

MINUTES OF THE SENATE ASSESSMENT AND TAXATION COMMITTEE

The meeting was called to order by Chairman David Corbin at 10:45 a.m. on March 9, 2004, in Room 519-S of the Capitol.

All members were present except:

Senator David Haley

Committee staff present:

Chris Courtwright, Legislative Research Department

Martha Dorsey, Legislative Research Department

Shirley Higgins, Committee Secretary

Conferees appearing before the committee:

Allie Devine, Kansas Livestock Association

Others attending:

See Attached List.

SB 543—Increase of net operating loss carry back refund of income tax

Allie Devine, Kansas Livestock Association (KLA), testified in support of **SB 543**. She noted that a letter attached to her written testimony from David Hetrick, a CPA with Hooper and Dick, LLC, fully explains the intent of the bill. She explained that Mr. Hetrick's firm has a considerable tax practice, and he has raised the issue of the \$1,500.00 tax refund with KLA on a numerous occasions. In his letter, he outlines an underlying interpretation issue with the Department of Revenue which has caused difficulties for Kansas' producers. Mr. Hetrick discusses a factual situation in his letter to illustrate the difficulty taxpayers have with being limited to \$1,500.00 per year increments to offset losses and gains. The bill raises the maximum amount allowed for an income tax refund resulting from a net operating loss carry back from \$1,500.00 to \$5,000.00. Mr. Hetrick states in his letter that it is important to clarify that any excess amount of overpayment can be applied to the taxpayer's income tax liability in future years without limitation. In addition, he contends that treatment of corporate taxpayers and individual taxpayers should be the same. Ms. Devine suggested that another possible solution would be allow the taxpayer to elect whether he or she wants to take a carry back loss in Kansas even though the taxpayer has elected to carry back a loss on his or her federal taxes and allow the taxpayer the loss for up to ten years. (Attachment 1)

Senator Corbin called the Committee's attention to written testimony in support of **SB 543** submitted by Leslie Kaufman, Kansas Cooperative Council. (Attachment 2)

Senator Donovan raised a question regarding the accuracy of the fiscal note on the bill, which indicates a \$165,000.00 decrease to the State General Fund. He noted that the amount reflects that only 47 operations would be able to utilize provisions in the bill. In response, Richard Cram, Kansas Department of Revenue, indicated that the Department would prepare other fiscal notes using other data.

Senator Lee asked Mr. Cram if "refund" on line 17, page 2, refers to an actual cash refund. Mr. Cram answered that the Department interprets it as a cash refund. Senator Lee also pointed out that it is unclear if the three year limitation on line 10, page 2, affects section (f). With regard to lines 19 through 20 in section (f), she noted that the time lines are not clear.

Senator Oleen asked for confirmation that the bill applies only to farms. Chris Courtwright, Legislative Research Department, suggested that perhaps the bill could be interpreted as not being limited to farm losses but applying to all net operating losses. Mr. Cram said that the Department interprets the bill as being limited to farm net operating losses. He noted that the fiscal note would change substantially if the bill applied to all net operating losses. To avoid confusion, Mr. Cram recommended that the bill be amended with language making it clear that it applies only to farm net operating losses.

Senator Corbin suggested that Ms. Devine request that concerned CPAs present testimony clarifying the intent

CONTINUATION SHEET

MINUTES OF THE SENATE ASSESSMENT AND TAXATION COMMITTEE at 10:45 a.m. on March 9, 2004, in Room 519-S of the Capitol.

of the bill. Ms. Devine noted that the accountants who drafted the bill had difficulty with interpretations when researching the legislative history on the issue. Senator Corbin suggested that perhaps the issue should be recommended as a topic for a summer interim study. With this, the hearing on **SB 543** was closed.

Senator Corbin called the Committee's attention to the minutes of the March 8 meeting.

Senator Donovan moved to approve the minutes of the March 8, 2004, meeting, seconded by Senator Buhler. The motion carried.

