

Notice

Notice Number: 05-05
Tax Type: Individual Income Tax
Brief Description: Kansas Income Tax Treatment of Certain Payments Received from the Regents Retirement Plan.
Keywords:
Approval Date: 06/02/2005

Body:

**KANSAS DEPARTMENT OF REVENUE
OFFICE OF POLICY & RESEARCH**

NOTICE 05-05

**Kansas Income Tax Treatment of
Certain Payments received From
The Regents Retirement Plan**

Advice has been requested concerning the income tax treatment of certain payments received from the Regents Retirement Plan.

Introduction

During the period of their employment, faculty and other persons who are employed by the State Board of Regents or by educational institutions under its management and who are in the unclassified service under the civil service act are required by K.S.A. 74-4925 to contribute a percentage of their gross income to the Regents Retirement Plan (the "Plan"). Contributions under this defined contribution (money purchase) plan are applied to the development of individual employee account balances and possible purchase of annuities from companies authorized by the Board to participate in the Plan. Plan contributions by a participant are made on a tax-deferred basis under an agreement for salary reduction executed in accordance with Section 403(b) of the Internal Revenue Code, subject to the rules and regulations adopted by the Board and the requirements of the selected investment providers.

The Board has selected Teacher Insurance Annuity Association – College Retirement Equities Fund ("TIAA-CREF"), the Aetna Life Insurance and Annuity Company, Lincoln National Pension Company and the Security Benefit Life Insurance Company ("alternative investment providers") to provide alternative investment options to participants in the Plan.

Each eligible employee is responsible for selecting an alternative investment provider and the alternative investment options to which the employee's basic retirement contributions under the Plan, as provided for by K.S.A. 74-4925, as amended, are to be deposited. The employee may utilize all alternative investment options offered by the alternate investment provider selected by the employee within the limitations of the agreement between the Board and the alternate investment provider and the employee's contract with the alternate investment provider.

At any time before retirement, a participant can transfer funds accumulated under the Plan from one alternate investment provider to another, subject to the established policies of the approved companies and in accordance with applicable Internal Revenue Service requirements.

For a participant who has terminated employment, the Plan's transferability rules continue to govern funds accumulated under the Plan. However, if the participant later participates in another employer's Internal Revenue Code Section 403(b) defined-contribution retirement plan, the transferability rules of the subsequent employer's plan

will govern funds accumulated under the Plan.

Upon retirement, a participant is entitled to receive a benefit under any one of the options available from the approved company handling all or a portion of the participant's account(s).

Distributions are available only upon termination of employment, retirement or phased retirement. A terminated or retired participant in the Plan has full access to all accumulations, including the portion attributable to Plan contributions made by the employing institution. Participants in the phased retirement program have access to up to 99% of all accumulations, including the portion attributable to Plan contributions made by the employing institution. As a rule these payments are taxable for federal income tax purposes. Therefore, these payments are generally included in federal adjusted gross income.

Kansas law requires the use of federal adjusted gross income as the starting point for computing the Kansas income tax. Certain addition or subtraction "modifications" are then made in accordance with K.S.A. 79-32,117. Subsection (c)(ii) of K.S.A. 79-32,117 provides that "Any amounts received which are included in federal adjusted gross income but which are specifically exempt from Kansas income taxation under the laws of the state of Kansas" are to be subtracted from federal adjusted gross income prior to computing the Kansas income tax.

All Plan benefits are specifically exempt from Kansas income tax. The exemption is found in K.S.A. 74-4923(b), which states, in pertinent part:

(b) Any annuity, benefits, funds, property or rights created by, or accruing to any person under the provisions of K.S.A. 74-4901 *et seq.* or 74-4951 *et seq.*, and amendments thereto, shall be exempt from any tax of the state of Kansas or any political subdivision or taxing body of the state;

Questions have arisen as to how the exemption from Kansas income tax contained in K.S.A. 74-4923(b) should be claimed with regard to payments from Plan membership accounts and related accounts. This process is discussed in the context of the manner in which payments are likely to be received: Direct one-time payments, monthly payments, and rollover payments.

