FISCAL IMPACT REPORT

SPONSOR Sanchez, M. **ORIGINAL DATE** 02/10/14 **LAST UPDATED** **HB**

SHORT TITLE Repeal Capital Gains Deduction **SB** 302

ANALYST Dorbecker

APPROPRIATION (dollars in thousands)

Appropriation					Recurring or Nonrecurring	Fund Affected
FY14	**FY15**	**FY16**	**FY17**	**FY18**		
	$36,000.0	$36,000.0	$36,000.0	$36,000.0	Recurring (5 years)	General Fund

Parenthesis ( ) indicate expenditure decreases

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY14	**FY15**	**FY16**	**FY17**	**FY18**		
		$67,000.0 - $75,000.0	$71,000.0 - $80,000.0	$75,000.0 – 84,000.0	Recurring	General Fund

Parenthesis ( ) indicate revenue decreases

SOURCES OF INFORMATION
LFC Files

Responses Received From
Department of Finance and Administration (DFA)
Higher Education Department (HED)
New Mexico Lottery Authority (NMLA)
Taxation and Revenue Department (TRD)

SUMMARY

Synopsis of Bill

Senate Bill 302 proposes a new section in the Tax Administration Act to make a monthly distribution to the Lottery Tuition Fund equal to $3 million dollars. The bill also repeals Section 7-2-34 NMSA 1978 of the Income Tax Act that provides a deduction of 50 percent of net capital gain income.

The effective date of the provisions of Section 1 (distribution) is July 1, 2014. The provisions of Section 2 (repeal of capital gains deduction) apply to taxable years beginning on or after January 1, 2015.

FISCAL IMPLICATIONS

The bill makes a distribution to the Lottery Tuition Fund for five years, appropriating $180 million from the general fund. According to Section 7-1-6.1 NMSA 1978, a distribution is made "as of the last day of the month" and a monthly distribution of $3 million is a recurring expense to the general fund of $36 million annually. Because the general fund revenue increase exceeds this appropriation, the bill would have a positive impact to the general fund.

TRD used New Mexico personal income data from tax year 2012 in their analysis to determine approximately 73,500 people claimed net capital gain deductions that totaled $1,190 million. The future years' capital gains deductions were calculated by applying capital gain realizations projection growth rates from 2012, published by The Budget and Economic Outlook, to Tax Year 2012 New Mexico personal income capital gain deductions.

TRD forecasted the fiscal impact for repealing the capital gains deduction by applying a 4 percent average tax rate to the projected capital gain deductions. However, LFC staff took into consideration a 2009 report (2006 data) from the Institute on Taxation and Economic Policy in which the proportion of federal taxpayers submitting returns with capital gains is less than 10 percent if their adjusted gross income is $50,000 or less. As such, LFC assumed taxpayers reporting capital gains paid a higher average marginal tax rate, and therefore assumed an increase in PIT revenue to the general fund based on an average marginal tax rate of 4.5 percent.

The range in the revenue table is the difference between the TRD and LFC assumptions.

SIGNIFICANT ISSUES

TRD reports that unlike the federal government, New Mexico treats capital gains as income and provides a 50 percent deduction for capital gains.

TRD is quoted as saying "Because paying taxes on capital gains is voluntary – that is, people can choose not to sell the assets – there is a very real possibility that investors will choose not to liquidate the assets and reinvest them, not for productive economic reasons, but for tax reasons; in those situations, New Mexico would receive no income tax revenue as opposed to the tax on 50 percent of the revenue that it currently receives."

According to the Higher Education Department (HED), the lottery currently transfers approximately $43 million a year to the lottery tuition fund. The agency projects the demand for full tuition reimbursement in FY15 would exceed $67 million and the additional $36 million a year from this bill would translate to approximately $79 million in FY15. HED reports that amount would allow for full tuition reimbursement and would leave a balance of approximately $12 million in the fund that would be rolled forward for future year funding. However, according to HED there is a projected shortfall in FY14 that this bill would not address.

DFA notes this legislation does not address the long-term structural reform that is needed to maintain solvency of the lottery fund as recommended by Governor Martinez through her veto of Senate Bill 113 during the 2013 session.

ADMINISTRATIVE IMPLICATIONS

TRD estimates a minimal administrative impact. The repeal of the deduction for net capital gain income can be implemented as part of the annual renewal process for the personal income tax program. Forms, instructions, and publications will need to be modified.

TRD also predicts a moderate Information Technology (IT) impact because the bill will require an update to GenTax and to the Taxpayer Access Point system that could be completed within the annual updates. Changes to revenue accounting will be necessary for TRD to be able to distribute money to the Lottery Tuition Fund.

OTHER SUBSTANTIVE ISSUES

DFA notes that if the bill is passed and signed, federal tax language for capital gains (and losses) will remain unchanged for New Mexico taxpayers. Specifically, if a taxpayer's capital losses exceed their capital gains, the excess can be deducted on their tax return and used to reduce other income, such as wages, up to an annual limit of $3,000 ($1,500 for married filing separately.) If the total net capital loss is more than the yearly limit on capital loss deductions, the taxpayer can carry over the unused part to the next year and treat it as if it was incurred in that next year.

ALTERNATIVES

DFA was quoted as saying “A state Higher Education Department task force recently reported many other options for assisting the lottery tuition fund that include giving priority to students from low-income families, raising the grade-point average for eligibility, cutting the number of semester's tuition covered or lowering lottery scholarships to keep the fund solvent.”

RELATIONSHIP

SB 302 relates to HB 321.

Does the bill meet the Legislative Finance Committee tax policy principles?

1. **Adequacy**: Revenue should be adequate to fund needed government services.
2. **Efficiency**: Tax base should be as broad as possible and avoid excess reliance on one tax.
3. **Equity**: Different taxpayers should be treated fairly.
4. **Simplicity**: Collection should be simple and easily understood.
5. **Accountability**: Preferences should be easy to monitor and evaluate

HD/svb:jl