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# NOTICE 12-08

## NET OPERATING LOSSES

## In Brief

During the 2012 Legislative Session House Bill 2117 was passed and signed into law. As explained below, new provisions in the Bill provide:

1) The net operating deduction for individuals has been eliminated starting in tax year 2013.

2) An individual may not carry net operating losses forward to tax year 2013 or later years, or back to earlier years.

3) The requirement to add-back a federal net operating loss as an addition modification remains in effect.

## Generally

Provisions in the Bill change the way pass-through entities are taxed. These businesses, including sole proprietorships, partnerships, S corporations, limited liability companies, and other pass-through entities, are generally not taxed as corporations. Instead, if elected for federal income tax purposes, the income is "passed through" to the business owner and, when the owner is an individual, the income is taxed on the owner's individual income tax return.

The Bill includes provisions which exempt the income of certain businesses from the Kansas income tax beginning in tax year 2013. Specifically, the Bill exempts income reported on lines 12, 17 and 18 of IRS Form 1040. Line 12 is self-employment income from federal Schedule C. Line 17 is certain income from rental real estate, trusts and "pass-through" business entities, including partnerships, Subchapter S corporations and limited liability companies reported on federal Schedule E. Line 18 is farm income from federal Schedule F.

Because these categories of income of certain businesses will no longer be subject to tax, the Bill includes provisions which prohibit individuals from deducting losses arising from these categories. Beginning in tax year 2013, these deductions will only be available to corporations that are subject to the Kansas corporate income tax, i.e. C corporations. One of the deductions that will not be available to individuals is the net operating loss deduction.

**New Language**

The statute controlling the use of net operating losses is K.S.A. 79-32,143. Section 17 of the Bill amends K.S.A. 79-32,143 to add new subsection (g) which provides:

> *(g) For tax year 2013, and all years thereafter, a net operating loss allowed by this section shall only be available to taxpayers subject to the income tax on corporations imposed pursuant to subsection (c) of K.S.A. 79-32,110, and amendments thereto, and used only to determine such taxpayer's corporate income tax liability.*

In accordance with the new law, no net operating loss deduction will be allowed for an individual for tax year 2013 or later years.

**Carry-Forward and Carry-Back**

K.S.A. 79-32,143 requires that net operating losses which are incurred after December 31, 1987, be carried forward until fully used or until ten years has elapsed, whichever occurs first. If ten years has elapsed, or the taxpayer has died, and unused loss remains, the loss may be carried back. A Kansas net operating loss which is incurred after December 31, 1987 cannot be carried back prior to carrying the loss forward.

Because net operating losses will not be allowed on individual income tax returns for tax year 2013 and later years, net operating losses from tax year 2012 and prior years cannot be carried forward to tax year 2013 or later years. This does not mean, however, that these losses can be carried back to prior years. New subsection (g) provides that net operating losses are available only to C corporations, and not to individuals. It does not create a situation where a net operating carry-back will be allowed. As a result, carry-over losses from tax year 2012 or prior years will simply not be available as of January 1, 2013.

**Modifications**

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. K.S.A 79-32,117(b)(iii) currently provides that the federal net operating loss deduction claimed on the taxpayer's federal income tax return must be added to federal adjusted gross income in computing Kansas adjusted gross income. HB 2117 did not amend this provision, so the requirement of adding back the amount of the federal net operating loss deduction will continue for tax year 2013 and later years.

## 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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