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

ORIGINAL DATE 2/19/07
SPONSOR Smith **LAST UPDATED** **HB**
SHORT TITLE WORKING FAMILY & ARMED SERVICES TAX CREDIT **SB** 1156

ANALYST Francis

REVENUE (dollars in thousands)

Estimated Revenue			Recurring or Non-Rec	Fund Affected
FY07	**FY08**	**FY09**		
($22,750.0)	($91,125.0)	($50,621.0)	Recurring	General Fund

(Parenthesis ( ) Indicate Revenue Decreases)

SOURCES OF INFORMATION
LFC Files

Responses Received From
Taxation and Revenue Department (TRD)
Department of Finance and Administration (DFA)
Human Services Department (HSD)
Department of Health (DOH)
Department of Veteran Services (DVS)

SUMMARY

Synopsis of Bill

Senate Bill 1156 combines several tax related provisions together: personal income tax rate reduction, active duty military personal income tax exemption, working families tax credit and a gross receipts tax credit for private hospitals.

Personal Income Tax Rate Reduction. This section accelerates the current phase-in of the personal income tax rate reductions. Under current law, the top personal income tax rate will be 5.3 percent in tax year 2007 and 4.9 percent in 2008. This bill would accelerate the schedule so the rate would be 4.9 percent in 2007 forward, a reduction of 0.4 percent in the top personal income tax rate in 2007. This is effective January 1, 2007.

Table 1: Tax Rate Cut

Tax Year	Current Law	SB265
2006	5.3%	5.3%
2007	5.3%	4.9%
2008	4.9%	4.9%

Active Duty Military Exemption. This section exempts income earned from active duty service from the state personal income tax. The effective date is January 1, 2007 so would apply for tax year 2007.

Working Families Tax Credit. This section creates a new personal income tax credit called the "Working Families Tax Credit" (WFTC) that is calculated as 10 percent of the federal Earned Income Credit (EIC). The credit is refundable, meaning if the credit exceeds the taxpayer's liability, the excess is refunded to the taxpayer. SB 317 also amends the low-income comprehensive tax rebate (LICTR) to make a taxpayer ineligible for LICTR if the taxpayer receives the WFTC. SB 317 also explicitly excludes credits provided in the Income Tax Act from the calculation of modified gross income. The effective date is January 1, 2007.

Gross Receipts Tax Credit for Certain Hospitals. This section provides a gross receipts tax credit for hospitals licensed by the Department of Health (for-profit hospitals). The credit equals one third of the state gross receipts tax rate in FY08, two-thirds of state gross receipts tax in FY09, and the entire state gross receipts tax rate in FY10 and beyond. The bill will be applicable to tax reporting periods after July 1, 2007.

FISCAL IMPLICATIONS

Table 2: Fiscal Impact of SB1156

		FY07	**FY08**	**FY09**
Working Families Tax Credit	Enacts a 10% credit based on federal EITC; Cannot be claimed if LICTR is claimed.	-	(27,900)	(29,100)
Accelerate PIT rates to 4.9 percent	Reduces tax year 2007 top personal income tax rate to 4.9 percent.	(19,800)	(46,200)	-
Armed Forces Exemption	Exempts active duty military from personal income tax	(2,950)	(11,990)	(10,400)
GRT Credit for Hospitals	Provides private hospitals with a gross receipts tax credit; phased in over three years.	-	(5,035)	(11,121)
Total Fiscal Impact		**(22,750)**	**(91,125)**	**(50,621)**

Personal Income Tax Rate Reduction. Using a model provided by the Taxation and Revenue Department (TRD), the full year impact would be a $66 million reduction in personal income tax collections. Thirty percent of the impact, or $19.8 million, occurs in FY07 because the first quarter of 2007 personal income tax collections will have been at the current rates. In FY08, the impact is $46.2 million or 70 percent of the tax year impact. While this would reduce current estimates of recurring general fund revenues, the reduction is only for these two fiscal years and does not recur in the future.

