

Notice 17-03

Changes To Addition And Subtraction Modifications Related To Nonwage Business Income (Revised December 6, 2017)

Generally

The calculation of an individual's Kansas income tax starts with federal adjusted gross income. Certain modifications, either additions or subtractions, required by K.S.A. 79-32,117 are then made to arrive at Kansas adjusted gross income.

The 2017 Kansas Legislature approved Senate Bill 30, which impacts state income tax law. Provisions in Section 5 of the Bill amended K.S.A. 79-32,117 to limit the time period for which five addition modifications and four subtraction modifications are effective. The overall effect of these amendments is to make these modifications effective only for tax years beginning after December 31, 2012 and ending before January 1, 2017.

Changes In The Law

Addition Modifications – Certain Losses and Deductions No Longer Subject to Tax

As explained in Notice 12-11, in 2012, Kansas law was amended to provide that for tax years beginning after December 31, 2012, certain categories of nonwage business income were exempt from income tax. To prevent individuals from claiming excessive losses or deductions associated with this nonwage business income there was a requirement that certain losses or deductions be added to the taxpayer's federal adjusted gross income when computing Kansas income tax. Because Senate Bill 30 provides this nonwage business income is no longer exempt from Kansas income tax (as explained below in the section on Subtraction Modifications) the requirement that certain losses or deductions associated with this nonwage business income be added to federal adjusted gross income when computing Kansas income tax has been removed.

Losses

(1) Business losses

Prior to passage of Senate Bill 30, subsection (b)(xix) provided an addition modification for business losses reported on federal Schedule C and line 12 of federal Form 1040. Under federal law, Schedule C is used to report income or losses from a sole proprietorship, and income paid to individuals considered statutory employees for federal income tax purposes. Now this modification is limited to tax years beginning after December 31, 2012, and ending before January 1, 2017. As a result, these losses are no longer added to federal adjusted gross income when calculating Kansas income tax. Specifically, the statute now provides:

(b) There shall be added to federal adjusted gross income:

(xix) For ~~all~~ taxable years beginning after December 31, 2012, and ending before January 1, 2017, the amount of any: (1) Loss from business as determined under the federal internal revenue code and reported from schedule C and on line 12 of the taxpayer's form 1040 federal individual income tax return; . . .

(2) Losses From Certain Entities and Certain Types of Losses

Prior to passage of Senate Bill 30, subsection (b)(xix) provided an addition modification for losses reported on federal Schedule E and line 17 of federal Form 1040. Under federal law, Schedule E is used to report income received from, or losses related to, certain entities (including partnerships, S corporations, limited liability companies, estates and trusts) and certain types of income (including income from rental real estate, royalties, residual interests in real estate mortgage investment conduits, and net farm rental). Now this modification is limited to tax years beginning after December 31, 2012, and ending before January 1, 2017. As a result, these losses are no longer added to federal adjusted gross income when calculating Kansas income tax. Specifically, the statute now provides:

(b) There shall be added to federal adjusted gross income:

(xix) For ~~all~~ taxable years beginning after December 31, 2012, and ending before January 1, 2017, the amount of any: (2) loss from rental real estate, royalties, partnerships, S corporations, except those wholly owned subsidiaries subject to the Kansas privilege tax, estates, trusts, residual interest in real estate mortgage investment conduits and net farm rental as determined under the federal internal revenue code and reported from schedule E and on line 17 of the taxpayer's form 1040 federal individual income tax return;

(3) Farm Income

Prior to passage of Senate Bill 30, subsection (b)(xix) provided an addition modification for farm losses reported on federal Schedule F and line 18 of federal Form 1040. Under federal law, Schedule F is used to report net farm profit or loss. Now this modification is limited to tax years beginning after December 31, 2012, and ending before January 1, 2017. As a result, these losses are no longer added to federal adjusted gross income when calculating Kansas income tax. Specifically, the statute now provides:

(b) There shall be added to federal adjusted gross income:

(xix) For ~~all~~ taxable years beginning after December 31, 2012, and ending before January 1, 2017, the amount of any: farm loss as determined under the federal internal revenue code and reported from schedule F and on line 18 of the taxpayer's form 1040 federal income tax return;

Deductions

Certain items are deductible under federal law, but the deduction is not shown on federal Schedule C, E, or F. Instead, the deduction is shown on a line of the federal Form 1040. These include:

- A. One-half of self-employment taxes. Line 27, IRC §164(f)
- B. Contributions to retirement plans by self-employed. Line 28, IRC §62(a)(6)
- C. Purchases of health insurance by self-employed. Line 28, IRC §162(l)
- D. Deduction for domestic production activities. Line 35, IRC §199

Prior to passage of Senate Bill 30, subsection (b) provided additional modifications for these deductions. Now these modifications are limited to tax years beginning after December 31, 2012, and ending before January 1, 2017. As a result, these deductions are no longer added to federal adjusted gross income when calculating Kansas income tax. Specifically, the statute now provides:

Self-employment taxes

(b) There shall be added to federal adjusted gross income:

(xx) For ~~all~~ taxable years beginning after December 31, 2012, and ending before January 1, 2017, the amount of any deduction for self-employment taxes under section 164(f) of the federal internal revenue code as in effect on January 1, 2012, and amendments thereto, in determining the federal adjusted gross income of an individual taxpayer, to the extent the deduction is attributable to income reported on schedule C, E or F and on line 12, 17 or 18 of the taxpayer's Form 1040 federal income tax return.