The meeting was adjourned at 11:05 a.m.

The next meeting is scheduled for March 10, 2004.



Since 1894

TESTIMONY

To: Senate Assessment and Taxation
Senator David Corbin, Chair

From: Allie Devine, Vice President and General Counsel

Subject: **Support for SB 543**

Date: March 9, 2004

The Kansas Livestock Association (KLA), formed in 1894, is a trade association representing over 6,000 members on legislative and regulatory issues. KLA members are involved in many aspects of the livestock industry, including seed stock, cow-calf and stocker production, cattle feeding, grazing land management and diversified farming operations.

Thank you Mr. Chairman and Members of the Committee. KLA strongly supports the provisions of SB 543.

KLA supports efforts to give maximum flexibility to producers in compliance with income taxes. As you know, it is not unusual for agricultural operations to have large fluctuations in income over a period of years. The ability of producers to carry losses backward or forward is a valuable tool for them and the state as this process allows for more consistent taxes.

Attached to my testimony is a letter I received from Mr. David Hetrick, CPA, Lewis, Hooper, & Dick, LLC. This firm has a considerable tax practice and has raised the issue of the \$1,500.00 tax refund to our association on numerous occasions. We requested this bill be introduced. We believe the increase of the tax refund to \$5,000.00 is a good improvement to the system and we support the bill. Mr. Hetrick outlines an underlying interpretation issue with the Department of Revenue that has caused difficulties for Kansas's producers. If the committee cannot support the language of SB 543, we believe there may be other ways of addressing the problems our members experience.

At the bottom of page 2 top of page 3, of Mr. Hetrick's letter, he has outlined a factual situation to illustrate the troubles taxpayers have. In his example, a producer in 2001 had a significant loss of \$764,353, which he was required to carry back on his state and federal income taxes to tax year 1996 in which he had a substantial tax payment. In the following paragraphs, Mr. Hetrick outlines the remainder of his example. The key point

Senate Assessment + Taxation
3-9-04
Attachment 1

here is that the taxpayer is limited to \$1,500.00 per year increments. At this rate it would take the taxpayer 38 years to offset his losses and gains. This incremental process appears to defeat the intent of the legislature and the benefits the carry back loss provisions were intended to grant. SB 543 increases the incremental movement, but does not eliminate it.

We understand that the state cannot afford to write large refunds to taxpayers. Perhaps a simple fix would be to limit the refund to \$1,500 as current law or \$5,000.00 as proposed in SB 543 and to clarify that there is no limitation on the carrying forward of excess or overpayment amounts (in the example the \$56,180.00) to be completely used in any year to offset the tax liability for that year. Mr. Hetrick has suggested language on page 4 or his testimony.

Another possible solution would be to allow the taxpayer to elect whether he/she want to take a carry back loss in Kansas even though the taxpayer has elected to carry back a loss on his/her federal taxes and allow the taxpayer to carry forward the loss for up to ten years. Today, Kansas's taxpayers must carry back the loss on their Kansas taxes if they carry the loss back federally even though the credit is limited to \$1,500.00.

Mr. Hetrick also raises issues of the differing treatment of individuals and corporations. We ask that the legislature also consider this issue. Mr. Hetrick has summarized all the issues on page 5 and we ask that you consider his proposals.

Mr. Chairman, we support any efforts in this area and appreciate your time and consideration of these issues.



March 5, 2004

Ms. Allie Devine
Kansas Livestock Association
6031 S.W. 37th Street
Topeka, KS 66614

Comments on Senate Bill 543

Dear Allie,

We appreciate the opportunity to provide our views on Senate Bill 543, and to provide some insight into what we believe are the problems of interpretation in the existing law. We wish we were able to attend the hearing with you, but both Rodney and I have prior commitments next week.

Background on Kan. Stat. Ann. § 79-32,143 regarding Net Operating Losses

Since 1987, Kansas has generally not allowed taxpayers to carry a net operating loss back to prior years, but Kansas does allow a carry forward of the loss for ten years.

