

MINUTES OF THE SENATE COMMITTEE ON ASSESSMENT AND TAXATIONThe meeting was called to order by Senator Paul "Bud" Burke at
Chairperson11:00 a.m. ~~xxxxx~~ March 8, 1984 in room 526-S of the Capitol.All members were present except: Senator Hayden (excused)
Senator Mulich (excused)Committee staff present: Don Hayward, Revisor's Office
Tom Severn, Research Dept.
Wayne Morris, Research Dept.

Conferees appearing before the committee:

Representative Robin Leach
T. C. Anderson, KSCPA
Ron Gaches, Kansas Association of Commerce and Industry
Harvey Sorenson, KSCPA, Wichita
Chuck Engle, Peat, Marwick; Wichita
John A. Strain, Strain and Pottberg, Junction City
Austin Nothorn, Attorney
Harley Duncan, Secretary of Revenue
Tom Sheridan, Chief, Audit Bureau, Revenue Department

The committee held a hearing on HB 2611 which changes the state tax treatment of Chapter 337 corporate liquidations and also increases the personal exemption amount for individual tax payers from \$1,000 to \$1,100.

The chairman called on Wayne Morris for a brief explanation of the bill. He told the committee the bill was originally introduced by the interim tax committee to deal with corporation liquidations and it deleted the requirement that a corporation add to its federal tax income the gain received from its liquidation under Section 337 of the Internal Revenue Code. It is retroactive for one year, and at the same time limits the credit that individual taxpayers get for the gain paid by corporations to credits for liquidations for tax years prior to 1983 and would allow such credits for liquidations occurring after December 1979 to be carried forward. A new section would be enacted to delay the interest on amounts due refunds payable to allow both the state and taxpayers time to comply with the new law. Kansas has never conformed to Section 337 of the federal Internal Revenue Code and when the state conformity law was enacted in 1967, the recommendation was that Kansas not conform and that it tax the gain at the corporate level and avoid the question of double taxation by giving individuals a credit for their proportionate share of the tax paid by the corporation. The bill would essentially conform the state law to the federal tax code beginning in the 1983 tax year. The gain is not taxable to the corporation, but at the individual level.

A major change added by the Committee of the Whole was regarding personal exemptions, beginning in the 1984 tax year, and increasing the amount from \$1,000 to \$1,100. The fiscal note indicates the increase in personal exemption would cause a decrease of \$8.9 million in revenue to the state.

Representative Leach told the committee he was here to speak to the amendment added on the House floor which raised the individual Kansas exemption \$100 and explained the reason for this. In 1975 individual income taxes amounted to \$170 million; in 1985, projection is a contribution of \$650 million to the General Fund. He said the main reason changes came about was because the state didn't choose to nonconform to the federal Economic Recovery Tax Act and the result was there was nothing to stem these shifts to the individual. He tried to raise the individual income tax exemption by \$100, and this passed overwhelmingly in the House. To keep up, he said, the individual exemption should go to \$1400. He is aware there will be an \$8.9 million drain on the General Fund because of this amendment and suggested there were ways to offset this, such as an increase in the corporation tax rate. He urged keeping the bill as is or expanding on it.

CONTINUATION SHEET

MINUTES OF THE SENATE COMMITTEE ON ASSESSMENT AND TAXATION,

room 526-S, Statehouse, at 11:00 a.m./p.m. on March 8, 1984

T. C. Anderson, Executive Director, Kansas CPA's, spoke in support of HB 2611 and said only Section 337 liquidations are taxed in this method.

Harvey Sorenson, an attorney practicing in the tax area in Wichita, described the existing tax structure in Kansas and explained the provisions of HB 2611. (Attachment #1)

Ron Gaches, KCCI, spoke in support of HB 2611 insofar as it affects the corporate Section 337. He said he would rise in support of the proposal worked by the interim committee in its present form. However, their organization has no position on the individual deduction.

