



**PRESENTATION TO HOUSE TAX COMMITTEE
ON 2012 HOUSE BILL 2117**

**By Richard Cram, Director of Policy & Research
Kansas Department of Revenue**

January 17, 2013

INDIVIDUAL INCOME TAX

Income Tax Rates Lowered for Individuals, Estates, & Trusts

Senate sub for HB 2117

TY 2012 Income Tax Rates

Married Filing Joint

\$0 - \$30,000	3.50%
\$30,001 - \$60,000	6.25%
\$60,001 and over	6.45%

Single, Head of Household, or

Married filing separate

\$0 - \$15,000	3.50%
\$15,001 - \$30,000	6.25%
\$30,001 and over	6.45%

Effective TY 2013 Income Tax Rates

Married Filing Joint

\$0 - \$30,000	3.00%
\$30,001 and over	4.90%

Single, Head of Household, or

Married filing separate

\$0 - \$15,000	3.00%
\$15,001 and over	4.90%

See Notice 12-06

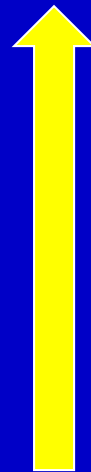
INDIVIDUAL INCOME TAX

STANDARD DEDUCTION AMOUNTS EFFECTIVE TY 2013

Senate sub for HB 2117

Tax year 2012 Individual Income Tax Standard Deduction Amounts;

- **Single & Married Filing Separate.** \$3,000
- **Head of Household** \$4,500
- **Married Filing Joint** \$6,000



Effective TY 2013 Individual Income Tax Standard Deduction Amounts;

- **Single & Married Filing Separate.** \$3,000
- **Head of Household** \$9,000
- **Married Filing Joint** \$9,000

See Notice 12-10

Additional deduction amounts for people over 65 and or blind are Not affected by this new legislation

INDIVIDUAL INCOME TAX

ITEMIZED DEDUCTION NOT CHANGED by Senate substitute for House Bill 2117

Standard deduction or itemized deductions:

- If you did not itemize your deductions on your federal return, you must take the standard deduction on your Kansas return.
- If you itemized on your federal return, you may either itemize or take the standard deduction on your Kansas return, whichever is to your advantage.
- If you are married and file separate returns, you and your spouse must use the same method of claiming deductions – if one of you itemize, the other must also itemize
- See Notice 12-07 for more information

INCOME TAX

EARNED INCOME CREDIT (EIC)

2010 HB 2360

- 2012 IS LAST TAX YEAR FOR EIC RATE AT **18%** OF FEDERAL EIC.
- EIC WILL RETURN TO **17%** OF FEDERAL EIC IN TAX YEAR **2013**.

INDIVIDUAL INCOME TAX

CREDIT FOR TAXES PAID TO OTHER STATES

Senate Sub for HB 2117

- Effective January 1, 2013
- Must be a Resident Individual, Resident Estate, or Resident Trust.
- A credit toward Kansas Tax liability for income tax paid to another state on income derived from sources in another state, And INCLUDED in KANSAS Adjusted Gross Income (KAGI).
- Credit cannot be greater than KAGI.

INDIVIDUAL INCOME TAX

ELIMINATION OF CREDITS FOR:

- INDIVIDUALS
- PARTNERSHIPS
- S-CORPS
- LLCs
- OTHER PASS THROUGH ENTITIES

Effective TY
2013

Credits and Modifications Repealed

Effective TY
2013

- (K-33) Agritourism Credit
- (K-62) Alternative Fuel Credit
- (K-42) Assistive Technology Contribution
- (K-56) Child and Day Care Assistance Credit
- (K-39) Credit for Plugging Abandoned Oil or Gas Well
- (K-37) Disabled Access Credit (Business)
- (K-81) Environmental Compliance Credit
- (K-68) Individual Development Account Credit
- (K-76) Port Authority Credit
- (K-53) Research & Development Credit
- (K-57) Small Employer Healthcare Credit
- (K-38) Swine Facility Improvement Credit
- (K-36) Telecommunications Credit
- (K-61) Temporary Assistance to Families Contribution Credit
- (K-55) Venture & Local Seed Capital Credit

- (K-47) Adoption Credit
- (K-37) Disabled Access Credit (Principle Dwelling)
- (K-72) Law Enforcement Training Center
- (K-54) National Guard Employer Health Insurance Credit
 - Credit for Child & Dependent Care Expenses (Claimed on Line 14 of K-40)
 - Qualified Long Term Care Insurance Premiums (Claimed on Line A14 of Schedule S)

Senate Sub for HB 2117
See Notices 12-04 & 12-05

INDIVIDUAL INCOME TAX

ELIMINATION OF SUBTRACTION MODIFICATIONS FOR INDIVIDUAL, PARTNERSHIP, S CORP, LLC & OTHER PASS THROUGH ENTITIES EFFECTIVE TY 2013

Senate Sub for HB 2117

- **Net Operating Loss (NOL) Schedule (CRF)**
 - NOLs from tax years 2012 and prior years cannot be carried forward to tax year 2013 or later years.
 - Must continue to add back NOL if claimed on Federal return
 - See Notice 12-08

- **Expensing Deduction Schedule (K-120EX)**
 - Not available for Individual, Partnership, S-Corp, LLC and other pass through entities after TY 2012.
 - See Notice 12-03

INCOME TAX

New Small Business Income & Farm Income Subtractions

Effective Tax Year 2013, there will be a subtraction modification available on certain non-wage business income for small business owners, income reported by LLCs, S corps, sole proprietor, and farmers. These new subtraction modifications will be allowed for the following:

- Net profit from business as reported on **Line 12** of Form 1040 from federal **Schedule C**
- Net income from rental real estate, royalties, partnerships, S corps, estates, trusts, residual interest in real estate mortgage investment conduits and net farm rental, as reported on **Line 17** of Form 1040 from federal **Schedule E**
- Net farm profit from as reported on **Line 18** of Form 1040 from federal **Schedule F**
- Add Back to FAGI on Kansas return include: Loss from business, Loss from rental real estate, partnerships, S corps, estates, etc., Farm loss, Deduction for self-employment taxes, Deduction for pension, profit-sharing and annuity plans for self-employed persons, Deduction for health insurance, Deduction for domestic production activities.
- **See Notice 12-11 and Revenue Ruling 19-2012-02**

FOOD SALES TAX

2012 INDEXING INCOME THRESHOLDS & REFUND AMOUNT:

<u>INCOME</u>	<u>REFUND</u>
■ \$0 TO \$18,350	\$94 Refund per exemption
■ \$18,351 to \$36,700	\$47 Refund per exemption

***** Must provide SSN for all dependents *****

2012 LAST YEAR FOR FOOD SALES TAX REFUND

- **Effective January 1, 2013, The Food Sales Tax Refund is repealed.**
- **See Notice 12-13**

HOMESTEAD

2012 MAXIMUM

“HOUSEHOLD INCOME”

- Indexed to inflation-

\$32,400

2012 Last year for Renters

- Effective January 1, 2013 Renters will no longer qualify and may not claim a Homestead Property Tax Refund
- See Notice 12-14

SALES TAX

Kansas State Sales Tax Rate
Scheduled to change effective
July 1, 2013

6.3% ↓ 5.7%
Sales Tax

JUST DOWN
THE ROAD

WITHHOLDING

Withholding Tables

- New Withholding tables, effective January 1, 2013, based on the new income tax rates for TY 2013 are available Kansas Department of Revenue website www.ksrevenue.org.
- Kansas Department of Revenue does not send out new tables.

CORPORATE INCOME TAX

Expensing (TY 2012) SB 196

The expense deduction is available to all Kansas businesses for certain qualifying machinery and equipment, as well as canned computer software, placed into service in Kansas starting in tax year 2012.

- A one time deduction is allowed for machinery and equipment purchased in the year that it is placed in service in Kansas. Must qualify under federal Sec. 168. Accelerated cost recovery system.
- The expensing deduction is the difference between the cost of the item and the present value of the stream of depreciation deductions allowed under normal federal depreciable life.
- **Recapture** may occur if property is later moved out of state or sold.
- If the expensing deduction is claimed then the taxpayer is not eligible to claim many Kansas tax credits, accelerated depreciation, or deductions.
- Complete Schedule K-120EX
- **ONLY AVAILABLE FOR C-CORPS STARTING IN TAX YEAR 2013**

