

## WELCOME TO "NEW TAX-SHIRE"

### SMALL BUSINESS OWNERS BRACE FOR BIG TAX HIKES

The brand new **Limited Liability Company (LLC) Tax** has come home to roost in Concord. After being slipped into the budget at the 23rd hour and 59th minute in the dead of night without a public hearing --- the legislators who voted for it are now flummoxed that ordinary working people are irate.

For some reason in New Hampshire, perhaps due to the character and strength of our White Mountains, we just don't expect the abuse of the political process that would allow an **income tax on small business owners to become law without a public hearing and vigorous debate and then to be applied retroactively!**

What is the LLC Tax? Simply put it extends the 5% Interest and Dividends Tax (I&D) to the stream of income a business owner pays him or herself above a level of "**reasonable compensation**" that is determined by government officials in Concord. Setting aside for a moment that it is an upside down world when Concord officials have the power to determine what a business owner can pay themselves --- this tax is **fundamentally new** and specifically targets **business owner income**.

For example—a business owner conducting business as an LLC or partnership pays him or herself a salary of \$100,000. The DRA then determines the level of "reasonable compensation" that the business owner should pay him or herself is only \$50,000. The \$50,000 that is allowed as compensation would not be taxed under either the Business Profits Tax (BPT) or the I&D Tax. But the second \$50,000 is now taxed twice – once at the 8.5% BPT rate (\$4,250) and again as an after-tax "dividend" under the 5% I&D Tax (\$2,287). Total Tax Hit = \$6537 per

this example.

Historically, since its inception over 85 years ago, the Interest and Dividends Tax has applied only to passive forms of income – true dividends and interest. Now this fundamental tax change applies to business owner income and to add insult to injury, personnel from the DRA have stated that the tax **would apply to capital gains**.

How in the world did New Hampshire get here? It starts with no public hearing when legislators wrote this law in June! Generations of New Hampshire citizens of all political stripes have steadfastly opposed an income tax and this tax would probably not have seen the light of day except for the hidden stealth and secrecy of its inception.

The Department of Revenue (DRA) just completed four forums on implementing the rules for new LLC tax. At these forums, the DRA made it perfectly clear to the nearly 1000 people who attended, that they were not there to discuss the merits of implementing the tax, but on how best to collect it. New Hampshire citizens turned out in droves because they are angry their voices were not heard when the legislation was voted on, and that their voices will be largely ignored now that it is law. Many are small business owners struggling to keep their doors open in this terribly difficult economy. One after another, they made a compelling case about how fearful they are that this tax will undermine their business's ability to stay afloat.

Naturally this tax has its defenders – primarily the Democrats who voted for and signed it into law --- and their spin is in over-drive. They claim the tax merely closes a loophole, which does not pass the straight face test. Whether inadvertent or by design, the LLC tax does not apply to sole-proprietors. So if the design of the tax was to close loop-holes and provide equity why weren't sole-proprietors also taxed?

Tax equity among business owners was debated when the Legislature created the Business Enterprise Tax in 1993. As every business owner knows, the BET is a .75% tax on the salary of every employee including the owner --- but paid exclusively by the owner not the employee. Businesses are subject to both the BET and BPT, but can credit their BET exposure against BPT obligations to prevent double taxation. When the BET was adopted it broadly spread the burden of business taxation so a few companies were not stuck with the entire tax bill. But in reality the BET is a .75% income tax on business owners. Supporters of the LLC tax took another **giant leap forward** --- and supporters should be honest enough to call it what it is – **a narrow but hefty income tax on business owners**.

As the questions mount, the problems are just beginning. If the tax is applied **retroactively** it is a certain lawsuit given our constitution's prohibition on retroactive taxation. People are expected to pay the tax for all of 2009, but the **compliance rules aren't finished** and are unlikely to be adopted before the end of February. The **tax is due 6 short weeks later**. I twice suggested to DRA they **waive all penalties and fines for the first year**. I have received no answer to what should be common sense. In addition, **book-keeping costs are likely to be extreme** – a potential cure worse than the disease.

Along with others, **I have filed legislation to repeal this tax**. Taxing business owners at a time when 50,000 people are out of work and businesses are struggling sends a terrible message. If you are considering opening a business in New Hampshire—Don't! If you are in business here already – Leave!

When the business tax climate in Massachusetts beats that of New Hampshire----we have a problem even Democratic spin won't solve. Repeal of this tax and spending discipline maintains our tax advantage and gets New Hampshire back to work.

If we don't repeal this tax we might as well change our border welcome signs to:

**Welcome to NEW TAX-SHIRE!**