

MINUTES OF THE HOUSE COMMITTEE ON ASSESSMENT AND TAXATION

The meeting was called to order by Representative Jim Braden at
Chairperson

9:05 a.m./~~p.m.~~ on January 24, 1984 in room 519S of the Capitol.

All members were present ~~except~~.

Committee staff present:

Tom Severn, Legislative Research Department
Wayne Morris, Legislative Research Department
Don Hayward, Revisor of Statutes' Office
Nancy Wolff, Secretary to the Committee

Conferees appearing before the committee:

Rod Bieker, Office of the Attorney General
Tom Sheridan, Department of Revenue
Bill Edds, Department of Revenue
Tim O'Sullivan, Wichita attorney
John Strain, Junction City C.P.A.
T. C. Anderson, Kansas Society of C.P.A.'s
Harvey Sorenson, Kansas Society of C.P.A.'s
Chuck Engle, Wichita C.P.A.

Rod Bieker of the Kansas Attorney General's office, requested that the committee introduce a bill to amend the Kansas intangibles tax. (Exhibit I) Representative Schmidt moved that the committee introduce a conceptual bill based upon input from the Department of Revenue and the Attorney General's office. Representative Frey seconded the motion. The motion carried.

Wayne Morris of staff reviewed House Bill 2611. House Bill 2611 would amend K.S.A. 79-32,138 and 32,140 to repeal the special modification for gain from corporation liquidations after January 1, 1983 and allow the credit for liquidations between 1980 and 1982 to be carried forward. The history of this bill is contained in the 1984 Interim Committee Reports under Proposal No. 1.

Timothy O'Sullivan, an attorney from Wichita, gave testimony in support of House Bill 2611. (Exhibit II)

John A. Strain, C.P.A., of the firm Strain & Pottberg, of Junction City, gave testimony in support of House Bill 2611, but suggested that the effective date for New Section 4 be changed to "years commencing after December 31, 1981". (Exhibit III)

T. C. Anderson of the Kansas Society of Certified Public Accountants, gave testimony in support of House Bill 2611 and introduced Harvey Sorenson who spoke in support of the bill. (Exhibit IV) Mr. Sorenson also presented a possible amendment to House Bill 2611. (Exhibit V)

Chuck Engle, a certified public accountant and a senior manager in the Wichita tax department for an accounting firm, presented testimony in favor of House Bill 2611. He also presented some possible amendments to the legislation. (Exhibit VI)

Bill Edds of the Department of Revenue, testified in opposition of House Bill 2611. He stated that the Department has no opposition to conforming to the federal method of taxation in 337 liquidations, but that they were opposed to the retroactive provisions in House Bill 2611 and the carryover of the credit. He also presented an example of two different taxpayers and how they would be affected by House Bill 2611. (Exhibit VII) He also reviewed testimony that was presented to the Special Committee on Assessment and Taxation during the interim. (Exhibit VIII)

CONTINUATION SHEET

MINUTES OF THE HOUSE COMMITTEE ON ASSESSMENT AND TAXATION,
room 519S, Statehouse, at 9:05 a.m.~~p.m.~~ on January 24, 1984

The Chairman appointed a subcommittee comprised of Representatives Rolfs, VanCrum, and Vic Miller to research House Bill 2611 and report back to the committee with their findings.

Representative Rolfs made a motion that House Bill 2329 be removed from the table. Representative Frey seconded the motion. Motion carried. Hearings are scheduled on House Bill 2329 on Thursday, January 26 at 9:00 a.m.

The minutes of the January 17, 1984 and January 18, 1984 meetings were approved as written.

The meeting was adjourned at 10:50 a.m.

such tax by the imposition and levying of any other taxes as may be authorized by law or by increasing its ad valorem tax levy for the general fund for any year in which revenue is not received from the tax on gross earnings derived from money, notes and other evidence of debt in an amount not to exceed the amount of such tax received in the year prior to elimination of such tax. The increase in the amount of such ad valorem tax authorized herein shall be in addition to any aggregate levy amount which may be fixed by any existing state law or any law which may hereafter be enacted.

(f) On or after January 1, 1983, upon submission of a petition signed by not less than 5% of the qualified electors of a county, city or township not levying a tax under the provisions of this act requesting the same, the governing body of such taxing subdivision shall be required to submit to the electors of such taxing subdivision at the next primary or general election held in such taxing subdivision a proposition to impose a tax pursuant to this act in an amount not exceeding the limitations prescribed in this section. Such proposition shall be in substantially the following form: "Shall _____ (county)(city)(township) impose a tax on gross earnings derived from money, notes and other evidence of debt at a rate of _____ pursuant to 1982 H.B. No. 3142 to reduce property taxes?" Any such election shall be noticed, called and conducted in the manner prescribed by the general bond law. If a majority of the electors voting thereon at such election vote in favor of the proposition the board of county commissioners or the township board shall provide by resolution or the governing body of any city shall provide by ordinance for the imposition of such taxes in the manner prescribed by this act. Such taxes shall be effective for all taxable years commencing after December 31 of the year in which such proposition is approved by the electors of the taxing subdivision.

History: L. 1982, ch. 63, § 1; May 13.

12-1,102. Same; definitions. When used in this act the following terms shall have the meanings ascribed to them in this section:

(a) "Money" means gold and silver coin, United States treasury notes, and other forms of currency in common use;

(b) "notes and other evidence of debt" means certificates evidencing shares of stock otherwise taxable to the owner or holder, notes, bonds, debentures, claims secured by deed, liquidated claims and demands for money, accounts receivable, and all written instruments, contracts or other writings evidencing, calling for, fixing or showing a fixed obligation, determined or determinable, at present or in the future, in favor of the holder thereof. Notes and other evidence of debt shall not mean oil or gas leases or any interests created thereby or arising therefrom or any royalty interests in oil or gas.

History: L. 1982, ch. 63, § 2; May 13.

12-1,103. Same; tax situs of gross earnings. The tax situs of gross earnings derived from money, notes and other evidence of debt which is received or receivable by persons, firms and corporations or subsidiaries or parent corporations of such firms or corporations, arising out of, or acquired in the conduct of, business transacted by such person, firm or corporation or subsidiary or parent corporation thereof in the state of Kansas, shall be at the principal office of such person, firm or corporation or subsidiary or parent corporation of such firm or corporation located within the state, or if there is no such office within the state, at the place or places at which the business operations of such person, firm or corporation or subsidiary or parent corporation of such firm or corporation is carried on.

History: L. 1982, ch. 63, § 3; May 13.

12-1,104. Same; filing of returns; persons required to file and pay tax. (a) Every taxpayer receiving earnings which are taxable under the provisions of this act shall file a return on or before August 1 in the year 1982, and on or before July 1 of each year thereafter with the county clerk of the county in which the gross earnings has acquired situs. Such return shall contain such information and be made upon forms prescribed and provided by the state director of taxation. The director of taxation shall include forms for the making of such return with each state income tax return distributed by the state department of revenue.

