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

ORIGINAL DATE 1/30/17
SPONSOR Ely **LAST UPDATED** 3/13/17 **HB** 201/aHTRC/a/HFl#1

SHORT TITLE New Top Income Tax Bracket **SB**

ANALYST Graeser

REVENUE (dollars in thousands)

Estimated Revenue					R or NR **	Fund Affected
FY17	FY18	FY19	FY20	FY21		
$-	$7,800.0	$26,080.0	$27,040.0	$28,000.0	Recurring	General Fund

Parenthesis ( ) indicate revenue decreases. ** R = recurring; NR = non-recurring

Duplicates, Relates to, Conflicts with, Companion to: HB-48, HB-61, HB-68, HB-82, HB-117, HB-169, HB-193, SB-41, SB-50, SB-123, SB-196

SOURCES OF INFORMATION
LFC Files

Responses Received From
Taxation and Revenue Department (TRD)

SUMMARY

Synopsis of HFl#1 Amendment

The House Floor amendment restored the top bracket to $306,667, preserving the tradition ratio between bracket values for Married Joint and Single filers.

Synopsis of HAFC Amendment

The House Taxation and Revenue Committee amended the top bracket amount for single filers from $306,667 to $345,000.

Synopsis of Bill

House Bill 201 creates a new income tax bracket for taxable years beginning on or after January 1, 2018. The existing rates and brackets remain the same, but new upper rates are added. For married individuals filing separately (SEP) with income over $230,000, the tax is $11,066 plus 5.9 percent of the excess over $230,000. For heads of household (HOH), surviving spouses, and married individuals filing jointly (MFJ) with income over $460,000, the tax is $22,132 plus 5.9

percent of the excess over $460,000. For single individuals (SNGL) and for estates and trust with income over $306,667, the tax is $14,747.17 plus 5.9 percent of the excess over $306,667. The bill also repeals an earlier version of Section 7-2-7 NMSA 1978.

Effective Date: Date not specified; 90 days following adjournment (June 16, 2017); applicability is contained within the statute text.

FISCAL IMPLICATIONS

The amendment responded to a TRD comment on the original bill:

> "The income multiple of this legislation (1.0, 2.0, & 1.3) deviates from the statutory multiples for lower thresholds (1.0, 2.0, 1.5). Horizontal equity ensures similarly-situated taxpayers face similar tax burdens. To align the new brackets to the existing multiple schedule, the new thresholds would be $230,000, $460,000, and $345,000 for SEP, HOH/MFJ, and SNGL respectively. (Or, alternatively, $204.4K, $408.8K, and $306.7K for SEP, HOH/MFJ, and SNGL respectively)"

However, the recent (post 2002) ratios have been 1.0 2.0 and 1.33. In the pre-2002 rates and brackets scheme, the top brackets were in the ratio 1.0: 1.35: 1.66: 2.000 (MFS: Sing: HoH; MFJ). With the HFl amendment, the top bracket ratios have been restored to 1.0: 1.333: 2.0

~~The revenue is estimated to decrease by an estimated 3% from the original. In the higher income brackets as proposed in this bill, most of the taxpayers are married joint filers.~~

The provisions of this bill partially reverse the Governor Richardson era PIT rate cuts. (CHAPTER 2, LAWS 2003 and later amended to delay the phased-in rate cuts.)

As such, it can be considered as the reduction of a tax expenditure. Tax expenditures are of concern to LFC, because they may be counter to the LFC tax policy principles of adequacy, efficiency, and equity. The concern has been that due to the increasing cost of tax expenditures, revenues may be insufficient to cover growing recurring appropriations.

Personal income tax rate changes are fortunately relatively easy to estimate.

TRD has calculated the fiscal impact of this bill: " TRD used GenTax taxpayer data from tax years 2010-2015 to estimate the revenue impact. Tax year 2014 is considered the most current dataset for this analysis. Personal Income Tax (PIT) growth rates forecast by the Consensus Revenue Estimating Group (CREG) in December 2016 were used to estimate out-year revenues. This estimate assumes that existing taxpayers who are impacted by this bill will remain in the state."

