

Fiscal Estimate Narratives

DOR 8/21/2003

LRB Number 03-2929/1	Introduction Number AB-461	Estimate Type Original
Subject Related entities		

Assumptions Used in Arriving at Fiscal Estimate

For purposes of calculating a taxpayer's state franchise or income tax, the bill would require taxpayers to add to taxable income any amount the taxpayer deducted or excluded under the Internal Revenue Code for management and service fees, interest expenses and costs, intangible expenses and costs, and any other expenses and costs between related parties.

The department may disallow the tax consequences of a transaction by asserting the sham transaction doctrine or any other related tax doctrine. In such a case, the taxpayer would have the burden of demonstrating a valid, good faith business purpose other than tax avoidance and economic substance apart from the tax benefit. The taxpayer would have the burden of demonstrating by clear and convincing evidence that the asserted non-tax business purpose is commensurate with the tax benefit claimed.

Data are not available to estimate the fiscal effect of disallowing these deductions. This is because the data do not distinguish between those deductions that are between related parties and those that are between unrelated parties. The Department of Revenue believes the fiscal effect would be substantial.

As illustration, based on corporate income and franchise tax statistics compiled by the Department, if 10% of deductions appearing on the federal income tax return under "rent," "interest" and "other deductions" were assumed to be related parties and therefore disallowed as a result of this bill, corporate tax revenues would increase by an estimated \$50 million annually. If 50% of those deductions were assumed to be disallowed, corporate tax revenue would increase by an estimated \$260 million annually. Other types of deductions not included in these estimates would also be disallowed as a result of this bill. These estimates should be considered speculative.

Long-Range Fiscal Implications