Chuck Engel, CPA, spoke in support of passage of HB 2611. (Attachment #2) He explained an example illustrating the inequitable results under current Kansas law and said this bill eliminates this inequity.

John Strain, CPA suggested this bill should be amended to put the tax so the corporations are paying tax on its collections, and the individuals paying tax on their respective gain contained in their collections over the ensuing years on their respective shares of the installment contracts. (Attachment#3)

Austin Nothern, attorney, said some taxpayers and corporations who have gone through this process for 1983, having withheld or paid the tax to the state, made their distribution of the net left over and filed the necessary forms for them and turned in their charter and are out of business. Some 800 shareholders were involved in one case they have and it would be very difficult and complex going back to get all this done. If this is done retroactively, maybe an optional element would be helpful.

In response to the question about why this bill should not be amended to have this option, T. C. Anderson said this issue was not discussed in the House. The people contacting them represented small family businesses and not until two weeks ago did this issue arise, the optional aspect.

Secretary Duncan spoke opposing the retroactive part of HB 2611 (See Attachment #4) He said he supports conformity to the federal law on Section 337 liquidations and allowing the credit is proper to avoid double taxation of income.

Tom Sheridan, Chief, Audit Bureau, commented that in the years he's been with the state, he doesn't recall a Section 337 loss. The sale of stock is an individual matter and Section 337 is a corporate matter.

The chairman called attention to written testimony from Marian Warriner, League of Women Voters, expressing opposition to what would be a satisfactory measure except for the loss of \$8.9 million in revenue under the individual deduction portion of the bill.

The chairman adjourned the meeting at 11:55 a.m. The committee meets on March 12, 11:00 a.m.

Harvey Sarsen

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

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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.

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 (h)(1) preserves the existing credit provisions as they relate to liquidations occurring in such taxable years. However, subparagraph (h)(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.

Presentation on House Bill No 2611

March 8, 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.

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Statement of Support

for House Bill 2611

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.

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.

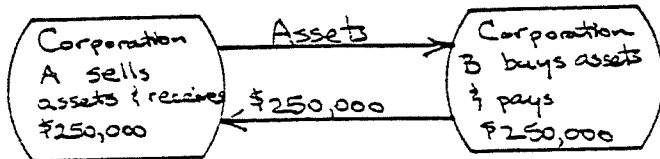
SALE OF ASSETS

Step 1

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

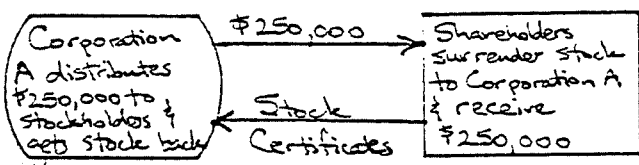
Step 2

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	3,805.75	
Net tax	<u> </u>	<u> </u>

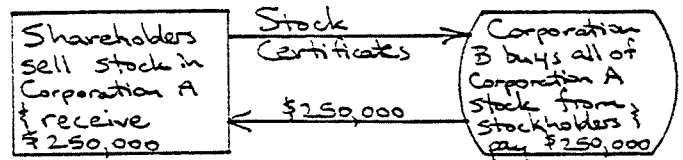
Total tax to Ks. \$9,562.50

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	

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

Individual Shareholder Computation

		<u>Sale of Assets</u>	
Cash received on sale of assets	\$ 250,000	Cash received from corporate liquidation	
Basis in assets	100,000	(\$250,000 less Kansas tax of \$9,562.50)	\$ 240,437.50
	<u> </u>		<u> </u>
Taxable gain	\$ 150,000	Kansas tax, net of credit	-0-
	<u> </u>		<u> </u>
Tax on 1st \$25,000	\$ 1,125.00		
Tax on amount above \$25,000	8,437.50		
	<u> </u>		
Total tax	\$ 9,562.50		
	<u> </u>		
		<u>Sale of Stock</u>	
		Cash received from corporate stock sale	\$ 250,000.00
		Basis in stock	100,000.00
			<u> </u>
		Taxable gain	\$ 150,000.00
			<u> </u>
		Kansas tax	\$ 4,150.00
			<u> </u>

Assumes married taxpayer filing jointly with spouse.