Retirement plans by self-employed

(b) There shall be added to federal adjusted gross income:

(xxi) For ~~all~~ taxable years beginning after December 31, 2012, and ending before January 1, 2017, the amount of any deduction for pension, profit sharing, and annuity plans of self-employed individuals under section 62(a)(6) of the federal internal revenue code as in effect on January 1, 2012, and amendments thereto, in determining the federal adjusted gross income of an individual taxpayer.

Purchases of health insurance by self-employed.

(b) There shall be added to federal adjusted gross income:

(xxii) For ~~all~~ taxable years beginning after December 31, 2012, and ending before January 1, 2017, the amount of any deduction for health insurance under section 162(l) of the federal internal revenue code as in effect on January 1, 2012, and amendments thereto, in determining the federal adjusted gross income of an individual taxpayer.

Domestic production activities.

(b) There shall be added to federal adjusted gross income:

(xxiii) For ~~all~~ taxable years beginning after December 31, 2012, and ending before January 1, 2017, the amount of any deduction for domestic production activities under section 199 of the federal internal revenue code as in effect on January 1, 2012, and amendments thereto, in determining the federal adjusted gross income of an individual taxpayer.

Subtraction Modifications – Nonwage Business Income No Longer Exempt

In 2012, Kansas law was amended to provide that for tax years beginning after December 31, 2012, there would be a subtraction modification for three categories of income: (1) nonwage business income; (2) income from certain types of entities; and (3) farm income. Subsequent amendments added other, related, subtraction modifications. Senate Bill 30 amends subsection (c) to remove these subtraction modifications. By not allowing this income to be subtracted from federal adjusted gross income when calculating Kansas adjusted gross income, this income is now subject to Kansas income tax.

(1) Stockholders in Banks and Savings and Loans

Prior to passage of Senate Bill 30, subsection (c)(xiv) provided the subtraction modification, for income received by a taxpayer who is a stockholder in a Kansas bank, national banking association, savings and loan, or federal savings association, for which an S corporation election has been made, excluded the portion of income or loss reported on schedule E and included on line 17 of the taxpayer's form 1040 federal individual income tax return. This exclusion prevented a taxpayer from claiming a deduction for this income twice; once under (c)(xiv) and once under (c)(xx). Now this exclusion is limited to tax years beginning after December 31, 2012, and ending before January 1, 2017. As a result, all income that qualifies under (c)(xiv) may be subtracted from federal adjusted gross income when calculating Kansas income tax. Specifically, the statute now provides:

(xiv) For all taxable years commencing after December 31, 1996, that portion of any income of a bank organized under the laws of this state or any other state, a national banking association organized under the laws of the United States, an association organized under the savings and loan code of this state or any other state, or a federal savings association organized under the laws of the United States, for which an election as an S corporation under subchapter S of the federal internal revenue code is in effect, which accrues to the taxpayer who is a stockholder of such corporation and which is not distributed to the stockholders as dividends of the corporation. For ~~all~~ taxable years beginning after December 31, 2012, and ending before January 1, 2017, the amount of modification under this subsection shall exclude the portion of income or loss reported on schedule E and included on line 17 of the taxpayer's form 1040 federal individual income tax return.

(2) Nonwage Business Income

Prior to passage of Senate Bill 30, subsection (c)(xx) provided a subtraction modification for income reported on federal Schedule C and line 12 of federal Form 1040. Under federal law, Schedule C is available only to sole proprietors and to individuals considered statutory employees for federal income tax purposes. Now this modification is limited to tax years beginning after December 31, 2012, and ending before January 1, 2017. As a result, this income may no longer be subtracted from federal adjusted gross income when calculating Kansas income tax. Specifically, the statute now provides:

(c) There shall be subtracted from federal adjusted gross income:

(xx) For ~~all~~ taxable years beginning after December 31, 2012, *and ending before January 1, 2017*, the amount of any: (1) Net profit from business as determined under the federal internal revenue code and reported from schedule C and on line 12 of the taxpayer's form 1040 federal individual income tax return; . . .

