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The Beacon Hill Institute for Public Policy Research

News Release

The Enterprise Value Tax: Another Misbegotten Job Killer

(BOSTON, MA) A proposed federal Enterprise Value Tax will double taxes on business partnerships in Massachusetts, adding $611 million to the state's federal tax burden. As a result of the tax, the state will lose 5,400 jobs, $9.5 million in investment and $673 million in disposable income.

This is the finding of a new study, *The Enterprise Value Tax: What it Means for the Massachusetts Economy,* published today by the Beacon Hill Institute at Suffolk University and sponsored by the Massachusetts Chamber of Commerce.

The President's Plan for Economic Growth and Deficit Reduction to the Joint Select Committee on Deficit Reduction contains a provision that would tax, as ordinary income rather than capital gains, the net proceeds from the sale of what is deemed an "investment services partnership interest"(ISPI). An ISPI is any interest in an investment partnership that is acquired by a person as a result of activities involving the purchase and sale of certain "specified assets," defined to include partnership interests, securities and real estate holdings.

Under current law, the gains from the sale of a partnership are taxed at the capital gains rate of 15%, consistent with the general rule that business interests should be treated as capital assets. The EVT would raise the effective tax rate from 15% to 30% on a total of $4.073 billion in capital gains received annually by Massachusetts residents, who receive these gains in exchange for putting their own capital and earnings at risk.

The proposal reverses the longstanding practice of taxing all long-term capital gains at 15%. U.S. tax law provides for the preferential treatment of capital gains in order to encourage saving and risk taking. This treatment of capital gains mirrors similar treatment of investment income and pension contributions and earnings.

The tax would fall mainly on the financial, insurance and real estate sectors, which comprise 25% of the Massachusetts economy. Massachusetts ranks second in the nation in venture capital per person. Although publicly touted as a tax on financial firms, the EVT will have broad sweeping impact on other industries such as family-owned businesses, natural resources firms, and many other partnership businesses.

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According to David Tuerck, Executive Director of the Institute, "The EVT would fall most heavily on states like Massachusetts and California, which are important centers of high-tech innovation and of venture capital and turnaround investment funds. The EVT is a particularly misbegotten way to achieve deficit reduction. It punishes long term investment and takes capital out of the economy."

"This proposal could inflict lasting damage on the Massachusetts economy just as we are starting to recover from a recession," said Debra Boronski, president of the Massachusetts Chamber of Commerce. "If Congress removes nearly $700 million in disposable income from our economy, more small businesses will fold and we will slip back into recession. We need more investment in our economy right now, not less. But this proposal provides a clear disincentive for investment in job creation."

The study is available at www.beaconhill.org.

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Executive Summary

President Obama's Plan for Economic Growth and Deficit Reduction contains a provision that would tax, as ordinary income rather than capital gains, the net proceeds from the sale of what is deemed an "investment services partnership interest"(ISPI). An ISPI is any interest in an investment partnership that is acquired by a person as a result of activities involving the purchase and sale of certain "specified assets," defined to include partnership interests, securities and real estate holdings.

This provision, which is labeled as the "Enterprise Value Tax" (EVT), would force certain partnerships to pay ordinary income tax on the sale of any part of their business. Although publicly touted as a tax on financial firms, the EVT will have broad sweeping impact on other industries such as natural resources, real estate, and many other businesses. The EVT represents an important departure from current law.

Under current law, most of the profits from the sale of investment partnerships are taxed at the capital gains rate, consistent with the long-standing general rule that business interests should be treated as capital assets. The tax rate on long-term capital gains is 15%. The EVT would treat these same profits as ordinary income, for which the top statutory tax rate is 35%.

The purpose of this study is to assess the effects of this change on the Massachusetts economy. The implications for Massachusetts are potentially severe, considering that the state is a center for venture capital and the incubation of high-technology businesses. The plan would be particularly punishing toward the financial, insurance and real estate (FIRE) sector, which comprises 25% of the state's economy.

We predict that persons who reside in Massachusetts will pay $611 million annually in new federal taxes under the plan. Using our State Tax Analysis Modeling Program, (STAMP), we also find that, as a result:

- The state will lose 5,400 jobs.
- Annual capital spending will fall by $9.5 million.
- Residents' real disposable income, or income available for spending and saving, will fall by $673.2 million.

These results are consistent with the argument from economics that a tax on capital income discriminates against saving and risk taking. By reducing saving, the tax reduces investment and employment, thus also reducing income and that part of income (i.e., disposable income) that is available to finance consumption. By reducing risk taking, the tax discourages innovation and, with it, technical progress, with further negative effects on investment, productivity, employment and income. These effects are likely to be especially severe for states like Massachusetts whose economies are centered on financial services and high technology.