MINERAL SEVERANCE TAX

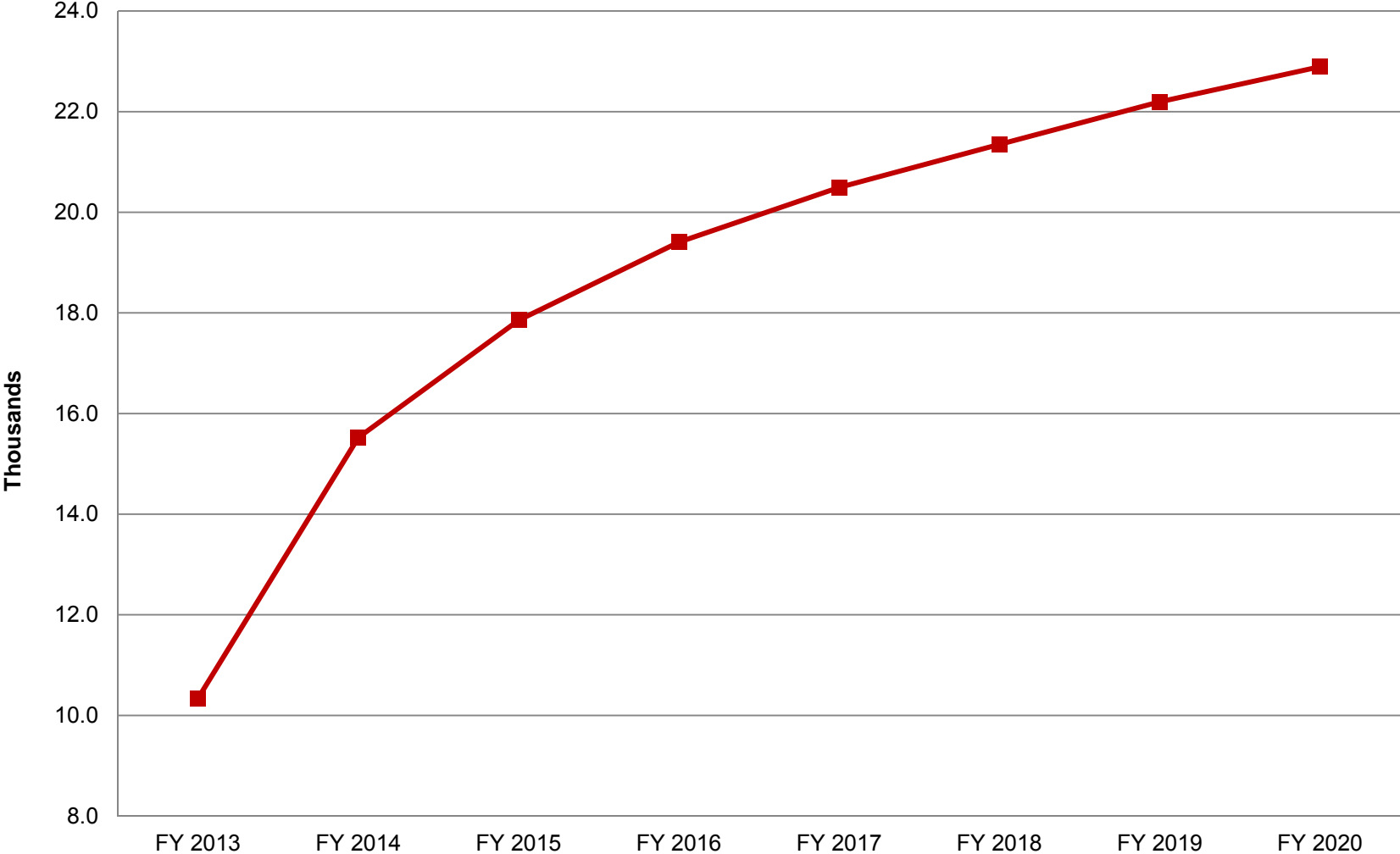
OIL PRODUCTION

Senate Sub for HB 2117

- **24 month exemption available for new oil pools occurring on or after July 1, 2012.**
- **Oil production from the pool cannot exceed 50 barrels, per well, per day Certified by the Corporation Commission and Director of Taxation.**
- **The 24 month exemption for all new gas pools is eliminated, regardless of the amount of gas produced.**
- **See Notice 12-02**

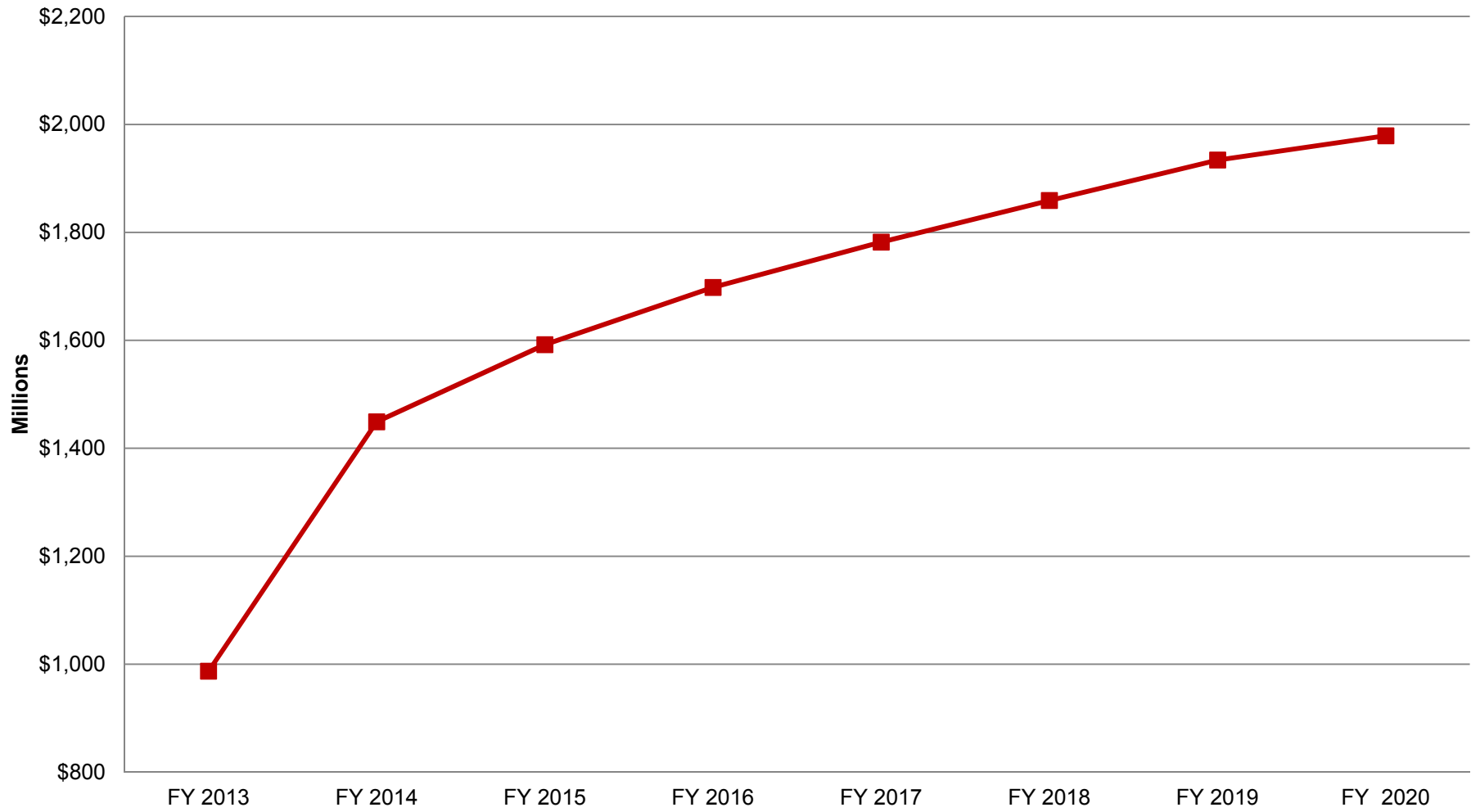
Number of Jobs Created Attributable to Tax Cut

Sen Sub for HB 2117



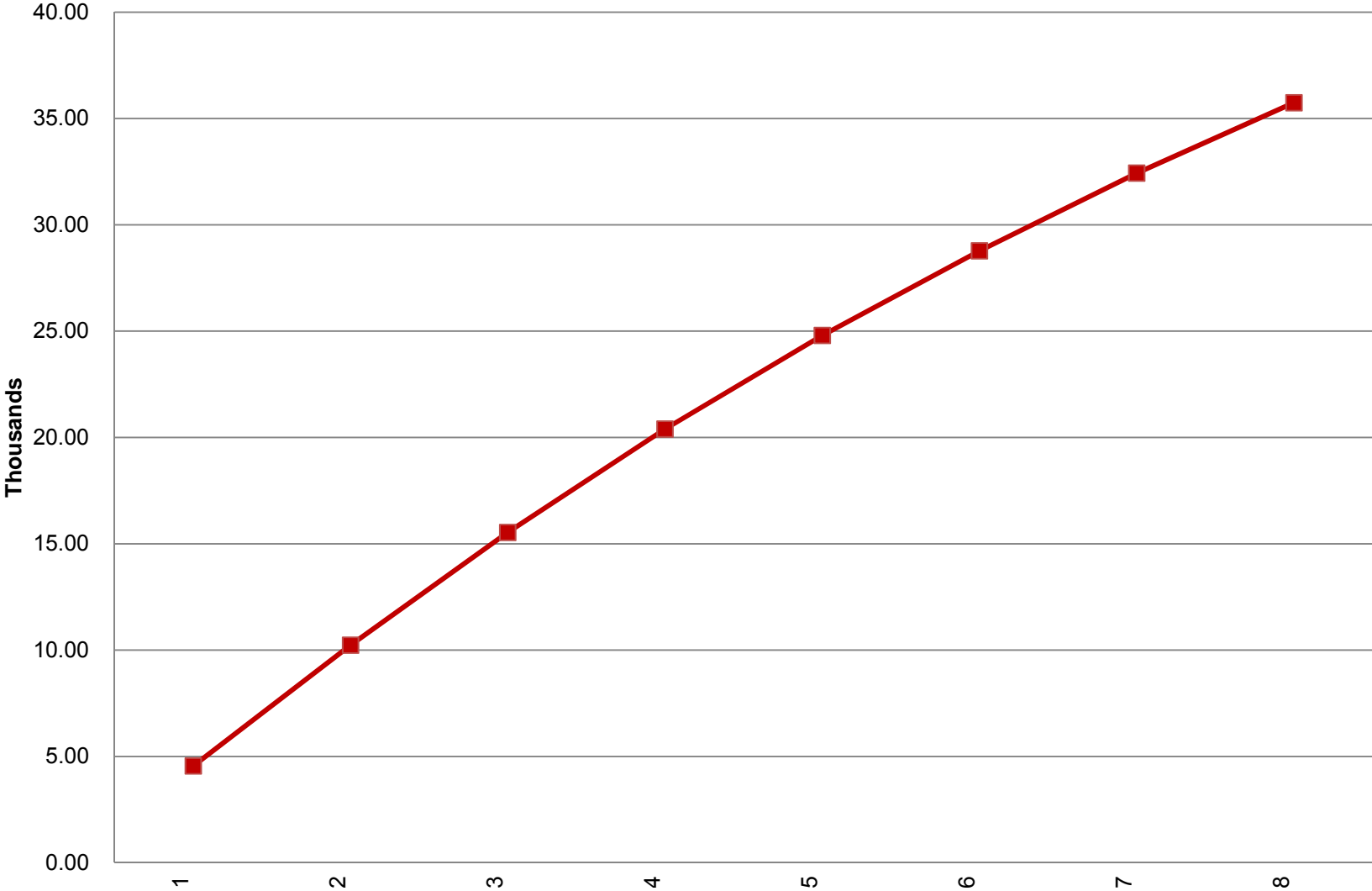
Increase in Disposable Income Attributable to Tax Cut

Sen Sub for HB 2117



Increase in Population Attributable to Tax Cut

Sen Sub for HB 2117



**REVISED NOTICE 12-02
(November 2012)**

2012 MINERAL SEVERANCE TAX LEGISLATIVE UPDATE

During the 2012 Legislative Session House Bill 2117 was passed and signed into law. Changes made by the Bill affect the mineral severance tax in Kansas.

The mineral severance tax is imposed by K.S.A. 79-4217. The law in effect prior to July 1, 2012 provided an exemption for the first 24 months of production of oil or gas from a “pool”. The term “pool” is defined in K.S.A. 79-4217(b)(4) to mean “an underground accumulation of oil or gas in a single and separate natural reservoir characterized by a single pressure system so that production from one part of the pool affects the reservoir pressure throughout its extent”.

