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

SPONSOR Wirth

ORIGINAL DATE 2/16/17
LAST UPDATED 2/21/17

HB

SHORT TITLE Limit Capital Gains Deduction from Income

SB 408

ANALYST Clark

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY17	FY18	FY19	FY20	FY21		
$0.0	$38,200.0	$39,000.0	$40,300.0	$41,600.0	Recurring	General Fund

Parenthesis ( ) indicate expenditure decreases.

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

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

Parenthesis ( ) indicate expenditure decreases.

Partially duplicates and conflicts with other bills affecting the capital gains deduction, including: HB201, HB310, HB311, HB365, and SB344

SOURCES OF INFORMATION
LFC Files

Responses Received From
Taxation and Revenue Department (TRD)

SUMMARY

Synopsis of Bill

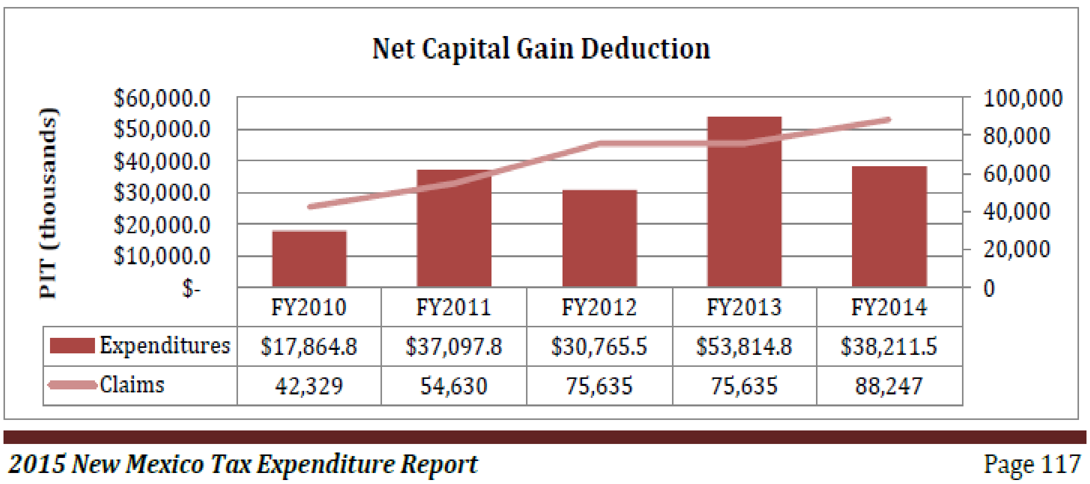
Senate Bill 408 reduces the net capital gains deduction to $1,000 from the current maximum of $1,000 or 50 percent of the capital gains included on a federal tax return. The bill also contains a temporary provision waiving penalties and interest due to underpayments made as a result of the changes in this bill – a necessary provision given the effective date of the bill.

The bill is applicable to tax years beginning January 1, 2017.

FISCAL IMPLICATIONS

The capital gains reduction is applicable for tax years 2017 and beyond. Some higher-income taxpayers will adjust their estimated payments for the remainder of calendar year 2017, but they are not required to do so because of the existence of the so-called "safe-harbor" feature. If higher-income taxpayers pay as much in total estimated payments for tax year 2018 as they owed for tax year 2017, there would be no penalty. However, the extra amount would still be due as a final settlement in April 2018. Some taxpayers adjust withholding from salaried employment to account for the additional taxes accruing to capital gains.

LFC staff estimated the fiscal impact based on 2014 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 this tax expenditure. Market volatility could cause individual years to be higher or lower than the given estimates.



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 markets began to recover.

Of further note, there is a loose correlation between the year-ending stock market price and the value of capital gains reported for a particular year. In January 2017, the Dow-Jones industrial average exceeded 20,000 for the first time in history, and many observers are expecting President Trump to continue to execute policies favorable to job growth and growth in the economy and, concomitantly, the stock prices.

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.

SIGNIFICANT ISSUES

In response to a similar bill, TRD noted on the capital gains portion, "…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."

LFC staff note that this bill clearly proposes a tax increase. On the other hand, it can be seen as partially restoring a previous (2003) tax cut. The 2003 cut was enacted in an attempt to make the state more attractive to businesses seeking to relocate or expand.

ADMINISTRATIVE IMPLICATIONS

There would be a minimal administrative impact.

CONFLICT

This bill partially duplicates and conflicts with other bills affecting the capital gains deduction, including: HB201, HB310, HB311, HB365, and SB344.

JC/sb/jle