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## FISCAL IMPACT REPORT

ORIGINAL DATE 02/08/10

SPONSOR Griego, E LAST UPDATED \_\_\_\_\_ HB \_\_\_\_\_

SHORT TITLE Higher Income Level Surtax and Distribution SB 128

ANALYST Clifford

### REVENUE (dollars in thousands)

Estimated Revenue			Recurring or Non-Rec	Fund Affected
FY10	FY11	FY12		
	13,115.0	87,481.0	Recurring	Public School Fund
	13,115.0	87,481.0	Recurring	Human Services Dept.
18,100.0	149,470.0	26,538.0	Recurring	General Fund
18,100.0	175,700.0	201,500.0	Recurring	Total

(Parenthesis ( ) Indicate Revenue Decreases)

General Fund impacts turn negative in FY13 and subsequent years. See discussion below.

Responses Received From  
Taxation and Revenue Department

### SUMMARY

#### Synopsis of Bill

In tax years 2010 through 2012, personal income tax rates would be increased by 3.3 percent – from 4.9 percent to 8.2 percent -- on taxable income in excess of \$150,000 (married joint and head of household filers), \$100,000 (single) and \$75,000 (married separate). Beginning July 1, 2011 6.65 percent of net personal income tax revenue would be distributed to the Public School Fund and another 6.65 percent would be distributed to the Human Services Department for expenditure in the Medicaid program. The Public School Fund would be made a non-reverting fund.

### FISCAL IMPLICATIONS

TRD reports that fiscal impacts were estimated using a detailed analysis of tax year 2007 data and then grown to reflect the estimated growth in income from 2007 to 2010 and beyond. TRD assumes that withholding tables will not be revised until July 1, 2010, so FY10 revenue is increased only by estimated payments. The remainder of the tax year 2010 impacts are delayed

until FY11 and FY12. This causes a temporary increase in fiscal impacts above the level of annual revenues. The FY11 distributions to the Public School Fund and Human Services Department are due to the modified accrual accounting for the change in distributions that begins in July 2011 under the bill.

Since the distribution of a portion of income tax revenue to the Public School Fund is permanent while the rate increases are temporary, the net effect on the general Fund turns negative in FY13 and thereafter as illustrated in the following table provided by TRD.

**Estimated Fiscal Impacts of SB 128 (million dollars)**

	<b>FY10</b>	<b>FY11</b>	<b>FY12</b>	<b>FY13</b>	<b>FY14</b>
Public School Fund	NFI	\$13,115.0	\$87,481.0	\$83,199.0	\$80,499.0
Human Services Dept.	NFI	\$13,115.0	\$87,481.0	\$83,199.0	\$80,499.0
General Fund	\$18,100.0	\$149,470.0	\$26,538.0	(\$74,297.0)	(\$155,497.0)
Total	\$18,100.0	\$175,700.0	\$201,500.0	\$92,100.0	\$5,500

**SIGNIFICANT ISSUES**

The proposal presents a trade-off between two desirable goals of tax policy. On the one hand it improves vertical equity by increasing the tax burden on households with a greater ability to pay. On the other hand, it reduces economic efficiency by reducing the after-tax return on work and investment in the state. The latter effect is muted somewhat because New Mexico income taxes are allowed as an itemized deduction on the federal income tax return. Thus, if a taxpayer itemizes deductions, and is in the 33% federal tax rate bracket, their federal tax liability will go down by one-third of their state tax increase, effectively saving the taxpayer that much of the tax burden.

TRD provided the following table showing increased tax liability by income bracket:

**Distribution of Change in Tax Year 2010 Tax Liability  
(2007 Income Levels)**

<b>Adjusted Gross Income</b>	<b>Number of Affected Returns</b>	<b>Change in Tax Liability</b>		
		<b>Total (\$000)</b>	<b>Average</b>	<b>Percent Distribution</b>
Under 100,000	136	81	599	0.1%
100,000 - 200,000	6,435	3,483	541	2.6%
200,000 - 500,000	17,158	33,759	1,968	24.9%
500,000 or more	9,691	98,355	10,149	72.5%
<b>Total</b>	<b>33,420</b>	<b>135,679</b>	<b>4,060</b>	<b>100.0%</b>

As illustrated in the following table, New Mexico’s present law top tax rate is around the midpoint among states in the western region. Like several other states, NM has a relatively flat tax rate structure. NM tax as percent of income is toward low end of states with income tax. If

SB 128 is adopted, New Mexico’s top rate would be one of the highest in the region. This table does not reflect any changes the other states may have made as part of their FY10 budgets.