Section 29 of the Bill amends K.S.A. 79-4217(b)(4) to limit the 24 month exemption to “the severance of gas or oil from any pool from which oil or gas was first produced on or after April 1, 1983, and prior to July 1, 2012 . . .” As a result of this language, gas or oil which is first produced on or after July 1, 2012 will not be exempt from the mineral severance tax. There is, however, an exception to this new rule for oil production.

Section 29 of the Bill also amends K.S.A. 79-4217 to create new subsection (b)(5). This subsection provides that, with regard to new oil pools, the 24 month exemption is available for initial production occurring on or after July 1, 2012, but only if production from the pool does not exceed 50 barrels per day, as certified by the Corporation Commission and the Director of Taxation. The Department is interpreting the production limitation to be 50 barrels per well in the pool, per day. If production exceeds this limit the well will not qualify for the exemption. The Department will base the 50 barrels per well per day calculation on the average daily severance and production of oil for such producing well, which well has not been significantly curtailed by reason of mechanical failure or other disruption of production, during the initial six-month production period, commencing with the date of first production from such well. If the date of first production for a well occurs other than the first day of the calendar month, then the average daily production calculation shall be based on the prorated production for the first and final calendar months in that initial production period, as necessary. For example, if the date of first production for a well in a new pool commences on August 15, 2012, the initial six-month production period shall be August 15, 2012 to February 15, 2013, and the production for the initial and final calendar months of production in that period shall be prorated.

For any well that has qualified for this exemption, if the average daily severance and production of oil from such well exceeds 50 barrels per day within any qualifying one-month production period after the initial qualifying production period, the exemption for such well shall be terminated as of the commencement of such one-month production period.

The Kansas Department of Revenue will assign a lease well number to each well that has been certified as a new pool by the Kansas Corporation Commission. When encountering a well that has multiple formations, each certified as a new pool, the Department requires that production be allocated separately on the Mineral Severance Tax Report.

Section 29 of the Bill eliminates the “new pool” 24 month exemption for all new gas pools, regardless of the amount of gas produced. There is a 24 month exemption for new oil pools, but only if oil production from the pool does not exceed 50 barrels, per well, per day.

Taxpayer Assistance

Additional copies of this notice, forms or publications are available from our web site, www.ksrevenue.org. If you have questions about income tax, please contact:

Taxpayer Assistance Center
Kansas Department of Revenue
915 SW Harrison St., 1st Floor
Topeka, KS 66612-1588
Phone: 785-368-8222
Hearing Impaired TTY: 785-296-6461
Fax: 785-291-3614

NOTICE 12-03

CERTAIN DEDUCTIONS LIMITED TO CORPORATE INCOME TAXPAYERS

During the 2012 Legislative Session House Bill 2117 was passed and signed into law. The Bill provides that, beginning in tax year 2013, certain deductions will only be available to corporations that are subject to the Kansas corporate income tax, i.e. C corporations.

Beginning in tax year 2013, the following deductions will not be available to individuals, S corporations, partnerships, limited liability companies, or other pass-through entities, and will be available only to C corporations:

1. The net operating loss deduction. (Section 17, amending K.S.A. 79-32,143)
2. The additional expense deduction for purchase of certain business property. (Section 18, amending K.S.A. 79-32,143a)

For additional information regarding the effect of the new law on existing net operating losses held by individuals, please see Notice 12-08.

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NOTICE 12-04

CREDITS AND SUBTRACTION MODIFICATION REPEALED

Credits Repealed

During the 2012 Legislative Session House Bill 2117 was passed and signed into law. Beginning in tax year 2013, certain credits are repealed. After tax year 2012 the credits listed below will not be available.

1. Credit for child and dependent care expenses. (Section 40, repealing K.S.A. 79-32,111a) Claimed directly on Form K-40 / Credit for Child & Dependent Care Expenses
2. Credit for expenditures to provide disabled access. (Section 40, repealing K.S.A. 79-32,176) Claimed on Schedule K-37 / Disabled Access Credit
3. Credit for adoption expenses. (Section 40, repealing K.S.A. 79-32,202) Claimed on Schedule K-47 / Adoption Credit
4. Credit for provision of health insurance for a member of the Kansas National Guard. (Section 40, repealing K.S.A. 79-32,213) Claimed on Schedule K-54 / National Guard Employer Health Insurance Credit
5. Credit for contributions to the Kansas Law Enforcement Training Center. (Section 40, repealing K.S.A. 79-32,242) Claimed on Schedule K-72 / Law Enforcement Training Center Credit

In addition to repealing the credits listed above, HB 2117 limits the availability of a number of other income tax credits to C corporations which pay the corporate income tax. For more information regarding these credits, please see Notice 12-05.

Subtraction Modification Repealed

Beginning in tax year 2013, a subtraction modification has been repealed. Currently, K.S.A. 79-32,117(c)(xvi) provides payments for long-term care insurance (up to \$1,000) may be subtracted from federal adjusted gross income in determining Kansas adjusted gross income. Section 12 of HB 2117 repeals this subtraction modification.

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NOTICE 12-05

ELIMINATION OF CERTAIN INCOME TAX CREDITS FOR INDIVIDUALS, PARTNERSHIPS, S CORPORATIONS, AND LIMITED LIABILITY COMPANIES

CARRY OVER OF UNUSED CREDITS

Elimination of Credits for Pass-Through Entities and Individuals

During the 2012 Legislative Session House Bill 2117 was passed and signed into law. Beginning in tax year 2013, certain credits will be available only to corporations that are subject to the Kansas corporate income tax, i.e. C corporations. The credits listed below will not be available to individuals, partnerships, S corporations, limited liability companies, or other pass-through entities.

1. Credit for financial support provided to persons eligible to receive aid to families with dependent children under agreement with SRS. (Section 1, amending K.S.A. 39-7,132 and Section 22, amending K.S.A. 79-32,200) Claimed on Schedule K-61 / Temporary Assistance to Families Contribution Credit
2. Credit for employers providing health insurance or care, or contributions to health savings accounts. (Section 2, amending K.S.A. 40-2246) Claimed on Schedule K-57 / Small Employer Healthcare Credit
3. Credit for contributions to an individual development account to assist a person with disabilities. (Section 3, amending K.S.A. 65-7107) Claimed on Schedule K-42 / Assistive Technology Contribution Credit
4. Credit for purchase of liability insurance by an agritourism operator. (Section 4, amending K.S.A. 74-50,173) Claimed on Schedule K-33 / Agritourism Liability Insurance Credit
5. Credit for contributions to community-based organizations through an individual development account. (Section 5, amending K.S.A. 74-50,208) Claimed on Schedule K-68 / Individual Development Account Credit
6. Credit for investment in Kansas Venture Capital, Inc. (Section 6, amending K.S.A. 74-8206) Claimed on Schedule K-55 / Venture and Local Seed Capital Credit
7. Credit for investment in certified Kansas venture capital companies. (Section 7, amending K.S.A. 74-8304) Claimed on Schedule K-55 / Venture and Local Seed Capital Credit

8. Credit for investment in a technology-based venture capital fund. (Section 8, amending K.S.A. 74-8316) Claimed on Schedule K-55 / Venture and Local Seed Capital Credit
9. Credit for investment in a certified local seed capital pool. (Section 9, amending K.S.A. 74-8401) Claimed on Schedule K-55 / Venture and Local Seed Capital Credit
10. Credit for expenditures to provide disabled access. (Section 19, amending K.S.A. 79-32,177) Claimed on Schedule K-37 / Disabled Access Credit
11. Credit for research and development expenditures. (Section 20, amending K.S.A. 79-32,182b) Claimed on Schedule K-53 / Research and Development Credit
12. Credit for provision of child care services or facilities. (Section 21, amending K.S.A. 79-32,190) Claimed on Schedule K-56 / Child Day Care Assistance Credit
13. Credit for expenditures for a qualified alternative-fueled motor vehicle or alternative-fuel fueling station. (Section 23, amending K.S.A. 79-32,201) Claimed on Schedule K-62 / Alternative-Fuel Tax Credit
14. Credit for required improvements to a qualified swine facility. (Section 24, amending K.S.A. 79-32,204) Claimed on Schedule K-38 / Swine Facility Improvement Credit
15. Credit for plugging an abandoned oil or gas well. (Section 25, amending K.S.A. 79-32,207) Claimed on Schedule K-39 / Credit For Plugging An Abandoned Oil or Gas Well
16. Credit for certain property taxes imposed on telecommunications companies. (Section 26, amending K.S.A. 79-32,210) Claimed on Schedule K-36 / Telecommunications Credit
17. Credit for income attributable to the retirement of indebtedness authorized by a single city port authority. (Section 27, amending K.S.A. 79-32,212) Claimed on Schedule K-76 / Single City Port Authority Credit
18. Credit for expenditures to bring a refinery into compliance with environmental standards or requirements. (Section 28, amending K.S.A. 79-32,222) Claimed on Schedule K-81 / Environmental Compliance Credit

In addition to the credits, listed above, which are only available to C corporations, additional credits are repealed, beginning in tax year 2013. After tax year 2012 the credits listed below will not be available.

1. Credit for household and dependent care expenses. (Section 40, repealing K.S.A. 79-32,111a) Claimed directly on Form K-40 / Credit for Child & Dependent Care Expenses.
2. Credit for expenditures to provided disabled access. (Section 40, repealing K.S.A. 79-32,176) Claimed on Schedule K-37 / Disabled Access Credit
3. Credit for adoption expenses. (Section 40, repealing K.S.A. 79-32,202) Claimed on Schedule K-47 / Adoption Credit
4. Credit for provision of health insurance for a member of the Kansas National Guard. (Section 40, repealing K.S.A. 79-32,213) Claimed on Schedule K-54 / National Guard Employer Health Insurance Credit
5. Credit for contributions to the Kansas Law Enforcement Training Center. (Section 40, repealing K.S.A. 79-32,242) Claimed on Schedule K-72 / Law Enforcement Training Center Credit

Carry Over of Unused Credits

New Section 36 of HB 2117 addresses the question of what happens to the unused portion of nonrefundable credits that carry over from years prior to 2013 and are held by individuals, partnerships, S corporations, limited liability companies, or any other pass-through entity. This Section specifically provides individual taxpayers may continue to carry these credits forward as long as all statutory requirements continue to be met. The Section provides:

Any nonrefundable credits applicable to the Kansas income tax imposed on individuals that are no longer available commencing in tax year 2013 pursuant to this act and earned in any tax year prior to 2013 which are unused may continue to be claimed, subject to the limitations applicable to any such credit pursuant to law at the time such credit was earned.

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NOTICE 12-06

INCOME TAX RATES LOWERED FOR INDIVIDUALS, ESTATES, AND TRUSTS

During the 2012 Legislative Session House Bill 2117 was passed and signed into law. Section 10 of the Bill amends K.S.A. 79-32,110, the statute which establishes the rates of income tax in Kansas. Beginning in tax year 2013, individual income tax rates are lowered at all levels. In addition, the current three-tier rate structure is replaced by a two-tier structure.

