

Fiscal impact reports (FIRs) are prepared by the Legislative Finance Committee (LFC) for standing finance committees of the NM Legislature. The LFC does not assume responsibility for the accuracy of these reports if they are used for other purposes.

Current FIRs (in HTML & Adobe PDF formats) are available on the NM Legislative Website (legis.state.nm.us). Adobe PDF versions include all attachments, whereas HTML versions may not. Previously issued FIRs and attachments may be obtained from the LFC in Suite 101 of the State Capitol Building North.

FISCAL IMPACT REPORT

ORIGINAL DATE 01/22/10

SPONSOR Ortiz y Pino LAST UPDATED _____ HB _____

SHORT TITLE Adjust Income Tax Rates SB 65

ANALYST Clifford

REVENUE (dollars in thousands)

Estimated Revenue			Recurring or Non-Rec	Fund Affected
FY10	FY11	FY12		
\$24,800.0	\$189,800.0	\$214,400.0	Recurring	General Fund

(Parenthesis () Indicate Revenue Decreases)

Responses Received From
Taxation and Revenue Department (TRD)

SUMMARY

Synopsis of Bill

Personal income tax rates would be increased as illustrated in the following table.

Tax Rate on Income in Bracket:		Taxable Income Brackets by Filing Status:					
Present Law	Proposed Law	Married Joint and Head of Household		Single		Married Filing Separate	
1.7%	1.7%	\$0	\$8,000	\$0	\$5,500	\$0	\$4,000
3.2%	3.2%	\$8,000	\$16,000	\$5,500	\$11,000	\$4,000	\$8,000
4.7%	4.7%	\$16,000	\$24,000	\$11,000	\$16,000	\$8,000	\$12,000
4.9%	5.2%	\$24,000	\$82,000	\$16,000	\$55,000	\$12,000	\$41,000
4.9%	5.8%	\$82,000	\$140,000	\$55,000	\$93,000	\$41,000	\$70,000
4.9%	6.3%	\$140,000	\$200,000	\$93,000	\$133,000	\$70,000	\$100,000
4.9%	6.8%	\$200,000	\$500,000	\$133,000	\$333,000	\$100,000	\$250,000
4.9%	7.7%	\$500,000	\$1,000,000	\$333,000	\$667,000	\$250,000	\$500,000
4.9%	8.2%	\$1,000,000	And up	\$667,000	And up	\$500,000	And up

FISCAL IMPLICATIONS

TRD reports that fiscal impacts were estimated using a detailed analysis of tax year 2007 data and then grown to reflect the estimated growth in income from 2007 to 2010 and beyond. TRD assumes that withholding tables will not be revised until July 1, 2010, so FY10 revenue is

increased only by estimated payments. The remainder of the tax year 2010 impacts are delayed until FY11 and FY12. This causes a temporary increase in fiscal impacts above the level of annual revenues.

SIGNIFICANT ISSUES

The proposal presents a trade-off between two desirable goals of tax policy. On the one hand it improves vertical equity by increasing the tax burden on households with a greater ability to pay. On the other hand, it reduces economic efficiency by reducing the after-tax return on work and investment in the state. The latter effect is muted somewhat because New Mexico income taxes are allowed as an itemized deduction on the federal income tax return. Thus, if a taxpayer itemizes deductions, and is in the 33% federal tax rate bracket, their federal tax liability will go down by one-third of their state tax increase, effectively saving the taxpayer that much of the tax burden.

As illustrated in the following table, New Mexico’s present law top tax rate is around the midpoint among states in the western region. Like several other states, NM has a relatively flat tax rate structure. NM tax as percent of income is toward low end of states with income tax. If SB 65 is adopted, New Mexico’s rates would move up to the second highest in the region after California. This table does not reflect any changes the other states may have made as part of their FY10 budgets.

State	Range of Tax Rates*	Top Bracket Single/Married	Income Tax as % of Personal Income**
Arizona	2.59% to 4.54%	\$150,000/\$300,000	1.54%
California	1% to 10.3%	\$1 million/\$1 million	3.07%
Colorado	4.63%	All Income	2.17%
Idaho	1.6% to 7.8%	\$25,440/\$50,881	2.6%
Montana	1% to 6.9%	\$15,600/\$15,600	2.56%
New Mexico	1.7% to 4.9%	\$16,000/\$24,000	2.11%
Oklahoma	0.5% to 5.5%	\$8,700/\$15,000	2.49%
Utah	2.3% to 6.98%	\$5,500/\$11,000	2.85%

Sources: *2009 State Tax Handbook, CCH publishing. ** U.S. Census.

