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## FISCAL IMPACT REPORT

ORIGINAL DATE 02/03/11

SPONSOR Rehm LAST UPDATED \_\_\_\_\_ HB 61

SHORT TITLE “Net Income” Definition for Income Taxes SB \_\_\_\_\_

ANALYST Burrows

### REVENUE (dollars in thousands)

Estimated Revenue			Recurring or Non-Rec	Fund Affected
FY11	FY12	FY13		
(\$5,200.0)	(\$94,200.0)	(\$69,800.0)	Recurring	General Fund

(Parenthesis ( ) Indicate Revenue Decreases)

### SOURCES OF INFORMATION

LFC Files

#### Responses Received From

Department of Taxation and Revenue (TRD)

### SUMMARY

#### Synopsis of Bill

House Bill 61 amends the definition of “net income” in the Income Tax Act (Section 7-2-2 NMSA 1978) so that the amount of state and local income and sales taxes included in the taxpayer’s itemized deductions will be excluded from net income for state personal income tax purposes.

### FISCAL IMPLICATIONS

According to TRD, the 2010 December consensus forecast estimates were used to calculate the revenue impact. The estimates were based on 2007 Federal and 2008 New Mexico Income Tax Return data. Federal income tax return data for 2007 was used to estimate, by income class, (1) state and local tax deductions as a percent of total itemized deductions and (2) state and local tax refunds claimed as income as a percent of adjusted gross income (AGI). For purposes of the simulation, itemized deductions were changed by state and local tax deductions, and adjusted gross income was changed by state and local tax refunds as a percent of AGI.

### SIGNIFICANT ISSUES

New Mexico currently disallows the itemized deduction of state and local taxes that are allowed under federal income tax provisions. One consequence of this policy is an increase 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 percent of the decreased liability under the proposal would come from households making more than \$100,000 per year of gross income. Only 3 percent of the decrease 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.

**States that allow deduction for state and local taxes:**

Arizona	Oklahoma
Hawaii	North Dakota
Vermont	

Source: TRD

The proposal creates a trade-off between two desirable goals of tax policy. On the one hand, reinstating the state and local tax deduction would increase the after-tax return on labor and capital invested in the New Mexico economy, thus encouraging business location and investment as well as employment and work effort. On the other hand, it would reduce the portion of the personal income tax burden on taxpayers with greater ability to pay.

The bill would reduce some complexity in the income tax for taxpayers who itemize.

**TECHNICAL ISSUES**

According to TRD, as drafted, the bill would permit excessive deductions because it leaves in place the deduction of amounts refunded to the taxpayer of state and local income and sales taxes (see Section 7-2-2N(8), on page 8, lines 11-16). When taxpayers are permitted to deduct their state and local tax payments, as they are allowed under federal law and under the proposal, it is important that they be required to include refunds in their income because those refunds represent over-payments of state and local tax that have been previously deducted. To correct the problem, the bill could strike present law Section 7-2-2N(8).

**WHAT WILL BE THE CONSEQUENCES OF NOT ENACTING THIS BILL**

State and local income taxes will continue to be excluded from taxpayer's itemized deductions, and as such will be included in the total tax liability of "net income" for state personal tax purposes.

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