Department of Finance and Administration

Legislative Impact Statement

Bill: HB1966 As Engrossed: 3/28/2013
Bill Subtitle: TO AMEND THE LAWS CONCERNING THE INCOME TAX ON CAPITAL GAINS.

Basic Change :

Rep. Carter, Collins

Senator J. Dismang

The bill creates an additional exemption for net capital gains on assets acquired before January 1, 2014. Net capital gains up to $5,000,000 continue receiving the current 30% exclusion; and gains above $5,000,000 would receive a 70% exclusion. This exclusion is available only to Individual Income tax filers.

The bill also creates a 70% exemption for any net capital gains relating to the sale of Arkansas property acquired on and after January 1, 2014. 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 on or after January 1, 2014 and the property must be held for one uninterrupted year from the date of acquisition. This exclusion is available to Individual Income tax filers and to Corporation Income Tax filers. Capital gains on property acquired on or after January 1, 2014 and not qualifying as Arkansas Property will be entitled to the same 30% exclusion as in current law. The Director of DFA is authorized to promulgate regulations to implement the act. The bill is effective for tax years beginning on or after January 1, 2014.

Revenue Impact :

FY2014 - $3.1 million revenue loss

FY2015 - $10.0 million revenue loss
FY2016 - $18.3 million revenue loss
FY2017 - $27.9 million revenue loss

Taxpayer Impact :

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

Resources Required :

Requires changes to tax booklets, forms, computer programs and return processing procedures.

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 :

None

Legal Analysis :

The special treatment for Arkansas Property likely violates the commerce clause of the US Constitution. The commerce clause prohibits states from engaging in economic protectionism and

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prevents states from enacting laws that benefit in-state economic interests while burdening out-of-state competitors. The special provisions for Arkansas Property encourage Arkansas individuals and businesses to invest in Arkansas businesses and property while making it more difficult for out-of-state companies to attract investment from Arkansas.

A similar provision was recently the subject of a lawsuit in Oklahoma. In *CDR Systems Corp. V. Oklahoma Tax Commission*, Oklahoma Court of Civil Appeals, Case No. 109,886 (Jan. 17, 2013) the court considered an Oklahoma law that imposed a longer holding period for an out of state company than for a company headquartered in Oklahoma for purposes of receiving preferential capital gains treatment. The Court of Civil Appeals held that this distinction was unconstitutional under the commerce clause. Whether the distinction between the in-state or out-of-state property is a longer holding period or a different tax rate is not significant. The real issue is whether the law results in economic protectionism. The preferential treatment of Arkansas Property in Speaker Carter's proposal likely violates the commerce clause.

If the special provisions for Arkansas Property are successfully challenged in the Arkansas Supreme Court, it is likely that the Court will extend that 70% exclusion to all capital gains income subject to Arkansas income tax. The Court has fashioned a similar remedy in other cases where state law provided preferential tax treatment to some, but not all, taxpayers. The revenue cost of a Court ruling of that nature would result in additional revenue loss of:

FY2014 - $0
FY2015 - $6.0M
FY2016 - $18.6M
FY2017 - $32.5M

Total revenue cost from the bill and an unfavorable court ruling would be:

FY2014 - $3.1M
FY2015 - $16.0M
FY2016 - $36.9M
FY2017 - $60.4M