

Kansas – New Law Repeals Pass-Through Income Deduction; Raises Tax Rates

Overview

On June 6, 2017, the Kansas State Legislature voted to overturn Governor Sam Brownback's veto of Senate Bill 30¹ ("S.B. 30"), thereby repealing Kansas's exemption on certain pass-through income and raising tax rates for state individual income tax purposes. In this Tax Alert, we summarize these law changes which are effective for tax years beginning on or after January 1, 2017, as well as offer some related taxpayer considerations.

Individual Income Tax

Repeal of Pass-Through Income Deduction

Effective retroactively to January 1, 2017, S.B. 30 removes the state individual income tax exemption for certain income received from pass-through entities that was originally enacted in 2012.² Pursuant to the legislation enacted in 2012, for tax years beginning on or after January 1, 2013, individual income taxpayers in Kansas were permitted a subtraction from their federal adjusted gross income for net income received from partnerships and S corporations as reported on Schedule E and Line 17 of the taxpayer's federal Form 1040 income tax return.³ Accordingly, under this new law, pass-through income reported on federal income tax Schedules C, E and F is fully taxable in Kansas effective retroactively to January 1, 2017. S.B. 30 also bars the assessment of any penalty or interest for underpayment of taxes due to the repeal of this pass-through income deduction provided that any underpayment is rectified by April 17, 2018.⁴

Kansas Nonresident Withholding Requirements

In 2014, S.B. 265 had removed the requirement that subchapter S corporations, partnerships, and limited liability companies withhold Kansas income tax on nonresident shareholders', partners', and members' share of Kansas source income.⁵ This repeal of withholding requirements was primarily due to the exemption of pass-through income from state income taxation that was enacted in 2012; however, despite this exemption's repeal under S.B. 30, Kansas has yet to enact any new legislation to reinstate the withholding requirement. As such, currently there is no requirement that pass-through entities in Kansas withhold tax on the income of nonresidents.

Increase in Kansas Individual Income Tax Rates

S.B. 30 increases state individual income tax rates. Previous individual income tax rates in Kansas were 2.7% on income less than or equal to \$15,000 (\$30,000 for married filing jointly taxpayers), and 4.6% on income greater than \$15,000 (\$30,000 for married filing jointly taxpayers).⁶ S.B. 30 creates three income tax brackets, with increased tax rates being phased in from 2017 to 2018.⁷ The brackets for tax years 2018 and thereafter are: 3.1% on income less than or equal to \$15,000 (\$30,000 for married filing jointly taxpayers); 5.25% on income greater than \$15,000 (\$30,000 for married filing jointly taxpayers) and less than or equal to \$30,000 (\$60,000 for married filing jointly taxpayers); and 5.7% on income greater than \$30,000 (\$60,000 for married filing jointly taxpayers).⁸ Similar to the repeal of the pass-through income deduction in this bill, S.B. 30 bars the assessment of penalties or interest on underpayment of taxes due to these changes in the tax rate brackets provided that any underpayment is rectified by April 17, 2018.⁹

¹ Kansas S.B. 30 (2017), a copy of which can be accessed [here](#).

² Kansas S.B. 30 § 5 (2017).

³ Kansas H.B. 2117 § 12 (2012).

⁴ Kansas S.B. 30 § 5 (2017).

⁵ Kansas S.B. 265 § 9 (2014).

⁶ Kan. Stat. Ann. § 79-32,110.

⁷ Kansas S.B. 30 § 4 (2017).

⁸ Kansas S.B. 30 § 4 (2017).

⁹ Kansas S.B. 30 § 4 (2017).

Considerations

Pass-through entities with Kansas taxable income that in the past have elected to not file a composite return to take advantage of the now repealed pass-through income exemption that was first enacted in 2012, may want to review and consult with their tax advisers regarding the effect of this new law on their tax reporting and compliance obligations – specifically considering whether to file a composite return in Kansas beginning with tax years commencing on or after January 1, 2017.

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