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Notice 14-04

Modification For Net Gain From Sale of Certain Livestock

(Revised July 15, 2014)

During the 2014 Legislative Session Senate Bill 265 was passed and signed into law. Section 3 of the Bill amends K.S.A. 79-32,117, which relates to modifications made in computing Kansas adjusted gross income.

The calculation of Kansas income tax begins with federal adjusted gross income. Certain addition and subtraction modifications are then made in order to determine Kansas adjusted gross income. The amendment to K.S.A. 79-32,117 creates a new modification which allows the net gain from the sale of certain livestock to be subtracted from federal adjusted gross income. The amended language, found in subsection (c)(xxii) of K.S.A. 79-32,117, provides:

> (c) There shall be subtracted from federal adjusted gross income:
>
> (xxii) For all taxable years beginning after December 31, 2012, 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 paragraph (xix) of subsection (b) attributable to the business in which the livestock sold had been used. As used in this paragraph, the term ‘‘livestock’’ shall not include poultry.

Effective Date / Amended Returns

The new subtraction modification found in amended K.S.A. 79-32,117(c)(xxii) applies to tax year 2013. It can be claimed on an amended 2013 income tax return by entering on Schedule S, Line A26 (other subtractions from federal adjusted gross income) the amount of net gain from sale of qualifying livestock (as described in new 79-32,117(c)(xxii)), and cannot exceed the amount of net losses entered as addition modifications on Lines A4, A6 and A7, which are attributable to the business in which the livestock sold had been used. A copy of federal Schedule 4797, as well as copies of all Schedules C, E or F, should be included with the amended return. Please see updated tax year 2013 instructions for Kansas Schedule S on the Department's website: www.ksrevenue.org

Depreciation

The new subtraction modification applies to gains from the sale of certain livestock. This includes both the IRC Sec. 1231 capital gain and the depreciation recapture gain.

Non-Livestock Gains or Losses

IRC Sec. 1231 gains or losses from sale of non-livestock assets are outside the scope of new subtraction modification. Those gains are subject to Kansas income tax and those losses should not be "added back" under K.S.A. 79-32,117(b)(xix).

For example assume that Farmer Smith sells some breeding cattle for a $5,000 gain. He also has a tractor (another Sec. 1231 asset) that he sells for a $1,000 loss. He reports a net Sec. 1231 gain of $4,000 on his federal form 4797 which then flows through to the federal Schedule D. He has a Schedule F loss of $10,000.

In the example, the $5,000 net gain from the sale of qualifying livestock becomes a subtraction modification of $5,000, if the taxpayer's Schedule F loss of $10,000 (reported on Line 18 of the taxpayer's federal 1040 return, and which is an "add-back" modification under K.S.A. 79-32,117(b)(xix) on the Kansas K40 return) is attributable to the business in which the livestock sold had been used. If the taxpayer's Schedule F loss of $10,000 is not attributable to the business in which the livestock sold had been used, then no subtraction modification for net gain from the sale of livestock would be allowed. The loss that is "added back" must be attributable to the business in which the livestock sold has been used, in order for the net gain from sale of livestock to be allowed as a subtraction modification up to the amount of that add-back loss.

Pass-Through Entities

Use of the new subtraction modification when there are pass-through entities depends on the facts of the situation. For example assume that Farmer Jones is the sole shareholder of an S corporation engaged in farming. The S corporation sells $5,000 of breeding cattle which qualifies for the subtraction modification and generates an ordinary (operating) loss of $3,000. Farmer Jones's K-1 from the S corporation shows a $5,000 Sec. 1231 gain and an ordinary loss of $3,000. Farmer Jones also farms some ground outside of the S corporation and his Schedule F farm loss is $6,000.

In the example, the S corporation has a $5,000 net gain (which passes through to the sole shareholder Farmer Jones) on the sale of livestock, which is an IRC Sec. 1231 capital gain, Farmer Jones will report on Schedule 4797. The S corporation's farming operation also incurs a

$3,000 loss, which will be reported on Schedule E and Line 17 of the Farmer Jones's individual federal 1040 return. Farmer Jones farming operation (outside the S corporation), incurs a $6,000 loss, which will be reported on Schedule F and Line 18 of his individual federal 1040 return.

