New Hampshire Department of Revenue Administration

Fiscal Note Quick Guide

17-0624

HB 644-FN-A-LOCAL, *extending the interest and dividends tax to capital gains, increasing exemptions from the tax, and providing for retirement system contributions on behalf of employers other than the state.*

House Ways & Means

This proposed legislation amends the RSA 77 Interest and Dividends (I&D) Tax to include the taxation of capital gain income and establishes a Capital Gains Reserve (CGR) Fund within the General Fund based on the tax collected from capital gain income. Capital gain reported on the taxpayer's federal income tax return that is equal to the positive sum of the net short-term capital gain or loss and the net long-term capital gain or loss reported shall be subject to the I&D Tax. Any capital gain income subject to taxation under the I&D Tax shall be deducted under the RSA 77-A Business Profits Tax (BPT).

The thresholds and exemptions for the I&D tax are raised from $2,400 to $7,500 for individuals, partnerships, limited liability companies, associations and executors and raised from $4,800 to $15,000 for joint filers. Exemptions are increased from $1,200 to $5,000 for a taxpayer who is older than 65, blind or disabled.

This proposed bill amends RSA 100-A:16, II(c-1) beginning with state FY2018 and for each state FY thereafter by establishing $45,000,000 as the amount that the state shall pay for benefits under the retirement system.

The state Treasurer shall invest amounts deposited in the new CGR Fund. The interest earned shall be deposited as unrestricted General Fund revenue.

The Department of Revenue Administration (DRA) is required to make two calculations for I&D Taxes paid on capital gains on or before December 31 each year starting December 31, 2017. The two calculations, however, cannot be completed by the DRA in the first year because the bill is applicable to taxable periods ending on or after December 31, 2017 and DRA will not have the data needed to perform these calculations. The Comptroller shall use the calculations provided by the DRA to transfer any excess revenue collected from capital gains during the most recent fiscal year from the General Fund into the CGR Fund. If there is a deficit the Comptroller shall transfer the difference from the CGR Fund to the General Fund, provided there are sufficient funds.

When the balance in the CGR Fund is in excess of an amount equal to 100% of the actual capital gain tax revenue for the most recently completed 3-year average annual period, the excess shall be transferred into the stabilization reserve account. The DRA is to assume, for the purposes of the biennial budget ending June 30, 2019, that the 3-year average shall be $110 million.

The act is effective July 1, 2017 and is applicable to tax periods ending on and after December 31, 2017.

The fiscal impact of this proposed bill is an indeterminable increase in revenue. However, the DRA made a number of broad assumptions in order to calculate a revenue impact based on the data available and estimated the increase in revenue in FY 2019 and each year thereafter in the amount of $86,811,818. This impact is calculated using Tax Year 2014 data for the I&D Tax as of 1/26/2017, Tax Year 2014 data for capital gains reported on the NH Business Tax return, and IRS return data for Tax Year 2014 for the Capital Gains reported to the IRS. The DRA estimates an increase in state revenues as a result of the inclusion of capital gains in the I&D Tax of $102,955,200. The DRA estimates a decrease in state revenues of $16,143.382 attributable to the proposed increases to the filing thresholds, deductions, and exemption amounts. The proposed legislation would provide a deduction from the BPT for capital gains taxed under the I&D Tax statute. As a result, some portion of capital gains currently taxed at the BPT rate of 8.5% will now be taxed at the I&D tax rate of 5%. The I&D Tax is paid by NH residents and the BPT tax is paid by entities with business activity in New Hampshire. The DRA is unable to determine which BPT taxpayers would be considered NH residents for purposes of the I&D Tax. As a result, the DRA is unable to estimate the fiscal impact of NH residents paying the 5% I&D Tax on capital gains instead of the 8.5% BPT. However, due to the lower tax rate paid by I&D taxpayers, any transition of capital gain income from the BPT to the I&D would decrease the revenue increase associated with taxing capital gains under the I&D Tax.

More specifically:

- Increasing the threshold and exemptions from $2,400 to $7,500 for individual filers and from $4,800 to $15,000 for joint filers and increasing the additional exemptions from $1,200 to $5,000 reduces revenues by $16,143,382.

- The DRA estimates that the capital gain income from NH residents would be similar to what is reported by the IRS on the NH Statement of Income (SOI). The SOI reports 123,020 NH individual income tax returns with net capital gain income for Tax Year 2014 in the amount of $2,622,840,000.

- For purposes of an estimate, the DRA assumes the SOI income of $10,000 and above AGI with net capital gains income reported would be reduced by a minimum of one deduction in the amount of $7,500 per return for a total deduction amount of $899,400,000 (119,920 multiplied by $7,500 = $899,400,000).

- The net capital gain income of $2,958,504,000 reduced by the total deduction amount of $899,400,000 equals $2,059,104,000 multiplied by the current 5% I&D tax rate is an estimated $102,955,200 in newly generated I&D Tax revenue.

Data and Methodology Weakness:

- The SOI data used is provided for individuals with AGI of $10,000 to $1,000,000 or more. The DRA is unable to limit the $2,958,504,000 to those who would meet the filing thresholds and cannot determine what, if any, exemptions would be used to offset tax owed.

- SOI data includes capital gain flow through income from non-NH partnerships that do not file an I&D Tax return in NH.

- SOI data includes capital gain flow through income from S-corps. S-corps are not taxable under the I&D Tax law; however, distributions from S-corps to NH inhabitants are subject to the I&D Tax.

- SOI data for capital gains is a net figure. For federal tax purposes, capital gains can offset capital losses. If in any one year, the maximum capital loss is in excess of $3,000, the balance of any additional loss over $3,000 can be applied to subsequent years. Alternatively, this proposed legislation would tax a positive net gain on the taxpayer's capital dispositions and does not provide a deduction if an individual or partner has a capital loss for that specified year.

- SOI data does not appear to capture capital gains received from non-NH taxpayers.

- The proposed legislation would provide a deduction from the BPT for capital gains taxed under the I&D Tax statute. As a result, some portion of capital gains currently taxed at the BPT rate of 8.5% will now be taxed at the I&D tax rate of 5%. The I&D Tax is paid by NH residents and the BPT tax is paid by entities with business activity in New Hampshire. The DRA is unable to determine which BPT taxpayers would be considered NH residents for purposes of the I&D Tax. As a result, the DRA is unable to estimate the fiscal impact of NH residents paying the 5% I&D Tax on capital gains instead of the 8.5% BPT. However, due to the lower tax rate paid by I&D taxpayers, any transition of capital gain income from the BPT to the I&D would decrease the revenue increase associated with taxing capital gains under the I&D Tax.

- As the bill is drafted, the phrase "[t]he capital gain reported on the taxpayer's federal income tax return…," appears to create a contradiction with the current treatment of I&D income from a partnership (and other entities), which is based on the distribution (constructive receipt, unless subject to tax at the entity level) and not the amounts reported on the Schedule K-1.

- Section 2 of the CGR Fund states that the DRA shall make two calculations for the CGR Fund. The calculations are to be based on the tax collected from capital gain income. It will be difficult for the DRA to ascribe the capital gain income to the taxable amount paid. Without a way for the DRA to ascribe the capital gain income to the taxable amount paid it is impossible for the DRA to estimate the average annual amount of revenue collected during the three fiscal years immediately prior to the most recently completed fiscal years for the tax on capital gains income.