Kansas income tax rates for tax year 2012, and for tax year 2013 and later years, are as follows:

Joint Returns

Rates for 2012:

<u>If the taxable income is:</u>	<u>The tax is:</u>
Not over \$30,000	3.5% of Kansas taxable income
Over \$30,000 but not over \$60,000	\$1,050 plus 6.25% of excess over \$30,000
Over \$60,000	\$2,925 plus 6.45% of excess over \$60,000

Rates for 2013 and later years:

<u>If the taxable income is:</u>	<u>The tax is:</u>
Not over \$30,000	3.0% of Kansas taxable income
Over \$30,000	\$900 plus 4.9% of excess over \$30,000

All Other Individuals
(As Well As Estates and Trusts)

Rates for 2012:

<u>If the taxable income is:</u>	<u>The tax is:</u>
Not over \$15,000	3.5% of Kansas taxable income
Over \$15,000 but not over \$30,000	\$525 plus 6.25% of excess over \$15,000
Over \$30,000	\$1,462.50 plus 6.45% of excess over \$30,000

Rates for 2013 and later years:

<u>If the taxable income is:</u>	<u>The tax is:</u>
Not over \$15,000	3.0% of Kansas taxable income
Over \$15,000	\$450 plus 4.9% of excess over \$15,000

Corporate Income Tax Rates Not Affected

Corporate income tax rates have not changed. For more information about corporate income tax, please see Notice 12-09.

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NOTICE 12-07

ITEMIZED DEDUCTIONS FOR INDIVIDUAL INCOME TAX

During the 2012 Legislative Session House Bill 2117 was passed and signed into law. Questions regarding whether an individual can continue to use itemized deductions for Kansas income tax purposes have arisen because of an apparent conflict created by certain amendments made in that Bill. By this Notice the Department is confirming that an individual can continue to use itemized deductions, as determined by K.S.A. 79-32,120, for Kansas income tax purposes.

K.S.A. 79-32,118 deals with the deduction to be claimed by an individual. Prior to amendment by HB 2117 the statute provided:

The Kansas deduction of an individual shall be his or her Kansas standard deduction unless he or she elects to deduct his or her Kansas itemized deductions under the conditions set forth in K.S.A. 79-32,120.

Section 13 of HB 2117 amends K.S.A. 79-32,118 to eliminate the reference to itemized deductions, suggesting that itemized deductions are no longer permissible for Kansas income tax purposes. As amended, K.S.A. 79-32,118 provides:

Commencing in tax year 2013, the Kansas deduction of an individual shall be ~~his or her~~ such individual's Kansas standard deduction ~~unless he or she elects to deduct his or her Kansas itemized deductions under the conditions set forth in K.S.A. 79-32,120.~~

K.S.A. 79-32,120, which expressly allows itemized deductions, was not modified or repealed by HB 2117. This statute provided, and continues to provide:

(a) If federal taxable income of an individual is determined by itemizing deductions from such individual's federal adjusted gross income, such individual may elect to deduct the Kansas itemized deduction in lieu of the Kansas standard deduction. The Kansas itemized deduction of an individual means the total amount of deductions from federal adjusted gross income, other than federal deductions for personal exemptions, as provided in the federal internal revenue code with the modifications specified in this section.

(b) The total amount of deductions from federal adjusted gross income shall be reduced by the total amount of income taxes imposed by or paid to this state or any other taxing jurisdiction to the extent that the same are deducted in determining the federal itemized deductions and by the amount of all depreciation deductions claimed for any real or tangible personal property upon which the deduction allowed by

K.S.A. 2008 Supp. 79-32,221, 79-32,227, 79-32,232, 79-32,237, 79-32,249, 79-32,250, 79-32,255 or 79-32,256, and amendments thereto, is or has been claimed.

The final Supplemental Note prepared for HB 2117 by the Legislative Research Department makes it clear the Legislature did not intend to eliminate itemized deductions. The Kansas Department of Revenue recognizes this Legislative intent. In addition, K.S.A. 79-32,120 specifically and expressly provides for itemized deductions. Accordingly, the Department will not interpret K.S.A. 79-32,118, a statute of more general application, to eliminate the use of itemized deductions. Instead the Department will continue to recognize the application of K.S.A. 79-32,120.

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NOTICE 12-08

NET OPERATING LOSSES

In Brief

During the 2012 Legislative Session House Bill 2117 was passed and signed into law. As explained below, new provisions in the Bill provide:

- 1) The net operating deduction for individuals has been eliminated starting in tax year 2013.
- 2) An individual may not carry net operating losses forward to tax year 2013 or later years, or back to earlier years.
- 3) The requirement to add-back a federal net operating loss as an addition modification remains in effect.

Generally

Provisions in the Bill change the way pass-through entities are taxed. These businesses, including sole proprietorships, partnerships, S corporations, limited liability companies, and other pass-through entities, are generally not taxed as corporations. Instead, if elected for federal income tax purposes, the income is “passed through” to the business owner and, when the owner is an individual, the income is taxed on the owner’s individual income tax return.

The Bill includes provisions which exempt the income of certain businesses from the Kansas income tax beginning in tax year 2013. Specifically, the Bill exempts income reported on lines 12, 17 and 18 of IRS Form 1040. Line 12 is self-employment income from federal Schedule C. Line 17 is certain income from rental real estate, trusts and “pass-through” business entities, including partnerships, Subchapter S corporations and limited liability companies reported on federal Schedule E. Line 18 is farm income from federal Schedule F.

Because these categories of income of certain businesses will no longer be subject to tax, the Bill includes provisions which prohibit individuals from deducting losses arising from these categories. Beginning in tax year 2013, these deductions will only be available to corporations that are subject to the Kansas corporate income tax, i.e. C corporations. One of the deductions that will not be available to individuals is the net operating loss deduction.

New Language

The statute controlling the use of net operating losses is K.S.A. 79-32,143. Section 17 of the Bill amends K.S.A. 79-32,143 to add new subsection (g) which provides:

(g) For tax year 2013, and all years thereafter, a net operating loss allowed by this section shall only be available to taxpayers subject to the income tax on corporations imposed pursuant to subsection (c) of K.S.A. 79-32,110, and amendments thereto, and used only to determine such taxpayer's corporate income tax liability.

In accordance with the new law, no net operating loss deduction will be allowed for an individual for tax year 2013 or later years.

Carry-Forward and Carry-Back

K.S.A. 79-32,143 requires that net operating losses which are incurred after December 31, 1987, be carried forward until fully used or until ten years has elapsed, whichever occurs first. If ten years has elapsed, or the taxpayer has died, and unused loss remains, the loss may be carried back. A Kansas net operating loss which is incurred after December 31, 1987 cannot be carried back prior to carrying the loss forward.

Because net operating losses will not be allowed on individual income tax returns for tax year 2013 and later years, net operating losses from tax year 2012 and prior years cannot be carried forward to tax year 2013 or later years. This does not mean, however, that these losses can be carried back to prior years. New subsection (g) provides that net operating losses are available only to C corporations, and not to individuals. It does not create a situation where a net operating carry-back will be allowed. As a result, carry-over losses from tax year 2012 or prior years will simply not be available as of January 1, 2013.

Modifications

The calculation of an individual's Kansas income tax starts with federal adjusted gross income. Certain modifications, either additions or subtractions, required by K.S.A. 79-32,117 are then made to arrive at Kansas adjusted gross income. K.S.A 79-32,117(b)(iii) currently provides that the federal net operating loss deduction claimed on the taxpayer's federal income tax return must be added to federal adjusted gross income in computing Kansas adjusted gross income. HB 2117 did not amend this provision, so the requirement of adding back the amount of the federal net operating loss deduction will continue for tax year 2013 and later years.

Taxpayer Assistance

Additional copies of this notice, forms or publications are available from our web site, **www.ksrevenue.org**. If you have questions about income tax, please contact:

Taxpayer Assistance Center
Kansas Department of Revenue
915 SW Harrison St., 1st Floor
Topeka, KS 66612-1588
Phone: 785-368-8222
Hearing Impaired TTY: 785-296-6461
Fax: 785-291-3614

NOTICE 12-09

RECENT CHANGES DO NOT AFFECT CORPORATE INCOME TAX

During the 2012 Legislative Session House Bill 2117 was passed and signed into law. Despite a multitude of changes, many of which are effective beginning with tax year 2013, the Bill did not make any changes to the corporate income tax rates or credits available to C corporations.

The income of C corporations will continue to be taxed at the rates currently imposed by K.S.A. 79-32,110(c), which are the normal tax of 4% on the first \$50,000 of taxable income and the 3% surtax on Kansas taxable income in excess of \$50,000.

Under current law the Kansas taxable income of a C corporation is determined by applying the same modifications as those available to an individual under K.S.A. 79-32,117(b) and (c). Section 12 of HB 2117 adds new addition modifications in subsections (b)(xix), (xx), (xxi), (xxii) and (xxiii), and a new subtraction modification in subsection (c)(xx). These modifications relate to business income and losses. However, Section 16 of the Bill amends K.S.A. 79-32,138 to specifically provide that these new addition and subtraction modifications do not apply to corporations subject to the Kansas corporate income tax. As a result, the modifications used for computing the Kansas corporate income tax will not change.

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NOTICE 12-10

STANDARD DEDUCTION FOR INDIVIDUAL INCOME TAX INCREASED

During the 2012 Legislative Session House Bill 2117 was passed and signed into law. Section 14 of the Bill amends K.S.A. 79-32,119 to increase the amount of the standard deduction for the individual income tax, beginning in tax year 2013.

The amount of the standard deduction for tax year 2012, and for tax year 2013 and later years, is as follows:

<u>Filing Status</u>	<u>2012</u>	<u>2013 and later years</u>
Single	\$3,000	\$3,000
Married	\$6,000	\$9,000
Head of household	\$4,500	\$9,000

A higher standard deduction amount is available if the taxpayer or their spouse is over 65 years of age and/or blind. As part of its instructions for Form K-40 Individual Income Tax Return the Department of Revenue provides a worksheet to assist with calculating the total amount of the standard deduction.

Taxpayers who qualify can choose to use itemized deductions. For more information, please see Notice 12-07.

Taxpayer Assistance

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NOTICE 12-11

KANSAS INCOME TAX

CHANGES TO ADDITION AND SUBTRACTION MODIFICATIONS

INCOME EXEMPT FROM KANSAS TAX

Generally

The calculation of an individual's Kansas income tax starts with federal adjusted gross income. Certain modifications, either additions or subtractions, required by K.S.A. 79-32,117 are then made to arrive at Kansas adjusted gross income.