(b) A return listing the gross earnings of every resident conservatee which are taxable pursuant to this act shall be filed by the conservator of such conservatee. The return

AN ACT relating to taxation; concerning the place at which gross earnings from money, notes and other evidence of debt shall be subject to taxation; amending K.S.A. 12-1,103, and repealing the existing section.

Be it enacted by the Legislature of the State of Kansas:

Section 1. K.S.A. 12-1,103 is hereby amended to read as follows: 12-1,103. (a) The tax situs of Gross earnings derive from money, notes and other evidence of debt which is received or receivable by persons, firms and corporations or

~~subsidiaries or parent corporations of such firms or corporations, arising out of, or acquired in the conduct of, business transacted by such person, firm or corporation or subsidiary or parent corporation thereof in the state of Kansas, shall be at the principal office of such person, firm or corporation or subsidiary or parent corporation of such firm or corporation located within the state, or if there is no such office within the state, at the place or places at which the business operations of such person, firm or corporation or subsidiary or parent corporation of such firm or corporation is carried on~~

any individual arising out of, or acquired in the conduct of, business transacted by such person in this state shall be presumed to have been received or receivable at the individual's place of domicile within this state or, if there is no such place of domicile, then at the place or places at which any of the money, notes or other evidence of debt are held and managed for the individual within this state.

(b) Gross earnings derived from money, notes and other evidence of debt which is received or receivable by any firm, association or corporation arising out of, or acquired in the conduct of, business transacted by such firm, association or corporation in this state shall be presumed to have been received or receivable at the principle business office of such firm, association or corporation located within this state or, if there is no such office, then at the place or places at which any of the money, notes or other evidence of debt are held ^{and} ~~or~~ managed for the firm, association or corporation within this state.

(c) The presumptions prescribed in subsections (a) and (b) of this section may be rebutted by substantial evidence that the person, firm, association or corporation otherwise entitled to receive the gross earnings from money, notes or other evidence of debt has relinquished possession and control over such money, notes or other evidence of debt and the gross earnings therefrom, and that the money, notes or other evidence of debt and the gross earnings therefrom have been localized at, and integrated with the business of, some location in this state other than that specified in subsection (a) or (b).

(d) Any issue concerning the place at which gross earnings from money, notes or other evidence of debt are subject to taxation within this state shall be determined in a tax protest action filed with the state board of tax appeals in accordance with the provisions of K.S.A. 1983 Supp. 79-2005, and any amendments thereto.

Sec. 2. K.S.A. 12-1,103 is hereby repealed.

Sec. 3. This act shall take effect and be in force from and after its publication in the Kansas Register.

TESTIMONY BEFORE THE HOUSE COMMITTEE
ON ASSESSMENT TAXATION

Re: HOUSE BILL NO. 2611

From: TIMOTHY P. O'SULLIVAN

Thank you for the opportunity to testify concerning House Bill No. 2611. In my opinion this bill corrects a severe inequity in Kansas corporate income tax law. I base my opinion upon actual experience in the tax field, having had the opportunity to see its impact on the Kansas shareholder.

In order to understand this inequity, I might give you some examples of how various corporate liquidations are handled and the tax impact thereon. First of all, the basic principle is that when a corporation liquidates, to the extent a shareholder receives assets exceeding that shareholders cost basis in the stock of the corporation, the shareholder will pay income tax on the capital gain both at the Federal and State level. This capital gain is subject to a 60% exclusion, whereby the shareholder really only pays tax on 40% of the difference between that shareholder's basis and the fair market value of assets distributed. In the simplest situation, the corporation would merely distribute all of its assets to its shareholders under Section 331 of the Internal Revenue Code. As the corporation made no sale of assets prior to distribution, there would be no gain to report at the corporate level either under Federal or State law, the capital gain to the shareholder being the only tax.

Variations on this approach occur under Section 333, which is known as a "one month" liquidation. Provided the corporation has little retained earnings or cash, the stockholders need not report any gain on distribution of the assets to the shareholders and shareholders merely take as their basis in the assets the same basis the corporation had in the

assets. The gain would then be recognized when the shareholders sold those assets to the extent of any consideration received exceeding that basis. This, essentially, is just like a 331 liquidation, but in those special situations where the corporation has little retained earnings or cash, the stockholders can defer gain on a distribution until they actually sell the assets they receive. Once again, however, no tax would be imposed at the corporate level, as no assets were sold.

A final variation is the Section 337 liquidation. This provision was enacted to allow a sale at the corporate level as long as the assets are distributed under a plan of liquidation within a one-year period. The theory here is that as long as the assets are going to be distributed to the shareholders who will recognize gain, there should not be an additional tax imposed at the corporate level. To do so would be, in effect, a double tax. You will note this theory is also consistent with the above two types of liquidations, as neither imposes a tax at the corporate level, all gain being recognized at the shareholder level. It simply should not make any difference whether the shareholders or the corporation make the sale, when under either circumstance, there will be gain recognized at the shareholder level.

As can be seen, the Federal law is the most consistent, justifiable position with respect to avoiding corporate tax on a Section 337 liquidation. Why, then, does Kansas impose a tax on such sales at the corporate level and, since 1967, through K.S.A. 79-32,141, allow a credit against the shareholder's Kansas income tax for the tax so paid? Having been in the Kansas Legislature at the time the most recent revision to this statute was made, in 1982, and in fact, having carried the Bill which made the most recent amendment on the floor of the House, my recollection is very clear. This most recent revision did not impose the Kansas corporation tax, nor enact the credit, this having been the law in 1967, but merely allowed the credit to be taken over a period of time where the taxpayer was in fact reporting the gain on the installment basis. When I and one or two other members of the House Assessment Taxation Committee met

concerning this Bill in the lounge on the fifth floor, the question arose as to why we needed this tax at all, being as the Federal Government did not impose this tax at the corporate level. The Department of Revenue's response was that this tax was needed to catch out-of-state taxpayers who otherwise would not report this gain to the State of Kansas. Moreover, the Department noted that the credit allowed would protect the Kansas taxpayer in this regard. Faced with what appeared to be justifiable state interest in the out of state stockholder and the credit payable to Kansas taxpayers, freeing the Kansas taxpayer from the financial burden, this Bill was presented as drafted without any Amendments questioning the continued need for imposition of the state corporate income tax within a Section 337 liquidation. Having watched this provision in actual operation, I have concluded from the following facts that this position is completely unjustifiable and should be repealed for tax years commencing January 1, 1983, the year this inequity was brought to the attention of the Kansas Legislature. These facts are as follows:

1. The only type of liquidation upon which this gain would be recognized would be a Section 337 liquidation, as under a Section 331 or Section 333 liquidation, there would be no such tax imposed. Consequently, although the end result in all three types of liquidations is the same, the corporation is essentially penalized for the type of liquidation selected.

