

Doug Albin, WaKeeney, KS

I am a business owner, and income tax preparer. My personal Kansas Income Tax in 2016 was less than 5 % of what it would have been if the exclusion were not in place.

I don't have an LLC. I have a C Corporation farm activity, so that business was not affected by the exclusion, and this is the business that I own that has employees where employment could be increased.

I have no employees that affect my personal income tax return. I saved a large amount of income tax, but my sources of income do not lend themselves to hiring or expanding. Had they been, I would certainly not take on an employee or expand just because of a 4.5% maximum tax savings, and I don't know anyone else who would either. This is not how business decisions are made. I get this benefit despite all of these facts.

In other words, the business that I own that would have the opportunity to expand hiring did not receive the benefit of the exclusion, while the business and rental activities I have that resulted in the Kansas Income Tax benefit are not ones that could result in more employment or expansion.

Despite the continued use of the description LLC exclusion, it is inaccurate. Lots of other income is excluded under this law, as you setting in here probably know. Land rents, real estate and personal property rentals, royalties, trust income, partnership income, estate income, S Corporation Income. Anything that flows from federal form 1040 schedules, C, F and E.

In what scenario would you imagine someone with oil royalties expanding hiring? Their business need is limited to signing lease papers and depositing checks.

I use most of my time to help businesses to get started, grow and thrive. I am eager to see job growth and expansion in our state. If I thought the LLC exclusion furthered this cause, I would be one of your greatest advocates. I have prepared income tax returns for others for nearly 40 years, and when making my own business decisions, or helping others make their decisions, I consider what affect all income and expenses have in this regard. I can assure you that the elimination of Kansas Income tax is not a material factor in this equation.

You have or will likely hear testimony by some who talk about their hiring and expanding based upon their tax savings. Please keep in mind that they would have to make an additional \$580,000 per \$12.00 an hour employee for this to be a result of this tax law change. Are you willing to give someone making \$580,000 per employee a free ride in paying their part of our shared bills on the hope that they will use this money to hire someone, even though they get the benefit whether they do or not? I challenge you to ask those praising the benefit of this exclusion the following question. Can you honestly say that your hirings and expansions significantly resulted from this law, and if so, would you be willing to share the work papers and calculations you used to determine that this law in fact significantly affected your decision?

If the logic of this exclusion seems sensible to anyone here, I ask you to consider using the following experiment in your own business with your own employees. Keep paying their salaries and wages, and tell them they will get paid whether they show up for work or not. This follows the same logic pattern as the LLC exclusion. The business gets the benefit whether they do what you hoped or not.

Again, I greatly benefitted financially from this exclusion, but not in a way that I consider fair, reasonable, or beneficial to our state. I would be greatly in favor of repeal, and will gladly pay the additional tax. It is not a sensible way to share the collective bills among people with similar incomes, where their Kansas Tax paying fate lies not on their behavior of hiring, expanding or improving the Kansas economy, but solely rests on which line where their income falls on the federal form 1040.

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Examples of Effects of Exclusion

<u>Passive Activities Receiving Tax Exclusion</u>	<u>Income Amount</u>	<u>Kansas Income Tax with Exclusion</u>	<u>Kansas Income Tax Before Exclusion</u>
Land Rental Income	\$100,000	\$0	\$4,600
Oil Royalty Income	\$100,000	\$0	\$4,600
Apartment Rental Income	\$100,000	\$0	\$4,600

In the above examples, how much hiring and expansion would result?

<u>Cost of Hiring Employee Considering Tax Effects Active Business Receiving Tax Exclusion</u>	<u>After Tax Cost If Exclusion Exists</u>	<u>After Tax Cost If No Exclusion</u>
Income Before Extra Hiring	\$250,000	\$250,000
Extra Hiring Wages	100,000	100,000
Income After Extra Hiring	<u>150,000</u>	<u>150,000</u>

Income Taxes Saved By Hiring Assuming 33% Federal Income Tax and 4.6% Kansas Income Tax

Kansas Income Tax Savings	0	4,600
Federal Income Tax Savings	33,000	31,482
Total Tax Savings	<u>33,000</u>	<u>36,082</u>
Net Cost of Hiring Employee After Tax Savings	<u>\$67,000</u>	<u>\$63,918</u>

The result in this example is that an employer that did hire additional employees actually had a higher after tax cost of adding employees than without the exclusion. How is this an incentive to hire?

