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FISCAL IMPACT REPORT

ORIGINAL DATE 3/01/07

SPONSOR Arnold-Jones LAST UPDATED _____ HB 1217

SHORT TITLE Bond Exclusion from Income Tax SB _____

ANALYST Francis

REVENUE (dollars in thousands)

Estimated Revenue			Recurring or Non-Rec	Fund Affected
FY07	FY08	FY09		
	(11,000.0)	(11,000.0)	Recurring	General Fund

(Parenthesis () Indicate Revenue Decreases)

SOURCES OF INFORMATION

LFC Files

Responses Received From
Taxation and Revenue Department (TRD)

SUMMARY

Synopsis of Bill

House Bill 1217 removes state and local bond interest from the definition of base income as defined in the Income Tax Act and the Corporate Income and Franchise Tax Act. This would exempt this type of income from income tax liability. The change would be effective for tax year 2007 and subsequent years. The interest on bonds issued by the State of New Mexico and local governments are already tax-exempt as is the interest on federal bonds. This would include other state and local bonds issued outside of New Mexico.

FISCAL IMPLICATIONS

TRD:

Information from New Mexico Individual and Corporate Income Tax returns yields the following: non-New Mexico state and local government bond dividend and interest income is currently claimed on approximately 32,000 of the state's approximately 900,000 personal income tax returns, and generates tax obligations totaling approximately \$9 million against individual income tax liability. Non-New Mexico state

and local bond interest and dividend is reported on approximately 1,000 corporate income tax returns, and generates tax obligations totaling approximately \$2 million annually. The \$11 million impact shown above is the simple sum of the two figures.

SIGNIFICANT ISSUES

Wisconsin Legislative Fiscal Bureau

(<http://www.legis.state.wi.us/lfb/Informationalpapers/4.pdf>):

State and Municipal Bond Interest. [All] states are required by federal law to exempt interest income derived from U.S. obligations from tax. In 2005, 36 states also provided a tax exemption for interest earned from their own state and municipal bonds. The state of Utah also provided an exemption for interest from non-Utah state and municipal bonds from states that provided a reciprocal exemption of interest from Utah obligations. Illinois, Iowa, Kansas, and Wisconsin exempted only specific state and local obligations. All state and municipal bond interest was exempt in Indiana, North Dakota (for standard-form filers), and the District of Columbia.

TRD:

New Mexico's practice of exempting interest and dividend of bonds issued by the state or its political subdivisions is widespread among states. However:

“... in *Davis v. Department of Revenue*, the Kentucky Court of Appeals held that the state's taxation of income from other states' bonds, while exempting income from Kentucky bonds, discriminated against interstate commerce in violation of the Commerce Clause. The court first observed that the Kentucky scheme “[c]learly” was “facially” discriminatory because “it obviously affords more favorable treatment to in-state bonds than it does to extraterritorially issued bonds.”¹

The proposed legislation is thus consistent with the ruling by the Kentucky Court of Appeals.

NF/mt

¹ Walter Hellerstein – “State and Local Tax Commentary” Issue 9, April 2006:
<http://ria.thomson.com/taxresearch/statelocal/hellerstein.pdf>.