TESTIMONY OF
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Before the Joint Standing Committee on Taxation
Hearing Date: *April 13, 2023*

LD 1276 – "*An Act to Create and Sustain Jobs and Affordable Housing Through the Development of Cooperatives and Employee-owned Businesses*"

Senator Grohoski, Representative Perry, and members of the Taxation Committee – good afternoon, my name is Michael Allen, Associate Commissioner for Tax Policy in the Department of Administrative and Financial Services. I am testifying at the request of the Administration Against LD 1276, "*An Act to Create and Sustain Jobs and Affordable Housing Through the Development of Cooperatives and Employee-owned Businesses.*"

This testimony is limited to the bill as it affects Maine Revenue Services. For taxable years beginning on or after January 1, 2024, to the extent included in federal adjusted gross income (for individuals) or federal taxable income (for corporations) and otherwise subject to Maine income tax, the bill proposes two income subtraction modifications to:

1) exempt up to $750,000 of gain recognized on the sale of a majority ownership interest in a qualified business to an employee stock ownership plan (ESOP) or a Subchapter S corporation owned by an ESOP, an eligible worker-owned cooperative, a consumer cooperative, an affordable housing cooperative, or a producer cooperative; and

2) exempt interest received during the taxable year with respect to a qualified business acquisition loan. Note that the bill also exempts such interest from the Maine franchise tax imposed on financial institutions.

Currently, capital gains and business interest are subject to both federal and State income tax.

This bill creates a $750,000 capital gains exclusion for sales of a business to an ESOP. Carving out certain types of capital gains for a tax incentive complicates the income tax and primarily benefits upper-income households. MRS tax data show that since 2016, the average number of ESOP sales per year is 9. It is not clear whether a capital gains exclusion will incentivize these types of sales.

The administration notes the following technical concerns:

- As currently written, the bill does not extend the subtraction modifications to trusts and estates subject to the Maine fiduciary income tax.
- As currently written, Section 7 of the bill does not apply to the taxable Maine assets of a financial institution.
- The bill should define a "producer cooperative" or clarify whether it is the same as an "Agricultural Cooperative" organized under 13 M.R.S., c. 85, sub-c. 2.
- The bill should clarify whether the exemption for interest received applies to interest received during the year of sale or whether the exemption applies to interest received over the life of the loan.

The estimated revenue impact is a revenue loss of approximately $500,000 per year.

Assuming that the bill will be amended to extend the subtraction modifications to the fiduciary income tax, the estimated administrative costs are $77,000 for fiscal year 2025 for one-time computer programming to add two lines to each of the individual, fiduciary, and corporate income tax returns, and to add one line to the franchise tax return to accommodate the income subtraction modifications.

A preliminary revenue estimate is an annual revenue loss of approximately $400-$500 thousand dollars.

The Administration looks forward to working with the Committee on the bill; representatives from MRS will be here for the Work Session to provide additional information and respond in detail to the Committee's questions.