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

SPONSOR Maestas **ORIGINAL DATE** 03/04/11 **LAST UPDATED** **HB** 516

SHORT TITLE Adjust Income Tax Rates **SB**

ANALYST Burrows

REVENUE (dollars in thousands)

Estimated Revenue			Recurring or Non-Rec	Fund Affected
FY11	FY12	FY13		
	($175,500.0)	($355,500.0)	Recurring	General Fund

(Parenthesis ( ) Indicate Revenue Decreases)

Conflicts with SB94, SB472, and HB572

SOURCES OF INFORMATION
LFC Files

Responses Received From
Taxation and Revenue Department (TRD)

SUMMARY

Synopsis of Bill

House Bill 516 proposes to amend the Income Tax Act by adding additional tax brackets at increasingly higher income levels, and reducing the tax rates on lower income levels.

Personal income tax rates would be amended as follows:

Beginning in tax year 2012:

Tax Rate on Income in Bracket:		Taxable Income Brackets by Filing Status:					
Current Law	Proposed Law	Married Joint and Head of Household		Single, Estates and Trusts		Married Filing Separate	
1.70%	1.00%	$0	$8,000	$0	$5,500	$0	$4,000
3.20%	1.00%	$8,000	$16,000	$5,500	$11,000	$4,000	$8,000
4.70%	1.00%	$16,000	$18,000	$11,000	$12,000	$8,000	$9,000
4.70%	2.00%	$18,000	$24,000	$12,000	$16,000	$9,000	$12,000
4.90%	2.00%	$24,000	$36,000	$16,000	$24,000	$12,000	$18,000
4.90%	3.00%	$36,000	$72,000	$24,000	$48,000	$18,000	$36,000
4.90%	4.00%	$72,000	$144,000	$48,000	$96,000	$36,000	$72,000
4.90%	5.00%	$144,000	$375,000	$96,000	$250,000	$72,000	$187,500
4.90%	6.00%	$375,000	$1,500,000	$250,000	$1,000,000	$187,500	$750,000
4.90%	7.00%	$1,500,000	And up	$1,000,000	And up	$750,000	And up

The provisions of this bill apply to taxable years beginning on or after January 1, 2012.

The effective date of the provisions of this bill is January 1, 2012.

FISCAL IMPLICATIONS

TRD reports tax liability by income bracket was calculated from 2008 income tax return information (the most recent year for which complete tax return data is available). Personal income growth factors were used to estimate liability growth to the forecast years. Calendar year liabilities were converted to fiscal years by applying historical payment patterns.

SIGNIFICANT ISSUES

TRD notes the bill would alter (in some cases increase) the progressivity of the state personal income tax. Changing income tax rates and thereby lowering the overall state personal income tax burden would increase the competitiveness of New Mexico's economy by encouraging investment and work effort.

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, New Mexico has a relatively flat tax rate structure. New Mexico tax as percent of income is toward the low end of states with income tax.

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	0.98%
California	1% to 9.3%	$44,814/$89,628	2.86%
Colorado	4.63%	All Income	2.31%
Idaho	1.6% to 7.8%	$26,320/$52,640	2.92%
Montana	1% to 6.9%	$15,600/$15,600	2.72%
New Mexico	**1.7% to 4.9%**	**$16,000/$24,000**	**1.53%**
Oklahoma	0.5% to 5.65%	$11,450/$20,500	2.13%
Utah	5%	All Income	2.94%

*State department of taxation for each state

**2009 U.S. Census

ADMINISTRATIVE IMPLICATIONS

TRD reports instructions, withholding tables, and tax tables for 2012 personal income and fiduciary income taxes would need to be revised. The changes will need to be publicized so that estimated tax filers are minimally affected. The oil and gas and pass-through entity withholding tax rates would need to be reviewed to ensure they are equitably adjusted. Any change in those rates must be published 90 days in advance. The revenue processing system and applications would need to be changed to reflect the new rates. Since TRD is provided with sufficient time to make these changes, the bill can be implemented at no additional costs.

CONFLICT

Senate Bill 94 proposes a surtax of 3.3 percent on high-income taxpayers.

Senate Bill 472 would impose a 1 percent surtax on high-income taxpayers.

House Bill 572 would increase tax rates for high-income taxpayers to allow for a more progressive tax system.

OTHER SUBSTANTIVE ISSUES

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 with annual incomes of $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 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 elasticity less than one, the more rapid growth of income tax can help total revenue keep pace with income growth.

WHAT WILL BE THE CONSEQUENCES OF NOT ENACTING THIS BILL

Personal income tax rates will remain as in current law.

LKB/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