**Private Letter Ruling**

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| **Ruling Number:** | **P-2001-067** |

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| **Tax Type:** | **Corporate Income Tax** |
| **Brief Description:** | **ESOP (Employee Stock Ownership Plan)** |
| **Keywords:** |  |
| **Approval Date:** | **07/02/2001** |

**Body:**

Office of Policy & Research  
  
  
July 2, 2001

XXXXXXXXXXXXXXX  
XXXXXXXXXXXXXXXX  
XXXXXXXXXXXXXXXX  
  
  
Dear XXXXXXXXXXX:  
  
I have been asked to respond to your letter dated June 15, 2001. In it, you ask for guidance on the tax status of an ESOP, which is the owner of 100% of the stock of an S-Corporation.  
  
In your letter you stated:

*Facts:*

· XXXXXXXXX elected S-Corporation status to be effective for tax year beginning 07/01/2000  
· XXXXXXXXXXX. has a 100% shareholder who is an ESOP (Employee Stock Ownership Plan) for tax year beginning 07/01/2000

*Questions:*

· Does your state accept an ESOP as a shareholder for an S-Corporation? Please cite state regulations, laws, etc. which support your answer.  
· If the state recognizes an ESOP as a shareholder, is this a taxable entity for your state? Please cite state regulations, laws, etc. which support your answer.  
  
  
Internal Revenue Code Section 512 states in pertinent part:  
  
“(e) Special rules applicable to S corporations  
  
(1) In general  
  
If an organization described in section 1361(c)(6) holds in an S corporation -  
  
(A) such interest shall be treated as an interest in unrelated trade or business, and  
  
(B) notwithstanding any other provision of this part -  
  
(i) all items of income, loss, or deduction taken into account under section 1366(a), and  
  
(ii) any gain or loss on the disposition of the stock in the S corporation,  
  
shall be taken into account in computing the unrelated business taxable income of such organization.  
  
(2) Basis reduction

Except as provided in regulations, for purposes of paragraph (1), the basis of any stock acquired by purchase (as defined in section 1361(e)(1)(C)) shall be reduced by the amount of any dividends received by the organization with respect to the stock.

(3) Exception for ESOP’s

This subsection shall not apply to employer securities (within the meaning of section 409(l)) held by an employee stock ownership plan described in section 4975(e)(7).”

K.S.A. 79-32,113 states:  
  
“Exempted organizations.  
  
(a) A person or organization exempt from federal income taxation under the provisions of the federal internal revenue code shall also be exempt from the tax imposed by this act in each year in which such person or organization satisfies the requirements of the federal internal revenue code for exemption from federal income taxation. If the exemption applicable to any person or organization under the provisions of the federal internal revenue code is limited or qualified in any manner, the exemption from taxes imposed by this article shall be limited or qualified in a similar manner.  
  
Per the I.R.C. Section 512(e)(3), certain unrelated business taxable income of employee stock ownership plans (“ESOP’s”) are excluded from the general imposition of federal income tax. Kansas law as contained in Chapter 79-32,113 mimics the federal tax treatment of entities exempt from federal tax. Therefore, it is the opinion of the Kansas Department of Revenue that the unrelated business taxable income of ESOP’s is exempt from taxation by Kansas to same extent said income is exempt from federal taxation.  
  
Exempt entities are not required to file income tax returns with Kansas unless they have taxable income or are ordered to prove their exempt status by the Director of Taxation. K.A.R. 92-12-14  
  
This is a private letter ruling pursuant to Kansas Administrative Regulation 92-19-59. It is based solely on the facts provided in your request. If it is determined that undisclosed facts were material or necessary to an accurate determination by the department, this ruling is null and void. This private letter ruling will be revoked in the future by operation of law without further department action if there is a change in the statutes, administrative regulations, or case law, or a published revenue ruling, that materially affects this ruling.  
  
Sincerely,  
  
  
  
Mark D. Ciardullo  
Tax Specialist  
  
MDC:mdc  
  
  
**Date Composed: 07/06/2001 Date Modified: 10/10/2001**