During the 2012 Legislative Session House Bill 2117 was passed and signed into law. Provisions in Section 12 of the Bill add five new addition modifications and one new subtraction modification to K.S.A. 79-32,117. The overall effect of these new provisions is to exempt certain categories of income from Kansas income tax.

Changes In The Law

Addition Modifications

K.S.A. 79-32,117(b) lists the items that are to be added in determining Kansas adjusted gross income. Section 12 of the Bill provides 5 new addition modification in subsection (b)(xix), (xx), (xxi), (xxii), and (xxiii). These new sections read as follows:

(b) There shall be added to federal adjusted gross income:

(xix) For all taxable years beginning after December 31, 2012, the amount of any: (1) Loss from business as determined under the federal internal revenue code and reported from schedule C and on line 12 of the taxpayer's form 1040 federal individual income tax return; (2) loss from rental real estate, royalties, partnerships, S corporations, estates, trusts, residual interest in real estate mortgage investment conduits and net farm rental as determined under the federal internal revenue code and reported from schedule E and on line 17 of the taxpayer's form 1040 federal individual income tax return; and (3) farm loss as determined under the federal internal revenue code and reported from schedule F and on line 18 of the taxpayer's form 1040 federal income tax return; all to the extent deducted or subtracted in determining the taxpayer's federal adjusted gross income. For purposes of this

subsection, references to the federal form 1040 and federal schedule C, schedule E, and schedule F, shall be to such form and schedules as they existed for tax year 2011, and as revised thereafter by the internal revenue service.

(xx) For all taxable years beginning after December 31, 2012, the amount of any deduction for self-employment taxes under section 164(f) of the federal internal revenue code as in effect on January 1, 2012, and amendments thereto, in determining the federal adjusted gross income of an individual taxpayer.

(xxi) For all taxable years beginning after December 31, 2012, the amount of any deduction for pension, profit sharing, and annuity plans of self-employed individuals under section 62(a)(6) of the federal internal revenue code as in effect on January 1, 2012, and amendments thereto, in determining the federal adjusted gross income of an individual taxpayer.

(xxii) For all taxable years beginning after December 31, 2012, the amount of any deduction for health insurance under section 162(l) of the federal internal revenue code as in effect on January 1, 2012, and amendments thereto, in determining the federal adjusted gross income of an individual taxpayer.

(xxiii) For all taxable years beginning after December 31, 2012, the amount of any deduction for domestic production activities under section 199 of the federal internal revenue code as in effect on January 1, 2012, and amendments thereto, in determining the federal adjusted gross income of an individual taxpayer.

Subtraction Modification

K.S.A. 79-32,117(c) lists the items that are to be subtracted in determining Kansas adjusted gross income. Section 12 of the Bill provides a new subtraction modification in subsection (c)(xx), which reads as follows:

(c) There shall be subtracted from federal adjusted gross income:

(xx) For all taxable years beginning after December 31, 2012, the amount of any: (1) Net profit from business as determined under the federal internal revenue code and reported from schedule C and on line 12 of the taxpayer's form 1040 federal individual income tax return; (2) net income from rental real estate, royalties, partnerships, S corporations, estates, trusts, residual interest in real estate mortgage investment conduits and net farm rental as determined under the federal internal revenue code and reported from schedule E and on line 17 of the taxpayer's form 1040 federal individual income tax return; and (3) net farm profit as determined under the federal internal revenue code and reported from schedule F and on line 18 of the taxpayer's form 1040 federal income tax return; all to the extent included in the taxpayer's federal adjusted gross income. For purposes of this subsection, references to the federal form 1040 and federal schedule C, schedule E, and schedule F, shall be to such form and schedules as they existed for tax year 2011 and as revised thereafter by the internal revenue service.

Subtraction Modification - Exempt Income

New subparagraph (c)(xx) provides a subtraction modification for three categories of income. By allowing these three categories of income to be subtracted from federal adjusted gross income to calculate Kansas adjusted gross income, this income is made exempt from Kansas income tax. It should be noted the three categories of exempt income are cumulative, not exclusive, so a taxpayer can take advantage of multiple subtraction modifications simultaneously. These three categories are: (1) income that is net profit from a business; (2) income from certain entities or of certain types; and (3) farm income.

(1) Income that is Net Profit From a Business

New subsection (c)(xx) provides a subtraction modification for income that is net profit from a business. Specifically, the new language states:

(c) There shall be subtracted from federal adjusted gross income:

(xx) For all taxable years beginning after December 31, 2012, the amount of any: (1) Net profit from business as determined under the federal internal revenue code and reported from schedule C and on line 12 of the taxpayer's form 1040 federal individual income tax return;

In order to qualify for the exemption, income must meet two requirements. First, the income must be properly reported on Schedule C of federal Form 1040. Second, the income must be properly reported on Line 12 of federal Form 1040. Income not properly reported in accordance with federal income tax law and instructions on Schedule C and line 12 of the federal Form 1040 is outside the scope of the subtraction modification language in paragraph (c)(xx).

Under federal law, Schedule C is available only to sole proprietors, to single member limited liability companies not treated as separate entities for federal income tax purposes, and to individuals considered statutory employees for federal income tax purposes. Statutory employees include full-time life insurance agents, certain agent or commission drivers and traveling sales persons, and certain homeworkers. A statutory employee receives a Form W-2 with the "statutory employee" designation box checked on the form. Schedule C is not available to employees. Therefore, employees who receive wages reported on federal form W-2 (other than statutory employees) will not qualify for the business income exemption.

(2) Income from Certain Entities and Certain Income

New subsection (c)(xx) provides a subtraction modification for income from certain entities and for certain types of income. Specifically, the new language states:

(c) There shall be subtracted from federal adjusted gross income:

(xx) For all taxable years beginning after December 31, 2012, the amount of any: (2) net income from rental real estate, royalties, partnerships, S corporations,

estates, trusts, residual interest in real estate mortgage investment conduits and net farm rental as determined under the federal internal revenue code and reported from schedule E and on line 17 of the taxpayer's form 1040 federal individual income tax return;

Entities

Certain income from any of the following entities may qualify under new subsection (c)(xx) and be exempt from Kansas income tax:

Partnerships
S Corporations
Estates
Trusts

In order to qualify for the exemption, income must meet three requirements. First, the income must be allocated to an individual as pass-through income from a partnership, S corporation, or conduit income from an estate or trust. Second, the income must be properly reported on Schedule E of federal Form 1040. Third, the income must be properly reported on line 17 of federal Form 1040. Income not properly reported in accordance with federal income tax law and instructions on Schedule E and on line 17 of the federal Form 1040 is outside the scope of the subtraction modification language of paragraph (c)(xx). See Revenue Ruling 19-2012-02 regarding certain income that does or does not qualify for exemption.

Taxpayers with ownership interests in partnerships or S corporations, and beneficiaries of trusts and estates should receive a Form K-1. The Form K-1 instructions should designate the line, schedule, and/or form on which income from the partnership, S corporation, trust or estate should be reported. That information is needed to determine whether such income is includable in the exemption provided by new subsection (c)(xx).

Income from limited liability companies is not specifically included in the new subtraction modification language. However, K.S.A. 17-76,138, which is part of the statutes dealing with limited liability companies, provides that for all purposes of Kansas taxes, a limited liability company "shall be classified as a partnership unless classified otherwise for federal income tax purposes." As a result, certain pass-through income from a limited liability company that is treated as a partnership for federal income tax purposes will qualify for the exemption provided by new subparagraph (c)(xx).

A professional corporation may be formed in accordance with K.S.A. 17-2706 *et seq.* A professional corporation formed under these provisions will not qualify for the exemption provided by new subparagraph (c)(xx) unless an S corporation election is made for federal income tax purposes.

In order to qualify a partnership, limited liability company, or S corporation must be a pass-through entity for federal income tax purposes under the federal "check the box" provisions.

Types of Income

The following types of income qualify under new subsection (c)(xx) and are therefore exempt from Kansas income tax:

Rental real estate
Royalties
Residual interests in real estate mortgage investment conduits
Net farm rental

In order to qualify for the exemption, income must meet two requirements. First, the income must be properly reported on Schedule E of federal Form 1040. Second, the income must be properly reported on Line 17 of federal Form 1040. Income not properly reported in accordance with federal income tax law and instructions on Schedule E and on line 17 of the federal Form 1040 is outside the scope of the subtraction modification language of paragraph (c)(xx).

(3) Farm Income

New subsection (c)(xx) provides a subtraction modification for farm income. Specifically, the new language states:

(c) There shall be subtracted from federal adjusted gross income:

(xx) For all taxable years beginning after December 31, 2012, the amount of any: (3) net farm profit as determined under the federal internal revenue code and reported from schedule F and on line 18 of the taxpayer's form 1040 federal income tax return;

In order to qualify for the exemption, income must meet two requirements. First, the income must be properly reported on Schedule F of federal Form 1040. Second, the income must be properly reported on Line 18 of federal Form 1040. Pursuant to Schedule F instructions, a farmer who is a single member limited liability company not treated as a separate entity for federal income tax purposes may use Schedule F. Income not properly reported in accordance with federal income tax law and instructions on Schedule F and on line 18 of the federal Form 1040 is outside the scope of the subtraction modification language of paragraph (c)(xx)(3).

It should also be noted that “farm rental” income qualifies for exemption under (c)(xx)(2), mentioned above.

Addition Modifications - Inclusion of Losses and Deductions

Because the categories of income explained above will no longer be subject to tax, the Act includes provisions in new subsection (b)(xix) which prohibit individuals from deducting losses or claiming certain deductions associated with these categories of income.

(1) Loss from Business

New subsection (b)(xix) provides an addition modification for loss from business. Specifically, the new language states:

(b) There shall be added to federal adjusted gross income:

(xix) For all taxable years beginning after December 31, 2012, the amount of any: (1) Loss from business as determined under the federal internal revenue code and reported from schedule C and on line 12 of the taxpayer's form 1040 federal individual income tax return;

In order to be included as an add-back, the loss must meet two requirements. First, the loss must be properly reported on Schedule C of federal Form 1040. Second, the loss must be properly reported on Line 12 of federal Form 1040. Loss not properly reported in accordance with federal income tax law and instructions on Schedule C and line 12 of the federal Form 1040 is outside the scope of the addition modification language in paragraph (b)(xix)(1).

