SUMMARY OF PROPOSAL #21
for consideration by the
ARKANSAS TAX REFORM AND RELIEF LEGISLATIVE TASK FORCE

TOPIC: To Repeal the Capital Gains Tax Exemption for Capital Gains over $10 Million

Summary of Proposal for Consideration

To repeal the capital gains tax exemption for capital gains over $10 million under Arkansas Code § 26-51-815, effective for tax years beginning January 1, 2019.

Fiscal Analysis

According to the Department of Finance and Administration, the reduced rate on capital gains, both the complete exclusion of gains over $10,000,000 and the fifty percent (50%) rate reduction for gains less than $10,000,000, has a revenue estimate of $53,700,000. For tax year 2016, approximately a dozen filers utilized this deduction for an aggregate revenue impact of $4,650,000.

Legal Analysis

Background

Arkansas currently exempts one-hundred percent (100%) of capital gains over ten million dollars ($10 million) and fifty percent (50%) of capital gains under ten million dollars ($10 million).

ACT 848 of 1985 provided a phase-in of an exclusion for capital gains. Beginning in calendar year 1987, ten percent (10%) of all capital gains were to be excluded from income; beginning in calendar year 1988, thirty percent (30%) of all capital gains were to be excluded from income; and beginning in calendar year 1989, forty percent (40%) of all capital gains were to be excluded from income.

ACT 35 of 1987 postponed the capital gains phase-in from ACT 848 of 1985 by two (2) years for each phase-in period.

ACT 933 of 1989 again postponed the capital gains phase-in from ACT 848 of 1985 for another two (2) years for each phase-in period.

ACT 882 of 1991 repealed the phase-in period for capital gains under ACT 848 of 1985 and provided for a maximum capital gains tax rate of six percent (6%) for individuals and S corporations.

ACT 1160 of 1995 adopted 26 U.S.C. § 1202, as in effect on January 1, 1995, regarding the exclusion of capital gains from certain small business stock for the purpose of computing Arkansas income tax liability.

ACT 1005 of 1999 excluded from income thirty percent (30%) of capital gains with the remaining seventy percent (70%) being treated as regular income. The six percent (6%) rate on capital gains was repealed.

ACT 1548 of 2001 exempted one hundred percent (100%) of net capital gain from a venture capital investment, if the investment was made on or after January 1, 2001, and held for at least five (5) years.

ACT 1488 of 2013 increased the capital gains exemption from thirty percent (30%) to fifty percent (50%) on capital gains under ten million dollars ($10 million) and exempted one hundred percent (100%) of the capital gains over ten million dollars ($10 million).

ACT 1173 of 2015 and ACT 22 of 2015 temporarily reduced the capital gains exemption for capital gains under ten million dollars ($10 million) from fifty percent (50%) to forty-five percent (45%) from February 1, 2015, to July 1, 2016. Beginning July 1, 2016, the capital gains exemption was increased back to fifty percent (50%) for capital gains under ten million dollars ($10 million), and it has not been materially amended since.

Potential Legal Issues

None.

Other States

- Iowa: Capital gains from the sale of stocks or bonds do not qualify for a capital gains deduction unless fifty percent (50%) of the gain was realized from the sale or exchange of employer securities of an Iowa corporation to a qualified Iowa employee stock ownership plan (ESOP). To be eligible for the capital gains deduction, the Iowa ESOP must own at least thirty percent (30%) of all outstanding employer securities issued by an Iowa corporation after completion of the transaction. Iowa's capital gains deduction is very complex, and the Iowa Department of Revenue has provided multiple flow charts to determine eligibility for additional capital gain deductions for the sale of certain farm land, the sale of certain businesses, the sale of livestock, and the sale of timber. (IA St. § 422.7)

- Louisiana: Taxpayers are allowed a deduction of net capital gains, limited to gains recognized and treated by federal income tax as arising from the sale or exchange of an equity interest of a non-publicly traded corporation, partnership, limited liability company, or other business organization commercially domiciled in the state that the taxpayer has held for a minimum of five (5) years. Depending on the length of time a commercial domicile is held, the capital gain deduction will range from fifty percent (50%) for five (5) years and up to one hundred percent (100%) for thirty (30) years or more. (LA St. § 47:293)

- Mississippi: Long-term capital gains are considered taxable income. Mississippi allows for a capital gains exemption for capital gains arising from property held for productive use or investment, sales of stock for stock in the same corporation, transfers to a corporation controlled by the transferor, sales of stock for stock on reorganization, most involuntary conversions of property, and sales of certain domestic entities that have been held for more than one (1) year. Stock dividends are also exempt from tax. (MS St. § 27-7-9)

- Missouri: Taxpayers are allowed a deduction equal to fifty percent (50%) of the net capital gain from the sale or exchange of a Missouri corporation to a qualified Missouri employee stock ownership plan if, upon completion of the transaction, the qualified Missouri employee stock ownership plan owns at least thirty percent (30%) of all outstanding employer securities issued by the Missouri corporation. (MO St. § 143.114)

- Oklahoma: Oklahoma allows a capital gain deduction for qualifying gains that result from the sale of the following assets:
    - Real property or tangible personal property located within Oklahoma that has been directly or indirectly owned by the taxpayer for a holding period of at least five (5) years;
    - Stock or an ownership interest in an Oklahoma company, limited liability company, or partnership where such stock or ownership interest has been directly or indirectly owned by the taxpayer for a holding period of at least two (2) years; or
    - The sale of real property, tangible personal property, or intangible personal property located within Oklahoma as part of the sale of the assets of an Oklahoma company, limited liability company, partnership, or proprietorship business enterprise that has been directly or indirectly owned by the taxpayer for a holding period of at least three (3) years.

    (OK St. 68 § 2358)

- Tennessee: Tennessee provides a capital gain exemption for a return of capital if the shareholders' investment was returned and the right of the shareholder to future earnings is reduced or eliminated, or when a shareholder sells shares of a mutual fund. (TN St. § 67-2-104; TN Dep't of Revenue April 5, 2017 article)

- Texas: Texas does not have a corporate or individual income tax, and there does not appear to be a capital gains exemption for the franchise tax.