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FISCAL IMPACT REPORT

ORIGINAL DATE 2/12/18

SPONSOR SCORC LAST UPDATED _____ HB _____

SHORT TITLE Income Tax Deductions SB CS/CS/279/SCORCS/SCORCS

ANALYST Graeser/Clark

REVENUE (dollars in thousands)

Estimated Revenue*					Recurring or Nonrecurring	Fund Affected
FY18	FY19	FY20	FY21	FY22		
\$0	Approximately Neutral Compared with CREG Forecast, Possibly Significantly Negative Compared with Federal Law Changes	Minimal	\$0	\$0	Nonrecurring	General Fund

Parenthesis () indicate expenditure decreases

***Note: The “Approximately Neutral” scoring is in relation to the latest revenue forecast; however, if federal tax reform is believed likely to add revenue to the next iteration of the consensus revenue forecast in August, this bill would eliminate most of that revenue – possibly tens of millions of dollars**

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY18	FY19	FY20	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
Total	Unknown				Nonrecurring	Taxation and Revenue Department

Parenthesis () indicate expenditure decreases

Duplicates, Relates to, Conflicts with, Companion to: a number of bills adjust personal income tax rates and brackets.

SOURCES OF INFORMATION

- LFC Files
- TRD Files
- IRS Statistics of Income history

SUMMARY

Synopsis of Bill

The Senate Corporations and Transportation Committee Substitute for the Senate Corporations and Transportation Committee Substitute for Senate Bill 279 proposes two “hold harmless” provisions applicable only to the 2018 personal income tax year. The state personal income tax statute would be modified for one year and then return to current law. Rather than using the revised federal standard deduction and personal exemption amounts for TY 2018 for state purposes, the bill would substitute the values for TY 2017. However, the rules for itemizing deductions (including the state and local income tax, or SALT, deduction) would be those for TY 2018 and impacted by the federal tax reform changes.

The table below shows the changes made by federal tax reform.

	Current Law (2017)	New Law	Current Personal Exemption	New Personal Exemption
Single	\$6,350	\$12,000	\$4,150	\$0
MFJ	\$12,700	\$24,000		
MFS				
Head of Household	\$9,350	\$18,000		
Surviving Spouse				

There is no effective date of this bill. It is assumed that the effective date is 90 days after this session ends or May 16. The bill is self-repealing. TRD would implement changes to the withholding tables effective July 1, 2018. It is unknown if state wage withholding tables have been modified to accommodate the changes attributable to federal tax reform effective January 1, 2018.

FISCAL IMPLICATIONS

The consensus revenue estimating group did not include the impact of federal tax reform in the mid-session revenue update, because no complete, detailed analysis was available to estimate the impact on state tax revenues.

The three principal changes made by the federal tax reform that are applicable to New Mexico personal income tax revenues are to repeal the current personal exemption amounts, roughly double the standard deduction, and change the rules for itemizing deductions.

It is difficult to translate these federal tax impacts into state tax impacts. Preliminary LFC modeling indicates a likely positive impact to the general fund, but it is important to note this analysis is preliminary and does not represent an official estimate of the state tax revenue impact from federal tax reform. The analysis does not capture all of the possible impacts on individual taxpayer liabilities in the state, and limitations exist on data available even to TRD regarding some impacts.

The Institute for Taxation and Economic Policy (ITEP) estimated a \$44 million increase in New Mexico revenues. TRD statements early in the legislative session indicated the impacts could largely offset each other and the final impact may be revenue neutral, but additional analysis

recently led TRD to produce estimates in the same ballpark as the ITEP projection. More analysis is needed by economists and tax professionals, and it is possible (because of the data limitations) that the impact will continue to be uncertain for some time.

Because of these estimates but accompanying limitations, this bill may be revenue neutral when scored against the consensus revenue estimating group (CREG) mid-session update, but it may create a significant negative general fund impact if CREG were to include federal tax reform impacts to the August 2018 estimate. Given the recent ITEP and TRD estimates, this bill could prevent the state from receiving tens of millions of dollars it otherwise would get.

SIGNIFICANT ISSUES

This could cause minor to moderate filing burdens on some taxpayers because taxpayers would essentially need to compute federal income taxes twice – once for federal purposes and once for state purposes. However, for most people this will likely be a minor inconvenience, and hopefully electronic filing software systems would perform all these calculations in the background, creating no additional burden on users of those systems.

