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

ORIGINAL DATE 02/08/12
SPONSOR Maestas **LAST UPDATED** ___ **HB** 305

SHORT TITLE Adjust Income & Gross Receipts Tax Rates **SB** ___

ANALYST Walker-Moran

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY12	**FY13**	**FY14**	**FY15**	**FY16**		
0	($57,300)	($116,500)	($124,500)	($127,000)	Recurring	General Fund (PIT)
0	($253,789)	($521,752)	($539,479)	($554,527)	Recurring	General Fund (GRT)

(Parenthesis ( ) Indicate Revenue Decreases)

Relates to SB 229

SOURCES OF INFORMATION
LFC Files

Responses Received From
Taxation and Revenue Department (TRD)

SUMMARY

Synopsis of Bill

Personal Income Tax: House Bill 305 amends section 7-2-7 NMSA 1978 to change the individual income tax rates and the taxable income brackets.

The applicability date of the income tax changes is January 1, 2013.

Gross Receipts Tax: House Bill 305 also amends 7-9-4 NMSA 1978 to decrease the excise tax by one percent from 5.125% to 4.125%.

The effective date of the gross receipts tax is January 1, 2013.

FISCAL IMPLICATIONS

This bill may be counter to the LFC tax policy principle of adequacy. According to the LFC staff General Fund Recurring Appropriation Outlook for FY14 and FY15, December 2011 forecasted revenues will be insufficient to cover growing recurring appropriations.

Personal Income Tax: The TRD use a simulation model to estimate each calendar year's tax liability at 2009 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.

Summary of Personal Income Tax proposed changes in HB 305:

Married Individuals Filing Separate Returns				
Bracket	**Taxable Income**	**HB 305 Taxable Income**	**Tax**	**HB 305 Tax**
1	Not over $4,000	Not over $9,000	1.7%	2.0%
2	$4,000 - $8,000	$9,000 - $18,000	$68 + 3.2% of excess over $4,000	$180 + 3.0% of excess over $9,000
3	$8,000 - $12,000	$18,000 - $36,000	$196 + 4.7% of excess over $8,000	$450 + 4.0% of excess over $18,000
4	Over $12,000	$36,000 - $72,000	$384 + 4.9% of excess over $12,000	$1,170 + 5.0% of excess over $36,000
5	NA	$72,000 - $187,500		$2,970 + 6.0% of excess over $72,000
6	NA	$187,500 - $750,000		$9,900 + 7.0% of excess over $187,500
7	NA	Over $750,000		$49,275 + 8.0% of excess over $750,000

Heads of Household, Surviving Spouses and Married Individuals Filing Joint Returns				
Bracket	**Taxable Income**	**HB 305 Taxable Income**	**Tax**	**HB 305 Tax**
1	Not over $8,000	Not over $18,000	1.7%	2.0%
2	$8,000 - $16,000	$18,000 - $36,000	$136 + 3.2% of excess over $8,000	$360 + 3.0% of excess over $18,000
3	$16,000 - $24,000	$36,000 - $72,000	$392 + 4.7% of excess over $16,000	$900 + 4.0% of excess over $36,000
4	Over $24,000	$72,000 - $144,000	$768 + 4.9% of excess over $24,000	$2,340 + 5.0% of excess over $72,000
5	NA	$144,000 - $375,000		$5,940 + 6.0% of excess over $144,000
6	NA	$375,000 - $1,500,000		$19,800 + 7.0% of excess over $375,000
7	NA	Over $1,500,000		$98,550 + 8.0% of excess over $1,500,000

Single Individuals and for Estates and Trusts				
Bracket	**Taxable Income**	**HB 305 Taxable Income**	**Tax**	**HB 305 Tax**
1	Not over $5,500	Not over $12,000	1.7%	2.0%
2	$5,500 - $11,000	$12,000 - $24,000	$93.50 + 3.2% of excess over $5,500	$240 + 3.0% of excess over $12,000
3	$11,000 - $16,000	$24,000 - $48,000	$269.50 + 4.7% of excess over $11,000	$600 + 4.0% of excess over $24,000
4	Over $16,000	$48,000 - $72,000	$504.50 + 4.9% of excess over $16,000	$1,560 + 5.0% of excess over $48,000
5	NA	$72,000 - $150,000		$2,760 + 6.0% of excess over $72,000
6	NA	$150,000 - $1,000,000		$7,440 + 7.0% of excess over $150,000
7	NA	Over $1,000,000		$66,940 + 8.0% of excess over $1,000,000

<u>Gross Receipts Tax</u>: This bill would reduce General Fund revenues by an amount equal to one percent of the taxable gross receipts across the entire state. Taxable gross receipts estimates from the second half of FY 2013 onward were taken from the December 2011 Consensus Revenue Estimate.