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.

BEFORE THE SENATE COMMITTEE ON
ASSESSMENT AND TAXATION

HEARING, MARCH 8, 1984, TOPEKA, KANSAS
RE: HB 2611

STATEMENT OF JOHN A. STRAIN, CPA, OF THE FIRM
STRAIN & POTTBERG, CPAs, OF JUNCTION CITY, KANSAS

Senate Bill 836 of 1982 as amended by Senate Bill 564, Chapter 410 of 1982, provided that installment sales of corporations liquidating under Section 337 of the Internal Revenue Code, should be taxed in full at the corporate level in the final year of the corporation.

To put this in perspective, this is the same as taxing your expected salary for the next 15 or 20 years in one year. There are valid reasons why you should not pay tax in one single year on what is only deemed to be your income for the next 15 or 20 years. You may not be re-elected. You may move out of state. You may not have any income, and you might even be dead.

But this is what the legislature did in Chapter 410 to corporations which liquidated after an installment sale of its property in 1982 and 1983. The vagaries of business and economics being what they are, why should a Kansas group of stockholders be forced to endure a present detriment in exchange for a speculative credit against their individual tax over the 15 or 20 years? A corporation which liquidates under Section 337 must distribute its assets within 12 months. Many times an installment contract is virtually the only asset it has to distribute. Where then, I ask, is the money going to come from to pay the corporate tax on an installment sale running 15 to 20 years?

In the classic case of Eisner v. Macomber, 252 U.S. 189, the United States Supreme Court defined taxable income as:

"Income is the gain from capital, from labor or from both combined; something of exchangeable value, proceeding from the property, severed from the capital however invested or employed, and received or drawn by the recipient for his separate use, benefit and disposal."

And as Justice McReynolds said in another classic, Farmers Loan & Trust v. State of Minnesota, 280 U.S. 204:

"Taxation is an intensely practical matter, and laws in respect of it should be construed and applied with a view of avoiding, as far as possible, unjust and oppressive consequences."

Let's look at how an installment sale works in a Section 337 liquidation:

Sale price of a business was	\$ 1,000,000
Purchase price of that business	
less depreciation is now	600,000
There is an apparent gain of	\$ 400,000

The purchaser pays \$100,000 down and agrees to pay off seller's purchase contract of \$500,000 and pay the balance of \$400,000 over 20 years.

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The Department of Revenue contends that under your law, the whole \$400,000 is taxable at once in the final return and the tax is \$26,437.50. How many of you would be prepared for a tax like that on the next fifteen years' income?

The seller is still liable to the original owner on contract for \$500,000. Both that obligation and the new obligation of \$400,000 will run for 15 years. The corporation received only \$100,000 cash which it must use to pay off other debts, notes, accounts and final expenses.

Where is the gain derived from capital in this case? What is that something of exchangeable value proceeding from the property? What is it, that has been severed from capital, drawn by the recipient for separate use, benefit and disposal? Where is the efficiency in tax administration if financial status of the distributees is devastated and leaves them to recover as best they can with no particular Kansas law to benefit them in case of default?

And after the purchaser has defaulted, how does the taxpayer regard his situation with reference to favorable Federal treatment when he has had to pay a corporate tax of \$26,437.50 to Kansas on a fictitious tax base?

Now, HB 2611 is a good one for the future but it leaves 1982 and 1983 installment sales in a travesty. Bear in mind that under the general principles of installment sales taxation, the taxpayer pays tax on the allocable part of the profit represented in the money which he collects in that year. With this, I have no argument. That is fair - just as it is fair for you to pay tax on your present income - not on expected income for the next 15 or 20 years.