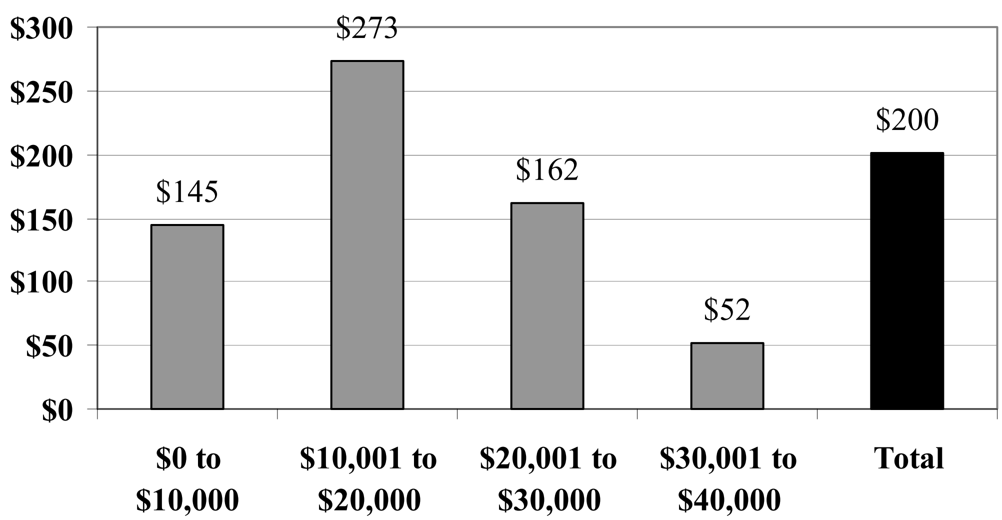
Active Duty Military Exemption. Exempting active duty salaries from personal income tax would result in a $10 million reduction in personal income tax revenues going to the general fund. Since the tax year straddles two fiscal years, the FY07 impact is $3 million, reflecting 30 percent of the tax year and the FY08 impact is $12 million, which include 70 percent of tax year 2007 and 50 percent of tax year 2008.

According to TRD, the fiscal impact is based on approximately 7,000 active duty military in New Mexico earning an average $45,000 per year as well as an additional 3,000 active duty National Guard and army reserve members. The average tax relief to service members would be $1,350 and $133 for National Guard and army reserve members.

Working Families Tax Credit. Enacting this credit would reduce general fund personal income tax revenue by $30 million per tax year. Even though the credit is for tax year 2007, it is assumed that it will be claimed in the filing season in 2008 and so all of the impact is in FY08. The credit is expected to grow to $30.2 million in FY09.

In 2004, 199,552 New Mexican taxpayers received the federal EIC and 90 percent of the credits were in excess of liability. A total of $364 million in EIC were claimed. Using this number as the base, the cost to the state of the WFTC would be $36.4 million. Some of those taxpayers would find it more beneficial to file for the LICTR and that would reduce the impact on the general fund to $27.9 million. Figure one shows the total net benefit—the additional benefit of WFTC above LICTR—by income cohort. The average benefit for all taxpayers is $200. Table two shows that 64 percent of the benefit goes to heads of household or single parents and most of them are in the $10,001 to $20,000 income range.

Figure One: Average Benefit by Income Cohort



Gross Receipts Tax Credit for Certain Hospitals. All of the state's for-profit hospitals are currently located within municipal areas, where the state tax rate is 3.775 percent. Therefore, the credit will eliminate the state gross receipts tax paid by for-profit hospitals once it is fully phased in. The bill does not apply to local option gross receipts taxes, so for-profit hospitals will still pay a little over 1 percent local gross receipts tax.

A New Mexico Hospital Association survey on hospital gross receipts indicates that for-profit hospitals paid gross receipts tax of $16.5 million in FY05 and $21.4 million in FY06, of which 60 percent went to the state and 40 percent went to local governments. Assuming that the impacted tax base will grow by 10 percent each year, the credit will reduce general fund revenue by about $5,034.9 thousand in FY08, $11,120.8 thousand in FY09, and $18,252.7 thousand once it is fully phased-in in FY10.

SIGNIFICANT ISSUES

Personal Income Tax Rate Reduction. In 2003, legislation was enacted lowering the top rate and collapsing the number of income brackets. In 2002, the top rate on taxable income over $100,000 for married filers and $65,000 for single filers was 8.2 percent. As a result of the 2003 legislation, by tax year 2007, the top rate would decrease to 4.9 percent and the top income bracket would begin at $24,000 in taxable income for married filers and $16,000 for single filers. In the 2005 session, the phase-in schedule for the top rate decrease was delayed until 2008 and the head-of-household filing status was merged with the married filing jointly status. The schedule was modified again in the 2005 special session as revenues came in stronger than expected. This bill restores the final phase-in year to 2007 rather than 2008. See table one for details about the changes to the personal income tax law over the last four years.

