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

SPONSOR Sanchez, B. **ORIGINAL DATE** 03/04/11 **LAST UPDATED** **HB**

SHORT TITLE High-Income Taxpayer Surtax **SB** 472

ANALYST Burrows

REVENUE (dollars in thousands)

Estimated Revenue			Recurring or Non-Rec	Fund Affected
FY11	FY12	FY13		
$4,700.0	$54,500.0	$60,200.0	Recurring	General Fund

(Parenthesis ( ) Indicate Revenue Decreases)

Conflicts with HB516, HB572

SOURCES OF INFORMATION
LFC Files

Responses Received From
Taxation and Revenue Department (TRD)

Responses Not Received From
Department of Finance and Administration (DFA)

SUMMARY

Synopsis of Bill

Senate Bill 472 proposes to amend the Income Tax Act to impose a surtax of 1 percent on taxable income in excess of the following:

- $80,000 for married individuals filing separately;
- $160,000 for heads of households, surviving spouses, and married individuals filing jointly; or
- $100,000 for single individuals, estates, and trusts.

The bill provide for the taxable year 2011 compliance with the first required annual payment of estimated taxes will be determined based on the provisions applicable in tax year 2010. The provisions of this bill are applicable for tax years beginning on or after 2011.

Because no effective date is provided in the bill, its provisions will become effective 90 days after the 2011 Legislative Session adjourns, on June 17, 2011.

FISCAL IMPLICATIONS

TRD reports a simulation model was used to estimate each calendar year's tax liability at 2008 income levels (the most recent year for which complete tax return data is available). Personal income growth factors were used to increase the liability estimates to the relevant income levels. Calendar year liabilities were converted to fiscal years by applying historical payment patterns. Estimates assume that withholding tables are not revised until July 1, 2011. As a result, FY11 revenues are assumed to increase only due to estimated payments; withholding is unaffected until FY12 and the majority of the calendar year 2011 revenue impact is delayed until FY12 and FY13, thereby inflating the revenue impact for FY12 and FY13.

SIGNIFICANT ISSUES

TRD notes the proposal creates a trade-off between two desirable goals of tax policy. On the one hand, it would impose a greater portion of the personal income tax burden on taxpayers with greater ability to pay. On the other hand, raising income tax rates would reduce the after-tax return on labor and capital invested in the New Mexico economy, thus reducing the competitiveness of New Mexico's economy by discouraging business location and investment as well as employment 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 notes that withholding tables for tax year 2011 have already been created, so those tables would need to be revised.

CONFLICT

House Bill 516 would adjust the rates and gradation of personal income taxes to allow for a more progressive tax system.

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

TECHNICAL ISSUES

According to TRD, Section 4 could be interpreted to mean that taxpayers are in compliance with *all* provisions of Section 7-2-12.2 if they make the first required annual payment of estimated taxes based on provisions applicable for the 2010 tax year. This ambiguity could be resolved if the section is amended to state, "for the taxable year 2011, a taxpayer is deemed to have complied with the provisions of Section 7-2-12.2 NMSA 1978 for the taxpayer's first required annual payment of estimated taxes due for taxable year 2011 if that payment is based on the provisions of the version of Section 7-2-7 NMSA 1978 applicable on January 1, 2010 through December 31, 2010."

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/bym

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