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

SPONSOR: Robinson DATE TYPED: 2/22/05 HB

SHORT TITLE: Income Tax Deduction for Business Sale SB 549

ANALYST: Taylor

REVENUE

Estimated Revenue		Subsequent Years Impact	Recurring or Non-Rec	Fund Affected
FY05	**FY06**			
($875)	($1,600.0)	($1,220.0)	Recurring	General Fund

(Parenthesis ( ) Indicate Revenue Decreases)

SOURCES OF INFORMATION

LFC Files

Responses Received From
Taxation and Revenue Department

SUMMARY

Senate Bill 549 would provide an income tax deduction for net capital gains income from the sale of a closely held trade or business. The size of the deduction is equal to the taxpayer's net capital gain from the sale of a closely held trade or business in the taxable year for which the deduction is being claimed, provided that the gain is included in the taxpayer's base income.

A closely held trade or business is defined to mean a trade or business operated as a sole proprietorship or a corporation, partnership, limited partnership, limited liability company or other legal entity, whose equity is controlled by 75 or few qualifying owners.

The bill carries no applicability date, and is assumed to become effective 90 days after the end of the legislative session.

FISCAL IMPLICATIONS

TRD estimates that this bill will reduce general fund revenues by $1.6 million in FY06. The estimate assumes net capital gains in New Mexico will total approximately $1.5 billion annually, and further estimated that of 3.4 percent of this was this, or $50 million was from the sale of closely held businesses. They report that 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. They also note that 30 percent of capital gains will be deductible in tax year 2005. This leaves a base of $35 million in tax year 2005 ($50 million less 30 percent deductible). The revenue loss decreases over time, reflecting the increased proportion of capital gains that are deductible (50 percent in 2007) and phased-in income tax rate reductions.

The FY 05 fiscal impact is based on the assumption that the provisions of the bill would apply to tax year 2005. This stems from the state's adoption accrual revenue accounting.

ADMINISTRATIVE ISSUES

TRD reports modest administrative impacts that can be absorbed with existing resources.

TECHNICAL ISSUES

TRD provided the following technical issues:

1. The proposal should have an applicability date explaining to which tax years the proposed policy applies.
2. As currently written, SB 549 would appear to violate the Commerce Clause since it discriminates against interstate commerce by applying only to capital gains that would be allocated or apportioned to New Mexico. The remedy to this problem would be to make the deductions available to all taxpayers with gains from a closely-held business.

BT/lg