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## FISCAL IMPACT REPORT

ORIGINAL DATE 1/27/06

SPONSOR Smith LAST UPDATED \_\_\_\_\_ HB \_\_\_\_\_

SHORT TITLE Low and Middle Income Taxpayer Tax Exemption SB 313

ANALYST Francis

### REVENUE (dollars in thousands)

Estimated Revenue			Recurring or Non-Rec	Fund Affected
FY06	FY07	FY08		
(1,200.0)	(2,400.0)	(2,400.0)	Recurring	General Fund

(Parenthesis ( ) Indicate Expenditure Decreases)

Duplicates HB 385

### SOURCES OF INFORMATION

LFC Files

Taxation and Revenue Department (TRD)

### Responses Received From

Taxation and Revenue Department (TRD)

### SUMMARY

#### Synopsis of Bill

Senate Bill 313 amends the Income Tax Act to expand the income brackets for the exemption for low- and middle-income taxpayers. The effective date is for tax years beginning January 1, 2006 forward.

### FISCAL IMPLICATIONS

SB 313 would give average tax relief of \$44 per return for 55 thousand returns. This will lower personal income tax collections \$1.2 million in FY06 and \$2.4 million in FY07 and subsequent years. The personal income tax revenues are distributed entirely to the general fund.

The low- and middle-income tax exemption was passed into law during the 2005 regular session and rather than a smooth phase-out, the bill contained caps on the adjustable gross income. This meant that many taxpayers missed out on the exemption. SB 313 corrects this anomaly. By removing the caps and allowing for a phase-out, the exemption slowly fades with increased income rather than falling dramatically once a taxpayer reaches a certain income.

**TECHNICAL ISSUES**

TRD recommends adding language that would make it clear to the tax filer that the exemption phases out to zero and is never a negative exemption (which would theoretically result in a tax liability).

**OTHER SUBSTANTIVE ISSUES**

TRD has provided an illustration of the impacts and the phase-out:

**Illustration: Current and Proposed Low-and Middle-Income Personal Income Tax Exemptions**

House Taxation and Revenue Committee Substitute for House Bills 410, 582, 844 and 1086, enacted in 2005, created a new personal income tax exemption for low- and middle-income taxpayers. The exemption is \$2,500 multiplied by the number of exemptions claimed for federal income tax purposes for taxpayers in certain income ranges. Beyond a threshold level of adjusted gross income (AGI), the exemption declines by a percentage of the increase in AGI over the threshold. The percentage rate of decline depends on filing status, as shown in column 3 of Table 1 below. Present law provides that the exemption is eliminated completely for taxpayer’s with income above a cap which depends on their filing status, as indicated in column four of the summary table. Taxpayers previously filing head of household returns will file joint returns as a result of the new legislation and receive the same exemption levels as joint return filers. Under the proposal, these caps would be eliminated. Under the phase out schedule for the exemptions already in present law, exemptions would thus be available for taxpayers with AGI up to the amounts shown in column six of the table.

**Table 1: Summary -- Current and Proposed Law Exemption Variables**

Filing Status	AGI Threshold	Decline Rate (%)	AGI Above Which Exemption is Zero	Exemption For Immediately Preceding AGI*	Proposed AGI Above which Exemption is Zero*
Married Joint	\$24,000	10	\$40,667	\$850	\$49,000
Single	\$16,000	15	\$27,110	\$925	\$32,667
Married Separate	\$12,000	20	\$20,333	\$900	\$24,500

\*Assumes one exemption for federal tax purposes. \*\*AGI above which exemption is zero.

**New Personal Income Tax Exemption – Single Filers**



As illustrated above, current statutes generate rather awkward conditions wherein the exemptions drop to zero abruptly above the AGI cap.<sup>1</sup> Hence, for example, a single taxpayer claiming one exemption for federal purposes whose adjusted income totals \$27,110 would be eligible for the new exemption totaling \$925. The new exemption would vanish if the taxpayer's AGI increased by \$1 to \$27,111 however. Tax savings from the \$925 exemption would depend on the taxpayer's *taxable* income, but probably be in the range of \$25. By eliminating the AGI caps in present law, the proposal extends the exemptions along the decline rates in present law as shown by the dashed line in the graphic above. Thus, single taxpayers could qualify for exemptions until their adjusted gross incomes exceeded \$32,667.

**Table 2: Proposed New Exemption Extension Data by Filing Status**

	Joint	Single	Head of Household	Separate	All Returns
<b>Non- Schedule B Filers</b>					
Total Tax Savings	\$1,409,326	\$514,895	\$363,806	\$14,800	\$2,302,826
Number of Returns	23,388	20,117	5,926	548	49,979
Reported Exemptions	73,307	20,780	14,067	752	108,906
Average Savings Per Return (\$)	\$60	\$26	\$61	\$27	\$46
Average Savings Per Exemption (\$)	\$19	\$25	\$26	\$20	\$21
<b>Schedule B Filers*</b>					
Total Tax Savings	\$79,179	\$31,026	\$11,226	\$2,843	\$124,275
Number of Returns	2,725	1,739	341	52	4,857
Reported Exemptions	8,169	1,767	853	64	10,853
Average Savings Per Return	\$29	\$18	\$33	\$55	\$26
Average Savings Per Exemption	\$10	\$1	\$1	\$44	\$3
<b>All Filers</b>					
Total Tax Savings	\$1,488,505	\$545,921	\$375,032	\$17,643	\$2,427,101
Number of Returns	26,113	21,856	6,267	600	54,836
Reported Exemptions	81,476	41,560	28,134	816	119,759
Average Savings Per Return	\$57	\$25	\$60	\$29	\$44
Average Savings Per Exemption	\$18	\$13	\$13	\$22	\$16

Information source: compiled and calculated from 2003 New Mexico personal income tax return data. \* Schedule B filers receive income from outside and within New Mexico. They are therefore required to calculate tax obligations as if all income is earned in New Mexico and pay tax based on the percentage of income earned in New Mexico. Estimates shown above assume Schedule B filers receive the exemptions proportion to the ratio of their New Mexico to total income. Schedule B filers tend to benefit less than other taxpayers from the new exemptions because their incomes tend to be higher than Non-Schedule B filers.

Personal income tax return information summarized in Table 2 indicates the fiscal impacts of the proposal would total approximately \$2.4 million annually if they had been in place during the 2003 tax year. The exemptions could have been claimed on approximately 55,000 returns with total exemptions reported of 120 thousand. Tax savings of \$44 per return and \$16 per exemption would be available under the proposal. Actual impacts of the proposed extension could differ from amounts shown in Table 2, for a number of reasons. Population increases, as well as changes in the average number of federal exemptions, taxable and adjusted gross income will affect the exemption amounts claimed. However, based on projections of population and income

<sup>1</sup> The condition was caused by an apparent inconsistency between legislative intent and the manner in which the legislation was drafted.

growth, it appears that the total amount claimed each year will be relatively stable around the \$2.4 million figure. Total fiscal impacts are stable because income growth results in some new taxpayers becoming eligible for the extended exemption while others lose eligibility because their income grows to the point that it exceeds the implicit income caps in the phase-out formula.

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