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

**SPONSOR** O'Neill

**ORIGINAL DATE** 1/24/17
**LAST UPDATED**
**HB**

**SHORT TITLE** Additional Upper-Tier Tax Brackets
**SB** 50

**ANALYST** Graeser

**REVENUE (dollars in thousands)**

| Estimated Revenue | | | | | R or NR ** | Fund Affected |
|---|---|---|---|---|---|---|
| FY17 | FY18 | FY19 | FY20 | FY21 | | |
| $0.0 | $97,800.0 | $99,600.0 | $101,700.0 | $105,100.0 | Recurring | General Fund |

(Parenthesis ( ) indicate revenue decreases)

**ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)**

| | FY17 | FY18 | FY19 | 3 Year Total Cost | R or NR ** | Fund Affected |
|---|---|---|---|---|---|---|
| **Total** | $0.0 | $20.0 | $0.0 | $20.0 | Nonrecurring | TRD Administrative Fund |

(Parenthesis ( ) indicate expenditure decreases)

Duplicates, Relates to, Conflicts with, Companion to all other bills amending the personal income tax act. These include at this point: HB 48, HB 76, HB 117, HB 169, HB 201 and SB 50.

**SOURCES OF INFORMATION**
LFC Files

Responses Received From
Taxation and Revenue Department (TRD)

**SUMMARY**

Synopsis of Bill

Senate Bill 50 adds an additional tax bracket for married individuals filing separately with income over $187,500 of $8,983.50 plus 8.2% of the excess over $187,500; $17,967 plus 8.2% of excess over $375,000 for heads of household, surviving spouses and married individuals filing jointly with income over $375,000, and 11,970.50 plus 8.2% of excess over $250,000 of excess over $250,000 for single individuals and for estates and trusts.

The provisions of the bill are applicable to taxable years beginning on or after January 1, 2017. The effective date is not specified: 90 days following adjournment (June 16, 2017);

## FISCAL IMPLICATIONS

The Taxation and Revenue Department (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) 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. A detailed discussion of methodology is provided below. Per the technical comment below, this estimate assumes the bill does not intend to be retroactive to tax year 2008. As such, it does not include revenues from penalties and amended returns dating back to tax year 2008. The taxes from prior years would be due immediately and potentially subject to penalty under Section 7-2-12.2 NMSA 1978.

LFC notes that this new bracket would, in addition to increasing immediate revenue, it would partially restore previously progressive growth rates.

## SIGNIFICANT ISSUES

This would effectively return the personal income tax to rates in place before Governor Richardson approved a reduction during the 2003 session (Laws 2003, ch. 2, § 4). The 2003 phased-in reduction dropped the top personal income tax rate to 4.9 percent. This bill does not return the brackets to values in place prior to the 2003 session. Thus, the effective income elasticity will not return to the 1.63 before the change. That is, a 10 percent increase in net personal income resulted in a 16.3 percent increase in income tax liability. Since the 2003 change was fully phased-in by tax year 2007, the income elastic is approximately 1.0. This change, in addition to an immediate increase would also partially restore the historical progressive income elasticity. A rough estimate is that the income elasticity would increase from 1.0 to 1.2.

## ADMINISTRATIVE IMPLICATIONS

TRD notes a moderate impact. The legislation creates notification and adjudication challenges for TRD. The effective date limits TRD’s ability to adequately notify taxpayers who may need to adjust their withholding to comply with current statute. Section 7-2-12.2 NMSA 1978 imposes penalties if taxpayers fail to make their required annual payment. Waiving these penalties is not simple; some taxpayers may be subject to penalties for finance prior to the effective date of the rate increase. Forms, instructions, internal software systems, and Taxpayer Access Point will need to be updated at significant cost.

## TECHNICAL ISSUES

TRD has some technical concerns with provisions of the bill: An effective date discrepancy exists as written. Page 1, line 19 indicates taxable years on or after January 1, 2008; page 3, line 15 indicates taxable years on or after January 1, 2017. As written, the bill retroactively raises rates on all taxpayers going back to tax year 2008. However, TRD does not believe this is the intent of the bill.

If implemented with the 2008 effective date, taxpayers will be required to file amended returns. Additionally, the bill implicates Section 7-2-12.2 NMSA 1978. Under this bill, taxpayers could be subject to penalty for failing to make required annual and estimated payments. Moreover, if the bill contained a safe-harbor from penalties, that safe harbor would create significant processing and adjudication issues for TRD; some taxpayers may be subject to late filing and late payment penalties unrelated to a safe harbor, forcing a manual calculation - on a taxpayer-by-taxpayer basis - of the amount of penalty due and the amount waived under a potential safe harbor. This could also force slower processing, which could increase interest due to taxpayers under Section 7-1-68 NMSA 1978.

TRD believes the current statute of limitations precludes assessing new taxes for periods prior to tax year 2013. Current law permits TRD to examine returns from earlier periods if there exists an underpayment greater than 25 percent of the calculated liability. For some very high income earners this bill could create problems.

LFC notes that traditionally, the state has held to a doctrine of ex-post facto related to tax law. That is, no law affected already paid taxes would be enacted. Ex post facto laws are prohibited by the New Mexico Constitution, Article II, Sec 19.

**Methodology for Estimated Revenue Impact – Detailed Discussion:** TRD used GenTax taxpayer data to estimate the revenue impact. Tax year 2014 is considered the most current dataset for this analysis. PIT growth rates forecast by the CREG December 2016 were used to estimate out-year revenues.

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: 604 Separate filer's with taxable income over $187 thousand; 12,935 Married joint or Head of Household with taxable income over $375 thousand; and 3,432 Single with taxable income over $250 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 & 2014 were used to forecast the revenue gain. In general, CREG estimates that 60% of fiscal year PIT collections are for the prior tax year, and 40% are from preceding tax years (i.e. FY2015 PIT is the sum of 60% of tax year 2014 liabilities and 40% of tax year 2013 liabilities). The PIT growth rates from the December 2016 CREG forecast was applied to the new revenue estimate.

Finally, the estimate **does not** include revenue due from taxpayers filing amended returns dating back to tax year 2008. Both taxpayers and TRD could have penalty and interest liability due to Sections 7-2-12.2 and 7-1-68 NMSA 1978.

LG/al/jle