FISCAL IMPACT REPORT

SPONSOR	Townsend/Montoya/Duncan/Spence Ezzell/Martinez, A.	**LAST UPDATED**	
		ORIGINAL DATE	2/3/24
SHORT TITLE	Flat Income Tax Rate	**BILL NUMBER**	House Bill 280
		ANALYST	Faubion

REVENUE*
(dollars in thousands)

Type	FY24	FY25	FY26	FY27	FY28	Recurring or Nonrecurring	Fund Affected
PIT	-	($1,730,000.0)	($1,794,000.0)	($1,859,000.0)	($1,928,000.0)	Recurring	General Fund

Parentheses ( ) indicate revenue decreases.
*Amounts reflect most recent analysis of this legislation.

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT*
(dollars in thousands)

Agency/Program	FY24	FY25	FY26	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
	-	$24.4	-	$24.4	Nonrecurring	General Fund
Total	-	$24.4	-	$24.4	Nonrecurring	General Fund

Parentheses ( ) indicate expenditure decreases.
*Amounts reflect most recent analysis of this legislation.

Conflicts with House Bill 252

Sources of Information

LFC Files

Agency Analysis Received From
Taxation and Revenue Department (TRD)

SUMMARY

Synopsis of House Bill 280

House Bill 280 (HB280) changes the personal income tax rates to a flat one percent rate on all taxable income.

The provisions in this bill apply to taxable years beginning January 1, 2024.

FISCAL IMPLICATIONS

This proposal would reduce the revenues generated from the personal income tax by roughly 75 percent. TRD notes the impact to revenue is immense, starting at over $1.7 billion in FY25, and rising to over $1.9 billion in 2028. Recurring revenue reductions of this magnitude will need to be met either with corresponding cuts to expenditures or by finding alternative sources of revenue.

The impact of the proposed changes to the income tax brackets was estimated using tax years 2021-2022 tax return data for New Mexico taxpayers. Using the University of New Mexico's Bureau of Business and Economic Research (BBER) January 2024 forecast, the Taxation and Revenue Department (TRD) indexed the data to tax year 2025 and then grew the estimate annually by BBER's New Mexico's wage and salary growth.

SIGNIFICANT ISSUES

The personal income tax structure proposed in this section would decrease taxes for all taxpayers, with the rate decreases targeted at higher earners who currently pay the highest rates. This proposal decreases the personal income tax progressivity. Used in tax analysis, progressivity is a measure of tax share by income and does not connote ideological alignment of the tax proposal. A progressive tax means, as income rises, a larger share of one's income is paid to that tax, as one's ability to pay increases. Under the proposed structure, low-income earners will pay a much higher share of their income to taxes than higher earners. The lowest-earning taxpayers average a negative tax liability after claiming eligible credits and refunds under both the proposed and current structure.

TRD notes the following:

> Personal income tax (PIT) represents a consistent source of revenue for many states. For New Mexico, PIT is approximately 25 percent of the state's recurring general fund revenue. While this revenue source is susceptible to economic downturns, it is also positively responsive to economic expansions. New Mexico is one of 41 states, along with the District of Columbia, that impose a broad-based PIT (New Hampshire and Washington do not tax wage and salary income). Like several states, New Mexico computes its income tax based on the federal definition of taxable income and ties to other statues in the federal tax code. This is referred to as "conformity" to the federal tax code. The PIT is an important tax policy tool that has the potential to further both horizontal equity, by ensuring the same statutes apply to all taxpayers, and vertical equity, by ensuring the tax burden is based on taxpayers' ability to pay.
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> The last substantial amendment to the PIT brackets was passed in 2005, though the changes made by that amendment were not fully implemented until tax year 2008. In 2019, HB6 added an additional 5.9 percent top income bracket to each filing status, effective from tax year 2021. As New Mexico PIT brackets are not indexed to inflation, taxpayers have gradually moved into higher tax brackets, a phenomenon described as "bracket creep," despite the fact that their "real income," or the purchasing power of their income, has not changed. Over time, the effective PIT rate, which is the average tax rate paid by a taxpayer on their total gross income, has therefore increased. The federal personal income tax indexes both the standard deduction and tax brackets.

Current New Mexico PIT tax structure is progressive, progressive meaning that higher-income taxpayers are taxed at a higher rate. This reduces horizontal equity but encourages vertical equity. This bill applies a flat one percent tax to all taxable income, regardless of income level. This tax structure is regressive in nature, whereby lower-income taxpayers pay a greater percentage of taxable income and reduces vertical equity but creates horizontal equity.

All taxpayers will see a decrease in their tax liability with most of the savings from this bill occurring for higher-income taxpayers as demonstrated in the table below. This bill eliminates the progressive nature of current New Mexico tax brackets and thus erodes vertical equity. The tax liability for taxpayers in the bottom tax bracket will fall on average by $4.64 per taxpayer. The tax liability for taxpayers in the top bracket will fall by an average of $13,404.76 per taxpayer.

