

## Thoughts on 2012 Kansas Tax Act (Senate Substitute for HB 2117)

Effective in 2013, major changes take effect in the Kansas Income Tax of individuals, estates and trusts.

In brief, rates are reduced to 3% and 4.9% (3% bracket is 30,000 joint, 15,000 for all others), standard deductions are increased for joint and head of household to \$9,000 (single remains at \$3,000), approximately 20 credits are repealed, and income from Schedules C, E, and F is excluded from taxable income.

The Act has no impact on 2012 returns. The Act has little or no impact on C corporations. Some notes about the exclusion of Schedules C, E, and F income:

Schedule C is sole proprietorships, Schedule F is farm income, while Schedule E includes rentals, royalties, farm rental, and income from trades or business operation coming from partnerships, S corporations, and estates & trusts.

Note that losses are added back, which makes sense since profits are not taxed. Along with this, net operating losses are repealed, and certain ancillary deductions are added back including the DPAD, 1/2 SE tax, SE Health insurance, and retirement plan deductions of self-employed individuals.

There have been reports in the media that taxpayers should drop their investments into a partnership in order to exclude investment income, but this is incorrect advice: investment income from partnerships is still reported on Schedule B and Schedule D and is not excluded under the Act. Gain from sale of business assets is also still subject to tax.

On the other hand, this will increase the incentive to liquidate investments and pay down business debt.

Also, businesses operating as C corporations will want to consider electing S corporation status or otherwise restructuring to take advantage of the Act, although other considerations such as fringe benefits, loss carryovers, and federal tax impact must be considered carefully.

As an example, many physician groups and other professional organizations operate as C corporations, but pay out all profits as wages so as to avoid tax at the corporate level. These C corporation owners with their income on W-2's will continue to pay Kansas tax. To the extent these profits can be received as S corporation profit or partnership profit, Kansas tax could be avoided. Note however, that S corporations must pay reasonable compensation to owners for services, and that moving from a C corporation to a partnership is a taxable liquidation of the corporation.

Bottom line is, consult your tax advisor.