Therefore I suggest that in your deliberations, you amend HB 2611 granting an election so corporations (and their distributee shareholders) which liquidated in 82 & 83 under Sec 337 be relieved of tax at the corporate level on uncollected portions of installment contracts if the corporation already has paid tax, or will pay tax, on the proportionate gain represented in the collections in that particular year.

This then puts the tax where it should be, the corporation paying tax on its collections, and the individuals paying tax on their respective gain contained in their collections over the ensuing years on their respective shares of the installment contract.

The credit against the individual Kansas tax for the corporate tax paid in the year of liquidation should be allowed to the distributee shareholders as now provided in present law and also in HB 2611.

Those corporations and shareholders which filed returns and settled their taxes in a 337 liquidation for 1982 and 1983 should have the option of staying with that action without further statutory change.

Thank you for the opportunity to speak at this hearing.





Kansas
DEPARTMENT OF REVENUE

Attachment #4

State Office Building
Topeka, KS 66625

MEMORANDUM

March 8, 1984

TO: The Honorable Paul Burke, Chairman
Senate Committee on Assessment and Taxation

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

SUBJECT: House Bill 2611 - Section 337 Liquidations

Thank you for the opportunity to appear before you on HB 2611. I appear in opposition to the bill as it now reads.

Provisions of the Bill

As it stands before this Committee, HB 2611 makes three changes to the Kansas income tax law:

1. It brings the state tax code into conformity with the federal code with respect to taxing Section 337 liquidation gains. In essence, we would move to a system where those gains are taxed at the individual stockholder level, rather than taxing the gain at the corporate level and providing a credit to individuals for their proportionate share of the tax paid by the corporation. This would be effective for liquidations occurring in tax years beginning after December 31, 1982.
2. The bill modifies the individual income tax credit provisions of current state law with respect to 337 liquidations to provide that the unused portion of any credit resulting from a liquidation occurring after December 31, 1979 may be carried forward to offset an individual's income tax liability in succeeding years until the credit is used entirely. Under current law, the credit may be applied against an individual's liability only in the year or years in which the individual receives a liquidation distribution. To the extent that an individual's credit exceeds his/her liability in that year, the credit may not be carried forward.
3. The bill increases the personal exemption under the Kansas income tax from \$1,000 per individual to \$1,100 for tax years beginning after December 31, 1983, i.e., tax year 1984.

HTD
3/8/84

Department of Revenue Position

The Department of Revenue opposes two provisions of HB 2611: (a) the retroactive effective date of December 31, 1982 (tax year 1983) and forward for conformity with federal 337 treatment; and (b) the carryforward provisions for the individual credit on 337 gains. The Department takes no position on the third component of the bill increasing the personal exemption amount.

Retroactive Conformity -- The Department, in principle, supports a move toward conformity with the federal treatment of 337 liquidation gains, i.e., taxing the gain at the individual level rather than the corporate level. This could have some negative revenue consequences in that gains accruing to non-resident shareholders would not be taxable in Kansas. This will, however, be offset to some degree by higher individual tax rates. The Department does, however, oppose the retroactive application of federal conformity to liquidations occurring after December 31, 1982 and recommends that this be changed (line 165) to December 31, 1983. The Department objects to the retroactive date for two reasons.

First, the retroactive application will cause serious confusion, problems and administrative workload for both the taxpayer and the Department. For those liquidations occurring in tax year 1983 for which returns have been filed and the tax paid, a process such as follows will have to go forward.

- The corporation, which is likely non-existent at this time, must file an amended return excluding the gain and seeking a refund. This must be accompanied by a complete list of shareholders with their addresses and social security numbers.
- The Department must locate the returns of all resident shareholders, eliminate the credit taken by the individual, and make an assessment of the additional tax due from the individual.
- The Department must then choose whether to issue the corporate refund when all individuals have been assessed or whether to wait with the refund until all individuals have paid the liability. If the refund is processed prior to payment, the Department stands to lose money or incur collection costs where there is difficulty in collecting from the individual. If the Department holds the refund until payment, the individuals will have incurred and paid a liability before they receive the additional distribution from the liquidating corporation.
- Once the refund is made, the liquidated and likely non-existent corporation must distribute the refund proportionally among shareholders.

