 2023). The final bill contained replacement revenues for schools, fire departments, and EMS districts.

Kentucky's generous agricultural property tax preferences have been the subject of investigative journalism and periodic reform efforts. Although the farmland protection statute applies to 10 contiguous acres of land used in connection with the production of agricultural products (KRS 132.010), news articles have concluded that "assessments are now automatically slashed for 10 or more contiguous acres once used for farming, no matter how long ago" (Cheves and Blackford 2016). When asked whether he checked the current use of property receiving agricultural assessment, one property valuation administrator (PVA) told reporters, "The previous PVA didn't do it for 30 years, and when I came in I didn't see any point in stirring things up" (Cheves and Blackford 2016). Although efforts to address this issue by legislation were blocked by the Kentucky Farm Bureau, individual PVAs have instituted new procedures to monitor land use (Blackford 2016; 2018).

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