(2) Loss from Certain Entities and Certain Types of Losses

New subsection (b)(xix) provides an addition modification for loss certain entities and certain types of losses. Specifically, the new language states:

(b) There shall be added to federal adjusted gross income:

(xix) For all taxable years beginning after December 31, 2012, the amount of any: (2) loss from rental real estate, royalties, partnerships, S corporations, estates, trusts, residual interest in real estate mortgage investment conduits and net farm rental as determined under the federal internal revenue code and reported from schedule E and on line 17 of the taxpayer's form 1040 federal individual income tax return;

Entities

Certain losses from any of the following entities may be included as an add-back under new subsection (b)(xix):

Partnerships
S Corporations
Estates
Trusts

In order to be included as an add-back, the loss must meet three requirements. First, the loss must be received by an individual as pass-through loss from a partnership, S corporation, estate or trust. Second, the loss must be properly reported on Schedule E of federal Form 1040.

Third, the loss must be properly reported on Line 17 of federal Form 1040. Loss not properly reported in accordance with federal income tax law and instructions on Schedule E and line 17 of the federal Form 1040 is outside the scope of the addition modification language in paragraph (b)(xix).

Loss from limited liability companies is not specifically included in the new addition modification language. However, K.S.A. 17-76,138, which is part of the statutes dealing with limited liability companies, provides that for all purposes of Kansas taxes, a limited liability company “shall be classified as a partnership unless classified otherwise for federal income tax purposes.” As a result, certain pass-through loss from a limited liability company that is treated as a partnership for federal income tax purposes will be considered an add-back under the addition modification provided by new subparagraph (b)(xix).

A professional corporation may be formed in accordance with K.S.A. 17-2706 *et seq.* A professional corporation formed under these provisions will not be subject to the add-back requirement provided by new subparagraph (b)(xix) unless an S corporation election is made for federal income tax purposes.

In order to be subject to the add-back requirement a partnership, limited liability company, or S corporation must be a pass-through entity for federal income tax purposes under the federal “check the box” provisions.

Losses

The following losses are subject to the add-back requirement of new subsection (b)(xix) and therefore may be subject to Kansas income tax:

- Loss from rental real estate
- Loss from royalties
- Loss from residual interests in real estate mortgage investment conduits
- Loss from farm rental

In order to be included as an add-back, the loss must meet two requirements. First, the loss must be properly reported on Schedule E of federal Form 1040. Second, the loss must be properly reported on Line 17 of federal Form 1040. Loss not properly reported in accordance with federal income tax law and instructions on Schedule E and line 17 of the federal Form 1040 is outside the scope of the addition modification language in paragraph (b)(xix)(2).

Farm Loss

New subsection (b)(xix) provides an addition modification for farm loss. Specifically, the new language states:

- (b) There shall be added to federal adjusted gross income:

(xix) For all taxable years beginning after December 31, 2012, the amount of any: (3) farm loss as determined under the federal internal revenue code and reported from schedule F and on line 18 of the taxpayer's form 1040 federal income tax return; all to the extent deducted or subtracted in determining the taxpayer's federal adjusted gross income.

In order to be included as an add-back, the loss must meet two requirements. First, the loss must be properly reported on Schedule F of federal Form 1040. Second, the loss must be properly reported on Line 18 of federal Form 1040. Loss not properly reported in accordance with federal income tax law and instructions on Schedule f and line 18 of the federal Form 1040 is outside the scope of the addition modification language in paragraph (b)(xix)(3).

Deductions

Certain federal deductions must be added to federal adjusted gross income to calculate Kansas adjusted gross income. These deductions are not shown on federal Schedule C, E, or F, but are instead shown separately on a line of the federal Form 1040. These include:

- A. One-half of self-employment taxes. Line 27, IRC §164(f)
- B. Contributions to retirement plans by self-employed. Line 28, IRC §62(a)(6)
- C. Purchases of health insurance by self-employed. Line 29, IRC §162(l)
- D. Deduction for domestic production activities. Line 35, IRC §199

New subsection (b)(xx) provides an addition modification for one-half of self-employment taxes. Specifically, the new language states:

(b) There shall be added to federal adjusted gross income:

(xx) For all taxable years beginning after December 31, 2012, the amount of any deduction for self-employment taxes under section 164(f) of the federal internal revenue code as in effect on January 1, 2012, and amendments thereto, in determining the federal adjusted gross income of an individual taxpayer.

New subparagraph (b)(xxi) provides an addition modification for contributions to retirement plans by self-employed. Specifically, the new language states:

(b) There shall be added to federal adjusted gross income:

(xxi) For all taxable years beginning after December 31, 2012, the amount of any deduction for pension, profit sharing, and annuity plans of self-employed individuals under section 62(a)(6) of the federal internal revenue code as in effect on

January 1, 2012, and amendments thereto, in determining the federal adjusted gross income of an individual taxpayer.

New subparagraph (b)(xxii) provides an addition modification for purchases of health insurance by self-employed. Specifically, the new language states:

(b) There shall be added to federal adjusted gross income:

(xxii) For all taxable years beginning after December 31, 2012, the amount of any deduction for health insurance under section 162(l) of the federal internal revenue code as in effect on January 1, 2012, and amendments thereto, in determining the federal adjusted gross income of an individual taxpayer.

New subparagraph (b)(xxiii) provides an addition modification for any deduction for domestic production activities. Specifically, the new language states:

(b) There shall be added to federal adjusted gross income:

(xxiii) For all taxable years beginning after December 31, 2012, the amount of any deduction for domestic production activities under section 199 of the federal internal revenue code as in effect on January 1, 2012, and amendments thereto, in determining the federal adjusted gross income of an individual taxpayer.

Overall Effect of Changes

The changes made by Section 12 of HB2117 to K.S.A. 79-32,117 allow certain categories of income to be subtracted from federal adjusted gross income in calculating Kansas adjusted gross income, while at the same time requiring certain losses and deductions to be added. The overall effect is to exempt certain categories of income from tax, without allowing related losses and deductions to be offset against other taxable income.

Taxpayer Assistance

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NOTICE 12-12

S CORPORATIONS OWNING BANKS, SAVINGS AND LOANS, OR FEDERAL SAVINGS ASSOCIATIONS

Generally

The calculation of an individual's Kansas income tax starts with federal adjusted gross income. Certain modifications, either additions or subtractions, required by K.S.A. 79-32,117 are then made to arrive at Kansas adjusted gross income.

During the 2012 Legislative Session House Bill 2117 was passed and signed into law. Provisions in Section 12 of the Bill add five new addition modifications and one new subtraction modification to K.S.A. 79-32,117. The overall effect of these new provisions is to exempt certain categories of income from Kansas income tax. For additional information about addition modifications for losses and deductions and subtraction modifications for income, please see Notice 12-11.

Subtraction Modifications Affecting Income From A Bank, Savings and Loan, or Federal Savings Association

Section 12 of the Bill amends K.S.A. 79-32,117 to add language to the subtraction modification found in paragraph (c)(xiv), and to add a new subtraction modification in paragraph (c)(xx). The italicized language below indicates the changes made and new language:

(c) There shall be subtracted from federal adjusted gross income:

(xiv) For all taxable years commencing after December 31, 1996, that portion of any income of a bank organized under the laws of this state or any other state, a national banking association organized under the laws of the United States, an association organized under the savings and loan code of this state or any other state, or a federal savings association organized under the laws of the United States, for which an election as an S corporation under subchapter S of the federal internal revenue code is in effect, which accrues to the taxpayer who is a stockholder of such corporation and which is not distributed to the stockholders as dividends of the corporation. *For all taxable years beginning after December 31, 2012, the amount of modification under this subsection shall exclude the portion of income or loss reported on schedule E and included on line 17 of the taxpayer's form 1040 federal individual income tax return.*

(xx) For all taxable years beginning after December 31, 2012, the amount of any: (1) Net profit from business as determined under the federal internal revenue code and reported from schedule C and on line 12 of the taxpayer's form 1040 federal individual income tax return; (2) net income from rental real estate, royalties, partnerships, S corporations, estates, trusts, residual interest in real estate mortgage investment conduits and net farm rental as determined under the federal internal revenue code and reported from schedule E and on line 17 of the taxpayer's form 1040 federal individual income tax return; and (3) net farm profit as determined under the federal internal revenue code and reported from schedule F and on line 18 of the taxpayer's form 1040 federal income tax return; all to the extent included in the taxpayer's federal adjusted gross income. For purposes of this subsection, references to the federal form 1040 and federal schedule C, schedule E, and schedule F, shall be to such form and schedules as they existed for tax year 2011 and as revised thereafter by the internal revenue service.

The new subtraction modification at K.S.A. 79-32,117(c)(xx), specifically (c)(xx)(2), allows taxpayers who are stockholders of S corporations to subtract income properly reported on federal Schedule E and on line 17 of the federal Form 1040 in computing their Kansas adjusted gross income. This applies to both distributed and undistributed income.

The subtraction modification at K.S.A. 79-32,117(c)(xiv) allows taxpayers who are stockholders of S corporation banks, savings and loans, or federal savings associations to subtract any undistributed S corporation bank, savings and loan, or federal savings association income in computing their Kansas adjusted gross income. The new language found in K.S.A. 79-32,117(c)(xiv) provides that the subtraction modification found in this paragraph cannot include income or loss properly reported on federal Schedule E and on line 17 of the federal Form 1040. This limiting language prevents a taxpayer from claiming two subtraction modifications for the same income. In other words, taxpayers who are stockholders of S corporation banks, savings and loans, or federal savings associations cannot subtract undistributed S corporation bank, savings and loan, or federal savings association income under the provisions of both K.S.A. 79-32,117(c)(xiv) and (c)(xx).

Taxpayer Assistance

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NOTICE 12-13

FOOD SALES TAX REFUND REPEALED

Kansas law provides a refund of sales tax paid on food by low income individuals who are elderly, disabled, or have young dependents living with them. For tax year 2012, the refund is available to individuals who are Kansas residents the entire year, whose household income is less than \$35,401, and who are 55 years of age or older, or totally and permanently disabled or blind, or who have a dependent under the age of 18 living with them the entire year. The controlling statutes are found in Kansas Statutes Annotated (K.S.A.) 79-3633 through 79-3639.

During the 2012 Legislative Session House Bill 2117 was passed and signed into law. Section 40 of the Bill provides that as of January 1, 2013, the food sales tax refund statutes found in K.S.A. 79-3633 through 79-3639 are repealed. As a result, food sales tax refunds will no longer be allowed.

The last year for which an individual may claim a food sales tax refund is 2012. The claim would be made on the individual's 2012 income tax return to be filed in 2013.

Taxpayer Assistance

Additional copies of this notice, forms or publications are available from our web site, www.ksrevenue.org. If you have questions about food sales tax refunds, please contact:

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NOTICE 12-14

HOMESTEAD PROPERTY TAX REFUNDS FOR RENTERS REPEALED

Kansas law provides a partial refund of property taxes paid by low income homeowners who are elderly, disabled, or have dependents under the age of 18 living with them. The refund is also available to low income homeowners who are disabled veterans or spouses of military personnel who died in the line of duty. The definition of a “claimant” and the specific requirements which must be met can be found in K.S.A. 79-4502.