2. The Kansas stockholder is not made whole by virtue of the credit. The reasons for this are several. First of all, even if the taxpayer could get a credit dollar for dollar against the corporate income tax, unless the corporate income tax was due at the same time as the taxpayer's individual return, the state would get the usage of the money in the meantime interest-free. Secondly, taking the credit against the Kansas income tax may make the taxpayer whole in Kansas, but the Federal government will reap a windfall as a lowering of the Kansas income tax by virtue of the credit will lower the Kansas income tax deduction on the Federal

return, thus increasing the taxpayer's Federal income taxes. If the Kansas taxpayer is in a 50% Federal tax bracket, for every dollar of credit he will get in Kansas, he will have to pay 50¢ of it back to the Federal government. Thirdly, in many cases there is a severe mismatch between the Kansas income tax liability and the corporate income tax which can be credited against that tax. In numerous instances the corporate tax will greatly exceed the Kansas income tax liability against which the corporate tax can be credited. For example, the taxpayer may have a high basis in his or her stock, depending upon when the stockholder purchased the stock, and thus have little gain on the liquidation, although the corporation itself may have had a tremendous gain upon the sale of assets. In addition, upon liquidation, as above discussed, the stockholder is entitled to a 60% capital gain exclusion, which tends to limit the amount of Federal and Kansas tax liability of the liquidation. There is no such exclusion for corporate income tax, a corporation being taxed on the full amount of the gain. Finally, the taxpayer may have losses in the year of liquidation from other activities, thereby inhibiting the stockholders ability to offset the credit against Kansas income tax liability.

3. Retention of the Kansas corporate income tax on a Section 337 liquidation creates a possible conflict with Federal law in another corporate section. Under Section 338, enacted in 1982 by Congress, the person or entity purchasing 80% of the stock of a corporation can be treated as having purchased the assets of the corporation instead of the stock. Essentially, when this provision is utilized, the assets can be depreciated at the corporate level starting at the level at which the stock was purchased instead of what in most instances would be a lesser level had the corporation continued with its old basis. Essentially, a purchaser is placed in the same position the purchaser would have been had the purchaser purchased the assets of the corporation and formed another corporation. The problem is that the corporation

has to recognize any gain the corporation would have otherwise have recognized under a 337 liquidation when the 338 election is made. This normally would be certain types of recapture items only. However, as K.S.A. 79-32,138(b)(ii) taxes any gain excluded from Federal taxable income by virtue of the application of Section 337, any corporation which made this 338 election could be subject to full recognition of Kansas corporate income tax. In such a situation, this would be even worse than under a Section 337 liquidation, as all of the assets remain in the corporation. Consequently, the stockholder would not have any gain on liquidation to increase the stockholders Kansas income tax to a level which would be able to utilize effectively the corporate tax credit.

In summary, the application of a corporate income tax at the Kansas level on a Section 337 liquidation is totally unjustifiable. Perhaps there would be more justification if the Kansas taxpayer was made whole upon the impact of the corporate income tax. However, as can be seen above, no Kansas taxpayer is made whole. Even under the unlikely circumstance that the Kansas taxpayer paid that taxpayer's individual income taxes at the time the corporate taxes were paid, and additionally, had enough individual tax liability to fully utilize the credit, the only winner is the Federal government, as that Kansas income taxpayer is still going to have to pay additional Federal income tax to the full extent that the lowered Kansas tax liability lowers that taxpayer's itemized deductions on his or her Federal income tax return. Moreover, the number of out-of-state stockholders on liquidation of Kansas corporations, one would think, would be only a very small percentage compared to the number of Kansas stockholders. Finally, the only out-of-state stockholders that are actually caught in this approach are those which choose a Section 337 liquidation, as liquidations under Section 331 or Section 333 still allow the out-of-state stockholder complete immunity from imposition of the Kansas corporate income tax which is imposed under a Section 337 liquidation.

I urge prompt passage of House Bill No. 2611. This Bill will correct a severe anomaly in Kansas corporate income tax law which both unjustifiably departs from Federal income tax law while at the same time unduly burdening the Kansas taxpayer.

BEFORE THE KANSAS SPECIAL COMMITTEE
ON ASSESSMENT AND TAXATION

HEARING January 24, 1984, R E House Bill No. 2611 concerning taxation of gain from certain corporate liquidations under Section 337 of the Internal Revenue Code. (Proposal No. 1)

STATEMENT of John A. Strain, CPA, of the firm Strain & Pottberg, CPAs, of Junction City, Kansas.

The new Sec. 4 provides, in effect, that gains in corporate liquidations in 1983 and later years will not be taxed at the corporate level.

House Bill No. 2611 retains the absurdity of taxation of so called "installment gains" at the corporate level for liquidations in 1982.

Why do I say absurdity? Because, enabling the Department of Revenue to assess tax at the corporate level on installment transaction in which contracts are made and very little cash surfaces can leave the shareholders with a huge tax load to be met immediately, presumably to be balanced by credits allowable over the contract period. This type of deferred tax balancing is not efficient tax administration, and it ignores the principles of fair taxation.

Let me offer an example taken from real life of 1982:

Sale Price of Business	\$ 1,000,000
Adjusted Basis	600,000
Apparent Gain	<u>\$ 400,000</u>

The corporation and its shareholders in liquidation still are obligated to the original owner on a contract for \$500,000 of the purchase price. The present purchaser pays the corporation \$100,000 down and executes a contract for \$900,000 payable over 20 years. Does the \$400,000 constitute "income" within the United State Supreme Court's definition in Eisner v. Macomber, 252 U.S. 189? I submit that it does not.

The \$100,00 cash is needed to pay off debts, accounts and final operating expenses. Under HB 2611, there is no relief for the corporation and only deferred relief, of sorts, to the shareholders over a period of 20 years.

The year 1982 is not so far back but what fairness and equity ought to be afforded also to corporation which liquidated then. Why the relief for 1983 liquidations but not for 1982 liquidations? If a law is bad, and K.S.A. 79-32,138 and 79-32,140 were bad, why don't we correct it where the mischief was done?

Because Chapter 410 of 1982 (Senate Bill 564) and Chapter 411 of 1982 (Senate Bill 836) created the problem for tax years commencing after December 31, 1981, why not make HB No. 2611 likewise effective for taxable years beginning after December 31, 1981?

Who validly can object to a good law knocking out a bad law back to the time when the bad law started?

Then, Kansas and Federal corporate and individual income tax returns can again be in harmony. This was the principle of conforming the Kansas income tax treatment to Federal law when conformity was passed back in 1967, was it not?