Kan. Stat. Ann. § 79-32,143(a) generally provides that "For net operating losses incurred in taxable years beginning after December 31, 1987, a net operating loss deduction shall be allowed in the same manner that it is allowed under the federal internal revenue code except that such net operating loss may only be carried forward to each of the 10 taxable years following the taxable year of the net operating loss."

In 1998, Congress added language to IRC § 172(b)(1)(F)(ii) (now re-designated as § 172(b)(1)(G)) which provides that "In the case of a taxpayer which has a farming loss (as defined in subsection (i)) for a taxable year, such farming loss shall be a net operating loss carryback to each of the 5 taxable years preceding the taxable year of such loss."

In adopting this change to § 172(b)(1) the House committee explained that "The NOL carryback and carryforward rules allow taxpayers to smooth out swings in business income (and Federal income taxes thereon) that result from business cycle fluctuations and unexpected financial losses. Farmers are particularly vulnerable to such fluctuations and losses. The Committee believes that farmers who suffer losses from their farming business should have an extended period in which to use such losses to offset taxable income in prior years."

CPAs

CHARLES H. CLAAR, JR., CPA
PHILLIP R. DICK, CPA
DAVID L. HETRICK, CPA
DONALD R. LINVILLE, CPA
GARY A. SCHLAPPE, CPA
RODNEY VAN NORDEN, CPA
SUE A. BRADLEY, CPA
SUSAN A. BURGARDT, CPA
THERESA DASENBROCK, CPA
MARY A. FLOTO, CPA
TRACEY HOMM, CPA
STEVEN D. JOSSERAND, CPA
KIMBERLY A. ROTH, CPA
JULIE M. RUMFORD, CPA
AMBER L. SCHWANKE, CPA
RADONA SMYTHE, CPA
MONICA J. WILSON, CPA

The Report of the Special Committee on Assessment and Taxation to the 2000 Kansas Legislature concluded that "the Committee notes the importance of the income tax in timing of marketing efforts and strategies for sale of farm products as well as the benefits of smoothing volatility in farm income for state revenue planning purposes. This issue is especially important to Kansas farmers at the current time due to low commodity prices. Therefore, the Committee recommends introduction of a bill to provide income loss carryback of five years on farm income to mirror the federal law."

The Kansas Legislature responded to the new Internal Revenue Code provision in 2000 by adding the following sentence to § 79-32,143(a) to provide some needed tax relief to Kansas farmers. "For net operating farm losses, as defined by subsection (i) of section 172 of the federal internal revenue code, incurred in taxable years beginning after December 31, 1999, a net operating loss deduction shall be allowed in the same manner that it is allowed under the federal internal revenue code except that such net operating loss may be carried forward to each of the 10 taxable years following the taxable year of the net operating loss."

However, due to concerns about the possible affect of these carrybacks on the Treasury the legislature added § 79-32,143(f) which provides that "No refund of income tax which results from a net operating loss carry back shall be allowed in an amount exceeding \$1,500 in any year. Any excess amount may be carried back or forward to any other year or years as provided by this section."

We commend the Committee for considering an increase in the allowable refund from \$1,500 per year to \$5,000 per year. However, we encourage the Committee to take this opportunity to address what we believe to be the unintended consequences resulting from the manner in which the Kansas Department of Revenue is interpreting the statute.

Interpretation of the limitation of overpayments under K.S.A § 79-32,143(f)

The addition in 2000 of the provision in K.S.A. § 79-32,143 allowing a carry back of a net operating loss from farming was intended to assist farmers who are more vulnerable to large swings in income than other taxpayers. The way that the provision is being interpreted may actually prolong the time before a farmer receives a Kansas tax refund on account of the Net Operating Loss.