SIGNIFICANT ISSUES

According to TRD, this bill would have profound impacts on the overall burden of the state's tax system. The PIT system is now approximately proportional; this bill would render PIT more progressive in some respects, but more regressive in others. The GRT is quite regressive and this bill, by decreasing the reliance of the revenue stream on the GRT would materially change the overall structure to be almost proportional. However, the changes would not be restricted to revenue. The joint burden (the combination of taxes and state spending on services and benefits) would be also profoundly affected depending on what decisions the Governor and Legislature would make to accommodate this very large impact on General Fund revenue.

The proposed gross receipts tax rate change would create inequality between the gross receipts and compensating tax rates. Without amending the compensating tax rate, imports would become relatively more costly. Although the Commerce Clause forbids the state from taxing out-of-state business at a higher rate than an in-state business, the legal burden of the state's compensating tax rests upon the consumer and this rate differential would be permissible. Conventionally, however, the state has set both taxes at the same rate.

ADMINISTRATIVE IMPLICATIONS

This bill results in a moderate administrative impact to the TRD. Most changes can be done at minimal cost as part of the annual or semi-annual update of the affected tax programs. The income tax changes proposed by this bill would affect the following tax programs: personal income tax, fiduciary income tax, oil and gas proceeds withholding, pass-through entity withholding, wage and other income withholding. Any change to rates for the oil and gas and pass-through entity withholding will need to be advertised 90 days in advance of the change.

OTHER SUBSTANTIVE ISSUES

According to the TRD, the proposed changes to income tax rates have some profound distributional implications. The tables below show the results of a micro-simulation of the proposed income tax changes. These tables display characteristics of those taxpayers who would pay less tax under the new rates, and those taxpayers who would pay more under the new rates. The data included on the first two tables is the number of returns, total tax payment decrease/increase from each income group, average tax payment decrease/increase per taxpayer, and the percentage of total tax payment decrease/increase experienced by each income group relative to the total tax payment decrease/increase across all groups. The third table shows those who experience tax increases and those who experience tax decreases as a percentage of their income group.

In terms of both the total increase by income group and the proportion of their income group benefitting, taxpayers in the $50,000-$100,000 income bracket benefit from this proposal. Surprisingly, the $100,000-$200,000 income bracket also benefits to a large degree considering the proposed increase to the upper marginal rates.

Although 97 percent of the total value of tax increases comes from the $200,000+ bracket, the surprising figure is the number of taxpayers in the lowest bracket that would experience a tax increase. About 59 percent of taxpayers with an adjusted gross income of less than $25,000 would pay more in taxes than before the tax rate changes. Even though these tax rate changes make PIT more progressive at the top marginal rate, they also have a regressive element.

Distribution of Change in Tax Year 2013 Tax Liability (based on 2009 Income Levels)

In the same income brackets some taxpayers will pay more taxes and some will pay less.

Decrease in Taxes Paid				
Adjusted Gross Income	**Number of Affected Returns**	**Total Decrease (thousands of dollars)**	**Average Tax Decrease**	**Percent Distribution**
Under 25,000	28,985	1,339	$46	0.9%
25,000 - 50,000	131,845	27,240	$207	17.4%
50,000 -100,000	174,530	81,084	$465	51.7%
100,000 -200,000	72,755	44,845	$616	28.6%
200,000 or more	7,226	2,260	$313	1.4%
Total	415,341	156,769	$377	100.0%

Increase in Taxes Paid				
Adjusted Gross Income	**Number of Affected Returns**	**Total Increase (thousands of dollars)**	**Average Tax Increase**	**Percent Distribution**
Under 25,000	41,629	473	$11	0.9%
25,000 - 50,000	32,542	473	$15	0.9%
50,000 -100,000	1,637	38	$23	0.1%
100,000 -200,000	2,499	591	$236	1.1%
200,000 or more	15,285	50,444	$3,300	97.0%
Total	93,592	52,019	$556	100.0%

Tax Change Percentages by Income Brackets

In the same income brackets some taxpayers will pay more taxes and some will pay less.

	Decrease in Taxes		**Increase in Taxes**	
Adjusted Gross Income	**Number of Taxpayers**	**Percentage of Income Group**	**Number of Taxpayers**	**Percentage of Income Group**
Under 25,000	28,985	41.0%	41,629	59.0%
25,000 - 50,000	131,845	80.2%	32,542	19.8%
50,000 -100,000	174,530	99.1%	1,637	0.9%
100,000 -200,000	72,755	96.7%	2,499	3.3%
200,000 or more	7,226	32.1%	15,285	67.9%
Total	415,341	81.6%	93,592	18.4%

Does the bill meet the Legislative Finance Committee tax policy principles?

1. **Adequacy**: Revenue should be adequate to fund needed government services.
2. **Efficiency**: Tax base should be as broad as possible and avoid excess reliance on one tax.
3. **Equity**: Different taxpayers should be treated fairly.
4. **Simplicity**: Collection should be simple and easily understood.
5. **Accountability**: Preferences should be easy to monitor and evaluate

EWM/lj:amm