Table 1: Proposed Rate Schedule

Taxable Income						
Married Filing Jointly, Surviving Spouses, Head of Household	Married Filing Separate	Single	2005	2006	2007	2008
<8000	<4000	<5500	1.7%	1.7%	1.7%	1.7%
8000-16000	4000-8000	5500-11000	3.2%	3.2%	3.2%	3.2%
16000-24000	8000-12000	11000-16000	4.7%	4.7%	4.7%	4.7%
24000+	12000+	16000+	**5.7%**	**5.3%**	**4.9%**	**4.9%**

Based on 2005 tax return data, a married filing jointly taxpayer reporting $24 thousand in taxable income has total adjusted gross income (AGI) of about $40 thousand. For singles reporting taxable income of $16 thousand, their AGI starts at $25 thousand. 311,000 taxpayers will receive the benefit of the lower rate, all of them above these AGI levels.

Working Families Tax Credit. Twenty states, including the District of Columbia, currently offer a state level EIC (Colorado's EIC is tied to their TABOR rules and so some years they do not allow the credit). The credit has proven to be a simple and efficient credit. It is also popular since it only goes to individuals and families with earned income. One of the key elements is the refundability of the credit: the taxpayer receives the full amount of the credit regardless of the tax liability. Twelve of the seventeen state EICs are refundable, according to research at the Institute on Taxation and Economic Policy. New York and Vermont have the most generous EICs allowing over 30 percent of the federal credit and making it refundable. Rhode Island has a 25 percent credit but it is not refundable which restricts its effectiveness.

TABLE 1: STATE EARNED INCOME TAX CREDITS BASED ON THE FEDERAL EITC

State	Percentage of Federal Credit (Tax Year 2006 Except as Noted)	Refundable	Workers Without Qualifying Children Eligible?
Delaware	20%	No	Yes
District of Columbia	35%	Yes	Yes
Indiana[a]	6%	Yes	Yes
Illinois	5%	Yes	Yes
Iowa	6.5%	No	Yes
Kansas	15%	Yes	Yes
Maine	5%	No	Yes
Maryland[b]	20%	Yes	No
Massachusetts	15%	Yes	Yes
Michigan	10% (effective in 2008; to 20% in 2009)	Yes	Yes
Minnesota[c]	Average 33%	Yes	Yes
Nebraska	8%	Yes	Yes
New Jersey[d]	20%	Yes	No
New York[e, f]	30%	Yes	Yes
Oklahoma	5%	Yes	Yes
Oregon	5% (to 6% in 2008)	Yes	Yes
Rhode Island	25%	Partially[g]	Yes
Vermont	32%	Yes	Yes
Virginia	20%	No	Yes
Wisconsin	4% - one child 14% - two children 43% - three children	4% - one child 14% - two children 43% - three children	No

Notes: From 1999 to 2001, Colorado offered a 10% refundable EITC financed from required rebates under the state's "TABOR" amendment. Those rebates, and hence the EITC, were suspended beginning in 2002 due to lack of funds and again in 2005 as a result of a voter-approved five-year suspension of TABOR. Under current law, the EITC is projected to resume in 2010.
a Presently scheduled to expire in TY 2011.
b Maryland also offers a non-refundable EITC set at 50 percent of the federal credit. Taxpayers in effect may claim either the refundable credit or the non-refundable credit, but not both.
c Minnesota's credit for families with children, unlike the other credits shown in this table, is not expressly structured as a percentage of the federal credit. Depending on income level, the credit for families with children may range from 25 percent to 45 percent of the federal credit; taxpayers without children may receive a 25 percent credit.
d The New Jersey credit is available only to families with incomes below $20,000.
e The New York credit would be reduced automatically to the 1999 level of 20 percent should the federal government reduce New York's share of the TANF block grant.
f Beginning in 2006, New York also allows certain non-custodial parents who are making child support payments to claim an EITC that is the greater of 20 percent of the federal EITC that they would be eligible for with one qualifying child as a custodial parent or 250 percent of the federal EITC for taxpayers without qualifying children.
g Rhode Island made a very small portion of its EITC refundable effective in TY 2003. In 2006, the refundable portion was increased from 10 percent to 15 percent of the nonrefundable credit (i.e. 3.75 percent of the federal EITC).

Source: Economic Policy Institute (www.epi.org)

For a single or married taxpayer with no children, the cut-off for benefits is very low but for taxpayers with children, the benefit goes to many more. The federal EIC can only be claimed if someone is below the income cut-offs and

- has a valid social security number
- is not filing separately
- is a US citizen or resident alien
- does not have foreign income
- does not have more than $2,800 in investment income
- has some earned income.

