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KANSAS DEPARTMENT OF REVENUE
OFFICE OF POLICY AND RESEARCH

REVISED NOTICE 05-04

Kansas Income Tax Treatment of
Certain Payments From The
Kansas Public Employees Retirement System (KPERS)

This Revised Notice 05-04 replaces Notice 05-04 issued May 20, 2005. Revisions were made to recognize changes made during the 2007 Legislative Session. The revisions affect only the section captioned "Roll-over Payments".

Advice has been requested concerning the income tax treatment of certain payments received from the Kansas Public Employees Retirement Systems (KPERS).

Introduction

During the period of their employment, KPERS members are required to contribute a percentage of their gross income to their own membership account. These contributions are credited with interest, based on the member's date of employment, throughout the KPERS membership period under K.A. A. 74-4919(1). Contributions plus accrued interest are defined as "accumulated contributions" by K.S.A. 74-4902.

Upon termination of employment or upon retirement KPERS members are entitled to receive certain payments from their KPERS membership account. 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 KPERS 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 KPERS membership accounts and related accounts. This Notice answers these questions with regard to payments of accumulated contributions upon termination of employment,

monthly retirement benefits, and partial lump-sum payments. The payments are discussed in the context of the manner in which they are 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 KPERS member must meet two requirements. First, the payment must be received directly from KPERS. 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 KPERS are not exempt.

Direct One-Time Payments

KPERS members who cease covered employment have the right under K.S.A. 74-4917 to withdraw 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, retiring KPERS members have the right under K.S.A. 74-4918, 74-4964 and 74-4964a to take part of their retirement benefit in a lump sum. This partial lump sum option means that upon retirement the member my elect to take a single lump-sum payment equal to a given percentage (up to 50%) of the actuarial present value of their lifetime benefit. The amount of the lump-sum payment will be included in federal adjusted gross income.

Because these payments are received directly from KPERS and are included in the KPERS member'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 include the maximum monthly retirement benefit payment, joint-survivor option monthly payments, and life-certain option monthly payments under K.S.A. 74-4918, 74-4964 and 74-4964a. These payments are taxable for federal income tax purposes and included in federal adjusted gross income.

Because these payments are received directly from KPERS and are included in the KPERS member'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.

Roll-Over Payments

The withdrawal of accumulated contributions under K.S.A. 74-4917 is considered an eligible rollover distribution under federal tax law. If a KPERS member elects to do a rollover into a qualified account the amount of the withdrawn and rolled over contributions will not be included in federal adjusted gross income.

Similarly, the partial lump-sum retirement option under K.S.A. 74-4918, 74-4964 and 74-4964a is considered an eligible rollover distribution under federal tax law. If a retiring KPERS member elects to do a rollover into a qualified account the amount of the rolled over partial lump-sum payment will not be included in federal adjusted gross income.

Because the rolled over withdrawn accumulated contributions or partial lump-sum retirement payment are not included in federal adjusted gross income no modification is made on the Kansas income tax return.

Federal law permits rollovers of KPERS funds 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 KPERS are deposited into qualified accounts where they will be commingled with other retirement funds. By way of example, the receiving account for KPERS rollover distributions may be another employer retirement plan. Once funds paid by KPERS are rolled over into a qualified account they lose their characterization as KPERS 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 KPERS.

When first issued, Notice 05-04 concluded this section on Roll-Over Payments by stating, "Because rollover of a KPERS payment deposited into a qualified retirement account is not included in federal adjusted gross income in the tax year when the KPERS payment was made and it has lost its characterization as a KPERS 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." This provision is being revised because of changes made during the 2007 Legislative Session.

During the 2007 Legislative Session, Senate Substitute for House Substitute for HB 2457 amended K.S.A. 74-4923(b). The amended statute, K.S.A. 74-4923 now states, in part, as follows:

> (b) Any annuity, benefit, 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, *including but not limited to, for all taxable years beginning after December 31, 2000, amounts received as a lump-sum payment at retirement as provided in K.S.A. 74-4918, 74-4964 or 74-4964a, and amendments thereto, and all earnings thereof*, shall be exempt from any tax of the state of Kansas or any political subdivision or taxing body of the state, *and such lump-sum payment at retirement, and all earnings thereof, shall retain such tax exempt status even if a retirant elects to roll over such lump-sum payment at retirement, and earnings, into a qualified retirement account whether segregated from or commingled with other retirement funds . . .*

Because of the amendments to K.S.A. 74-2923, Kansas law now provided that amounts received by a KPERS member as a lump sum payment and subsequently rolled over into a qualified retirement account, whether segregated from or commingled with other retirement funds, are exempt from Kansas income tax. This applies to all taxable years beginning after December 31, 2000.

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:

Taxpayer Assistance Center
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