The out-of-state stockholders who perhaps would escape Kansas income tax are not worth penalizing the residents who work, and live and create jobs, and pay taxes in Kansas in the regular course of business.

Accordingly, I request you to consider an earlier effective date for the New Section 4, namely, "years commencing after December 31, 1981".

Thank you for allowing me to appear before you at this hearing.

John A. Strain CPA

PROPOSED AMENDMENTS
TO K.S.A. 79-32,138 and 32,140. HB 2611

I. Introduction

Today we are going to consider HB 2611, which amends the Kansas income tax act to conform to the federal Internal Revenue Code with respect to the tax treatment of certain corporate liquidations. The bill is intended to eliminate the inconsistency between the federal and state tax treatment of Section 337 corporate liquidations and to provide relief to taxpayers caused by the inequities of the current provisions.

II. Description of Existing Tax Structure

For federal income tax purposes, a corporation may elect to liquidate under the provisions of Section 337 of the Internal Revenue Code. If a corporation makes such an election and then complies with all of the statutory requirements, no gain or loss is recognized by the corporation. Shareholders recognize gain or loss on liquidation of the corporation, measured by the difference between the fair market value of the assets received and their basis in their corporate stock.

The current Kansas income tax act taxes corporations generally on a conformity basis. A corporation is taxed on its federal taxable income subject to certain modifications. However, Kansas requires recapture of 337 gains and losses not recognized for federal income tax purposes. Kansas taxes the corporate gain (the difference between the sale price of the asset and the corporate basis in such asset) realized on the sale of assets pursuant to the 337 plan of liquidation.

Thereafter, each common shareholder is entitled to claim a credit for the corporate taxes paid on such gains on his Kansas income tax return in the year the taxpayer-shareholder receives payment with respect to his stock. The amount of the credit available to a particular shareholder bears the same relationship to the corporate tax paid as his common shares bear to all common shares outstanding, i.e., a

shareholder owning ten percent (10%) of the outstanding common stock is entitled to a credit equal to ten percent (10%) of the corporate gain tax paid.

The tax assessed is assessed on corporate gains. The credits allowed offset individual income tax. There is no direct correlation between the corporate taxes paid on corporate gains and the individual income taxes assessed on the shareholder's income from the dissolution and offset by the credit. It is possible to have corporate taxable gains and no individual gain subject to tax or no corporate taxable gains, but individual shareholder gains on liquidating, as well as the more common gain at both levels. Because of the variations in individual income levels, tax brackets and rates, and the differences between individual and corporate rates, the costs and benefits of the individual tax credit will vary from individual to individual. Furthermore, because the corporate tax is due in the year of the sale, and the individual credit is available in the year of receipt by the shareholder there can be significant timing differences between the time of payment to the state and the utilization of the credit.

III. Identification of the Problem

Since the amendment of the installment sales provision of Section 453 of the Internal Revenue Code by the Installment Sales Revision Act of 1980, a corporation may sell its assets on the installment basis while electing to exclude recognition of the gain under Section 337. The distribution of the installment note will not trigger recognition of gain for federal income tax purposes. The Installment Sales Revision Act also eliminates any minimum down payment requirement.

As a result of the changes in federal law it is now common for corporations to sell assets on the installment basis and thereafter to liquidate. It is not unusual for cash downpayments to be a small percentage of the sale price. As a result of these factors, there may be a timing difference between the payment of the corporate tax by the corporation and the utilization of the offsetting tax credit by the shareholder. This timing difference did not exist before 1980. These timing

differences have been known to extend from ten to twenty-five (10-25) years. Furthermore, Kansas income taxes may easily exceed the amount of the downpayment.

Several adverse consequences may result because of these changes in the federal law:

1. If the downpayment received on the installment sale is insufficient to pay the Kansas tax, the corporation will incur a debt to pay the tax and the shareholder would have to assume such indebtedness.

2. The shareholder will in effect make an interest free loan to the State of Kansas in the amount of the available credit to be recovered, if at all, from future reductions in Kansas tax. The value of the credit to the shareholder will decline because of the time value of money, the longer the delay between payment of the corporate tax and utilization of the credit.

3. A default on payment of the installment obligation will result in a loss of the credit, and no recovery in the amount of corporate tax paid.

4. It is possible for the corporate tax to exceed the credit, but never for the credit to exceed the tax.

In addition, the non-conformity with the Internal Revenue Code may cause other adverse results. Mr. O'Sullivan in his testimony will address the problems with new Section 338 of the Code as it bears on HB 2611.

IV. HB 2611

HB 2611 is intended to resolve the foregoing adverse results by bringing Kansas into conformity with the federal taxation of Section 337.

The bill is simple and straight forward. It's provisions are as follows:

1. Section 1 of HB 2611 amends K.S.A. 79-32,138 by

deleting the modifications to federal corporate taxable income with respect to the recognition of corporate gains and losses in a 337 liquidation. This section makes Kansas conform to the federal law.

2. Section 2 of HB 2611 preserves the existing tax treatment for corporate liquidations occurring prior to January 1, 1983. Subparagraph (b)(1) preserves the existing credit provisions as they relate to liquidations occurring in such taxable years. However, subparagraph (b)(2) eliminates the current provision which only permits a taxpayer to claim the credit in years in which payment is received, and permits an unlimited carryover of the credit until the entire credit is utilized.

3. New Section 3 provides that interest on additional assessments arising from these changes will commence on July 1, 1984. It further provides that interest on overpayments will not commence until ninety (90) days after a claim is filed.

4. New Section 4 makes the changes effective for taxable years commencing after December 31, 1982. This effective date is co-ordinated with the transaction dates of Section 2.

HB 2611 eliminates a serious and unnecessary non-conformity in Kansas and federal tax law and provides relief from the unintended adverse consequences of the current tax law. Changes in federal law since the adoption of the existing Kansas law have created burdensome and unjustified economic consequences to individual taxpayers which this bill eliminates.

0083 before the deduction of federal income taxes provided by sub-
 0084 section (c)(ii) shall be allocated as provided in K.S.A. 79-3271
 0085 through to K.S.A. 79-3293, inclusive, and amendments thereto,
 0086 plus any refund of federal income tax as determined under
 0087 paragraph (iv) of subsection (b) of K.S.A. 1982 Supp. 79-
 0088 32,117(b)(iv) 79-32,117, and minus the deduction for federal
 0089 income taxes as provided by subsection (c)(ii) shall be such
 0090 corporation's Kansas taxable income.