Current Tax Bracket	Estimated No. of Taxpayers	Estimated Fiscal Impact for FY2026 ($ thousand)	Average Tax Relief Per Taxpayer
1	431,000	($2,000)	($4.64)
2	67,000	($9,000)	($134.33)
3	58,000	($19,000)	($327.59)
4	501,000	($1,202,000)	($2,399.20)
5	42,000	($563,000)	($13,404.76)

By condensing all brackets onto one single one percent tax rate, the bill eliminates the so-called "marriage penalty". As defined by the Tax Foundation, a marriage penalty exists when a state's income brackets for married taxpayers filing jointly are less than double the bracket widths for single filers. As of tax year 2023, New Mexico is currently one of 15 states with a "marriage penalty" built into its income tax brackets.

This reduction in tax rate may impact the ability for taxpayers who previously had certified tax credits that are only to be applied against tax (i.e. are not refundable or transferable) to not receive the amount certified for eligibility. This may factor in the taxpayer's decision to invest in credits such as charitable incentive tax credits, energy conservation incentive tax credits, employment enhancement tax credits, or specific industry incentive tax credits.

By statute, those electing the entity-level tax will pay the maximum tax rate of either the highest tax bracket for PIT or the highest tax bracket for CIT. Currently the rates are equal; this bill will maintain the 5.9 percent maximum CIT tax rate for taxpayers electing the entity-level tax. Pass-through entity taxpayers are often thought of as corporate filers despite paying as individual owners under PIT. The lower PIT rate, which will be paid by sole proprietors, LLCs and partnerships, may be seen as a question of fairness between corporate filers filing under CIT. According to the Tax Foundation, these taxpayers will expend resources to calculate at the federal and state level the advantages to filing under different entities and under different state tax acts.

The proposed changes may impact pass-through entity taxpayers' decisions to elect the entity-level tax. The entity-level tax was enacted to address the federal Tax Cuts and Jobs

Act (TCJA) $10 thousand limitation on the deduction of state and local taxes for taxpayers that itemize federal deductions. Those electing the entity-level tax will pay the maximum tax rate of either the highest tax bracket for PIT or the highest tax bracket for Corporate Income Tax (CIT). Currently the rates are equal (5.9 percent); this bill will decrease the maximum PIT rate to 1.0 percent but maintain then the maximum rate of 5.9 percent under CIT. Pass-through entity taxpayers will weigh then the impact of their taxes on the federal side versus the impact on the state side. TRD cannot determine the aggregate impact to PIT revenue but would assume some negative impact to revenue with a portion of taxpayers no longer electing the entity-level tax at the 5.9 percent CIT rate and instead paying 1.0 percent income tax under PIT.

When the highest rates for the Income Tax Act and the Corporate Income and Franchise Tax Act do not align there are subsequent impacts for different withholding taxes such as pass-through entity and oil and gas proceeds. The proposed rate change impacts rates for Section 7-1-13(G) NMSA 1978 Federal adjustments other than the distributive share of federal adjustments; Section 7-3-14 NMSA 1978. Composite returns; and Section 7-3A-10 NMSA 1978, Election of entity-level tax. As noted above, the PIT rate decrease to 1.0 percent will place CIT above the highest tax bracket for PIT. By statute, Section 7-3A-10 (C) NMSA 1978, those electing the entity-level tax will then pay a higher tax rate at 5.9 percent.

PERFORMANCE IMPLICATIONS

As discussed in "Technical Issues" below, an effective date of May 15, 2024, with applicability for taxable years beginning on January 1, 2024 will impact TRD's administration of the personal income tax (PIT) bracket changes and fiscal impact. Typically, effective dates for PIT bracket changes allow for an adjustment of the withholding tables relied upon by employers and subsequent adjustments to employees withholding. This has a half-year fiscal year impact on the revenue as withholding is either adjusted up or down to reflect the change in the rates. Due to the timing, TRD assumes a full impact in FY25 for the tax year 2024 decrease in the PIT rate.

ADMINISTRATIVE IMPLICATIONS

This bill will have a low impact on the Information Technology Division (ITD), approximately 440 hours or about one month for an estimated staff workload cost of $24,420. Rate changes for Personal Income Tax and Fiduciary Tax will be included in the annual tax year changes. This change would impact the 2024 tax year programming. Although, the programming for income taxes could be handled during the normal process. Other programs impacted such as withholding would need a longer implementation time. It would be suggested that this change take place for tax year 2025.

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

Conflicts with House Bill 252 which proposes an alternative individual income tax structure.

TECHNICAL ISSUES

TRD notes while Section 2 denotes an applicability date, it does not specify a taxable year that the change will become effective. The default effective date of May 15, 2024, for the bill would cause an administrative burden for TRD and possible confusion for the public. Withholding tables would have to be changed mid tax-year. Publishing new withholding tables is normally done once a year in November prior to the upcoming tax year to allow time for employers to program and adjust their employees' withholding. TRD recommends that Section 2 be changed to "taxable years beginning on or after January 1, 2025."

OTHER SUBSTANTIVE ISSUES

In assessing all tax legislation, LFC staff considers whether the proposal is aligned with committee-adopted tax policy principles. Those five principles:

- **Adequacy**: Revenue should be adequate to fund needed government services.
- **Efficiency**: Tax base should be as broad as possible and avoid excess reliance on one tax.
- **Equity**: Different taxpayers should be treated fairly.
- **Simplicity**: Collection should be simple and easily understood.
- **Accountability**: Preferences should be easy to monitor and evaluate.

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