

THOUGHT LEADERSHIP

LEGAL UPDATES

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Kentucky DOR Says Artificial Intelligence Components Do Not Result in Custom Software

Not surprisingly, state Department of Revenues are finally addressing the taxability of Artificial Intelligence (AI) components. The Kentucky Department of Revenue recently issued guidance in its Winter 2025/2026 Sales Tax Facts publication, stating that sales and use tax applies to “prewritten computer software” and “prewritten computer software access services,” even if they have AI components.

Kentucky taxes prewritten computer software as tangible personal property. If accessed online, such software is also taxed as a taxable service. Only separately stated modifications or enhancements that are made exclusively for a single customer are exempt as “custom software.”

The Department maintains that AI, which adapts to user data without explicit programming, does **not** qualify as custom software despite its widespread use in modern applications.

What does this mean to you

Buyers and sellers of prewritten computer software that includes AI components should consider it to be taxable in Kentucky—one of the first states to consider the implications of artificial intelligence in the development of custom software. Other states will likely adopt a similar stance in the future.

Contact us

For further details or additional information, please contact Smitha Chintamaneni, Bill Schenkelberg, or a member of the Husch Blackwell State & Local Taxation team.