Examples of Kansas Income Tax on Individuals with Different Sources of Income

Married Filing Jointly							
No other Dependents							
2014 Income Tax Return							
			Schedule C	Schedule F	Schedule E	Schedule E	Schedule E
		Manager (Employee)	Welding Business	Unincorp. Farmer	Land Rental	Oil Royalties	Partnership Income
	Nurse						
Income:							
Wages	80,000	80,000					
Schedule C Income			80,000				
Schedule F Income				80,000			
Schedule E Income					80,000	80,000	80,000
Interest Income	50	50	50	50	50	50	50
Capital Gains	7,000	7,000	7,000	7,000	7,000	7,000	7,000
Total Income	87,050	87,050	87,050	87,050	87,050	87,050	87,050
Deductions from Total Income:							
Deductible part of Self-Employment Tax			5,652	5,652			
Federal Adjusted Gross Income	87,050	87,050	81,398	81,398	87,050	87,050	87,050
Additions:							
Deduction for Self-Employment Tax			5,652	5,652			
Subtractions:							
Schedule C Income			80,000				
Schedule F Income				80,000			
Schedule E Income					80,000	80,000	80,000
Kansas Adjusted Gross Income	87,050	87,050	7,050	7,050	7,050	7,050	7,050
Standard Deduction	7,500	7,500	7,500	7,500	7,500	7,500	7,500
Exemption Allowance	4,500	4,500	4,500	4,500	4,500	4,500	4,500
Taxable Income	75,050	75,050	(4,950)	(4,950)	(4,950)	(4,950)	(4,950)
Kansas Income Tax	2,971	2,971	0	0	0	0	0
Tax Savings	0	0	2,971	2,971	2,971	2,971	2,971

Example of Effect of Business Structure and Employee Hiring on Kansas Income Tax

<p>The following example represents a large family with 10 brothers and sisters, all who operate plumbing businesses. They all make \$150,000 per year before paying themselves anything. They each happen to have selected a different type of organizational structure.</p> <p>Those treated as S Corporations pay half of their profit out as wages to themselves, since IRS frowns upon S Corporation shareholders that work in their own business that don't reflect some of that profit as income subject to social security taxes, which can only happen via paying wages. Those that are taxed as corporations paid all of their profit out as wages so they can have access to the profit outside of the company to take care of their financial needs. In this example all of the owners used the entire \$150,000 to cover their living expenses.</p> <p>Some of them hired new employees, some did not. In this example, the cost of the additional employees was offset by additional revenue, so bottom line profit did not change. As you can see from this example, hiring employees has no effect on how much Kansas Income tax is paid by the business owner. The amount of tax paid is completely dependent upon profit level, and where the income is reported on form 1040.</p>									
IRS 1040 Line #	Business Form that each owner selected:	Additional New Employees Hired	Additional Revenue as Result of Hiring New Employees	Additional Payroll Costs of Hiring New Employees	Amount Subject to Federal Income Tax	Amount Subject to Kansas Income Tax	Amount of Kansas Income Tax Eliminated at 4.6%		
12	Sole Proprietorship	5	\$250,000	\$250,000	\$150,000	\$0		\$6,900	
12	Single Member LLC, making no special election	0	\$0	\$0	\$150,000	\$0		\$6,900	
17	Partnership	5	\$250,000	\$250,000	\$150,000	\$0		\$6,900	
17, 17	Multiple Member LLC, default is to be treated as partnership	0	\$0	\$0	\$150,000	\$0		\$6,900	
7, 17	S-Corporation	5	\$250,000	\$250,000	\$150,000	\$75,000		\$3,450	
7, 17	Single Member LLC, electing to be taxed as S Corp	2	\$100,000	\$100,000	\$150,000	\$75,000		\$3,450	
7, 17	Multiple Member LLC, electing to be taxed as S Corp	0	\$0	\$0	\$150,000	\$75,000		\$3,450	
7	C Corporation	5	\$250,000	\$250,000	\$150,000	\$150,000		\$0	
7	Single Member LLC electing to be taxed as C Corp	2	\$100,000	\$100,000	\$150,000	\$150,000		\$0	
7	Multiple Member LLC, electing to be taxed as C Corp	0	\$0	\$0	\$150,000	\$150,000		\$0	
Totals		24	\$1,200,000	\$1,200,000	\$1,500,000	\$675,000		\$37,950	