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

SPONSOR McCamley Martinez, J. **ORIGINAL DATE** 09/30/16 **LAST UPDATED** **HB** 12

SHORT TITLE Limit Capital Gains Deductions **SB**

ANALYST Clark

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY17	FY18	FY19	FY20	FY21		
\$35,000 - \$45,000	\$35,000 - \$45,000	\$35,000 - \$45,000	\$35,000 - \$45,000	\$35,000 - \$45,000	Recurring	General Fund

Parenthesis ( ) indicate revenue decreases

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY17	FY18	FY19	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
Total	Minimal			Minimal	Nonrecurring	TRD Operating Budget

Parenthesis ( ) indicate expenditure decreases

SOURCES OF INFORMATION
LFC Files

Responses Received From
Taxation and Revenue Department (TRD) – prior response to related bill

SUMMARY

House Bill 12 changes the current deduction from net income of the taxpayer's capital gains in an amount equal to the greater of:
- Up to \$1,000 or
- 50 percent

to just up to \$1,000.

The bill also makes a minor language change. The provisions of the bill are applicable for tax years beginning on or after January 1, 2016.

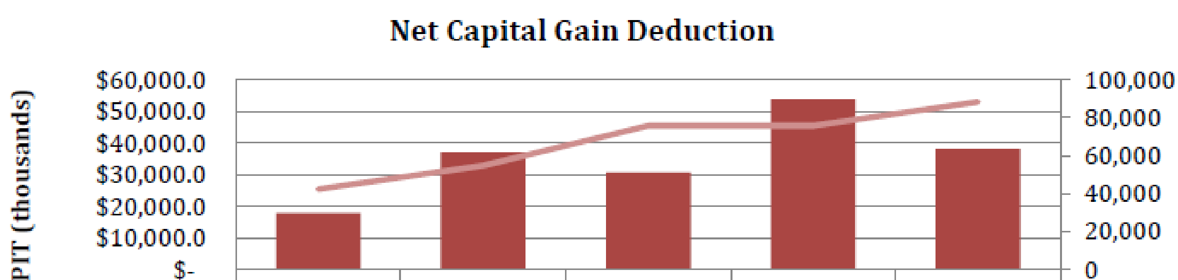
FISCAL IMPLICATIONS

LFC staff estimated the fiscal impact based on 2013 New Mexico federal taxpayer data and New

Mexico tax expenditure data reported in the TRD 2015 Tax Expenditure Report (TER). The consensus revenue estimating group revenue projections show increasing personal income tax revenues over time, but the increases are dwarfed by historic swings in the cost of the tax expenditure. Therefore, the savings from this bill is shown as a large range that remains constant across years. However, market volatility could cause individual years to be higher or lower than the given range.

As reported in the 2015 TER, the cost of the deduction has varied; during the five-year period from FY10 - FY14, the expenditure was as low as $17.9 million (FY10) and peaked at $53.8 million (FY13). The five-year average expenditure for this period is $35.6 million, but there is also an upward trend as the country exited the recession and market began to recover.

The savings from this bill would be nearly as great as if the deduction were eliminated altogether. Using the highest number of claims reported in the five-year period shown in the 2015 TER, and using an average tax rate for all filers of 4.3 percent, if all claimants qualified for the $1,000 maximum deduction in the bill, the cost to the state would be $3.8 million annually – an order of magnitude less than the current cost of the deduction.



	FY2010	FY2011	FY2012	FY2013	FY2014
Expenditures	$17,864.8	$37,097.8	$30,765.5	$53,814.8	$38,211.5
Claims	42,329	54,630	75,635	75,635	88,247

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SIGNIFICANT ISSUES

TRD notes: "…although 100 percent of New Mexico taxpayers are eligible to claim the net capital gains deduction (NCGD), a taxpayer must have qualifying income to apply it. Over 65 percent of the NCGD claimants have taxable incomes less than $100 thousand. These claimants account for approximately 30 percent of the total deduction amounts claimed. In contrast, the top 10 percent of wage earners claiming a NCGD account for over 66 percent of net capital gain income earned. To maximize this deduction, a taxpayer must have net capital gain income greater than $25 thousand. During tax year 2013, federal income tax data indicates that the average amount of net capital gain income earned by New Mexico taxpayers was $13.7 thousand, 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, [reducing] the deduction will have an adverse effect on a large segment of claimants whose income is under $100 thousand and may result in outward emigration of high wage earners."

ADMINISTRATIVE IMPLICATIONS

There will be a minimal administrative impact to TRD due to the need to update forms, instructions, documents, and software systems. However, these are one-time costs.

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

JC/jll