State	Range of Tax Rates*	Top Bracket Single/Married	Income Tax as % of Personal Income**
Arizona	2.59% to 4.54%	\$150,000/\$300,000	1.54%
California	1% to 10.3%	\$1 million/\$1 million	3.07%
Colorado	4.63%	All Income	2.17%
Idaho	1.6% to 7.8%	\$25,440/\$50,881	2.6%
Montana	1% to 6.9%	\$15,600/\$15,600	2.56%
<b>New Mexico</b>	<b>1.7% to 4.9%</b>	<b>\$16,000/\$24,000</b>	<b>2.11%</b>
Oklahoma	0.5% to 5.5%	\$8,700/\$15,000	2.49%
Utah	2.3% to 6.98%	\$5,500/\$11,000	2.85%

Sources: \*2009 State Tax Handbook, CCH publishing. \*\* U.S. Census.

New Mexico personal income tax revenue has been reduced by several significant statutory changes in the last several legislative sessions as illustrated in the following table. As a result, total annual collections have been reduced by approximately \$450 million, roughly one-third of what collections would have been in the absence of the changes.

<b>Session:</b>		<b>General Fund FY11 (\$ millions)</b>
2003	Income tax deduction for capital gains	(36.0)
2003	Reduce income tax rates	(360.0)
2003	Withholding on oil and gas distributions	30.0
2005	Low & Moderate Income Tax Exemption	(30.0)
2007	Working Families Tax Credit	(40.0)
2007	Rural health care practitioner tax credit	(5.0)
2007	Armed forces income tax exemption	(10.0)
	<b>Total</b>	<b>(451.0)</b>

Although some of the recently-enacted changes were targeted at low-income households, the majority of the tax relief was directed to higher income households. Since the personal income tax is the most progressive component of the state’s tax system, these changes have made the state’s tax system somewhat less progressive. A recent study sponsored by the government of the District of Columbia compared the combined burden of all state and local taxes on households with different income levels. For purposes of property tax comparisons, the study looked at a hypothetical household living in the largest city in each state. Among western states, New Mexico’s combined tax burden was less regressive than that of most other states. Results of the 2008 study are summarized in the following table. The overall tax burden in New Mexico

was slightly above the average in the region, except for households making \$25,000.

**State & Local Taxes as a Percent of Household Income**

<b>City, State</b>	<b>\$25,000</b>	<b>\$50,000</b>	<b>\$75,000</b>	<b>\$100,000</b>	<b>\$150,000</b>
<b>Albuquerque, NM</b>	<b>9.9%</b>	<b>7.7%</b>	<b>7.7%</b>	<b>7.9%</b>	<b>7.5%</b>
Billings, MT	7.5%	4.4%	5.6%	6.1%	6.5%
Boise, ID	9.0%	6.2%	7.2%	8.0%	8.4%
Denver, CO	11.3%	6.6%	6.7%	7.3%	6.9%
Houston, TX	9.9%	6.1%	5.6%	5.4%	4.4%
Las Vegas, NV	9.8%	6.5%	5.4%	5.0%	4.0%
Los Angeles, CA	10.7%	10.0%	8.6%	8.5%	8.9%
Oklahoma City, OK	10.9%	7.3%	7.9%	8.2%	7.9%
Phoenix, AZ	11.6%	5.9%	5.8%	6.3%	5.9%
Salt Lake City, UT	11.4%	7.2%	7.7%	8.0%	7.7%
<b>Average</b>	<b>10.2%</b>	<b>6.8%</b>	<b>6.8%</b>	<b>7.1%</b>	<b>6.8%</b>

Source: Government of the District of Columbia.

**RELATIONSHIP**

SB 25, SB 122, SB 65, HB 9 and HB 143.

***The Legislative Finance Committee has adopted the following principles to guide responsible and effective tax policy decisions:***

- 1. Adequacy:*** revenue should be adequate to fund government services.
- 2. Efficiency:*** tax base should be as broad as possible to minimize rates and the structure should minimize economic distortion and avoid excessive reliance on any single tax.
- 3. Equity:*** taxes should be fairly applied across similarly situated taxpayers and across taxpayers with different income levels.
- 4. Simplicity:*** taxes should be as simple as possible to encourage compliance and minimize administrative and audit costs.
- 5. Accountability/Transparency:*** Deductions, credits and exemptions should be easy to monitor and evaluate and be subject to periodic review.

***More information about the LFC tax policy principles will soon be available on the LFC website at [www.nmlegis.gov/lcs/lfc](http://www.nmlegis.gov/lcs/lfc)***