As I hope you can see, the process required is at best cumbersome for the taxpayer and the Department, and at worst it places some amount of state revenue at risk. Of greatest concern to me is the fact that individuals will be assessed what could be considerable additional tax before they receive an additional distribution from the refunded corporate tax. Also of concern is the ability of the Department and the liquidated corporation to locate all shareholders. I

would note that the Department has received an expression of serious concern from one individual associated with a liquidation occurring in 1983 that paid over \$340,000 in tax and had 850 shareholders. It is the position of this individual that they are not interested in participating in this process.

Our second concern about the retroactive effective date is one of principle rather than procedure. I have to ask myself why should the tax rules be changed after the tax year has already been closed. The only answer I can arrive at is that someone must have ignored the tax rules and is now seeking relief. I consider this to be inappropriate.

Credit Carryforward -- The provision allowing the carryforward of the "unused" liquidation credit at the individual level is ever more problematic in my mind. The purpose of the credit is simply to avoid a double taxation of the gain occurring in a 337 liquidation. That is having been taxed at the corporate level in Kansas, a credit is allowed to individuals (who must include the gain from their stock in their income) to avoid the income being taxed twice. The full credit for all stockholders is equal to the total tax paid at the corporate level, and it is apportioned among shareholders in proportion to the liquidation distribution they receive. That is, if \$100,000 in corporate tax were paid on a liquidation and an individual received 25 percent of the total liquidation distribution, his/her credit would equal \$25,000. Under current law, the credit may be used only in the year or years in which a liquidation distribution is received. If the credit brings a taxpayer's liability to zero before it is exhausted, it may not be applied to the future income under current law. It still achieves its purpose of limiting the taxation of the gain to only one level, i.e., the corporate level. This is not uncommon for tax credits. Credits for taxes paid to other states, child care credits and business and job development credits are all limited to a one-year application, even if there is a portion that is "unused". In fact, only the solar credit and the handicapped accessibility credit are refundable or may be carried forward under current law.

To allow unused 337 credits to carryforward would be to allow this credit to be used to offset the tax on income arising from other sources in future years when no gain was received from the liquidation. This stands in stark contrast to the original purpose of avoiding double taxation of the gain. With a carryforward, not only is the taxpayer's liability reduced to zero in the year he/she received the gain, but the credit carries forward to offset other income. Again, it presents a situation of a retroactive change in the tax rules providing relief to some who feel aggrieved by the rules in place at the time they elected a 337 liquidation.

In short, the Department supports conformity with the federal treatment of 337 liquidation gains on a prospective basis, but it feels that carryforward of the 337 credits from 1979 forward is inappropriate under any circumstances.

HTD:a/2/S421

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>	

LWVK LEAGUE OF WOMEN VOTERS OF KANSAS

909 Topeka Boulevard-Annex

913/354-7478

Topeka, Kansas 66612

March 8, 1984

STATEMENT TO THE SENATE ASSESSMENT & TAXATION COMMITTEE IN OPPOSITION TO SECTION 4 OF SB 2611.

Mr. Chairman and Members of the Committee:

The League of Women Voters of Kansas must oppose what would otherwise be a satisfactory measure because there is a loss of revenue of \$8.9 million.

Noting measures already passed or pending, e.g., school finance, that demand additional revenue, we do not feel that the best interests of the citizens of Kansas will be served by this change unless the loss of revenue is recovered.

Possible ways include the original counterpart, a slight increase in the corporate income tax, or an adjustment of the individual income tax upward sufficient to replace the \$8.9 million.

Marian Warriner

Marian Warriner, LWVK Lobbyist
State Finance