0091 Sec. 2. K.S.A. 1983 Supp. 79-32,140 is hereby amended to
 0092 read as follows: 79-32,140. (a) For corporate liquidations occur-
 0093 ring in taxable years commencing prior to January 1, 1983, to
 0094 the extent that a corporation incurs a Kansas income tax liability
 0095 by reason of gains realized in a sale or sales which qualify as
 0096 being exempt from federal income taxation under section 337 of
 0097 the internal revenue code, such Kansas income tax liability so
 0098 attributable to such gains shall be allowed as a credit against the
 0099 Kansas income tax liability of each common stockholder of such
 0100 corporation in an amount which bears the same ratio to such
 0101 Kansas income tax liability as the liquidation distribution re-
 0102 ceived or receivable by such common stockholder bears to the
 0103 liquidation distribution received or receivable by all common
 0104 stockholders. (b) (1) Except as otherwise provided in paragraph
 0105 (2) of this subsection, such credit shall be allowable only in the
 0106 taxable year or years of each stockholder in which such liquida-
 0107 tion distribution is received and taxable years in which payments
 0108 are received on an installment obligation received by the stock-
 0109 holder as part of the liquidation distribution and shall be limited
 0110 to the amount of Kansas income tax liability, if any, of such
 0111 stockholder for such year or years as computed before applica-
 0112 tion of the credit provided by this section and before any credits
 0113 for withholding or estimated tax payments. (2) For corporate
 0114 liquidations occurring after December 31, 1979, and before
 0115 January 1, 1983, such credit shall be deducted from the stock-
 0116 holder's income tax liability in the taxable year or years of each
 0117 stockholder in which such liquidation distribution is received
 0118 and taxable years in which payments are received on an install-
 0119 ment obligation received by the stockholder as part of the

in corporate taxable years commencing

Presentation on House Bill No. 2611

January 24, 1984

by Chuck Engle

Chuck Engle is a certified public accountant and a senior manager in the Wichita tax department of Peat, Marwick, Mitchell & Co. Chuck serves on the Federal and State Taxation Committee of the Kansas Society of Certified Public Accountants.

Index

	<u>Page</u>
Statement of Support for Change in Kansas Law	1
Example Illustrating Inequitable Results under Current Kansas Law	2-4
Suggested Changes to House Bill No. 2611	5-8
Emphasis on Sales Transaction vs. Year of Liquidation	9
Questions and Answers	10

Statement of Support
for Change in Kansas Law

I support the effort to bring Kansas tax law into conformity with federal tax law in regard to sales described in Section 337 of the internal revenue code. Current tax law is unfair to Kansans who operate their business in corporate form and sell assets out of the corporation instead of selling their stock in their corporations. The following pages set forth an example illustrating the inequity in current Kansas law.

I generally support House Bill No. 2611 but offer my suggestions for modifications to the bill on pages 5 through 8 of this pamphlet. The changes I suggest would place the emphasis of the change in law on the sale transaction instead of a tax year. For my discussion on why the emphasis should be on sales vs. tax year, please read page 9 of this pamphlet.

Example Illustrating
Inequitable Results under
Current Kansas Law

Corporation B desires to purchase the operations of Corporation A. There are two possible ways of acquiring Corporation A's operations:

1. Corporation B purchases all the assets of Corporation A
2. Corporation B buys all the stock of Corporation A

Under current Kansas law the first alternative of selling assets and not stock will result in a tax paid to Kansas (but not to federal) on the money received by A in the sale of the assets. There will be another Kansas tax computed when this same money is paid out to the stockholders (a federal tax is due on this transaction also). One can see, then, that Kansas taxes the money twice - once at the corporate level and again when received by the stockholders. It is exactly this result that federal tax law tries to avoid. Accordingly, the federal tax law taxes the money only upon receipt by the stockholders. I believe Kansas should correspond to federal law and tax the money once.

Kansas law does provide partial relief to the double taxation by allowing a credit on the stockholder's income tax return. However, as can be seen in the example on the following pages, this relief is only a partial relief from the double taxation burden. Effectively, Kansas law taxes the shareholder at the higher of the corporate tax rate or the individual income tax rate. This is unfair since the transfer of ownership of Corporation A operations could be achieved through a sale of stock by the shareholders of Corporation A to Corporation B resulting in no tax to Kansas at the corporate level. Should the tax results be different under the two possibilities enumerated above on the transfer of operations from one corporation to another? I submit not, and that is why Kansas law should be changed.

In the following example the stockholders who have their corporation sell assets and receive the sale proceeds in liquidation of the corporation will pay 2.3 times the Kansas taxes they would pay if they had merely sold their stock.

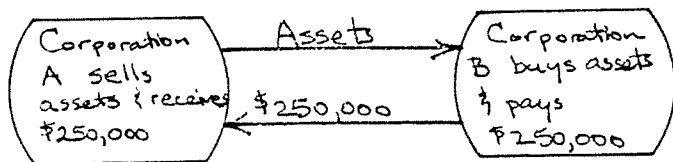
SALE OF ASSETS

Step 1

Corporation A adopts plan of complete liquidation as it plans to sell its assets to Corporation B for \$250,000

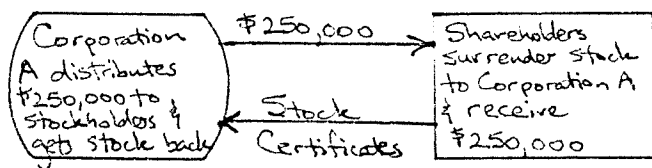
Step 2

Sale of Assets



Step 3

Liquidate Corporation



KANSAS TAX LIABILITY *

Tax paid by Corporation on sale of assets in Step 2 above (Note: No federal tax due on this transaction) \$9,562.50

Tax paid by individual stockholder on receipt of liquidating proceeds:

Gross tax	\$3,805.75	
Credit allowed	<u>3,805.75</u>	
Net tax	<u> --</u>	<u> --</u>

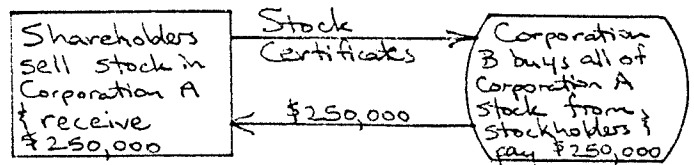
Total tax to Ks. \$9,562.50

SALE OF STOCK

Step 1

Sale of Stock

Shareholders of Corporation A sell stock (instead of the corporate assets) to Corporation B; i.e.



Step 2

Corporation B may either -

1. Operate corporation A or
2. Liquidate corporation A by transferring the assets from A to itself

KANSAS TAX LIABILITY *

No tax paid at corporate level to Kansas. Only tax to Kansas (and federal) is at stockholder level.

Tax paid by individual stockholder on receipt of liquidating proceeds:

Gross tax	\$4,150.00
No credit as no tax paid at corporate level	<u> --</u>

Net tax to Kansas 4,150.00

* Kansas tax liability computations and the assumptions made are on the next page of this packet.

