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

ORIGINAL DATE 01/23/10
SPONSOR Ortiz y Pino **LAST UPDATED** 02/02/10 **HB**

SHORT TITLE Federal Deductions as State Taxable Income **SB** 25

ANALYST Clifford

REVENUE (dollars in thousands)

Estimated Revenue			Recurring or Non-Rec	Fund Affected
FY10	**FY11**	**FY12**		
$5,000	$90,200.0	$64,800.0	Recurring	General Fund

(Parenthesis ( ) Indicate Revenue Decreases)

SOURCES OF INFORMATION
LFC Files

Responses Received From
Taxation and Revenue Department (TRD)

SUMMARY

Synopsis of Bill

Senate Bill 25 amends the definition of "net income" in the Income Tax Act to subtract the amount of state and local taxes from the taxpayer's itemized deductions. The result is that state and local taxes will be added back into net income for the purposes of determining tax liability.

FISCAL IMPLICATIONS

According to TRD, the revenue estimate was derived using 2007 federal tax return data for New Mexico households published by the IRS Statistics of Income (SOI) Division. Taxpayers' itemized deductions were reduced by the estimated portion attributable to state and local taxes. In addition, taxpayers' gross income was reduced by estimated state and local income tax refunds. The revised values were then run through the Department's tax year simulation model and then increased to 2010 levels using the personal income growth forecast. In general, tax year liability changes were converted to fiscal year revenue estimates by applying historical payment patterns to tax year liabilities. In fiscal year 2010 the only adjustment made by taxpayers would be a partial adjustment to estimated payments.

SIGNIFICANT ISSUES

New Mexico currently allows the same itemized deductions as allowed for federal income tax purposes, including the deduction for state and local taxes. Deductible taxes include income taxes, property taxes and, under certain circumstances, sales taxes. This policy provides ease of compliance for taxpayers, but one consequence is a reduction in the effective income tax rate for households that itemize deductions. In general, households are more likely to itemize deductions the higher their income level. TRD's analysis of 2007 federal tax return information indicates that roughly 70% of the increased liability under the proposal would could from households making more than $100,000 per year of gross income. Only 3% of the increase would come from households with less than $50,000 of gross income.

Only five other states follow federal provisions that allow either state and local income taxes or state and local sales taxes to be claimed as itemized deductions. However, 11 states that do not allow deductions for state and local income taxes do permit deductions for sales taxes that were deducted for federal tax purposes.

States that allow deduction for state and local taxes

Arizona	Oklahoma
Hawaii	Rhode Island
New Mexico	Vermont

States that allow deduction for state sales tax

Delaware	Nebraska
Iowa	New York
Kansas	North Dakota
Maryland	Utah
Missouri	Virginia
Montana	

Source: Wisconsin Legislative Fiscal Bureau

TRD provided the following table showing impacts by income class.

Distribution of Change in Tax Year 2011 Tax Liability
(2007 Income Levels)

Adjusted Gross Income	Number of Affected Returns	Change in Tax Liability: Total ($000)	Average	Percent Distribution
Under 50,000	72,469	3,663	51	6.0%
50,000 - 75,000	44,288	7,739	175	12.7%
75,000 - 100,000	33,293	8,249	248	13.5%
100,000 - 200,000	50,560	18,627	368	30.5%
200,000 - 500,000	16,714	10,564	632	17.3%
500,000 or more	8,475	12,267	1,447	20.1%
Total	225,799	61,109	271	100.0%

ALTERNATIVES

Under current federal law, a new limitation on total itemized deductions for very high income households will take effect in 2011. In order to treat those households fairly who experience a reduction in their total itemized deductions, the proposal might be modified so that the state and local tax deduction being disallowed is reduced pro rata with the reduced total itemized deductions for federal purposes.

TC/svb:mew

The Legislative Finance Committee has adopted the following principles to guide responsible and effective tax policy decisions:

1. ***Adequacy:*** *revenue should be adequate to fund government services.*
2. ***Efficiency:*** *tax base should be as broad as possible to minimize rates and the structure should minimize economic distortion and avoid excessive reliance on any single tax.*
3. ***Equity****: taxes should be fairly applied across similarly situated taxpayers and across taxpayers with different income levels.*
4. ***Simplicity****: taxes should be as simple as possible to encourage compliance and minimize administrative and audit costs.*
5. ***Accountability/Transparency:*** *Deductions, credits and exemptions should be easy to monitor and evaluate and be subject to periodic review.*

More information about the LFC tax policy principles will soon be available on the LFC website at www.nmlegis.gov/lcs/lfc