"Line 17 of PIT-1 was used to identify qualifying taxpayers. The average number of taxpayers by filing status using the new income brackets are: 56 SEP with taxable income over $230 thousand; 1,245 HOH/MFJ with taxable income over $460 thousand; and 420 SNGL with taxable income over $306.7 thousand."

"The new revenue estimate attributed to the tax increase was calculated by applying the proposed tax rate to the difference between total taxable NM income and the income bracket floor for each filing status. Total taxable NM income was derived from line 11, column 2 of the PIT-B form if a PIT-B was filed and line 18a of PIT-1 reflected 'B', or line 17 of PIT-1 if line 18a reflected

'R'. "B" indicates the taxpayer filed a PIT-B; "R" indicates the taxpayer did not file a PIT-B and used the published rate tables."

"Estimates from tax years 2013 and 2014 were used to forecast the revenue gain. In general, CREG estimates that 60 percent of fiscal year PIT collections are for the prior tax year, and 40 percent are from preceding tax years (i.e. FY2015 PIT is the sum of 60 percent of tax year 2014 liabilities and 40 percent of tax year 2013 liabilities). The PIT growth rates from the December 2016 CREG forecast were applied to the new revenue estimate. A portion of estimated payments – 30 percent of the revenue increase - are received in FY18 from the first two quarters of 2018. Fiscal 2019 revenues are estimated as 60 percent of the final settlements for the 2018 tax year. Thereafter, the standard forecasting mechanic applies."

SIGNIFICANT ISSUES

TRD notes, "… This legislation implicates the tax policy principal of vertical equity by increasing the tax rate. There is a risk that an increase will incentivize outbound migration from New Mexico."

LFC staff note that the 2003 rate reduction and increase in the capital gains deduction occurred in an environment of surplus revenues. Testimony at the time indicated that major obstacle to out-of-state firms expanding into the state may have been because of an excessively high 8.2 percent top marginal rate that kicked in at $100,000 in taxable income. Pursuant to the 2003 legislation, the rate was phased down over a period of years to the current 4.9% top marginal rate kicking in at $24,000 for HOH/MFJ. Because the vast bulk of taxable income is subject to the top marginal rate, the derived income elasticity of the personal income tax is effectively 1.0. In 2001 (prior to the rate reduction), the income elasticity was about 1.43, meaning that a 10 percent increase in personal income triggered a 14.3 percent increase in personal income tax.

Observing the long-term impact of the 2003 rate reduction effectively puts into question whether the rate reduction was effective in expanding the state's economy or in inducing out-of-state companies to expand into the state.

This observation also puts into question whether the rate increase proposed in this bill will trigger significant out-migration to lower tax regime states.

What is important for the state, however, is to pay attention to our state competitors in the four-corners region. Colorado's flat PIT rate is 4.63 percent, while Texas has no personal income tax, at all. The Arizona top marginal rate is 4.54 percent, which kicks in at $300,000 for MFJ. Utah, like Colorado, has a flat PIT rate, slightly higher than Colorado at 5.0 percent.

Reinstating a relatively high top marginal bracket will increase the out-year growth potential of the tax. LFC staff estimate that the provisions of this bill will increase the income elasticity to 1.1 from the current 1.0.

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

HB 61	EXTEND SOLAR MARKET TAX CREDIT
HB 68	RURAL HEALTH CARE PRACTITIONER TAX CREDIT
HB 82	EXTEND SOLAR MARKET TAX CREDIT

HB 117	SUPPLEMENTAL INCOME TAX
HB 169	INCOME TAX DEDUCTIONS
HB 193	SOLAR MARKET TAX CREDIT PERMANENT
HB 201	NEW TOP INCOME TAX BRACKET
SB 41	EXTEND SOLAR MARKET TAX CREDIT
SB 50	ADDITIONAL UPPER-TIER TAX BRACKETS
SB 123	TAX REFORM
SB 196	SMALL BUSINESS INVESTMENT TAX CREDIT

ADMINISTRATIVE IMPLICATIONS

TRD indicates that implementing the provisions of this bill would occur within the regular, annual maintenance tasks.

LG/jle/sb