Kansas Tax LIABILITY COMPUTATIONS AND ASSUMPTIONS

In my computations of Kansas tax liability under the two alternatives of —

1. Sale of assets, or
2. Sale of stock,

I assumed:

1. Basis of assets sold by Corporation A equals \$100,000
2. Basis of stock in Corporation A equals \$100,000
3. No other income in corporation
4. No other income to stockholders

My assumptions are to simplify the example and maintain a fair example to compare the tax results of the two alternatives.

Corporate Tax Computation

Cash received on sale of assets	\$ 250,000
Basis in assets	<u>100,000</u>
Taxable gain	<u>150,000</u>
Tax on 1st \$25,000	1,125.00
Tax on amt. above \$25,000	<u>8,437.50</u>
Total tax	<u>9,562.50</u>

Individual Shareholder Computation

<u>Sale of Assets</u>	
Cash received from corporate liquidation (\$250,000 less Ks tax of \$9562.50)	<u>\$240,437.50</u>
Ks. tax, net of credit	<u>- 0 -</u>

<u>Sale of Stock</u>	
Cash received from corporate stock sale	\$250,000
Basis in stock	<u>100,000</u>
Taxable gain	<u>150,000</u>
Ks. tax	<u>\$4,150.00</u>

Assumes married taxpayer filing jointly with spouse.

Suggested Changes to House Bill
No. 2611 *

Session of 1984

HOUSE BILL No. 2611

By Special Committee on Assessment and Taxation

Re Proposal No. 1

12-19

0018 AN ACT relating to taxation of income; concerning taxation of
0019 gain from certain corporate liquidations; amending K.S.A.
0020 1983 Supp. 79-32,138 and 79-32,140 and repealing the existing
0021 sections.

0022 *Be it enacted by the Legislature of the State of Kansas:*

0023 Section 1. K.S.A. 1983 Supp. 79-32,138 is hereby amended to
0024 read as follows: 79-32,138. (a) Kansas taxable income of a corpo-
0025 ration taxable under this act shall be the corporation's federal
0026 taxable income for the taxable year with the modifications spec-
0027 ified in this section.

0028 (b) There shall be added to federal taxable income: (i) The
0029 same modifications as are set forth in ~~K.S.A. 1982 Supp. 79-~~
0030 ~~32,117(b)~~ subsection (b) of K.S.A. 79-32,117, and amendments
0031 thereto, with respect to resident individuals.

0032 (ii) ~~Any gain excluded from federal taxable income by virtue~~
0033 ~~of the application of section 337 of the internal revenue code. For~~
0034 ~~purposes of this subsection any gain not otherwise included in~~
0035 ~~federal taxable income that would be received from an install-~~
0036 ~~ment obligation distributed in the liquidation shall be added to~~
0037 ~~federal taxable income in the corporation's final taxable year.~~

0038 (iii) (ii) The amount of all depreciation deductions claimed
0039 for any real or tangible personal property upon which the de-
0040 duction is allowed by K.S.A. ~~1982 Supp. 79-32,161, and amend-~~
0041 ~~ments thereto.~~

0042 (iv) (iii) The amount of all depreciation deductions claimed
0043 for any property upon which the deduction allowed by K.S.A.
0044 79-32,168, and amendments thereto, is claimed.

0045 (v) (iv) The amount of any charitable contribution deduction

* Changes shown in margin for line nos 0092, 0093,
0113, 0114, 0115, 0137 and 0138

0046 claimed for any contribution or gift to or for the use of any
0047 racially segregated educational institution.

0048 (c) There shall be subtracted from federal taxable income: (i)
0049 The same modifications as are set forth in ~~K.S.A. 1982 Supp.~~
0050 ~~79-32,117(e)~~ *subsection (c) of K.S.A. 79-32,117*, and amendments
0051 thereto, with respect to resident individuals.

0052 (ii) The federal income tax liability for any taxable year
0053 commencing prior to December 31, 1971, for which a Kansas
0054 return was filed after reduction for all credits thereon, except
0055 credits for payments on estimates of federal income tax, credits
0056 for gasoline and lubricating oil tax, and for foreign tax credits if,
0057 on the Kansas income tax return for such prior year, the federal
0058 income tax deduction was computed on the basis of the federal
0059 income tax paid in such prior year, rather than as accrued.
0060 Notwithstanding the foregoing, the deduction for federal income
0061 tax liability for any year shall not exceed that portion of the total
0062 federal income tax liability for such year which bears the same
0063 ratio to the total federal income tax liability for such year as the
0064 Kansas taxable income, as computed before any deductions for
0065 federal income taxes and after application of subsections (d) and
0066 (e) of this section as existing for such year, bears to the federal
0067 taxable income for the same year.

0068 ~~(iii) Any loss not deducted from federal taxable income by~~
0069 ~~virtue of the application of section 337 of the internal revenue~~
0070 ~~code.~~

0071 ~~(iv) (iii)~~ An amount for amortization of the amortizable costs
0072 of a certified oil production process as computed under K.S.A.
0073 ~~1982 Supp. 79-32,161~~, and amendments thereto.

0074 ~~(iv)~~ (iv) An amount for the amortization deduction for a solar
0075 energy system allowed pursuant to K.S.A. 79-32,168, and
0076 amendments thereto.

0077 (d) If any corporation derives all of its income from sources
0078 within Kansas in any taxable year commencing after December
0079 31, 1979, its Kansas taxable income shall be the sum resulting
0080 after application of subsections (a) through (c) hereof. Otherwise,
0081 such corporation's Kansas taxable income in any such taxable
0082 year, after excluding any refunds of federal income tax and

0083 before the deduction of federal income taxes provided by sub-
 0084 section (c)(ii) shall be allocated as provided in K.S.A. 79-3271
 0085 ~~through~~ to K.S.A. 79-3293, inclusive, and amendments thereto,
 0086 plus any refund of federal income tax as determined under
 0087 paragraph (iv) of subsection (b) of K.S.A. 1982 Supp. 79-
 0088 ~~32,117(b)(iv)~~ 79-32,117, and minus the deduction for federal
 0089 income taxes as provided by subsection (c)(ii) shall be such
 0090 corporation's Kansas taxable income.

