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

ORIGINAL DATE 03/17/11
SPONSOR Garcia, M.P. **LAST UPDATED** **HB** 572

SHORT TITLE Restore Progressivity to the Income Tax Rates **SB**

ANALYST Golebiewski

REVENUE (dollars in thousands)

Estimated Revenue			Recurring or Non-Rec	Fund Affected
FY11	FY12	FY13		
$700.0	$26,100.0	$44,000.0	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 572 gradually introduces more progressivity into the personal income tax schedule. It does so as follows:

For CY11:

Tax Rate on Income in Bracket		Taxable Income Brackets by Filing Status					
Present Law	Proposed Law	Married Filing Jointly, Head of Household		Single		Married Filing Separately	
1.70%	1.70%	$0	$8,000	$0	$5,500	$0	$4,000
3.20%	3.20%	$8,000	$16,000	$5,500	$11,000	$4,000	$8,000
4.70%	4.70%	$16,000	$24,000	$11,000	$16,000	$8,000	$12,000
4.90%	4.90%	$24,000	$250,000	$16,000	$167,000	$12,000	$125,000
4.90%	5.30%	$250,000	And up	$167,000	And up	$125,000	And up

For CY12:

Tax Rate on Income in Bracket		Taxable Income Brackets by Filing Status					
Present Law	Proposed Law	Married Filing Jointly, Head of Household		Single		Married Filing Separately	
1.70%	1.70%	$0	$8,000	$0	$5,500	$0	$4,000
3.20%	3.20%	$8,000	$16,000	$5,500	$11,000	$4,000	$8,000
4.70%	4.70%	$16,000	$24,000	$11,000	$16,000	$8,000	$12,000
4.90%	4.90%	$24,000	$250,000	$16,000	$167,000	$12,000	$125,000
4.90%	5.30%	$250,000	$500,000	$167,000	$333,000	$125,000	$250,000
4.90%	6.00%	$500,000	And up	$333,000	And up	$250,000	And up

For CY13:

Tax Rate on Income in Bracket		Taxable Income Brackets by Filing Status					
Present Law	Proposed Law	Married Filing Jointly, Head of Household		Single		Married Filing Separately	
1.70%	1.70%	$0	$8,000	$0	$5,500	$0	$4,000
3.20%	3.20%	$8,000	$16,000	$5,500	$11,000	$4,000	$8,000
4.70%	4.70%	$16,000	$24,000	$11,000	$16,000	$8,000	$12,000
4.90%	4.90%	$24,000	$250,000	$16,000	$167,000	$12,000	$125,000
4.90%	5.30%	$250,000	$500,000	$167,000	$333,000	$125,000	$250,000
4.90%	6.00%	$500,000	$1,000,000	$333,000	$667,000	$250,000	$500,000
4.90%	6.80%	$1,000,000	And up	$667,000	And up	$500,000	And up

FISCAL IMPLICATIONS

TRD:

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

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.

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 major revenue raiser 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

Related bills include: HB 119, SB 7, and SB 472.

TECHNICAL ISSUES

The proposal would increase income tax liabilities in tax year 2011 which is already underway. TRD may not be able to 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.

JAG/svb:mew