FISCAL NOTE

Bill #: SB486

Title: Allow stock investment in qualifying Montana business without tax consequence

Primary Sponsor: Bob DePratu

Status: Introduced

____ Sponsor signature Date

____ Chuck Swysgood, Budget Director Date

Fiscal Summary

	FY2002 Difference	FY2003 Difference
Expenditures:		
General Fund	$20,241	
Net Impact on General Fund Balance:	**$(20,241)**	**$0**

Yes	No		Yes	No	
	X	Significant Local Gov. Impact	X		Technical Concerns
	X	Included in the Executive Budget		X	Significant Long-Term Impacts
	X	Dedicated Revenue Form Attached		X	Family Impact Form Attached

Fiscal Analysis

ASSUMPTIONS:

1. This proposal provides that a qualifying exchange of stock in a corporation, or the sale of stock with the cash transferred within 180 days, in order to provide capital to a qualifying new or expanding business is exempt from the state individual income tax (this bill does not apply to the corporation license tax). Under current federal law, usually there is no recognition of a capital gain in an *exchange* of stock for stock in a new business; because Montana ties to the federal definition of income, there would also be no recognition of gain from these types of exchanges for state tax purposes. A *sale* of stock prior to transferring the receipts from that sale to a new business would constitute a taxable event for federal purposes, with any gain from the sale subject to federal income tax; but under the provisions of this bill those gains would be exempt for state purposes. Taxpayers choosing to capitalize a new business will do so in a manner that allows an exemption from both federal and state tax; i.e., they will chose to exchange stock, rather than sell it first. Consequently, there is no fiscal impact from this proposal from events that provide for the initial capitalization of new businesses via the exchange of stock.

2. A qualifying business must be 1) a "new" or "expanding" business; that 2) operates primarily in the state (i.e., it has a majority of its employees in the state); that 3) adds 5 full-time employees; and 4) pays those new employees a "livable wage" for a period of not less than 18 months from the time the exchange of stock takes place. A livable wage is defined as an hourly wage equal to 150% of the federal poverty index for a family of two for the prior year divided by 2080.
3. If after five years the new business continues to meet the employee and location qualifications described in assumption 2, and has had at least $10,000 in sales or rental business-related income in at least 2 of the last 5 years, the taxable basis of the original investment in the new business is the value of the stock at the time of transfer to the new business. That is, there would be a "step up" in basis for taxation purposes from the original basis in the stock to the value of the stock at the time of the exchange in stock for stock of the new business. The ultimate revenue consequence to the state general fund would be a reduction in revenue equal to the effective tax rate applied to the capital gains at the time the stock is eventually sold times the difference in value of the stock between the time of original purchase and the time of exchange with the new business.
4. This proposal, to the extent that qualifying exchanges occur, will reduce revenue to the state general fund. However, because the revenue impacts do not occur for at least five years (see assumption #1) there is no impact from this proposal in the current biennium. There will be a reduction in revenue in future biennia; however, the department has no means of providing an accurate estimate of the fiscal impact that might occur then.
5. Administrative expenses would increase by $20,241 in fiscal year 2002 in order to modify individual income tax forms to accommodate the capital gains exclusion provided for in this bill.

TECHNICAL NOTES:

1. Section 1, subsection (5) specifies that five years after the investment in the qualifying business, if the business continues to meet the employee and location qualifications of subsection (3)(a)…the taxable basis of the investment in the qualifying business is the fair market value of the stock at the time of transfer. It is not clear if this means that the business must meet the employee and location qualifications for the entire 5-year period, or if they must meet those qualifications at that point in time five years later.