0091 Sec. 2. K.S.A. 1983 Supp. 79-32,140 is hereby amended to
 0092 read as follows: 79-32,140. (a) For ~~corporate liquidations occur-~~ *sales*
 0093 ~~ring in taxable years commencing prior to January 1, 1983,~~ to
 0094 the extent that a corporation incurs a Kansas income tax liability
 0095 by reason of gains realized in a sale or sales which qualify as
 0096 being exempt from federal income taxation under section 337 of
 0097 the internal revenue code, such Kansas income tax liability so
 0098 attributable to such gains shall be allowed as a credit against the
 0099 Kansas income tax liability of each common stockholder of such
 0100 corporation in an amount which bears the same ratio to such
 0101 Kansas income tax liability as the liquidation distribution re-
 0102 ceived or receivable by such common stockholder bears to the
 0103 liquidation distribution received or receivable by all common
 0104 stockholders. (b) (1) Except as otherwise provided in paragraph
 0105 (2) of this subsection, such credit shall be allowable only in the
 0106 taxable year or years of each stockholder in which such liquida-
 0107 tion distribution is received and taxable years in which payments
 0108 are received on an installment obligation received by the stock-
 0109 holder as part of the liquidation distribution and shall be limited
 0110 to the amount of Kansas income tax liability, if any, of such
 0111 stockholder for such year or years as computed before applica-
 0112 tion of the credit provided by this section and before any credits *sales*
 0113 for withholding or estimated tax payments. (2) For ~~corporate~~
 0114 ~~liquidations occurring after December 31, 1979, and before~~
 0115 ~~January 1, 1983,~~ such credit shall be deducted from the stock-
 0116 holder's income tax liability in the taxable year or years of each
 0117 stockholder in which such liquidation distribution is received
 0118 and taxable years in which payments are received on an install-
 0119 ment obligation received by the stockholder as part of the

(but not in corporate tax years commencing
 before January 1, 1980)

0120 liquidation distribution as computed before application of the
0121 credit allowed by this section and before any credits for with-
0122 holding or estimated tax payments. If the amount of such tax
0123 credit exceeds the stockholder's income tax liability for any such
0124 taxable year, the amount thereof which exceeds such tax liabil-
0125 ity may be carried over for deduction from the stockholder's
0126 income tax liability in the next succeeding taxable year or years
0127 until the total amount of the tax credit has been deducted from
0128 tax liability.

0129 New Sec. 3. (a) Whenever, as a result of the provisions of this
0130 act, an assessment of additional income tax is required to be
0131 made, no interest or penalties shall begin to accrue upon such
0132 assessment until July 1, 1984.

0133 (b) Whenever, as a result of the provisions of this act, an
0134 overpayment of income tax was incurred, interest shall not ac-
0135 crue on such overpayment until 90 days after the date of receipt
0136 of the taxpayer's claim of overpayment of tax.

0137 New Sec. 4. ~~The provisions of section 1 shall be applicable~~
0138 to all ~~taxable years commencing~~ after December 31, 1982.

0139 Sec. 5. K.S.A. 1983 Supp. 79-32,138 and 79-32,140 are
0140 hereby repealed.

0141 Sec. 6. This act shall take effect and be in force from and
0142 after its publication in the Kansas register.

Sales

Amendment

Emphasis on Sales Transaction

vs.

Year of Liquidation

Currently House Bill No. 2611 provides for a transition in Kansas law to conform with federal law based upon the year of liquidation. The emphasis should be placed upon the sale transaction, as it is the sales transaction that causes Kansas to be in nonconformity with federal law. Placing the emphasis on years of liquidation can create unusual results. For example, a sale in January 1983 by a corporation with a year ended December 31, 1983 would be under the new Kansas law. A sale in November 1983 (10 months later) by a corporation with a tax year ended November 30, 1983 would be under the old Kansas law. It is illogical that a January sale is under new law and a subsequent sale in November is under the old law. Due to this unusual result, I believe House Bill No. 2611 should be amended to place the emphasis on the sales transaction and not the year of liquidation. For the appropriate changes, please see my notations on pages 5 through 8 of this pamphlet.

Questions and Answers

Kansas House Bill 2611

- Q - Kansas tax law does not conform to federal tax law in regard to sales by corporations under Section 337 of federal internal revenue code (IRC). What is the result of this nonconformity?
- A - Federal IRC Section 337 exists to avoid double taxation on proceeds from the sale of assets by a corporation which is liquidating within 12 months after such sale. Kansas law taxes the sale proceeds twice, once at the corporate level and once at the stockholder level.
- Q - Is there any relief under Kansas law for this double taxation?
- A - There is provision in Kansas law to provide relief for the double taxation. Frequently this relief is not sufficient to put the stockholder in the same position that he would have been if, instead of selling assets at the corporate level and then liquidating, the stockholder had sold his stock.
- Q - Why did Kansas pass a law so that it would not be in conformity with federal income tax law when in almost all other areas it conforms directly with the federal tax laws?
- A - There was concern that if the tax was not imposed at the corporate level, Kansas would receive no tax on the transfer of assets from one corporation to another if there were any stockholders residing outside of Kansas. The reason Kansas would collect no tax on the sale of the business assets within Kansas was that at the time of liquidation the gain to the stockholder is taxed only by the state in which that stockholder lives. A direct sale of stock would not result in taxes to Kansas if the stockholder lives outside of Kansas. Since a sale of stock by a nonresident does not result in tax liability to Kansas, a sale of assets before liquidation should not either.
- Q - Why change the tax law in Kansas for sales occurring after 1982? Isn't this making the law retroactive?
- A - Sales were made during 1983 which without a retroactive change in the tax law will result in this aforementioned unfair treatment to the stockholders. Perhaps in the sense of fairness the law should be repealed back to its original enactment date. However, this is not practical due to the fact that the Kansas Department of Revenue does not maintain sufficient tax return files.

HOUSE BILL 2611

<u>Calendar Year</u>		<u>1982</u>	<u>1983</u>	<u>1984</u>	
<u>Individual A</u>					
337 Distribution	\$125,000				
Salary		\$ 24,000	\$28,000	\$32,000	
337 Cost Basis	<u>100,000</u>				
Gain		<u>25,000</u>			
Kansas Adjusted Gross Income		\$ 49,000	\$28,000	\$32,000	
Deductions		<u>12,000</u>	<u>14,000</u>	<u>16,000</u>	
Taxable Income		\$ 37,000	\$14,000	\$16,000	
Tax		2,175	510	640	
337 Credit	\$ 8,437	<u>(2,175)</u>	<u>(510)</u>	<u>(640)</u>	Remaining to be used (5,112)
Net Tax Due		<u>\$ -0-</u>	<u>\$ -0-</u>	<u>\$ -0-</u>	

<u>Individual B</u>					
337 Distribution	\$125,000				
Salary		\$ 24,000	\$28,000	\$32,000	
337 Cost Basis	<u>10,000</u>				
Gain		<u>115,000</u>			
Kansas Adjusted Gross Income		\$139,000	\$28,000	\$32,000	
Deduction		<u>12,000</u>	<u>14,000</u>	<u>16,000</u>	
Taxable Income		\$127,000	\$14,000	\$16,000	
Tax		10,180	510	640	
337 Credit	8,437	<u>(8,437)</u>	<u>-0-</u>	<u>-0-</u>	
Tax Due		<u>\$ 1,743</u>	<u>\$ 510</u>	<u>\$ 640</u>	

