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

		ORIGINAL DATE	02/01/10		
SPONSOR	Sandoval	**LAST UPDATED**		**HB**	155
SHORT TITLE	Income Tax Act Changes			**SB**	
				ANALYST	Clifford

REVENUE (dollars in thousands)

Estimated Revenue			**Recurring or Non-Rec**	**Fund Affected**
FY10	**FY11**	**FY12**		
	$1,551.0	$1,698.0	Recurring	General Fund

(Parenthesis ( ) Indicate Revenue Decreases)

SOURCES OF INFORMATION
LFC Files

Responses Received From:
Taxation and Revenue Department (TRD)

SUMMARY

Synopsis of Bill

House Bill 155 makes numerous substantive and technical changes to the individual income tax. The major substantive changes have to do with "indexing," i.e. increasing dollar amounts in the statute every year to reflect inflation. Two sets of indexing changes are made, one set reduces the growth of income tax liabilities and one set increases that growth. The net effect is a relatively minor increase in total income tax obligations.

Provisions that reduce liabilities include indexing of the following amounts (1) Tax rate income brackets, so the threshold amount of income at which a higher tax rate applies would increase each year; (2) Modified gross income for purposes of determining eligibility for the Low-Income Comprehensive Tax Rebate (LICTR); (3) Income thresholds for the extra exemption for low- and middle-income taxpayers. In addition to the indexing provisions, eligibility for the extra exemption for low/middle income taxpayers would be based on income after certain exemptions and deductions rather than on adjusted gross income. This will enable more households to benefit from the exemption.

Provisions that increase liabilities include (1) Standard deduction and personal exemption amounts would be de-coupled from federal tax law provisions and would be indexed but with a lower inflation factor than is applied to the federal amounts. (2) Personal exemption amounts would be phased out for high-income taxpayers at a faster rate than the phase-out of the federal personal exemption. The inflation factor applied to all indexed amounts is the consumer price index reduced by 1 percent per year.

Other substantive provisions include: (1) the definition of "modified gross income" for purposes of LICTR eligibility would exclude "public assistance and welfare benefits, cost of living allowances and gifts" to the extent that these items are not included in taxable income. (2) Rules are provided clarifying treatment of income, deductions, exemptions and credits for taxpayers who file a return for a fractional part of a year. (3) The special tax rate applied to lump sum amounts is repealed.

Changes apply to tax years beginning in 2010 and after.

FISCAL IMPLICATIONS

TRD reports that impacts were calculated using a simulation model with detailed information from individual tax returns. TRD did not provide a breakout of the fiscal impacts of the separate components of the proposal.

SIGNIFICANT ISSUES

TRD identified the following as potential advantages of the proposal:

- Most taxpayers will be able to determine their income tax from the look-up tables using only their filing status, number of personal exemptions, and federal AGI.
- For taxpayers eligible for refundable rebates or credits, the computation of modified gross income will be much easier and require less record keeping.
- The proposal would make the personal income tax fairer over time because it would be indexed for inflation. Currently, rate brackets, the low- and middle-income exemption, and LICTR lose value over time due to inflation, effectively imposing a tax increase due to inflation.
- The CPI overstates the effect of inflation on taxpayers' purchasing power because it does not take into account their ability to change purchasing patterns to mitigate the effect of price increases. Using an inflation adjustment factor of CPI less 1%, adjusts for this behavioral change and ensures that the revenue cost of indexing will be no greater than it is under current law.
- Decoupling from the federal standard deduction and personal exemption amounts provides greater flexibility in designing New Mexico family- and child-related tax benefits. Decoupling from the federal standard deduction would also enable the State to make explicit decisions regarding whether to adopt (and therefore incur revenue losses associated with) special federal standard deductions.

ADMINISTRATIVE IMPLICATIONS

TRD notes:

> The income tax forms and instructions would need to be revised, and computer systems updated. Outreach efforts to return preparers and software developers would also be needed.

OTHER SUBSTANTIVE ISSUES

The proposal would cause a number of changes affecting liabilities of almost all taxpayers. Net effects on any particular set of taxpayers are difficult to predict. The following table illustrates some of the changes:

	Nature of Change	Decrease in Liability vs. Present Law	Increase in Liability vs. Present Law	Type of Household Affected
Personal Exemption	Reduced indexing		√	All
Standard Deduction	Reduced indexing		√	Low/Middle Income
LICTR	Newly indexed	√		Low Income
Low/Middle Income Exemption	Newly indexed, expanded eligibility	√		Low & Middle Income
Bracket Creep	Newly indexed	√		Middle & Higher Income
Personal exemption phase-out	Faster phase-out		√	High Income

It appears that low-income households will see a net benefit under the proposal and that high-income households will see a net tax increase.

WHAT WILL BE THE CONSEQUENCES OF NOT ENACTING THIS BILL

New Mexico's income tax is only partially indexed – itemized deductions and standard deductions are drawn from the federal statutes which are fully indexed. New Mexico's tax brackets and state-specific credit and exemption amounts are not indexed.

POSSIBLE QUESTIONS

Since the proposal creates a shifting of tax liabilities, with some households seeing tax increases and others decreases, is information available on the numbers of households seeing each and the amounts per household?

TC/mew