Table one shows the cut-off and peak amounts and the maximum credit for each class of filer. For example, a married filer with one child and adjusted gross income of between $8,000 and $16,500 would receive the maximum federal credit of $2,747 (state credit = $275). The same filer with income over $34,001 in adjusted gross income would receive no federal credit and, thus, no state credit.

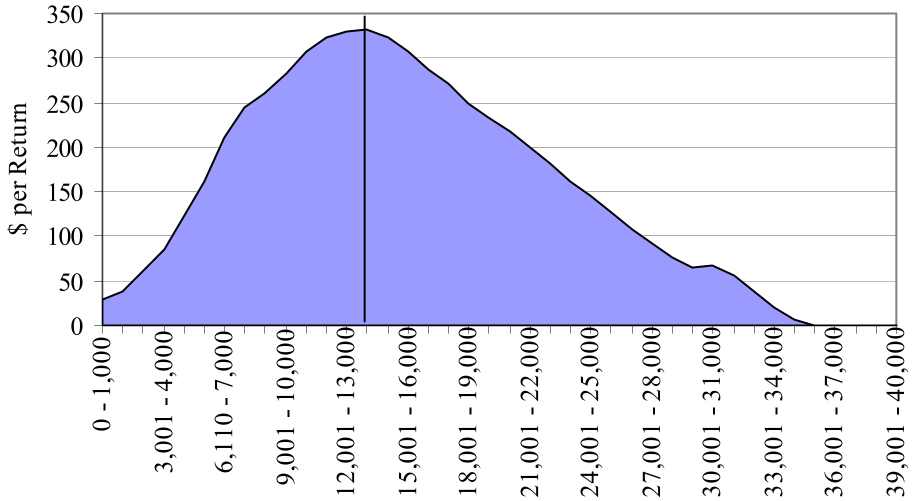
Table 1: Federal Income Cut-offs for Earned Income Credit

	Adjusted Gross Income			Maximum Credit
	Cut-off	Peak		
		Start	Finish	
Single				
No children	12,120	5,500	6,500	412
One child	32,001	8,500	14,500	2747
More than one child	36,348	11,500	14,500	4536
Married				
No children	14,120	5,500	8,500	412
One child	34,001	8,000	16,500	2747
More than one child	38,348	11,500	16,500	4536

Source: IRS 2006 Tax Year

For filers without children, they must be age 25 to 65, not a qualifying child or dependent of another person and must have lived in the United States for more than six months. For filers with children, the children must be younger than 19, younger than 25 if a full time student, or permanently disabled. The children also have to have lived with the filer for more than six months and cannot be claimed as a qualifying child or dependent of another person.

Figure Two: Working Families Tax Credit Phase-out



Source: TRD

One of the features of the EIC is that it phases-out at higher incomes. Figure two, which is based on 2005 data, shows the maximum average credit of about $325, which would be $3,250 for the federal EIC, is reached at an income level of $13,000. This is an average of all tax filers, whether single or not or childless or not.

Table 2: Average Benefit by Filing Status and Income

	Total Benefits	**Number of Returns**	**Average Benefits per Return**	**Share of Total Benefits**
Single				
$0 to $10,000	$594,047	6,984	$85	5%
$10,001 to $20,000	$872,052	3,861	$226	3%
$20,001 to $30,000	$141,349	1,036	$136	1%
$30,001 to $40,000	$1,813	35	$52	0%
Total	$1,609,261	11,916	$135	9%
Married Joint				
$0 to $10,000	$881,612	5,632	$157	4%
$10,001 to $20,000	$4,348,460	14,831	$293	11%
$20,001 to $30,000	$2,998,852	16,593	$181	12%
$30,001 to $40,000	$265,967	4,901	$54	4%
Total	$8,494,891	41,957	$202	30%
Head of Household				
$0 to $10,000	$2,917,551	17,693	$165	13%
$10,001 to $20,000	$11,034,522	40,760	$271	29%
$20,001 to $30,000	$3,754,323	24,982	$150	18%
$30,001 to $40,000	$97,982	2,046	$48	1%
Total	$17,804,378	85,481	$208	61%
All returns				
$0 to $10,000	$4,393,210	30,309	$145	22%
$10,001 to $20,000	$16,255,034	59,452	$273	43%
$20,001 to $30,000	$6,894,524	42,611	$162	31%
$30,001 to $40,000	$365,762	6,982	$52	5%
Total	$27,908,530	139,354	$200	100%

Source: TRD

Gross Receipts Tax Credit for Certain Hospitals. Under current law, for-profit hospitals qualify for a 50 gross receipts tax deduction (Section 7-9-73.1 NMSA 1978). The bill effectively reduces the gross receipts tax paid by for-profit hospitals from 50 percent of the normal state rate to nothing once it is fully phased-in in FY10.

