NET CAPITAL GAINS EXCLUSION (tax attorney perspective)

Prior to the enactment of the net capital gains exclusion, Louisiana residents who were contemplating the sale of a business that would generate significant capital gain recognition would seek to change their legal domicile to Texas or Florida prior to the sale so that the gain would not be subject to Louisiana or any state income tax. It was so prevalent that tax lawyers had a template that was routinely used to legally accomplish the change of domicile, which they provided to such residents. Once the resident moved out of Louisiana, so did the proceeds from the sale transaction. Instead of the resident remaining in Louisiana to reinvest the sales proceeds in Louisiana, he or she would be in Texas or Florida reinvesting the sales proceeds.

When estimating how much additional tax revenue Louisiana will gain by eliminating the net capital gains exclusion do not overlook the fact that residents contemplating sales of businesses that will generate significant capital gain recognition will once again change their legal domicile to Texas or Florida prior to the sale, and Louisiana will lose both future tax revenue from the business as well as the future tax revenue associated with the reinvestment of the sales proceeds.

Focusing on sales of just businesses that would generate significant capital gain recognition also misses an essential point. The net capital gains exclusion is also important to start up entrepreneurs in Louisiana who likewise occasionally sell a newly created business so that they can raise capital to invest in their next better venture. Imposing the Louisiana tax again on these transactions will stifle the flow of reinvestment dollars into new start up small businesses and the future tax revenue associated therewith.

The assertion that the net capital gains exclusion is unconstitutional because it only applies to sales of equity or substantially all the assets of entities commercially domiciled in Louisiana is a red herring. Both resident and nonresident individuals are treated equally with respect to qualifying transactions. For transactions that fail to qualify because the entity is not commercially domiciled in Louisiana, nonresidents and residents will be treated the same with respect to any Louisiana income tax based upon the location of the assets at the time of the sale. With respect to sales of equity interests of entities not commercially domiciled in Louisiana, nonresidents will not be subject to any Louisiana income tax on such transactions. Residents will be subject to Louisiana income tax, but they will receive a dollar for dollar credit against their Louisiana income tax for any tax paid to another state on the same transaction. A compelling economic state interest in stemming the flow of investment capital out of Louisiana, equal treatment of all taxpayers on qualifying transactions, no discrimination against nonresidents, and a credit mechanism to eliminate double taxation on residents all suggest that the net capital gains exclusion will withstand constitutional scrutiny.

Bundling the elimination of the net capital gains exclusion together with elimination of the federal tax deduction and the deduction for excess federal itemized deductions is mixing apples and oranges. In terms of repetitiveness, the latter two occur for most individual taxpayers filing a Louisiana income tax return every tax year. On the other hand, most individual taxpayers will never sell a business and for those that do, they are often once in a lifetime events or at least sporadic events. In terms of revenue potential, any revenue generated by the elimination of the net capital gains exclusion is dwarfed in comparison to the revenue that would be generated by the elimination of the federal income tax deduction and the deduction of excess federal itemized deductions.