F I S C A L   I M P A C T   R E P O R T

SPONSOR Trujillo, CH **ORIGINAL DATE** 2/1/16 **LAST UPDATED** **HB** 220

SHORT TITLE Repeal Capital Gains Deduction **SB**

ANALYST Graeser

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY16	FY17	FY18	FY19	FY20		
	12,700.0 – 13,300.0	34,200.0 – 36,700.0	43,700.0 – 47,900.0	45,800.0 – 50,300.0	Recurring	General Fund

Parenthesis ( ) indicate revenue decreases

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY16	FY17	FY18	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
Total		44.0		44.0	NR	TRD Operating

Parenthesis ( ) indicate expenditure decreases

Relates to HB-79 (Working families tax credit increase w/ Capital Gains repeal) and HB-169 (Capital gains reinvestment

SOURCES OF INFORMATION
LFC Files

Responses Received From
Taxation and Revenue Department (TRD)

SUMMARY

House Bill 220 provides a delayed repeal of Section 7-2-34 NMSA 1978. There is no effective date of this bill. It is assumed that the new effective date is 90 days after this session ends (May 18, 2016). The provisions of the bill are applicable for tax years beginning on or after January 1, 2017.

FISCAL IMPLICATIONS

“The Taxation and Revenue Department (TRD) used 2013 New Mexico federal taxpayer data and New Mexico tax expenditure data reported in the 2015 Tax Expenditure Report (TER) to complete this analysis. TRD then projected the growth of the net capital gains deduction (NCGD) based on the PIT growth rates in the revised January 2016 consensus revenue estimates. The fiscal impact is offered here as a range because the actual expenditure varies each year. The impact reflects fiscalized tax-year data."

Although 100% of New Mexico taxpayers are eligible to claim the NCGD, a taxpayer must have qualifying income to apply it. Over 65% of the NCGD claimants have taxable incomes less than $100,000. In contrast, the top 10% of wage earners claiming a NCGD account for over 66% of net capital gain income earned.

As reported in the 2015 TER the cost of the NCGD has varied; during the 5-year period from 2010-2014 the expenditure was as low as $17.9 million (2010) and peaked at $53.8 million (2013). The 5-year average expenditure for this period is $35.6 million. This analysis does not attempt to explain the annual fluctuation; there are numerous economic reasons that can contribute to the variance.

To estimate the fiscal impact TRD assumes that the 2014 NCGD expenditure is a high-average representation of the annual liability. The PIT growth rates from the December 2015 General Fund Consensus Revenue Estimate, revised, are applied. This calculation artificially grows the expenditure and discounts the probability of negative variance. These estimates were used to create two time-series averages: a 3-year average and a 5-year average.

During the period 2015-2017 the 5-year average is the upper limit; during the period 2018-2020 this average inverts with the 3-year average. This method allows for variance during the estimate period, but does not quantify it accurately. Therefore, the fiscal impact is provided as a range using the least and greatest values of the 3-year average, the 5-year average, and the annual estimate.

SIGNIFICANT ISSUES

TRD notes: "…although 100% of New Mexico taxpayers are eligible to claim the NCGD, a taxpayer must have qualifying income to apply it. Over 65% of the NCGD claimants have taxable incomes less than $100,000. These claimants account for approximately 30% of the total deduction amounts claimed. In contrast, the top 10% of wage earners claiming a NCGD account for over 66% of net capital gain income earned. To maximize this deduction a taxpayer must have net capital gain income greater than $25K. During tax year 2013, federal income tax data indicates that the average amount of net capital gain income earned by New Mexico taxpayers was $13,679, indicating that many New Mexico taxpayers are using this deduction based on small amounts of capital gain income, such as from the sale of a residence or from interim withdrawals from a retirement account. From a revenue adequacy perspective, this bill has the positive effect of increasing state revenues. However, elimination of the deduction will have an adverse effect on a large segment of claimants whose income is under $100,000 and may result in outward emigration of high wage earners."

ADMINISTRATIVE IMPLICATIONS

TRD notes, "Moderate Impact: Forms, instructions and documents will need to be updated. IT and software systems will need to be updated and configured. These are one-time charges attributed to the changes."

OTHER SUBSTANTIVE ISSUES

Laws 1999, Chapter 205 provided a maximum $1,000 capital gains deduction. In 2003, as part of Governor Richardson's major PIT cuts, this was increased to the greater of $1,000 or (after TY 2006) 50% of net capital gains. The 2003 FIR expected this deduction to cost the general fund $25,000 annually. TRD, in the 2015 TER, reports the following amounts:

	FY 10	FY 11	FY 12	FY 13	FY 14
Impact (Thousands)	$17,864.8	$37,097.8	$30,765.5	$53,814.8	$38,211.5
# Claimants	42,329	54,630	75,635	72,000	88,247

ALTERNATIVES

In the same way that the deduction was phased in, it could be phased out.

WHAT WILL BE THE CONSEQUENCES OF NOT ENACTING THIS BILL

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

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