Before the law was changed in 2000, a farmer who elected to carry his federal net operating loss back to receive an immediate refund would carry his Kansas net operating loss forward to the following year, like other Kansas taxpayers. Since 2000 a Kansas farmer is required to carry his Kansas farm loss back if he elects to carry his federal loss back, even though his refund is limited to \$1,500 per year.

We can illustrate the problem with our experience in representing a Kansas farm corporation last fall. For the 2001 tax year, the taxpayer reported a loss on its Kansas income tax return of \$764,353. Taxpayer attached Form K-139F to carry this loss back to the 1996 tax year under the provisions of § 79-32,143 resulting in an overpayment of \$56,180. Taxpayer claimed the \$1,500 refund on Form K-120 for 2001, resulting in an overpayment of \$54,680 (\$56,180 less \$1,500 refund).

For the 2002 tax year, the taxpayer reported income on its Kansas income tax return of \$747,656. The income tax on this income amounted to \$53,277 before credits. Taxpayer claimed the \$54,680 overpayment remaining from the carry back of its 2001 loss as a credit on its 2002 return. \$53,277 of this credit was used to offset the income tax and the remaining \$1,403 was claimed as a refund since it did not exceed the \$1,500 limitation on refunds imposed by K.S.A. § 79-32,143(f).

The Department of Revenue sent a notice denying all but \$1,500 of the claimed credit and required the taxpayer to pay \$51,777 of tax (\$53,277 tax less \$1,500 credit) plus penalties and interest. We referred this matter to the problems resolution officer and ultimately to an appeals hearing officer and were informed that this is the official interpretation of the Department of Revenue.

The Department of Revenue interprets K.S.A. § 79-32,143(f) as requiring the payment of the \$56,180 overpayment resulting from the carryback of the net operating loss from farming at the rate of \$1,500 per year. This interpretation means that the taxpayer will have to wait for 38 years to receive refunds totaling the entire amount of the overpayment. We do not believe that this is a reasonable interpretation of K.S.A. § 79-32,143.

The addition in 2000 of the provision in K.S.A. § 79-32,143 allowing a carry back of a net operating loss from farming was intended to assist farmers who are more vulnerable to large swings in income than other taxpayers. If this provision had not been enacted the Taxpayer would have carried its 2001 loss of \$764,353 forward and completely offset the taxable income of \$747,656 for the 2002 tax year. The taxpayer would offset all of the 2002 income and would have a net operating loss carryover of \$16,697 available to reduce any income in future years.

The taxpayer applied its unused overpayment from the net operating loss carryback to its tax liability in the later year. We believe this follows the intent of K.S.A. § 79-32,143(f). We believe that the Secretary's interpretation of the provision ignores the last sentence of § 79-32,143(f) which provides that "Any excess amount may be carried back or forward to any other year or years as provided by this section."

The Department of Revenue treats the application of overpayment to tax liabilities as a refund and limits the amount to \$1,500. This is not consistent with other provisions of the Kansas Statutes. For example K.S.A 79-32,105 provides that "no refund shall be made for a sum less than \$5, but such amount may be claimed by the taxpayer as a credit against the taxpayer's tax liability in the taxpayer's next succeeding taxable year." Clearly there is a difference between a refund and a credit against future taxes.

We believe that K.S.A. §79-32,143 should allow a taxpayer to carry forward the overpayment resulting from the carryback of a net operating farm loss and to apply that overpayment against the income tax liabilities in the succeeding years in a manner that would offset the income tax liability for that year and provide a refund of no more than \$1,500. This interpretation of the statute is consistent with the intent of the legislature when enacting the statute to provide relief to Kansas farmers. The Secretary's interpretation places farmers in a worse position than if the net operating farm loss rules had not been enacted.

Although the problem arose out of the language added at the time the provision allowing a carryback of the farm net operating loss, the problem is not limited to farmers. K.S.A. § 79-32,143(d) provides that if a taxpayer does not have enough taxable income to use all of the net operating loss carry forward in the ten years following the year of the loss, then it is allowed to carry the unused loss back to the three years before the loss year. However, if the refund is limited to \$1,500 per year, after waiting ten years for the right to carry the loss back, the refund may not be fully allowed.