In addition to homeowners the refund has been available to renters, with 15% of the rent being treated as a deemed payment of property tax.

During the 2012 Legislative Session House Bill 2117 was passed and signed into law. Amendments made in Sections 30 through 35 of the Bill provide that as of January 1, 2013, only homeowners may claim a homestead property tax refund. On and after January 1, 2013, renters no longer qualify and may not claim a homestead property tax refund.

The last year for which renters may claim a homestead property tax refund is 2012.

Taxpayer Assistance

Additional copies of this notice, forms or publications are available from our web site, www.ksrevenue.org. If you have questions about homestead property tax refunds, please contact:

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REVENUE RULING 19-2012-02

AUGUST 30, 2012

APPLICATION OF 2012 HB 2117 TO CERTAIN INCOME RECEIVED BY INDIVIDUALS

Overview

This Revenue Ruling provides guidance on how the Department of Revenue will administer Section 12 of 2012 House Bill 2117 with regard to certain income (such as dividends, interest, capital gains, gain from sale of business assets, income from partnerships, S corporations, trusts and estates, and retirement benefits, such as IRA distributions, pensions and annuities) received by individuals.

The calculation of an individual's Kansas income tax starts with federal adjusted gross income. Certain addition or subtraction modifications to federal adjusted gross income, required by K.S.A. 79-32,117, are then made to arrive at Kansas adjusted gross income.

Section 12 of House Bill 2117 added a new individual income tax subtraction modification to K.S.A. 79-32,117. This new subparagraph provides:

(c) There shall be subtracted from federal adjusted gross income:

(xx) For all taxable years beginning after December 31, 2012, the amount of any: (1) Net profit from business as determined under the federal internal revenue code and reported from schedule C and on line 12 of the taxpayer's form 1040 federal individual income tax return; (2) net income from rental real estate, royalties, partnerships, S corporations, estates, trusts, residual interest in real estate mortgage investment conduits and net farm rental as determined under the federal internal revenue code and reported from schedule E and on line 17 of the taxpayer's form 1040 federal individual income tax return; and (3) net farm profit as determined under the federal internal revenue code and reported from schedule F and on line 18 of the taxpayer's form 1040 federal income tax return; all to the extent included in the taxpayer's federal adjusted gross income. For purposes of this subsection, references to the federal form 1040 and federal schedule C, schedule E, and schedule F, shall be to such form and schedules as they existed for tax year 2011 and as revised thereafter by the internal revenue service.

Certain requirements must be met for income to qualify for this subtraction modification, and therefore be exempt from Kansas income tax. These requirements are:

- (1) The income must be properly reported on Schedule C, Schedule E, or Schedule F of the individual's federal Form 1040, pursuant to the Internal Revenue Code and any instructions or regulations promulgated by the Internal Revenue Service.
- (2) The income must be properly reported on Line 12 (in the case of income reported on Schedule C), Line 17 (in the case of income reported on Schedule E), or Line 18 (in the case of income reported on Schedule F) of the individual's federal Form 1040, pursuant to the Internal Revenue Code and any instructions or regulations promulgated by the Internal Revenue Service.

Income which is properly reportable on any Schedule or any line of the individual's federal Form 1040 other than the Schedules and lines described above is outside the scope of the exemption provided in Section 12 of House Bill 2117.

Income from Partnerships, S Corporations, and LLC's

Federal Schedule K-1 is the form provided to a partner, S corporation or LLC shareholder, or beneficiary of an estate or trust. Schedule K-1 states the portion of the entity's income allocated to the partner, shareholder, or beneficiary, and specifically identifies the various items of entity income (interest, dividends, capital gains, etc.). These carry over to the partner, shareholder, or beneficiary for federal individual income tax purposes.

The IRS instructions for the Schedule K-1 provide specific directions as to how the partner, shareholder, or beneficiary should report the income on the individual federal income tax return of such partner, shareholder or beneficiary. Partners, shareholders, and beneficiaries should report dividend income on line 9 of federal Form 1040 and interest income on line 8 of federal Form 1040. Similarly, capital gain income is reported on Schedule D.

Income from Estates and Trusts

Simple Trusts

Under federal income tax law, income distributed or required to be distributed (whether actually distributed or not) to a beneficiary by a simple trust must be included in the gross income of the beneficiary. Such income in the hands of the beneficiary retains the same character as it had in the hands of the trust. See IRC Section 652; Treasury Regulation Section 1.652(a)-1; 1.652(b)-1. Therefore, the subtraction modification in new subparagraph K.S.A. 79-32,117(c)(xx), Section 12 of 2012 House Bill 2117, applies to the beneficiary as if the beneficiary had received the income directly from the source that produced it.

Estates and Complex Trusts

Under federal income tax law, income distributed or required to be distributed (whether actually distributed or not) to a beneficiary by an estate or complex trust must be included in the gross income of the beneficiary. Such income in the hands of the beneficiary retains the same character as it had in the hands of the estate or trust. See IRC Section 662; Treasury Regulation Section 1.662(a)-1; 1.662(b)-1. Therefore, the subtraction modification in new subparagraph K.S.A. 79-32,117(c)(xx), Section 12 of 2012 House Bill 2117, applies to the beneficiary as if the beneficiary had received the income directly from the source that produced it.

Grantor Trusts

Under federal income tax law, if the grantor or other person is treated as the owner of the trust corpus or income, or a portion thereof, such item of income is treated as if it had been received directly by the grantor or such other person. Such income is taken into account in computing the tax liability as if the trust had not been in existence during the period such person is treated as the owner. As a result, such income retains the same character as if directly received by the grantor or such other person and should be reported on the federal Form 1040 and Schedules accordingly. See IRC Section 671; Treasury Regulation Section 1.671-1; 1.671-2; 1.671-3; 1.671-4.

For example, if the grantor owns a sole proprietor business and places it in a will substitute revocable trust with the grantor as sole trustee, then assuming the grantor-trustee uses the federal reporting method provided at Treas. Reg. Section 1.671-4(b)(2)(A), the grantor would ignore the existence of the trust for federal income tax purposes and would properly report the income from operation of the business held in the trust on Schedule C and on Line 12 of the grantor's federal Form 1040 (thus qualifying for the new subparagraph K.S.A. 79-32,117 (c)(xx)(1) subtraction modification in Section 12), while interest, dividends, and capital gain income will be reported elsewhere on the return and will not qualify for the subtraction modification.

If the grantor-trustee uses the Treas. Reg. Section 1.671-4(a) reporting method, filing Form 1041 for the trust with a separate statement attached, the K-1 instructions for trust beneficiaries will apply to reporting the income on the grantor's federal Form 1040, with the income from operation of the business reported on Schedule E and Line 17 of the 1040 return (qualifying for the new subparagraph K.S.A. 79-32,117(c)(xx)(2) subtraction modification in Section 12), while interest, dividends, and capital gain income will not be reported on Schedule E or Line 17 of the 1040 (and will not qualify for the new subparagraph K.S.A. 79-32,117(c)(xx)(2) subtraction modification in Section 12).

Interest, Dividends, and Capital Gains Not Included

Income that is interest, dividends, or capital gains (including such income received from a grantor trust) properly reportable on any lines other than lines 12, 17, or 18 of federal Form 1040 will not meet the requirements imposed by new subparagraph K.S.A. 79-32,117(c)(xx) in Section 12, and cannot be claimed as part of that subtraction modification.

Line 8 of the federal Form 1040 is specifically provided for the reporting of interest. Line 9 is specifically provided for the reporting of dividends. Line 13 is specifically provided for the reporting of capital gain. Federal law contemplates, and federal forms and instructions clearly direct, the reporting of interest, dividends and capital gains from partnerships, S corporations, estates or trusts either directly on lines 8, 9, and/or 13 of federal Form 1040 or on federal Schedule D. According to federal income tax instructions these items of income are not to be reported on federal Schedule E, or on line 17 of federal Form 1040.

Gains from Sale of Certain Business Assets Not Included

Gain from the sale of certain business assets, involuntary conversions, or recapture (including such income received from a grantor trust) properly reportable on any lines other than lines 12, 17, or 18 of federal Form 1040 will not meet the requirements imposed by new subparagraph K.S.A. 79-32,117(c)(xx) in Section 12, and cannot be claimed as part of that subtraction modification. Form 1040 Line 14 is specifically provided for the reporting of certain types of gains or losses from sales of business property.

Federal Form 4797 is used to report sales of certain business assets, also involuntary conversions and recapture amounts. The IRS instructions for Form 4797 indicate income or loss, depending on its nature, is to be reported on federal Schedule A, federal Schedule D, line 14 of federal Form 1040, or federal Form 4684. Federal law contemplates, and federal forms and instructions clearly direct, the reporting of gains or losses from sales of business assets either directly on federal Form 1040, line 14, or on federal Schedule A, federal Schedule D, or federal Form 4684. Therefore, income from transactions reported on Form 4797 that according to federal income tax instructions is not properly reported on federal Schedules C, E, or F, and on lines 12, 17, or 18 of federal Form 1040, does not qualify for the new subparagraph K.S.A. 79-32,117(c)(xx) subtraction modification in Section 12.

Retirement Benefits Not Included

If an individual receives income in the form of retirement benefits, such as IRA, SEP or other qualified plan distributions, pensions or annuities, such income cannot be claimed as part of the subtraction modification provided by new subparagraph K.S.A. 79-32,117(c)(xx)(2) in Section 12.

Federal law contemplates, and federal forms and instructions clearly direct, the reporting of IRA distributions received by an individual on federal Form 1040, line 15. Federal law contemplates, and federal forms and instructions clearly direct, the reporting of pensions and annuities received by an individual on federal Form 1040, line 16.

According to applicable federal income tax law, regulations and instructions, generally, Form 1099-R is used to report all distributions from qualified retirement plans that are not otherwise reported on Form W-2 (Wage and Tax Statement), including pensions, annuities,

retirement or profit sharing plans, IRAs, or SEPs. Payments subject to withholding and employment taxes are reported on Form W-2.

If an individual receives income, or is responsible for the payment of tax on such income, from a trust or estate and such income consists of retirement benefits, such as IRA, SEP or other qualified plan distributions, pensions or annuities, such income retains its character as retirement benefits and cannot be claimed as part of the subtraction modification provided by new subparagraph K.S.A. 79-32,117(c)(xx)(2).

