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## FISCAL IMPACT REPORT

ORIGINAL DATE 1/30/18

SPONSOR Little LAST UPDATED \_\_\_\_\_ HB 143

SHORT TITLE Income & Sales Tax Deductions SB \_\_\_\_\_

ANALYST Iglesias

### REVENUE (dollars in thousands)

| Estimated Revenue |            |            |            |            | Recurring or<br>Nonrecurring | Fund<br>Affected |
|-------------------|------------|------------|------------|------------|------------------------------|------------------|
| FY18              | FY19       | FY20       | FY21       | FY22       |                              |                  |
| --                | (\$42,780) | (\$43,550) | (\$44,420) | (\$45,100) | Recurring                    | General Fund     |

Parenthesis ( ) indicate revenue decreases

### SOURCES OF INFORMATION

LFC Files

#### Responses Received From

Taxation and Revenue Department (TRD)

### SUMMARY

House Bill 143 changes the definition of net income in the Income Tax Act to remove the exclusion of state income and local sales taxes included in the taxpayer's federal itemized deductions from the base income for taxpayers other than estates or trusts. The effect is to allow the state and local tax deductions for state income tax purposes.

There is no effective date of this bill. It is assumed that the effective date is 90 days after this session ends. The provisions of the bill apply to taxable years on or after January 1, 2018.

### FISCAL IMPLICATIONS

The fiscal estimates were provided by the Taxation and Revenue Department (TRD), which used taxpayer data from GenTax to estimate the revenue impact. TRD used the aggregate sum of the amount attributed to the state and local tax deduction allowed at the federal level multiplied by each taxpayer's tax rate. Because the bill proposes to deduct this sum from the taxable base, the result is a loss to the general fund. Additionally, TRD states this legislation doubles the deduction currently available to taxpayers. A detailed explanation is offered in the Technical Issues section below.

## SIGNIFICANT ISSUES

According to TRD, this bill legislation reduces the taxable income of the top 30 percent of New Mexico taxpayers. This could be considered counter to the tax policy principal of equity, which indicates different taxpayers should be treated fairly.

## ADMINISTRATIVE IMPLICATIONS

TRD expects the bill to have minimal administrative impact to the department. Some reprogramming of information technology systems will be necessary.

## TECHNICAL ISSUES

TRD indicates the bill's provisions create an issue that doubles the deduction currently available to taxpayers. According to TRD, statutory definitions for state personal income taxes do not easily align to the mechanics of the tax return. TRD's detailed explanation of this effect is provided below:

New Mexico's PIT regime starts with Federal Adjusted Gross Income (FAGI). The reader is best served by having a current copy of federal Form 1040 and New Mexico PIT-1 to easily follow the explanation. The input value on PIT-1, Line 9, page 1 is FAGI. FAGI is obtained from Line 38 of federal Form 1040. Federal Form 1040 lines 7 through 21 are totaled on line 22; Line 22 is federal "total income." Federal Form 1040 lines 23 through 35 are deductions to total income, the sum totaled on line 36. Line 36 subtracted from line 22 is the difference input on line 37 and then copied to line 38.

Federal Form 1040 line 40 is "Itemized Deductions" computed as the sum of Schedule A. Lines 5 through 8 on Schedule A are "Taxes You Paid," and this sum is totaled on line 9. Line 5 on Schedule A is the greater of state income taxes or state general sales taxes paid. The value of this line is enumerated as an addback on New Mexico PIT-1 Line 10.

The reason the value of Schedule A Line 5 is an addback is because the total federal deduction from federal Form 1040 Line 40 is a deduction. This mechanic appears to be a legacy series of transactions due to prior changes to tax statutes. However, if the New Mexico PIT-1 Line 10 is allowed as a unique deduction, it will be the deduction of state taxes paid.

### **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