We encourage the Committee to clarify K.S.A. § 79-32,143(f). The language we suggest is:

"No refund of income tax which results from a net operating loss carry back shall be allowed in an amount exceeding ~~\$1,500~~ \$5,000 in any year. Any *overpayment* in excess of \$5,000 ~~amount~~ may be carried ~~back or~~ forward to any other year or years as provided by this section after the year of the loss and may be claimed as a credit against the tax. The refundable portion of such credit shall not exceed \$5,000 in any year."

Differing treatment for Corporations and Individuals

The Department of Revenue treats net operating farm losses of corporations differently than net operating farm losses of individuals. There is no difference in K.S.A. § 79-32,143 that justifies a different treatment for individuals than for corporations.

An individual taxpayer files Form K-67 to claim a refund for the carryback of a net operating farm loss. An individual has no way to claim a credit for the overpayment against future year taxes. The Department of Revenue has said it will mail checks of \$1,500 each year to individual taxpayers. However, several of our clients have discovered that they must call the Department of Revenue to remind them of the overpayment or they do not receive a check after the initial filing.

Since the overpayment is not allowed against the current year tax, the individual may need to pay \$1,500 more in estimated tax payments each year to avoid underestimate penalties since the refund is paid by check instead of offset current year taxes.

A corporation files Form K-139 to claim a refund for the carryback of a net operating loss. This form limits the refund to a single \$1,500 amount. The corporation must claim the overpayment, limited to \$1,500 each year, on its future tax returns to receive a benefit. If a corporation liquidates or goes out of existence, how will it ever receive the rest of the amount owed?

Summary

1. In summary we support the proposal to increase the refund of income tax which results from a net operating loss carry back from \$1,500 per year to \$5,000 per year.
2. We believe it is important to clarify that any excess amount of overpayment can be applied to the taxpayer's income tax liability in future years, without limitation. That only the refund, after offsetting that year's taxes, would be subject to the limitation.
3. Finally, we believe that the treatment of corporate taxpayers and individual taxpayers should be the same. Individual taxpayers should be able to use the overpayment to offset taxes in future years.

We appreciate the opportunity to provide our input in this process. We especially appreciate you and KLA for inviting us to join in the process and for presenting our comments to the Committee on our behalf. If you have any questions please give me a call.

Sincerely,



David L. Hetrick, C.P.A.
Lewis, Hooper & Dick, LLC



**Leslie Kaufman, Director
Government Relations
Kansas Cooperative Council**

**SENATE ASSESSMENT & TAXATION COMMITTEE
March 9, 2004**

SB 543 - Increasing the refund limit from net operating loss.

Chairman Corbin and members of the Senate Committee on Assessment & Taxation, thank you for the opportunity to provide comments on behalf of the Kansas Cooperative Council and share our support for SB 543. I am Leslie Kaufman and I serve the Kansas Cooperative Council as Government Relations Director. The Council includes 186 cooperative business members. Together, they have a combined membership of nearly 200,000 Kansans.

As you know, the proposal before you increases the amount of a refund available due to net operating loss from \$1,500 to \$5,000 per year. The increase will result in qualifying producers being able to receive a greater refund each year. This will allow them to re-coup their losses earlier and can provide an additional cash infusion in their operations. The ability to help offset a net operating loss as quickly as possible is important in agricultural operations.

The agricultural sector has faced significant challenges the past few years. Assisting farmers and ranchers with a tax mechanism such as the one embodied in SB 543 can ultimately benefit the broader agricultural economy and rural Kansas as producers channel these dollars through the local economy. As such, we encourage you to look favorably on this measure.

Thank you.

*Senate Assessment & Taxation
3-9-04
Attachment 2*