

May 6, 2015



The Honorable Marvin Kleeb, Chair  
House Tax Committee

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Re: HB 2430

The Kansas Society of Certified Public Accountants is **OPPOSED** to the passage of HB 2430, concerning the taxability of qualified income from business entities.

The Bill on its surface is intended to amend and modify the provisions of HB 2117 passed by the 2012 Kansas legislature. Under that law, all business income reported on Federal Schedules C, E and F was exempt from Kansas income tax and all business losses reported on Schedules C, E and F was non-deductible for Kansas income tax. The Bill replaces the exemption with a provision subjecting “qualified business income” to taxation at the lowest effective income tax rate.

The Bill provides that the “Business entity” must employ at least one employee for 2,080 hours per year and that the taxpayer must provide a certification that includes the name, social security number, position, location of employment, name of employer, employer FEIN and annual hours compensated for the employee and the name address and social security number of each individual owner of the business entity.

We have multiple concerns with the employment provision of the Bill. First, many small businesses employ numerous employees, but the employees may not work the 2,080 hours required in the bill. Question, if the business owner is active in the business and meets the 2,080 hour requirement, but does not receive a Form W-2, and all of the employees are part-time or seasonal, shouldn’t that business qualify for the lower rates. What about LLC’s where the members are active full-time but they do not receive a Form W-2 and all of the employees are part-time or seasonal, shouldn’t that business qualify for the lower rates.

Tiered business entities such as LLC’s or subchapter S corporations that have qualified subchapter S subsidiaries many times do not have employees at the top tier of the business structure. Under federal statute, all of the entities are “consolidated” with the top tier entity and are disregarded for federal income taxes. Under HB 2430 are these employees deemed to be employed by the top tier entity. Or in the circumstance where the subchapter S entity is a bank holding company with a bank subsidiary that files a Kansas privilege tax return, is the bank holding company eligible for the lower rates if the bank subsidiary has the qualified employees but the holding company does not?

Yet another example that is very common amongst taxpayers is to establish an LLC or partnership as a “holding company” that invests in other business entities. Most often, this holding company entity does not have any employees of its own. Does the holding company have to have employees to claim the benefit of the lower rates if the business entities it invests in provides a certification to the holding company? In this type of holding company scenario, some of the investments in business entities may be qualified while others are not. The complication and confusion to be caused by this employment requirement is hard to imagine at this moment in time.

So many small businesses in Kansas have employees that do not meet the 2,080 hour threshold. To carve those businesses out as non-qualified is counter-productive to a tax policy intended to incentivize businesses to locate and grow in Kansas.

The certification process on the surface does not appear to be too onerous given the information asked for. However, many small businesses lack the recordkeeping sophistication to track this payroll information and their cost of compliance in meeting the reporting requirement will reduce the benefit otherwise intended under the Bill. If a Kansas taxpayer invests in numerous “qualified businesses” then the requirements of the Bill is that the taxpayer must attached a copy of all relevant certifications to their Kansas income tax return. The compliance cost and the time required to track down these certifications will provide frustration to many Kansas taxpayers.

The certification must include the name, address and social security number of one employee who meets the qualification standard of 2,080 hours. In today’s business environment it is not uncommon for there to be multiple owners of a business entity. Some business entities can have hundreds of owners. The distribution of name, address and social security numbers of employees to anyone outside of the HR department of a business is bad policy and can lead to identity theft. This certification requirement needs to be re-considered or eliminated.

The Bill provides in Section 4(b)(iii) that the federal net operating loss shall be allowed as a deduction on the Kansas income tax return for any tax year beginning on or after January 1, 2015. For the years ending December 31, 2013 and 2014 the Kansas taxpayers were not allowed to claim any of the Federal net operating loss on their Kansas income tax returns. The result of this is that the net operating loss claimed on the 2013 and 2014 federal income tax return is being lost to the Kansas taxpayer. If this Bill moves forward it needs to correct this inconsistency.

Finally, this Bill is retroactive to January 1, 2015 in its application. As such, many small business taxpayers have not made estimated income tax payments to the state of Kansas for the first quarter of 2015 because they were not required to under existing statute. The Bill contains no provision exempting the Kansas taxpayers from potential penalties for underpayment of estimated income taxes due to this Bill being retroactive. Again if this Bill moves forward, it needs to correct this inconsistency.

We recognize that if a revenue option must be considered to balance the budget you have a very difficult deliberation to conduct. Providing an incentive for businesses to grow and expand in Kansas appears to be good policy to grow the Kansas environment. However, the Kansas statute only provides for two tax brackets with a maximum rate differential between the lower rate and the upper rate of 1.9%. Will a savings of 1.9% on an individual's Kansas income tax bill drive the behavior of business people when considering their expansion opportunities? Given the inherent complexities and compliance issues created by the employment provision of this Bill and the weakening of the incentives to grow jobs, we ask that you not support the passage of this Bill.

Respectfully submitted,

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Chair, KSCPA Legislative Committee