Generally

In order to qualify for exemption from Kansas income tax, payments received by a Plan participant must meet two requirements. First, the payment must be received directly from companies authorized by the Board to participate in the Plan: Teacher Insurance Annuity Association – College Retirement Equities Fund ("TIAA-CREF"), the Aetna Life Insurance and Annuity Company, Lincoln National Pension Company and the Security Benefit Life Insurance Company. Second, the payment must be included in the member's federal adjusted gross income in the year it is received.

Payments that are not included in the member's federal adjusted gross income in the year of receipt and payments that are not received directly from companies authorized by the Board to participate in the Plan are not exempt.

Direct One-Time Payments

A Plan participant who ceases covered employment may have the right to withdraw part or all of their accumulated contributions and have this amount paid directly to them. Upon withdrawal the contributions will be taxable for federal income tax purposes and included in federal adjusted gross income.

Similarly, a retiring Plan participant may have the right to take part or all of their retirement benefit in a lump sum. The amount of the lump-sum payment will be included in federal adjusted gross income.

Because these payments are received directly from companies authorized by the Board to participate in the Plan and are included in the Plan participant's federal adjusted gross income in the year received they are exempt from Kansas income tax.

In order to claim the exemption from Kansas income tax for direct one-time payments of withdrawn contributions or partial lump sum payments a subtraction modification should be made on the Kansas income tax return. This

modification should be an amount equal to the amount of the withdrawn accumulated contributions or partial lump-sum payment. The effect of the modification will be to remove the accumulated contributions or partial lump-sum payment from Kansas taxable income.

Monthly Payments

Monthly payments from Plan accounts are taxable for federal income tax purposes and included in federal adjusted gross income.

Because these payments are received directly from companies authorized by the Board to participate in the Plan and are included in the Plan participant's federal adjusted gross income in the year received they are exempt from Kansas income tax.

In order to claim the exemption from Kansas income tax for the monthly payments a subtraction modification should be made on the Kansas income tax return. This modification should be an amount equal to the total amount of the monthly payments. The effect of the modification will be to remove the monthly payments from Kansas taxable income.

Transfer and Roll-Over Payments

At any time before retirement, a participant can transfer funds accumulated under the Plan from one alternate investment provider to another, subject to the established policies of the approved companies and in accordance with applicable Internal Revenue Service requirements. Because these transfers are not included in federal adjusted gross income no modification is made on the Kansas income tax return.

For a participant who has terminated employment, the Plan's transferability rules continue to govern funds accumulated under the Plan. However, if the participant later participates in another employer's Internal Revenue Code Section 403(b) defined-contribution retirement plan, the transferability rules of the subsequent employer's plan will govern funds accumulated under the Plan. Because these transfers are not included in federal adjusted gross income no modification is made on the Kansas income tax return.

Federal law permits rollovers of funds accumulated under the Plan into a variety of qualified retirement accounts. In some cases the funds may be placed into a segregated account, such as a traditional IRA. In many cases, however, rollovers from the Plan are deposited into qualified accounts where they will be commingled with other retirement funds. By way of example, the receiving account for Plan rollover distributions may be another employer retirement plan. Once funds paid out of the Plan are rolled over into a qualified account they lose their characterization as Plan payments and become assets of the qualified account.

Payments from rollover accounts are received in a variety of ways, including as a lump sum and as annuitized payments (periodic or monthly payments), such as a monthly payment from an annuity. When a payment is received, it will be included in federal adjusted gross income. However, none of the payments made from a rollover account are paid directly by companies authorized by the Board to participate in the Plan.

Because rollover of a Plan payment deposited into a qualified retirement account is not included in federal adjusted gross income in the tax year when the Plan payment was made and it has lost its characterization as a Plan payment, payments from that account are not exempt from Kansas income tax. Therefore, no modification is made on the Kansas income tax return for a payment from a rollover account.

Taxpayer Assistance

Additional copies of this notice, forms or publications are available from our web site, www.ksrevenue.org. If you have questions about income tax, please contact:

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Date Composed: 06/02/2005 Date Modified: 06/02/2005

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