



100 SE 9th Street, Suite 502
Topeka, KS 66612

April 28, 2016

The Honorable Les Donovan, Chairman
Senate Assessment and Taxation Committee

Re: SB 508

Senator Donovan and Committee members:

The Kansas Society of Certified Public Accountants is opposed to and does not support SB 508 as drafted.

We understand and appreciate the Legislature's requirement to balance the Kansas budget and to achieve this requirement for the upcoming fiscal year you are considering the option to raise revenue via a modification to the 2012 legislation that exempts non-wage business income from taxation.

This proposed legislation has the effect of taxing 70% of non-wage business income derived from activities in which the taxpayer materially participates. If the taxpayer does not materially participate in the activity, 100% of the non-wage business income is subject to Kansas income tax. Along these same lines, the proposed legislation does provide for a deduction for losses from activities in which the taxpayer materially participates, but in the case of losses, the deduction is only available against non-wage business income not otherwise exempt from taxation.

The effect of this language is to tax the small business person in the years in which they have profits and deny them the deduction for losses in years of economic downturn. Most Kansas small businesses do not have multiple business enterprises that they conduct, hence they will be forever denied the deduction of losses when incurred because they will not have any other business activity in that year to offset the loss against. There is no equity in this type of legislative structure.

We caution the legislature from referencing the definition of *Materially Participates* as prescribed by Internal Revenue Code Section 469 in any proposed legislation. If the intent of utilizing this language is to subject passive activities to taxation, then the term *passive activity* should be utilized as defined in Code Section 469. The rationale for this is that under the Internal Revenue Code, an individual can materially participate in a rental activity, and still be deemed to be passive in that rental activity. If you do not utilize the *Words of Art* as prescribed in the Internal Revenue Code, the Department of Revenue will be required to draft lengthy regulations to explain any differences between

the federal and Kansas Statute. As a point of reference, the Internal Revenue Code regulations with reference to Code section 469 are over 72 pages long.

The 2012 legislation denied the deduction for certain otherwise allowable deductions related to earned income including the self-employment tax deduction, the health insurance premiums for self-employed and/or shareholder-employees of subchapter S corporations and the deduction for contributions to the taxpayer's retirement plan. The rationale for disallowing these deductions in 2012 was that the deduction was attributable to non-wage business income that was now exempt from Kansas taxation, so the deductions should be disallowed. Under the proposed legislation, 70% or maybe even 100% of the non-wage business income is now subject to tax, but the expenses otherwise allowable on the federal income tax return attributable to that income are disallowed on the Kansas return. Where is the equity?

Additionally, the 2012 legislation repealed the net operating loss carryover provisions due to the fact that non-wage business income was now exempt from Kansas tax. Now that non-wage business income is proposed to be subject to Kansas tax, the net operating loss carryovers should be re-instated, again in the spirit of taxpayer equity.

The 2012 legislation effectively de-coupled the Kansas tax statute from the Internal Revenue Code with reference to the taxation of non-wage business income. This proposed legislation further compromises Kansas having adopted the Internal Revenue Code of 1986, as amended, as the baseline of the Kansas income tax system and will result in substantial confusion to the taxpayers resulting in a compliance nightmare for taxpayers, tax professionals and the Kansas Department of Revenue.

In 2015, SB 270 and HB 2109 changed the treatment of guaranteed payments for pass through entities. This proposed legislation conflicts with and further confuses the treatment of guaranteed payments.

The KSCPA legislative executive committee and taxation task force, composed of experienced leaders in the KSCPA, stands ready to provide input and recommendations to the legislature.

Respectfully submitted,

Jay Langley, CPA, CGMA
Chair, Legislative Executive Committee
Kansas Society of CPAs