

**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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