About half of New Mexico's hospitals are for-profit. For-profit hospitals compete with non-profit hospitals in New Mexico and hospitals in neighboring states that do not pay gross receipts tax. The New Mexico Hospital Association reports that this bill will remove a competitive disadvantage against New Mexico's for-profit hospitals.

According to the NMHA, rural hospitals have no choice but to absorb the costs of uncompensated care for patients who cannot pay. In addition, it is difficult for for-profit hospitals to pass gross receipts tax on to consumers because Medicare will not reimburse for it.

DOH believes removing the gross receipts tax from for-profit hospitals will make them more profitable and could allow them to provide enhanced services in New Mexico.

The proportion of for-profit hospitals has increased over last few years because for-profit hospitals have more access to capital.

LFC notes that receipts of health practitioners have historically grown faster than receipts of other industries. Removing receipts from high-growth sectors from the gross receipts tax base makes it more difficult for tax revenue to keep pace with inflation.

PERFORMANCE IMPLICATIONS
Personal Income Tax Rate Reduction.
Active Duty Military Exemption.
Working Families Tax Credit.
Gross Receipts Tax Credit for Certain Hospitals.

ADMINISTRATIVE IMPLICATIONS

Personal Income Tax Rate Reduction. This change would require the Taxation and Revenue Department to modify withholding tables and instructions for 2007 but otherwise should pose little administrative burden.

Active Duty Military Exemption. Provisions of the proposed measure would impose relatively minor administrative impacts on the Taxation and Revenue Department. Provisions of the proposal could be administered with re-sources currently available to the Department.

Working Families Tax Credit. The Human Services Department reports that since the SB 1156 explicitly excludes credits from the calculation of modified gross income, a calculation used to determine eligibility, there would be minimal impact on the programs HSD administers such as food stamps or Medicaid.

Gross Receipts Tax Credit for Certain Hospitals. TRD reports they will experience moderate administration impacts due to this bill. TRD will need to revise forms, educate taxpayers, train personnel, modify audit processes, and manually process the credit.

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

Personal Income Tax Rate Reduction.
Active Duty Military Exemption.
Working Families Tax Credit.
Gross Receipts Tax Credit for Certain Hospitals.

TECHNICAL ISSUES

Personal Income Tax Rate Reduction.

Active Duty Military Exemption. According to the Department of Defense, "Active Duty" refers to "Full-time duty in the active service of a Uniformed Service, including fulltime training duty, annual training duty, and attendance while in the active service at a school designated as a Military Service school by law or by the Secretary concerned." SB1156 refers to "active service" which is presumed to mean "active duty" though clarification may be a necessary correction.

TRD notes that, as written, the measure could be interpreted to include an exemption for federal personal income tax obligations. It should be amended to clarify that it does not.

SB1156 does not distinguish between residents and non-residents.

Gross Receipts Tax Credit for Certain Hospitals. TRD notes the purpose of Section 1 of the bill is unclear. It appears possible that the language was intended to clarify that TRD should reduce the distributions to the general fund to prevent revenue impacts to local governments. If that is the intention of the sponsors, TRD recommends amending Section 1 to state "Distributions from the tax administration suspense fund *to the state general fund* of *net* revenue attributable to the gross receipts tax ..." The Senate Corporations and Transportation Committee amendment to the SB326 addressed this concern. **It may be important to amend this bill in the same way.**

OTHER SUBSTANTIVE ISSUES

Active Duty Military Exemption. By reducing state tax obligations, the proposed measure would tend to increase federal tax liability because state tax obligations are deductible against federal liability. Hence the net taxpayer benefit would be less than the $1,575 per claimant mentioned above. The $1,575 in state tax savings would, for example, be reduced to $1,260 ($1,575 x .8) for a taxpayer in the 20% federal tax bracket.

Working Families Tax Credit.
Gross Receipts Tax Credit for Certain Hospitals.

ALTERNATIVES

Personal Income Tax Rate Reduction.
Active Duty Military Exemption.
Working Families Tax Credit.
Gross Receipts Tax Credit for Certain Hospitals.

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