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August 15, 2023

Ms. Teresa L. Lee
Assistant Vice President
Washburn University
118 Morgan Hall
1700 SW College Avenue
Topeka, Kansas 66621

Email: Teresa.lee@washburn.edu

Re: Taxability to Kansas of rollovers from Washburn retirement and pension plans and the subsequent distribution from the receiving rollover plan.

Dear Ms. Lee:

Your email dated July 4, 2023, was forwarded to me for response. Thank you for your inquiry.

In that letter you question the taxability of rollovers from Washburn's retirement and pension plans to other plans (such as IRAs) and their subsequent distributions. Specifically, your letter reads as follows:

We are writing to request your advice regarding the Kansas income tax treatment of Washburn University retirement plan funds that are rolled into an Individual Retirement Account, as defined under Section 408(a) of the Internal Revenue Code ("IRA"), or a qualified retirement plan maintained by a different employer.

For background, Washburn University maintains two types of retirement plans: (i) a tax-favored plan under Section 457(d) of the Internal Revenue Code; and (ii) tax-sheltered plans under Section 403(b) of the Internal Revenue Code. These plans are collectively referred to as the Washburn retirement plan.

Background

Under K.S.A. 79-32,117(a), amounts which are subject to federal income tax will also be subject to Kansas income tax unless there is a specific modification provided for by Kansas statutory law. K.S.A. 79-32,117(c)(xix) provides such a modification by exempting the following amounts from Kansas income tax: "Amounts received by retried employees of Washburn University as retirement and pension benefits under the university's retirement plan."

In its capacity as plan sponsor, Washburn University intends to provide educational materials to terminated participants regarding their distribution and rollover options, including the tax considerations of each option. One such tax consideration is the application of K.S.A. 79-32,117(c)(xix) to rollovers.

Requested Advice

We respectfully request your advice on the matters below.

1. If the event a terminated participant rolls his or her Washburn University retirement funds into an IRA, we have the following questions:

   a. Will the Washburn rollover funds retain their tax exempt status under K.S.A. 79-32,117(c)(xix) if they are the only funds in the IRA? For instance, assume a former employee rolls her Washburn retirement plan funds (totaling $10,000) into an IRA. The IRA has no other funds in it. The following year, after the IRA has grown to $12,000 from investment gains, the individual receives a lump sum distribution of the entire amount in the IRA. Is the IRA distribution exempt from Kansas income tax?

   b. Will the Washburn rollover funds retain their tax exempt status under K.S.A. 79-32,117(c)(xix) if the IRA has funds from other sources (such as other contributions made by the individual or funds rolled over from another employer's retirement plan)? If yes, are there any requirements for keeping the Washburn rollover funds separate from other funds within the IRA or allocating the gains and losses attributable to Washburn rollover funds?

2. In the event a terminated participant rolls his or her Washburn University retirement funds into a qualified retirement plan maintained by another employer, will the rollover funds retain their tax exempt status under K.S.A. 79-32,117(c)(xix)? If yes, are there any requirements from keeping the Washburn rollover funds separate from other funds withing the new plan or allocating the gains and losses attributable to Washburn rollover funds?

3. K.S.A. 79-32,117(c)(xix) refers to 'retired employees' of Washburn University. Does "retried employees" include any participant that has incurred a severance of employment from Washburn University, regardless of age or whether the individual obtains employment elsewhere? In addition, under certain some circumstances the Internal Revenue Code allows in-service distributions or in-service rollovers to an IRA without penalty (for instance, where the participant obtains age 59 ½). In such a scenario, would active employees be treated as "retried employees" under K.S.A. 79-32,117(c)(xix) and retain favorable tax treatment for in-service distributions or rollovers to an IRA.

Applicable Guidance:

K.S.A. 79-32,117(c) There shall be subtracted from federal adjusted gross income:

. . .

(xix) Amounts received by retired employees of Washburn university as retirement and pension benefits under the university's retirement plan.

Responses to Questions:

Before addressing your questions, it is important to distinguish the tax consequences between rollovers and distributions.

Generally, for federal tax purposes, rollovers between retirement plans are allowed if both plans share the same tax characteristics for contributions (pre-tax dollars vs. after-tax dollars). If the rollover is allowed by the IRS, it is generally a non-taxable event, and is not included in federal adjusted gross income (FAGI). If not included in FAGI on the federal level, the transaction is not taxable to Kansas, and the income modification found in K.S.A. 79-32,117(c)(xix) is not needed. Rollover that are taxable at the federal level are generally taxable to the State of Kansas, unless a modification, such as K.S.A. 79-32,117(c)(xix) is applicable.

While the rollover to another account or plan may not be taxable, the subsequent distribution from the plan receiving the rollover could result in a taxable event. Against this backdrop, the modification found in K.S.A. 79-32,117(c)(xix) gains importance. The K.S.A. 79-32,117(c)(xix) modification is allowed in those instances where the distribution is made from the university's retirement plan. When the individual employee's account is rolled over into another retirement or pension investment outside the university's plan, it loses its identity, and the distributions from the receiving rollover pension or retirement plan no longer qualifies for the modification found in K.S.A. 79-32,117(c)(xix).

In addressing your specific questions, the response to questions 1a, 1b, and 2 is NO, the rolled over amounts will no longer qualify for modification under K.S.A. 79-32,117(c)(xix). While the rollover itself may not result in a taxable event or qualify for modification, the subsequent distribution from the retirement or pension plan outside the university's retirement plan does not qualify for modification. Whether or not the rolled over amounts are segregated or comingled into another plan is not material, since the distribution is not occurring from the university's retirement plan.

Concerning question 3, we would recommend that you consult the university's plan for its definition of /criteria for retirement. Generally, retirement is normally defined as leaving employment after obtaining a prescribed number of years of service and/or age and drawing retirement benefits from the system. In that context, an employee leaving employment before a set age and/or years of service or taking in-service contribution while still employed would not qualify for the modification as outlined in K.S.A. 79-32,117(c)(xix).

Hopefully, this letter has addressed the questions you raised. If you have additional questions or comments, please do not hesitate to contact us.

Sincerely,

Roger Basinger

Roger Basinger
Tax Specialist

RB:rb

NOTE: This private letter ruling / opinion letter is based solely on the facts provided in your request for advice. If material facts or information were not disclosed this letter is null and void. This letter will be revoked without further action by the Department if the statutes, administrative regulations, published revenue rulings, or court decisions that materially affect this opinion are changed.