Decoupling from these federal tax reform changes for one year allows the state to have detailed discussions about how to move forward and how to deal with issues of winners and losers based on prior federal code and the new code. This bill would give the state another year to work on estimates of the state revenue impact from the federal changes and give policymakers another year to consider whether to decouple again from the federal standard deduction and personal exemptions or conform again to the federal code, possibly making additional changes to reduce any unwanted impacts on state revenues or taxpayers.

For the previous major federal tax reforms enacted in 1986 under President Reagan, the changes in personal exemption and standard deduction amounts were only a portion of the overall story. Many exemptions, deductions and credits were repealed. On balance, New Mexico gained far more from the repeal of deductions than it lost from the changes in personal exemption and standard deduction amounts. In what was perhaps an excess of caution, New Mexico decoupled from the feds for personal exemptions and standard deductions in favor of state-specific amounts. It was not until 1991 that the state recoupled to the federal scheme as part of the mini-tax reform occasioned by the *Burns v. Michigan* and *Davis v. New Mexico* lawsuits that forced the state to treat federal retirees equitably with state retirees. And with this fix, the state was able to recouple.

ADMINISTRATIVE IMPLICATIONS

TRD will have to change withholding tables in July whether this approach is adopted or not. The real efforts will be in designing the forms and implementing the IT changes for the changes created by the federal tax reform. Decoupling, as suggested in this bill, might be more difficult than continuing with the existing paradigm.

OTHER SUBSTANTIVE ISSUES

ITEP estimated the following approximate 2019 federal tax impact for New Mexico residents:

2019 Final Trump-GOP Tax Bill in				New Mexico	
Income Group	Income Range		Average Income	Total Tax Change (Thousands)	Avg. Tax Change
Poorest 20%		\$19,660	\$12,600	\$ -22,500	\$ -130
Second 20%	\$19,660 to	\$37,330	\$29,000	\$ -57,800	\$ -340
Middle 20%	\$37,330 to	\$58,460	\$46,600	\$ -129,800	\$ -750
Fourth 20%	\$58,460 to	\$96,480	\$74,400	\$ -260,500	\$ -1,450
Next 15%	\$96,480 to	\$183,770	\$130,100	\$ -332,700	\$ -2,470
Next 4%	\$183,770 to	\$419,590	\$253,300	\$ -268,400	\$ -7,390
Richest 1%	\$419,590 and	higher	\$1,212,700	\$ -347,700	\$ -38,440
ALL			\$75,100	\$ -1,419,300	\$ -1,610

There are a number of features of the federal tax reform package that may affect New Mexico’s personal income tax liabilities. The following is a partial list of potential impacts:

1. SALT (not changed by this bill): taxpayers may deduct state and local taxes up to \$10 thousand. May not deduct sales taxes. Homeowners who itemize their deductions can deduct the interest paid on up to \$1 million of their mortgage principal.
2. Bill allows pass-through business owners to deduct a portion of their business income. This is a tax calculation, not a true deduction, so it will not affect state liabilities.
3. Taxpayers with large medical deductions currently can deduct the cost of out-of-pocket medical expenses if the total cost exceeds 10 percent of the taxpayer’s AGI. The new law would lower the floor for deductible expenses to 7.5 percent of AGI, but only in 2018 and 2019. It reverts to 10 percent in 2020.
4. 50 percent AGI limit on cash contributions to public charities would be increased to 60 percent. Taxpayers cannot deduct any portion of purchase of college athletic tickets. The amount deductible for volunteer mileage would be adjusted for inflation from the current \$0.14/mile.
5. Sets a limitation on charitable contributions for very high income taxpayers.
6. Sec 5002: research must have findings publicly available to remain exempt from UBIT.
7. Change in child tax credit. Currently \$1,000 per child, but aggregate amount is phased out as AGI increases. The child tax credit is refundable equal to 15 percent of earned income over \$3,000. Proposal to increase to \$1,600 and a new \$300 for non-child dependents. \$300 “family flexibility” credit for individual that isn’t a child or dependent. Credits will be phased out based on income thresholds, but marriage penalty eliminated. This has no effect on New Mexico liability.