BILL ANALYSIS AND FISCAL IMPACT REPORT
Taxation and Revenue Department

January 18, 2024

Bill: HB-37 **Sponsor:** Representative Christine Chandler and Senator Peter Wirth

Short Title: Limit Income Tax Capital Gains Deduction

Description: This bill amends Section 7-2-34 NMSA 1978, to increase the first of the "greater than" deduction options for net capital gains from $1,000 to $2,500, and then limiting the second of the greater than options of 40% of net capital gain income to 40% of $1 million of net capital gains income from the sale of a business allocated or apportioned to New Mexico. It also removes an outdated restriction related to a credit in the Venture Capital Investment Act that has been repealed.

Effective Date: January 1, 2025; Applicable to taxable years beginning on or after January 1, 2025.

Taxation and Revenue Department Analyst: Sara Grubbs

Estimated Revenue Impact*					R or NR**	Fund(s) Affected
FY2024	FY2025	FY2026	FY2027	FY2028		
--	--	$61,000	$63,000	$65,000	R	General Fund

* In thousands of dollars. Parentheses ( ) indicate a revenue loss. ** Recurring (R) or Non-Recurring (NR).

Methodology for Estimated Revenue Impact: The Taxation and Revenue Department (Tax & Rev) does not know whether the source of net capital gain income is from the sale of a business allocated or apportioned to New Mexico, but used tax return data for taxpayers claiming the capital gain deduction from tax year 2020 to tax year 2022 to estimate the fiscal impact of this bill.

Tax & Rev assumes for all eligible taxpayers with any source of net capital gain income, any taxpayer whose capital gain deduction currently equals exactly $1,000 would be eligible for the $2,500 deduction. This marginally decreases tax liability and tax revenue.

The estimate is inflated using Standard & Poor's 500 index's November 2023 forecast. Tax & Rev assumes no change in the number of taxpayers eligible for the deduction each year.

Additional analysis of Section 7-2-34 NMSA 1978 can be found in the 2023 New Mexico Tax Expenditure Report.[1]

Policy Issues: PIT represents a consistent source of revenue for many states. For New Mexico, PIT is approximately 25% of the state's recurring general fund revenue. While this revenue source is susceptible to economic downturns, it is also positively responsive to economic expansions. New Mexico is one of 41 states, along with the District of Columbia, that impose a broad-based PIT (New Hampshire and Washington do not tax wage and salary income). Like several states, New Mexico computes its income tax based on the federal definition of taxable income and ties to other statues in the federal tax code. This is referred to as "conformity" to the federal tax code. 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.

[1] See https://www.tax.newmexico.gov/forms-publications/

Current statute recognizes any taxpayer's capital gain during a tax year, regardless of income level. The increase in the deduction from any source of net capital gains decreases taxable income for taxpayers with lower levels of capital gains. However, higher earning individuals tend to also have higher levels of capital gains, so they receive a larger proportion of benefit from this deduction. Limiting the type of net capital gain to the sale of a qualified business and capping that income to $1 million reduces the proportion of high earning taxpayers. Out of all taxpayers that claim this capital gain deduction, approximately 3.8% of taxpayers claim a deduction over $1 million. The cap would not unduly harm lower-income beneficiaries with smaller capital gain. However, taxing capital gains or limiting a deduction affects savings and investment decisions over the long term. The $1 million cap could affect capital flight and cause decline in entrepreneurship in New Mexico.

Technical Issues: None.

Other Issues: None.

Administrative & Compliance Impact: Tax & Rev will need to make information system changes and update forms, instructions, and publications. Implementation will have a low impact on the Information Technology Department (ITD), approximately 100 hours or less than one month and an estimated staff workload cost of $5,550 is required. This implementation will be included in the annual tax year changes.

Estimated Additional Operating Budget Impact*				**R or NR****	**Fund(s) or Agency Affected**
FY2024	**FY2025**	**FY2026**	**3 Year Total Cost**		
--	$5.6	--	$5.6	NR	Tax & Rev – ITD staff workload

* In thousands of dollars. Parentheses ( ) indicate a cost saving. ** Recurring (R) or Non-Recurring (NR).

Related Bills: Similar bill, HB291, 2021 Regular Session.