Nick Jordan

Secretary of Revenue

**QUESTIONS AND ANSWERS
REGARDING
HB2117 OF THE 2012 LEGISLATIVE SESSION**

(UPDATED 11/2012)

During the 2012 Legislative Session House Bill 2117 was passed and signed into law. This Bill contains a number of provisions (most of which become effective January 1, 2013) which affect Kansas income tax, including those provisions commonly referred to as the “business tax exemption”. Additional information about various provisions in the Bill can be found in a series of Notices and a Revenue Ruling which are available through the Department’s web site at www.ksrevenue.org

This Questions and Answers document addresses specific questions received to date. As additional questions arise this document may be expanded and updated.

Social Security

- Q1. Does HB 2117 change how Social Security payments are taxed by the state of Kansas?
- A1. No. KSA 79-32,117(c)(xix) provides a subtraction modification that exempts social security income from Kansas income tax if the federal adjusted gross income of the taxpayer is less than or equal to \$75,000. The subtraction modification at new subparagraph (c)(xx), Section 12 of HB 2117 does not alter the computation of federal adjusted gross income, and so does not affect the determination of whether a taxpayer’s social security income is exempt from Kansas income tax.

Net Operating Losses

- Q1. Section 17(g) of 2012 HB 2117 amends K.S.A. 79-32,143 to add new subparagraph (g) which states that beginning in tax year 2013 the Kansas net operating loss deduction is available only to corporations in determining corporate income tax liability. Does this change result in the expiration of the 10 year period to carry forward net operating losses and, if so, does this entitle the taxpayer to carryback the loss in accordance with KSA 79-32,143(d)?
- A1. Section 17(g) of 2012 HB 2117 provides that “a net operating loss allowed by *this section* shall only be available to taxpayers subject to income tax on corporations...” The 10-year carry-forward period for net operating losses provided in K.S.A. 79-32,143(a) is no longer available to individual taxpayers beginning in tax year 2013. Accordingly, any unused Kansas net operating loss and the net operating loss carryback provisions in subparagraph (d) of KSA 79-32,143 are not applicable to individuals beginning in tax year 2013. See Notices 12-03 and 12-08.

Filing Requirements

- Q1. Is there still a requirement to file a form K-120S?
- A1. Yes. The filing requirement set forth in K.S.A. 79-3220(d) has not been changed. The Department of Revenue will continue to use the form K-120S for administrative purposes.
- Q2. Does the new law impact non-residents any differently than Kansas residents? For example, is a non-resident S corporation shareholder's Kansas business income exempt from Kansas income tax? If that is the only source of Kansas income for the non-resident, is he still required to file a Kansas tax return?
- A2. The new law applies to both residents and non-residents. Income that is exempt for a Kansas resident is also exempt for a non-Kansas resident. A non-Kansas resident receiving income from Kansas sources must file a Kansas income tax return regardless of whether tax will be due.

Kansas Expensing

- Q1. Section 18(h) of 2012 HB 2117 amends K.S.A. 79-32,143a to add new subparagraph (h), which provides that the Kansas expensing deduction enacted in 2011 SB 196 shall only be available to taxpayers subject to corporate income tax beginning in tax year 2013. Does this result in the elimination of any applicable recapture associated with a Kansas expensing deduction claimed by an individual in tax year 2012?
- A1. No. Section 18(h) of 2012 HB 2117 provides that the Kansas expensing deduction enacted in 2011 SB 196 is no longer available to individual income taxpayers beginning in tax year 2013. It does not repeal the recapture provisions in K.S.A. 79-32,143a(c) as they would apply to a Kansas expensing deduction claimed in tax year 2012.

IRA Contributions

- Q1. What types of IRA contributions are not subject to the new addition modification provisions for self-employment retirement account contributions contained in new subparagraph (b)(xxi), Section 12 of 2012 HB 2117 (amending K.S.A. 79-32,117)?
- A1. IRA contributions properly deductible on Line 32 of the federal 1040 return pursuant to the applicable Internal Revenue Service instructions are not included within the addition modification provisions of new subparagraph (b)(xxi) in Section 12 of 2012 HB 2117. Self-employment retirement account contributions properly deductible on Line 28 of the federal 1040 return pursuant to the Internal Revenue Service instructions are included within the addition modification provisions at new subparagraph (b)(xxi). See Notice 12-11.

Guaranteed Payments by a Partnership

- Q1. Do guaranteed payments made by a partnership to an individual partner qualify for the subtraction modification at new subparagraph 12(c)(xx) of 2012 House Bill 2117 (amending K.S.A. 79-32,117)?
- A1. Yes. Certain payments by a partnership to a partner, computed without regard to the income of the partnership, are characterized as “guaranteed payments,” and taxed, for federal income tax purposes, as ordinary income to the recipient partner. The Internal Revenue Service instructions for Form K-1 (1065) provide that “guaranteed payments” made by a partnership to a partner should be reported on the recipient partner’s Schedule E as non-passive income from a partnership.

Section 1231 Losses

- Q1. Is an IRC Section 1231 loss subject to the addition modification provisions at new subparagraph (b)(xix) of Section 12, 2012 House bill 2117 (amending K.S.A. 79-32,117)?
- A1. No. IRC Section 1231 gains and losses are generally reported on federal Form 4797 and would not be reported on Schedules C, E or F, and on Lines 12, 17 or 18 of the federal 1040 return. Therefore, such gains or losses are outside the scope of the addition and subtraction modification provisions in new subparagraphs (b)(xix) and (c)(xx) of Section 12, 2012 House Bill 2117.

Income From a REIT

- Q1. Is real estate investment trust (REIT) income eligible for the subtraction modification in new subparagraph (c)(xx)?
- A1. No. A real estate investment trust (REIT) reports its income on federal Form 1120-REIT and is taxed as a corporation. If a REIT distributes income to its shareholders or beneficiaries, that income is distributed in the form of dividends, either capital gain dividends or ordinary income dividends. Such income would not be reported on an individual taxpayer’s Schedule C, E or F, and on lines 12, 17 or 18 of the individual taxpayer’s federal Form 1040, so would not qualify for the subtraction modification in new subparagraph (c)(xx).

Income From a REMIC

- Q1. Does real estate mortgage investment conduit (REMIC) income qualify for the subtraction modification at new subparagraph (c)(xx) of Section 12, House Bill 2117, and if so, is there a difference in the treatment of income from a regular interest versus income from a residual interest?

- A1. Income from a regular interest in a REMIC does not qualify for the subtraction modification at new subparagraph (c)(xx), as it would not be properly reportable on Schedules C, E or F, and Lines 12, 17 or 18 of the recipient individual's federal 1040 return, pursuant to applicable Internal Revenue Service instructions. Income from a residual interest in a REMIC does qualify for the subtraction modification at new subparagraph (c)(xx), as such income would be properly reported on Schedule E and Line 17 of the recipient individual's federal 1040 return, pursuant to applicable Internal Revenue Service instructions.

Complex Non-Grantor Trust

- Q1. For a complex nongrantor trust, if the trust has income that is not distributed (or is not distributable) to a beneficiary pursuant to the terms of the trust, is that income eligible for the new subtraction modification at subparagraph (c)(xx) of Section 12, HB 2117?
- A1. No. The new subparagraph (c)(xx) subtraction modification would apply only to the income that is distributed (or distributable) to an individual beneficiary from the trust and is properly reported on Schedule E and Line 17 of the beneficiary's federal 1040 return, pursuant to the applicable Internal Revenue Service instructions. If there is income remaining in the trust on which the trust would be responsible for the federal income tax and not the beneficiaries, this income would not qualify for the new subparagraph (c)(xx) subtraction modification, because it will not be properly reported on a beneficiary's Schedule E and Line 17 of the individual's federal 1040, pursuant to the applicable Internal Revenue Service instructions.

Interest Earned in the Ordinary Course of a Trade or Business

- Q1. An S corporation that has elected to be taxed for federal income tax purposes as a pass-through entity is in the trade or business of lending money. Would the interest income earned by the S corporation from loans made by the S corporation to its customers and considered to be made in the ordinary course of its trade or business of lending money for federal income tax purposes, and reportable to the individual shareholders of the S corporation, qualify for the subtraction modification under Section 12(c)(xx)(2) of 2012 House Bill 2117?
- A1. Yes. According to the federal income tax instructions for the Form 1120S, interest income on loans considered to be made in the ordinary course of a trade or business of lending money for federal income tax purposes would not be considered "portfolio income" and would be considered included in "gross income derived in the ordinary course of a trade or business" (citing Treasury Temporary Reg. Section 1.469-2T(c)(3)) and properly reported on Line 5 of federal Form 1120S as "Other Income". This income would be reported in Box 1 of the federal Form K-1 provided to the individual shareholder, and so would be reported on Line 28 of the individual shareholder's federal Schedule E and be included in the calculation of income reported on Line 17 of the individual shareholder's federal Form 1040 (based on the IRS instructions for the Tax Year 2011 forms).

- Q2. A firm that is a partnership made up of individuals is in the trade or business of lending money. Would the interest income earned by the firm from loans considered to be made by the firm to its customers in the ordinary course of its trade or business of lending money for federal income tax purposes, and reportable to the individual partners, qualify for the subtraction modification under Section 12(c)(xx)(2) of 2012 House Bill 2117?
- A2. Yes. According to the federal income tax instructions for the Form K-1 (Form 1065) such income (interest income considered to be derived in the ordinary course of a trade or business of lending money for federal income tax purposes) and properly reported on Line 7 of federal Form 1065 as "Other Income" would not be considered "portfolio income," so would be reported in Box 1 of the federal Form K-1 provided to the individual partner, and would be reported on Line 28 of the individual partner's federal Schedule E and be included in the calculation of income reported on Line 17 of the partner's federal Form 1040 (based on the IRS instructions for the Tax Year 2011 forms).
- Q3. A sole proprietor is in the trade or business of lending money. Would the interest income earned by the sole proprietor from loans considered to be made to the sole proprietor's customers in the ordinary course of the sole proprietor's trade or business of lending money for federal income tax purposes qualify for the subtraction modification under Section 12(c)(xx)(1) of 2012 House Bill 2117?
- A3. Yes. According to the federal income tax instructions for Schedule C, such income would be properly reported as "Other Income" on Line 6 of Schedule C. It would then be included in the calculation of "net profit" in Line 31 of Schedule C and included in income reported on Line 12 of the individual sole proprietor's federal Form 1040 (based on the IRS instructions for the Tax Year 2011 forms).

FOR MORE INFORMATION

The Department has published a series of Notices and a Revenue Ruling regarding various aspects of 2012 HB 2117. These are available through our web site at: www.ksrevenue.org Please consult these resources for additional information.

If you have a specific question about the Department's policies regarding the provisions of HB2117 you can contact the Office of Policy and Research for more information. Submit your question to:

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