(3) Income From Certain Entities and Certain Types of Income

Prior to passage of Senate Bill 30, subsection (c)(xx) provided a subtraction modification for income reported on federal Schedule E and line 17 of federal Form 1040. Under federal law, Schedule E is used to report income received from certain entities (including partnerships, S corporations, limited liability companies, estates and trusts) and certain types of income (including income from rental real estate, royalties, residual interests in real estate mortgage investment conduits, and net farm rental). Now this modification is limited to tax years beginning after December 31, 2012, and ending before January 1, 2017. As a result, this income may no longer be subtracted from federal adjusted gross income when calculating Kansas income tax. Specifically, the statute now provides:

(c) There shall be subtracted from federal adjusted gross income:

(xx) For ~~all~~ taxable years beginning after December 31, 2012, *and ending before January 1, 2017*, the amount of any: (2) net income from rental real estate, royalties, partnerships, S corporations, estates, trusts, residual interest in real estate mortgage investment conduits and net farm rental as determined under the federal internal revenue code and reported from schedule E and on line 17 of the taxpayer's form 1040 federal individual income tax return;

(4) Farm Income

Prior to passage of Senate Bill 30, subsection (c)(xx) provided a subtraction modification for farm income reported on federal Schedule F and line 18 of federal Form 1040. Under federal law, Schedule E is used to report net farm profit. Now, this modification is limited to tax years beginning after December 31, 2012, and ending before January 1, 2017. As a result, this income may no longer be subtracted from federal adjusted gross income when calculating Kansas income tax. Specifically, the statute now provides:

(c) There shall be subtracted from federal adjusted gross income:

(xx) For *all* taxable years beginning after December 31, 2012, *and ending before January 1, 2017*, the amount of any: . . . (3) net farm profit as determined under the federal internal revenue code and reported from schedule F and on line 18 of the taxpayer's form 1040 federal income tax return;

(5) Draft, Breeding, Dairy Animals, and Animals Used for Sporting Purposes

Prior to passage of Senate Bill 30, subsection (c)(xxii) provided a subtraction modification for net gain from the sale of breeding animals subject to depreciation. Now, this modification is limited to tax years beginning after December 31, 2012, and ending before January 1, 2017. As a result, this income may no longer be subtracted from federal adjusted gross income when calculating Kansas income tax. Specifically, the statute now provides:

(xxii) For *all* taxable years beginning after December 31, 2012, *and ending before January 1, 2017*, the amount of net gain from the sale of: (1) Cattle and horses, regardless of age, held by the taxpayer for draft, breeding, dairy or sporting purposes, and held by such taxpayer for 24 months or more from the date of acquisition; and (2) other livestock, regardless of age, held by the taxpayer for draft, breeding, dairy or sporting purposes, and held by such taxpayer for 12 months or more from the date of acquisition. The subtraction from federal adjusted gross income shall be limited to the amount of the additions recognized under the provisions of subsection (b)(xix) attributable to the business in which the livestock sold had been used. As used in this paragraph, the term "livestock" shall not include poultry.

(5) Christmas Trees

Prior to passage of Senate Bill 30, subsection (c)(xxiv) provided a subtraction modification for net gain from the sale of Christmas trees. Now, this modification is limited to tax years beginning after December 31, 2012, and ending before January 1, 2017. As a result, this income may no longer be subtracted from federal adjusted gross income when calculating Kansas income tax. Specifically, the statute now provides:

(xxiv) For *all* taxable years beginning after December 31, 2013, *and ending before January 1, 2017*, the net gain from the sale from Christmas trees grown in Kansas and held by the taxpayer for six years or more.

Overall Effect of Changes

The changes made to K.S.A. 79-32,117 by Section 5 of Senate Bill 30 make certain nonwage income subject to Kansas income tax by eliminating the ability to subtract it from federal adjusted gross income in calculating Kansas adjusted gross income, while at the same time permitting certain losses and deductions to be subtracted. The overall effect is to tax nonwage business income while allowing related losses and deductions to be offset against any taxable income.

Estimated Tax Payments

As noted above, Kansas tax law changes made in 2012 stated that beginning after December 31, 2012, certain categories of nonwage business income were exempt from income tax. As a result, taxpayers receiving this nonwage business income were no longer required to make estimated tax payments, and have not made such payments for the last several years. The provisions of Senate Bill 30 change this, so **taxpayers receiving nonwage business income should immediately begin making estimated tax payments.**

The Department strongly encourages all taxpayers receiving nonwage business income to make estimated tax payments for tax year 2017, and to review their personal tax situation with their tax preparer or tax professional. Making estimated payments now will help avoid a large, unpaid tax bill later.

For additional information regarding estimated tax payment for nonwage business income, please see our Notice 17-09.

Taxpayer Assistance

Additional copies of this notice, forms or publications are available from our website, **www.ksrevenue.org**. If you have questions about this Notice, please contact:

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