New Mexico personal income tax revenue has been reduced by several significant statutory changes in the last several legislative sessions as illustrated in the following table. As a result, total annual collections have been reduced by approximately \$450 million, roughly one-third of what collections would have been in the absence of the changes.

Session:		General Fund FY11 (\$ millions)
2003	Income tax deduction for capital gains	(36.0)
2003	Reduce income tax rates	(360.0)
2003	Withholding on oil and gas distributions	30.0
2005	Low & Moderate Income Tax Exemption	(30.0)
2007	Working Families Tax Credit	(40.0)
2007	Rural health care practitioner tax credit	(5.0)
2007	Armed forces income tax exemption	(10.0)
Total		(451.0)

Although some of the recently-enacted changes were targeted at low-income households, the majority of the tax relief was directed to higher income households. Since the personal income tax is the most progressive component of the state’s tax system, these changes have made the state’s tax system somewhat less progressive. A recent study sponsored by the government of the District of Columbia compared the combined burden of all state and local taxes on households with different income levels. For purposes of property tax comparisons, the study looked at a hypothetical household living in the largest city in each state. Among western states, New Mexico’s combined tax burden was less regressive than that of most other states. Results of the 2008 study are summarized in the following table. The overall tax burden in New Mexico was slightly above the average in the region, except for households making \$25,000.

State & Local Taxes as a Percent of Household Income

City, State	\$25,000	\$50,000	\$75,000	\$100,000	\$150,000
Albuquerque, NM	9.9%	7.7%	7.7%	7.9%	7.5%
Billings, MT	7.5%	4.4%	5.6%	6.1%	6.5%
Boise, ID	9.0%	6.2%	7.2%	8.0%	8.4%
Denver, CO	11.3%	6.6%	6.7%	7.3%	6.9%
Houston, TX	9.9%	6.1%	5.6%	5.4%	4.4%
Las Vegas, NV	9.8%	6.5%	5.4%	5.0%	4.0%
Los Angeles, CA	10.7%	10.0%	8.6%	8.5%	8.9%
Oklahoma City, OK	10.9%	7.3%	7.9%	8.2%	7.9%
Phoenix, AZ	11.6%	5.9%	5.8%	6.3%	5.9%
Salt Lake City, UT	11.4%	7.2%	7.7%	8.0%	7.7%
Average	10.2%	6.8%	6.8%	7.1%	6.8%

Source: Government of the District of Columbia.

The proposal would create a significantly more progressive tax rate structure. In an economy with significant amounts of inflation, this can cause tax liabilities that increase significantly faster than incomes. This is due to the “bracket creep” phenomenon, i.e. taxpayers graduating into higher tax rate brackets due to the inflation of their incomes. Taxpayers may view this as unfair because the real purchasing power of their income is not increasing as fast as their tax liabilities. From the state’s standpoint, however, this can create a revenue bonanza as taxes rise more quickly than incomes. The relationship between revenue growth and income growth is known as the “elasticity” of a revenue. A more progressive rate structure tends to push this elasticity above 1, i.e. revenues grow faster than incomes. Since other state revenues tend to have an elasticity less than one, the more rapid growth of income tax can help total revenue keep pace with income growth.

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

House Bill 9 would impose an income tax surtax of 1 percent in tax years 2010 through 2012 on taxpayers making more than \$200,000 (married) or \$133,000 (single). Senate Bill 122 would impose an income tax surtax of 1 percent permanently on taxpayers making more than \$160,000 (married) or \$100,000 (single).

TECHNICAL ISSUES

The proposal would increase income tax liabilities in tax year 2010 which is already underway. TRD assumes that they will not modify withholding tables until July. This raises the possibility that some taxpayers making estimated payments according to present law requirements will be found to owe penalty for underpayment of estimated tax when the new tax rates take effect. To prevent imposing this penalty, the proposal could include language similar to this language from SB 122:

“TEMPORARY PROVISION.--For the taxable year 2010, a taxpayer is deemed to have complied with the provisions of Section 7-2-12.2 NMSA 1978 if the taxpayer has made the first required annual payment of estimated taxes due for taxable year 2010 based on the provisions of the version of Section 7-2-7 NMSA 1978 applicable on January 1, 2009.”

TC/svb

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