Situation A

- 6-15-84 Corporation files an amended return for the year ended December 31, 1983, to receive a refund from the tax previously paid on a 337 liquidation. Corporation section reviews information to determine the following:
(AMENDED RETURN NECESSARY)
1. Corporation must have submitted with the amended return a list of all shareholders, their addresses, and their social security numbers.
 2. If the information concerning the shareholders was not received, the corporation section must request it from the corporation.
- 6-30-84 Corporation section places refund in suspension and advises individual tax section of shareholders name, address, and social security number.
- 7-10-84 Individual tax section checks their accounts and finds three shareholders have previously filed individual returns. However, corporation section had four shareholders listed. Assessments for \$25,000 are sent to the three shareholders and a letter is sent to the fourth shareholder to determine if that shareholder had a Kansas liability and should have filed a return.
- 7-20-84 Individual #1, a Kansas resident, pays his liability at individual level.
- 8-20-84 Individual #2, a Kansas resident, pays his liability at individual level.
- 8-25-84 Receive letter from individual #4 stating that he always lived in New York and only received dividends and the 337 distribution from the corporation.
- 9-15-84 Second letter is sent to individual #3.
- 10-25-84 It is determined that the address we have for individual #3 is incorrect and cannot be located. None of the other shareholders know his location now and the liability assessed at the individual level remains unpaid.
- 10-28-84 Individual section notifies the corporate income tax section that one of the individuals assessed has not paid nor can they locate him.
- 10-30-84 Corporation section writes the corporation and the corporation finally determines individual #3's correct address. Corporation section notifies individual section of the correct address.
- 11-4-84 Individual section sends assessment to individual #3.
- 11-25-84 Individual #3 pays liability.
- 11-28-84 Individual section notifies corporate section that all liabilities are now paid.
- 12-3-84 Corporation section places refund to the corporation in process.
- 12-20-84 Corporation receives refund : distribute to shareholders.

HOUSE BILL 2611

Situation B

- 6-15-84 Corporation files an amended return for the year ended December 31, 1983, to receive a refund from the tax previously paid on a 337 liquidation. ^{#100,000} Corporation section reviews information to determine the following:
1. Corporation must have submitted with the amended return a list of all shareholders, their addresses, and their social security numbers.
 2. If the information concerning the shareholders was not received, the corporation section must request it from the corporation.
- 6-30-84 Corporation section places refund in process and advises individual tax section of shareholders name, address, and social security number.
- 7-10-84 Individual tax section checks the accounts and finds three shareholders have previously filed individual returns. However, corporation section had four shareholders listed. Assessments for \$25,000 are sent to the three shareholders and a letter is sent to the fourth shareholder to determine if that shareholder had a Kansas liability and should have filed a return.
- 7-20-84 Individual #1, a Kansas resident, pays his liability at individual level. Also, the refund is sent to the corporation.
- 8-20-84 Individual #2, a Kansas resident, pays his liability at individual level.
- 8-25-84 Receive letter from individual #4 stating that he always lived in New York and only received dividends and the 337 distribution from the corporation.
- 9-15-84 Second letter is sent to individual #3.
- 10-25-84 It is determined that the address we have for individual #3 is incorrect and cannot be located. None of the other shareholders know his location now and the liability assessed at the individual level remains unpaid.
- 10-28-84 Individual section notifies the corporate income tax section that one of the individuals assessed has not paid and cannot be located. At this point, the Department is out \$25,000.



Kansas
DEPARTMENT OF REVENUE

State Office Building
Topeka, KS 66625

MEMORANDUM

November 14, 1983

TO: Special Committee on Assessment and Taxation

FROM: Harley T. Duncan *HTD*
Secretary of Revenue

SUBJECT: I.R.C. 337 Liquidation Modification Removal,
Effective for years beginning after December 31, 1982

Per your request, the Department of Revenue has examined the possibility of legislation to repeal the 337 liquidation modification, with an effective date of years beginning after December 31, 1982, and the effect of such retroactive legislation upon the Department work effort.

1. Any corporation adding back the federal code section 337 gain or loss and paying the tax shown to be due for any period beginning after December 31, 1982, would be required to file amended returns excluding the 337 gain or loss. The corporation will be required to provide this Department with a list of all shareholders, by full name, address, social security or federal employer identification numbers, number of shares owned, and the dollar amount of each liquidating distribution to each shareholder.
2. The Audit Bureau would then need to prepare refunds on gains or assessments on losses to the corporations and compute interest at 1% per month on refunds and 1 1/2% per month on assessments from the due date of the return.
3. Upon receipt of the refund or balance due, the corporation will be required to distribute refunds to the shareholders or bill the shareholders for any balance due. This could cause a problem since, in most instances, the corporation would be completely closed out at that time. Enforcing the responsibility to distribute refund proceeds or assess additional payments will be difficult under such circumstances. It is also conceivable that requiring such transaction could run counter to Internal Revenue Code requirements that the closing of the liquidated corporation be completed within 12 months.
4. The corporation will need to file either an amended federal return for the original year of liquidation or a return for the subsequent year to show the receipt of the Kansas corporate tax refund and the additional liquidating distribution to the shareholders. This then could cause an amended Kansas corporate return to be filed also.

EXHIBIT VIII

1/24/84

5. At the individual level, making the change in the 337 Liquidation Credit retroactive to January 1, 1983 will require that the Income & Inheritance Bureau locate all returns filed in 1983 which claimed this credit. We do keep records of those individuals claiming the credit; however, making adjustments to these returns would involve locating and auditing these returns (three to four hundred received in a normal year). This would be an additional strain on our amended unit which is already heavily backlogged in processing the normal flow of amended returns.
6. Making the modification repeal retroactive will require each shareholder who claimed the liquidation credit to prepare and file an amended return along with the payment of the additional tax plus interest at 1 1/2% per month. The credit will have to be disallowed and the additional tax assessed and paid. The individual receipt of the additional liquidation distribution of the Kansas corporate tax originally paid will come in a subsequent year and will be recognized as additional income for both federal and Kansas purposes.
7. For out-of-state shareholders whose only Kansas income is from such liquidations, it is likely that the tax at the individual level will not be collected. These persons do not likely file Kansas returns. In that such income is intangible income, they would not be required to file a return.
8. The question of interest is a difficult one. Under normal Department policy, interest would be paid or assessed from the time the refund or tax was owed. This could be seen as onerous given that returns were filed under what was understood to be the tax law for 1983. To completely ignore interest, however, is likely to make collection efforts difficult.
9. The advantages of repealing the modification as of January 1, 1984, would be to simplify the Department's tasks of processing and auditing these returns since no amended returns would be required. Also, by prospective repeal, no amended action is required of either the liquidated corporation or the shareholders.
10. The committee should be aware that the topic of re-establishing the tax on liquidation gains at the corporate level is currently under discussion in the federal government.

HTD:b/2/S257