FISCAL NOTE

Bill #: SB0511 **Title:** Exclude stock capital gains from qualified start-up corporations

Primary Sponsor: Mangan, J **Status:** As Amended in Senate Committee

Sponsor signature Date David Ewer, Budget Director Date

Fiscal Summary

	FY 2006 Difference	FY 2007 Difference
Expenditures:		
General Fund	$0	$0
Revenue:		
General Fund	$0	$0
Net Impact on General Fund Balance:	$0	$0

- [ ] Significant Local Gov. Impact
- [x] Technical Concerns
- [ ] Included in the Executive Budget
- [x] Significant Long-Term Impacts
- [ ] Dedicated Revenue Form Attached
- [ ] Needs to be included in HB 2

Fiscal Analysis

ASSUMPTIONS:

1. This bill would allow as an *itemized deduction* for individual income tax purposes, and a *deduction from income* for corporation license tax purposes, the net capital gains from the sale of certain common or preferred stock.
2. In order to qualify for the deduction, the capital gains would have to be from the sale of common stock or preferred stock of a "qualified corporation". A qualified corporation is one that:
    a. is a C. corporation and has been reported as a C. corporation for federal tax purposes for the 2 years immediately preceding the year in which the deduction is claimed;
    b. was not publicly traded on a stock exchange or listed for over-the-counter trading or was not affiliated with a publicly traded company at the time the stock was purchased;
    c. is headquartered within the state and has its principal business operations located within the state;
    d. has at least 35% of its directors and officers and 60% of its employees residing in the state in the year in which the deduction is claimed, and for at least the 2 years immediately preceding the year in which the deduction is claimed;
    e. employed fewer than 100 full-time employees at the time the stock was purchased and has fewer than 500 full-time employees when the exemption is claimed;

f. is an active operating entity that produces goods or services. An active operating entity under this subsection (2)(b)(vi) does not include a passive investment entity that primarily engages in buying, holding, and trading assets for speculation on price changes such as:
   i. real estate holding companies, real estate investment trusts, and companies whose assets predominantly consist of real property or whose income is predominantly derived from the sale, rental, or management of real property or interests in real property such as leaseholds or mineral rights;
   ii. companies whose assets predominantly consist of or whose income predominantly arises from financial instruments such as futures contracts, insurance contracts, mortgages, or debt obligations;
   iii. shell business entities, as defined in 33-12-102, whose assets predominantly consist of share and equity interests in other companies.

3. Furthermore, in order to qualify for the deduction the capital gain must be from stock that was purchased after December 31, 2004 and is held for at least 3 years. Under this provision of the bill, the first time that a stock from a qualifying corporation could be sold and qualify for the exclusion would be after December 31, 2007 (tax year2008). Consequently, there is no revenue impact from this bill in the 2007 biennium as there would be no revenue impact from this bill until at least FY 2009.

There are no additional administrative expenses to the Department of Revenue associated with this bill.

FISCAL IMPACT:

	FY 2006 Difference	FY 2007 Difference
Revenues:		
General Fund (01)	$0	$0
Net Impact to Fund Balance (Revenue minus Funding of Expenditures):		
General Fund (01)	$0	$0

EFFECT ON COUNTY OR OTHER LOCAL REVENUES OR EXPENDITURES:
None.

LONG-RANGE IMPACTS:
Beginning with FY 2009, this bill could begin reducing revenues to the state general fund. The amount of revenue reduction will depend on the amount of stock that is purchased in qualifying corporations, the timing of when that stock is sold, the amount of the actual net capital gain associated with the sale of the stock, the net taxable income of the taxpayer selling the stock, and the marginal tax rate applied to the gain from the stock. There is no means of accurately estimating the revenue impact in future years, but the impact is likely to be relatively small to begin with and grow over time as more stock of qualifying corporations is purchased and subsequently sold.

TECHNICAL NOTES:
1. As amended, the bill codifies the deduction for qualifying capital gains income in 15-30-121, MCA. This section of law provides for *itemized deductions* for individual income tax purposes and is not the

appropriate section in which to codify a *deduction of income* for individual income tax purposes. Adjustments to income such as the one contemplated in this bill should be codified in 15-30-111, MCA and characterized as a "deduction" from *income*, rather than an "exclusion" of income. Clarifying the deduction as a "deduction" makes it very clear that the item of income is to be reported for income tax purposes, and subsequently recorded as a deduction from income, rather than as an exclusion (which in many cases are not even reported income tax purposes), or as an itemized deduction, *which would not allow the deduction from income for those taxpayers who choose to take the standard deduction.*

2. Section 1, subsection (2)(a) provides for the exclusion for stock that was "purchased" after December 31, 2004. There is no definition of the term "purchased" in the bill, and a definition should be provided to clarify if purchase includes contributions of money or property to the corporation in exchange for stock in the corporation constitutes a "purchase".
3. Limiting the tax free gain to shareholders of corporations with Montana headquarters may result in a constitutional challenge to the bill.