The key facts in determining whether the new subtraction modification can be claimed are whether the taxpayer has a loss reflected on Schedules C, E, or F and Lines 12, 17 or 18 of the taxpayer's federal 1040 return that is shown as an "add-back" modification on the Kansas return, and whether such loss is attributable to a business in which the livestock sold was used. In the above example, Farmer Jones' S corporation livestock operation and his farming operation outside his S corporation would be considered one farming business, in which the livestock sold was used. The $3,000 loss from the S corporation livestock operation reported on Schedule E and the $6,000 loss from the farming operation reported on Schedule F exceed the $5,000 net gain from the sale of livestock. As a result, the $5,000 net gain from livestock sale can be claimed as a subtraction modification under new K.S.A. 79-32,117(c)(xxii).

In another example, assume that Farmer Jones is the sole shareholder of an S corporation engaged in farming. The S corporation sells $30,000 of breeding cattle and also generates an ordinary (operating) loss of $40,000. Farmer Jones's K-1 from the S corporation shows a $30,000 Sec. 1231 gain and an ordinary loss of $40,000. Farmer Jones also farms some ground outside of the S corporation and his Schedule F farm income is $40,000 from selling grain. The cattle operation and the grain crop farming operation are both considered part of Farmer Jones's business in which the livestock sold had been used.

In this example, the S corporation has a $30,000 net gain (which passes through to the sole shareholder Farmer Jones) on the sale of livestock, which is an IRC Sec. 1231 capital gain, Farmer Jones will report on Schedule 4797. The S corporation's farming operation also incurs a $40,000 loss, which will be reported on Schedule E and Line 17 of the Farmer Jones's individual federal 1040 return. Farmer Jones farming operation (outside the S corporation), incurs a $40,000 profit, which will be reported on Schedule F and Line 18 of his individual federal 1040 return. The $40,000 Schedule E loss will offset the $40,000 Schedule F income, so no subtraction modification will be available for the $30,000 net gain from livestock sale under new K.S.A. 79-32,117(c)(xxii).

In a third example, assume that Farmer Jones is the sole shareholder of an S corporation engaged in farming. The S corporation sells $30,000 of breeding cattle and also generates an ordinary (operating) loss of $25,000. Farmer Jones's K-1 from the S corporation shows a $30,000 Sec. 1231 gain and an ordinary loss of $25,000. Farmer Jones also farms some ground outside of the S corporation and his Schedule F farm income is $10,000 from selling grain. Farmer Jones also has a sole proprietorship carpentry business, separate from his farming business (i.e. any profit or loss from his carpentry business is not attributable to the business in which the livestock sold had been used), which earned a net profit of $30,000, reported on Schedule C filed with Farmer Jones's federal 1040 return.

In this third example, the S corporation has a $30,000 net gain (which passes through to the sole shareholder Farmer Jones) on the sale of livestock, which is an IRC Sec. 1231 capital gain, Farmer Jones will report on Schedule 4797. The S corporation's farming operation also incurs a

$25,000 loss, which will be reported on Schedule E and Line 17 of the Farmer Jones's individual federal 1040 return. Farmer Jones farming operation (outside the S corporation), incurs a $10,000 profit, which will be reported on Schedule F and Line 18 of his individual federal 1040 return. The $25,000 Schedule E loss and the $10,000 Schedule F income partially offset one another, resulting in a net addition modification of $15,000 under K.S.A. 79-32,117(b)(xix) attributable to the business in which the livestock sold had been used, so a subtraction modification for the net gain from livestock sale under new K.S.A. 79-32,117(c)(xxii) is allowed, but limited to $15,000. Because the $30,000 profit Farmer Jones's sole proprietorship carpentry business reported on Schedule C and line 12 of Farmer Jones's federal 1040 return is not attributable to the business in which the livestock sold had been used, it can be claimed as a subtraction modification under K.S.A. 79-32,117(c)(xx).

Special Note

Please note that the amendment to K.S.A. 79-32,117 found in Senate Bill 265 was later included in House Bill 2143. This House Bill is a reconciliation bill. A reconciliation bill is used when a statute is amended in two or more separate bills. K.S.A. 79-32,117 was included in the reconciliation bill because it was amended by section 3 of Senate Bill 265 and by section 6 of House Bill 2057.

Taxpayer Assistance

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

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