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

SPONSOR: Robinson DATE TYPED: 10/29/03 HB

SHORT TITLE: Net Capital Gain Deduction for Business Sale SB 1

ANALYST: Williams

REVENUE

Estimated Revenue		Subsequent Years Impact	Recurring or Non-Rec	Fund Affected
FY04	**FY05**			
	(1,850.0)		Recurring, but declines over time due to interaction with 2003 tax package	General Fund

(Parenthesis ( ) Indicate Revenue Decreases)

SOURCES OF INFORMATION

LFC Files
No Responses Received From Agencies

SUMMARY

Synopsis of Bill

Senate Bill 1 authorizes a deduction in the amount of net capital gain from the sale of a closely-held business. To qualify for the deduction a taxpayer must sell (1) their entire interest in the business in a transaction in which substantially all of the equity interests are sold, or (2) the business must effectively sell all of its assets. The provisions of the bill would be applicable for taxable years 2004 and beyond.

Significant Issues

The tax package of 2003 (House Bill 167, Chapter 2) increased the maximum capital gains tax deduction from $1,000 of net capital gains to the greater of $1,000 or 50 percent of net capital gains by tax year 2007. Further, the tax package decreased marginal personal income tax rates.

FISCAL IMPLICATIONS

In an analysis of a related bill during the 2003 session, TRD noted New Mexico realized net capital gains will total $1 billion annually, and that of this amount, 3.4 percent or $34 million will result from the sale of closely held businesses. The 3.4% is drawn from I.R.S. data on the share that small business interests represent in the composition of assets in estate tax returns. The 2003 tax package is expected to reduce this base by about 20%. Multiplying by an updated average tax rate of 6.8 percent results in the $1.85 million fiscal impact shown above. Annual gains from the value of businesses tend to vary widely from year to year.

OTHER SUBSTANTIVE ISSUES

Under federal income tax statutes, state income tax payments are deductible for purposes of calculating federal income tax. Thus, because this proposal would reduce state income tax liabilities, it would also reduce these deductions, thereby increasing the taxpayer's federal income tax liability. This reduces the net benefits of the tax reduction for the taxpayer. For example, if a taxpayer is in the 30% tax bracket, the net benefit to the taxpayer of the state tax reduction would be reduced by 30%.

AW/lg