Department of Finance and Administration

Legislative Impact Statement

Bill: HB1007
Bill Subtitle: TO CREATE THE ARKANSAS CAPITAL GAINS REDUCTION ACT OF 2013.

Basic Change :
Rep. D. Altes

The bill creates an exemption for any net capital gains relating to the sale of Arkansas property. Arkansas property is defined as real property located in this state, tangible property located in this state and intangible property, stock or other ownership interest in an entity with its primary headquarters located in this state. The property must be acquired after July 1, 2013 and the property, except for real property, must be held for one uninterrupted year from the date of acquisition. The bill does not require a holding period for real property. The Director of DFA is given authority to promulgate regulations to implement the act. The bill is effective for tax years beginning on or after January 1, 2014.

Revenue Impact :
FY2014 - $2.3 M Loss
FY2015 - $15.2 M Loss
FY2016 - $30.3 M Loss
FY2017 - $41.4 M Loss

Taxpayer Impact :
Taxpayer must maintain additional documentation relating to any transactions that qualify for the net capital gain income tax exemption.

Resources Required :
Booklet changes, changes in forms, changes in computer programs and changes in return processing procedures. Estimated cost $10,000.

Time Required :
Six months after enactment.

Procedural Changes :
Employees will be required to verify that the qualifications for the exemption are met. Forms and instructions, computer programs, employee training and processing procedures need to be modified. Taxpayers, tax preparers and software companies will need to be informed.

Other Comments :
Section 2 (e)(1)(D) conflicts with ACA 26-51-815 (a)(1)(B) because Section 2 states that the bill will apply to C corporations, and the Code states that it does not apply to C corporations.

Legal Analysis :
House Bill 1007 of 2013 contains potential commerce clause violations; if passed the State would likely be subject to a lawsuit on these deficiencies. HB 1007 creates an income tax exemption for capital gains based on the Arkansas location of the appreciated property.

A State can violate the Commerce Clause of the United States Constitution when the State acts to favor in-state business over out-of-state business. The Commerce Clause prohibits States from enacting laws that discriminate against out-of-state business to benefit in-state businesses. "[W]here simple economic protectionism is effected by state legislation, a virtually per se rule of invalidity has been erected." *City of Philadelphia v. New Jersey*, 437 U.S. 617 (1978). State's retain the authority to regulate matters of legitimate local concern under the general police powers even if such regulation

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may affect interstate commerce. The burden on the State when a statute discriminates against interstate commerce is to demonstrate not only that it is serving a "legitimate local purpose" but also that there is no available nondiscriminatory methods to advance this purpose. *Maine v. Taylor*, 477 U.S. 131 (1986). Furthermore, the Court has also described this area of law stating that "[d]iscrimination against interstate commerce in favor of local business or investment is per se invalid, save in a narrow class of cases where the municipality can demonstrate, under *rigorous scrutiny*, that it has no other means to advance a legitimate local interest." *C & A Carbone, Inc. v. Town of Clarkstown*, 511 U.S. 383 (1994) (emphasis added). Recently, the Court summarized the requisite standards by stating:

> Time and again this Court has held that, in all but the narrowest circumstances, state laws violate the Commerce Clause if they mandate "differential treatment of instate and out of state economic interests that benefits the former and burdens the latter." *Oregon Waste Systems, Inc.* v. *Department of Environmental Quality of Ore.*, 511 U. S. 93, 99 (1994). *See also New Energy Co. of Ind.* v. *Limbach*, 486 U.S. 269, 274 (1988). This rule is essential to the foundations of the Union. The mere fact of nonresidence should not foreclose a producer in one State from access to markets in other States. *H. P. Hood & Sons, Inc.* v. *Du Mond*, 336 U.S. 525, 539 (1949). States may not enact laws that burden out of state producers or shippers simply to give a competitive advantage to instate businesses. This mandate "reflect[s] a central concern of the Framers that was an immediate reason for calling the Constitutional Convention: the conviction that in order to succeed, the new Union would have to avoid the tendencies toward economic Balkanization that had plagued relations among the Colonies and later among the States under the Articles of Confederation." *Hughes* v. *Oklahoma*, 441 U.S. 322, 325-326 (1979).

Under HB1007, business that are not situated in Arkansas or Arkansas residents purchasing property which gains in value outside of the State would not receive the benefits of the proposal. This is likely a *per se* burden on interstate commerce. While fostering in-state economic growth would likely be considered a valid governmental purpose, it is unclear whether such legislation would survive a constitutional challenge. Because there is no reason to discriminate against out-of-state appreciation of property save the origin of the property, the bill would likely fail to survive a constitutional challenge.

With respect to other states, HB 1007 goes beyond the scope and scale of similar protectionist legislation. None of the states with similar protectionist legislation, such as Oklahoma and Mississippi, have expressly survived legal challenge to the legislation. The non-partisan Tax Foundation has described Mississippi's capital gains as "unconstitutional." HB 1007 is also distinct by the exceedingly short period of time required for the property to be held prior to realization of gain compared to the three and five year requirements found in Oklahoma and Mississippi.