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## FISCAL IMPACT REPORT

<b>SPONSOR</b> <u>Chandler/Wirth</u>	<b>LAST UPDATED</b> <u>1/26/23</u>	
	<b>ORIGINAL DATE</b> <u>1/24/23</u>	
	<b>BILL</b>	
<b>SHORT TITLE</b> <u>Limit Capital Gains Tax Deduction</u>	<b>NUMBER</b> <u>House Bill 120</u>	
	<b>ANALYST</b> <u>Faubion</u>	

### REVENUE\* (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY23	FY24	FY25	FY26	FY27		
--	--	Up to \$71,200	Up to \$72,500	Up to \$74,400	Recurring	General Fund

Parenthesis ( ) indicate revenue decreases  
 \*Amounts reflect most recent version of this legislation.

### ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT\* (dollars in thousands)

	FY23	FY24	FY25	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
	--	\$5.5	--	\$5.5	Nonrecurring	General Fund - TRD/ITD
<b>Total</b>		<b>\$5.5</b>		<b>\$5.5</b>		

Parentheses ( ) indicate expenditure decreases.  
 \*Amounts reflect most recent version of this legislation.

Conflicts with Senate Bill 38.

### Sources of Information

LFC Files

Responses Received From  
 New Mexico Attorney General (NMAG)  
 Taxation and Revenue Department (TRD)

## SUMMARY

### Synopsis of House Bill 120

House Bill 120 (HB120) seeks to amend the limit of capital gains that may be deducted from personal income tax. The current limit is \$1,000 or 40 percent of the taxpayer's net capital gain income, whichever is greater. This bill changes the maximum a taxpayer may claim to \$2,500.

This bill does not contain an effective date, and as a result, would go into effect June 16, 2023, (90 days after the Legislature adjourns) if signed. The provisions of the bill apply to taxable years beginning on or after January 1, 2024.

## FISCAL IMPLICATIONS

Using tax return data for New Mexico taxpayers claiming the capital gains deduction, the Taxation and Revenue Department (TRD) estimated a three-year average for tax years 2019 through 2021 of the impact of decreasing the capital gains deduction to a maximum amount per taxpayer of \$2,500. Capital gains can fluctuate, and this average is assumed flat through tax years 2022 and 2023 because of weak national forecasts for stock growth and real estate investment. For tax year 2024, the effective tax year for this bill, the average capital deduction impact is grown by IHS Markit's January 2023 S&P 500 stock index forecast. This assumes a modest growth in capital gains and, therefore, an annual increase in general fund revenue from personal income tax (PIT).

As capital gains income is volatile and subject to the behavior of markets, the fiscal impact should be considered a high-end estimate. Capital gains deductions have been as low as \$41.2 million in 2019.

## SIGNIFICANT ISSUES

Only nine states—Arizona, Arkansas, Hawaii, Montana, New Mexico, North Dakota, South Carolina, Vermont, and Wisconsin—tax capital gains less than ordinary income. In addition, some states, including Colorado, Idaho, Louisiana, and Oklahoma, provide capital gains tax breaks only for capital gains on investments in in-state businesses, and a few states target industries. Approximately 85 percent of capital gains are generated by the wealthiest 5 percent of taxpayers.<sup>1</sup>

By taxing income differently depending on the source of the income, capital gains deductions erode both horizontal and vertical equity. Horizontal equity, the principle that taxpayers with equal income should pay equal tax, is eroded as those with capital gains income are taxed less than those with earned income or wage income. Vertical equity, the principle that tax obligations should increase as incomes rise, is eroded as those with investment income are not fully taxed on that income and should be contributing more to state taxes.

TRD notes the following:

Personal income tax (PIT) represents a consistent source of revenue for many states. While this revenue source is susceptible to economic downturns, it is also positively responsive to economic expansions. New Mexico is one of 42 states, along with the District of Columbia, that impose a broad-based PIT. The PIT is an important tax policy tool that has the potential to further both horizontal equity, by ensuring the same statutes apply to all taxpayers, and vertical equity, by ensuring the tax burden is based on taxpayers' ability to pay.

While any taxpayer may apply for this deduction, most of the financial benefit is realized by high-wealth individuals who have passive income derived from investments. The proposed changes to the capital gains deduction will increase the amount of income for high-wealth individuals that is subject to New Mexico PIT.

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<sup>1</sup> Center for Budget and Policy Priorities

## ADMINISTRATIVE IMPLICATIONS

Updates to forms, instructions, and publications will be incorporated into TRD's annual tax year implementation. These changes will cost \$5,500 in workload costs for TRD's Information Technology Division (ITD).

**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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