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FISCAL IMPACT REPORT

SPONSOR Garcia, MP **ORIGINAL DATE** 2/09/19 **LAST UPDATED** 2/13/19 **HB** 365

SHORT TITLE Personal Income Tax Modifications **SB**

ANALYST Graeser

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY19	FY20	FY21	FY22	FY23		
0.0	122,000.0	240,000.0	247,000.0	254,000.0	Recurring	General Fund PIT (Rates & Brackets)
		(29,000.0) or less	(29,000.0) or less)	(29,000.0) or less	Recurring	General Fund (PIT – LICTR)
	122,000.0	211,000.0 or more	218,000.0 or more	225,000.0 or more	Recurring	Net 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 365 modifies all of the existing personal income tax (PIT) brackets and rates, changing the rates and adding several new upper tiers. The bill also increases the amount of the low-income comprehensive tax rebate (LICTR) and increases eligibility for the rebate. Under current law, residents with incomes up to $22,000 may claim the rebate, and the bill would raise that maximum income to $34,060. Under current law, the maximum rebate size is $450, but the bill would increase the maximum rebate size to $697.

The effective date of the provisions of this bill is January 1, 2020. The rates and bracket changes and LICTR changes are effective for the 2020 taxable years. With this combination of effective date and applicability date, TRD will update the wage and salary withholding tables effective January 1, 2020.

FISCAL IMPLICATIONS

Note: LFC staff and TRD staff estimates of the fiscal effect of this bill differ slightly. The LFC model assumes TRD would publish withholding tables with the GRT instructions distributed in December 2019, anticipating the effective date of January 1, 2020. Thus, taxpayers subject to the Oil and Gas Withholding Act and individuals with wage and salary income would make payments at the new rates for the six month period of FY2020. The TRD model does not make this assumption. The LFC staff model for the LICTR changes forecasts almost the same fiscal impact as does the TRD model. However, neither the LFC staff model nor the TRD model use actual LICTR cell occupancy data obtained from the GenTax system.

LFC Staff Models for Revenue Impacts (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY19	FY20	FY21	FY22	FY23		
0.0	122,500	265,600.0	273,600.0	281,800.0	Recurring	General Fund PIT (Rates & Brackets)
		(29,400.0)	(28,800.0)	(28,200.0)	Recurring	General Fund (PIT – LICTR)
	122,5000	236,200.0	244,800.0	250,600.0	Recurring	Net General Fund

TRD Staff Models for Revenue Impacts (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY19	FY20	FY21	FY22	FY23		
0.0	0.0	240,192.0	247,398.0	254,820.0	Recurring	General Fund PIT (Rates & Brackets)
	0.0	$(29,000)	$(29,000)	$(29,000)	Recurring	General Fund (PIT – LICTR)
	0.0	211,192	218,398.0	225,820.0	Recurring	Net General Fund

For the purpose of the rate and bracket portion of this FIR, the TRD model, with a small adjustment has been used (assuming that TRD would publish updated withholding tables for wage income and instructions for taxpayers subject to Oil and Gas Withholding effective January 1, 2020 and the increase would provide about 6 months of collections at the higher rate. For the purpose of the LICTR portion of the impact, the TRD estimate is shown with the note, "impact is xxxx or less" with the net effect reported as "or more". Both LFC staff and TRD will continue to refine these LICTR estimates.

Further details are presented in the portion of this review entitled "Methodology Appendix".

This bill creates or expands a tax expenditure (LICTR) with a cost that is difficult to determine. This bill may be counter to the LFC tax policy principle of adequacy, efficiency, and equity. LFC has serious concerns about the significant risk to state revenues from tax expenditures and the increase in revenue volatility from erosion of the revenue base. Due to the increasing cost of tax expenditures, revenues may be insufficient to cover growing recurring appropriations. The committee recommends the bill adhere to the LFC tax expenditure policy principles for vetting, targeting, and reporting or be held for future consideration.

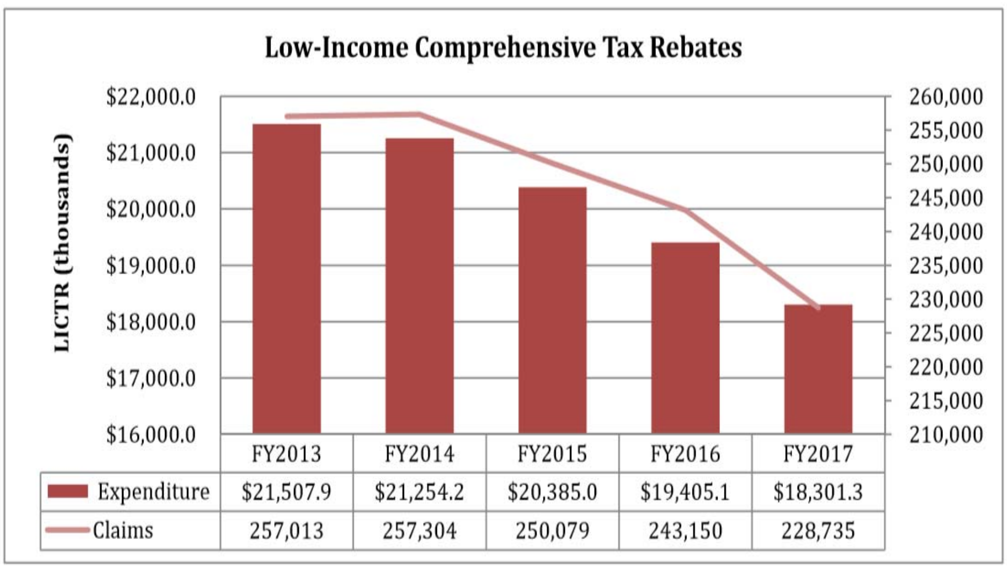
SIGNIFICANT ISSUES

TRD notes the following policy issues:

> "This legislation's personal income tax rate and bracket changes implicate the tax policy principle of equity. The legislation implicates vertical equity by increasing the tax burden on tax filers with higher incomes. The legislation implicates horizontal equity in a disparate manner by charging different tax rates for similarly situated taxpayers, vis-à-vis income brackets, but for varying filing status. Each filing status has a unique set of income brackets and tax rates."

The provisions of this bill effectively restore income elasticity to the personal income tax. Currently, a 10 percent increase in personal income in the state results in approximately a 10 percent increase in income tax collections. This is partially the result of the essentially flat rate bracket structure, with the top rate of 4.9 percent effective at a taxable income of $24,000 for married joint filing taxpayers and partially the effect of numerous tax expenditures that bear little or no relationship to income. The income elasticity effect of this bill would probably bring the overall system to a 1.25 income elasticity: that is, a 10 percent increase in income would result in a 12.5 percent increase in personal income tax collections.

The 2017 Taxation and Revenue Department Tax Expenditure Report details the following:



The LICTR increase looks at CPI inflation in the decades since 1998, when the LICTR table was last revised. CPI inflation has increase by 55 percent. The increases for each cell of the LICTR table have been increased by the 55 percent. The bill also proposes to increase the maximum Modified Gross Income to qualify for a rebate from $22,000 to $34,000. LFC staff expects this may increase the number of returns filed claiming the rebate from 228,700 to 355,000. TRD expects the number of claims to increase to 362,000.

PERFORMANCE IMPLICATIONS

The LFC tax policy of accountability may be met. For the past four years, TRD has published a Tax Expenditure Report. This report details the costs and coverage of a number of tax expenditures, including LICTR. This report is available to the public, as well as interim legislative committees.

ADMINISTRATIVE IMPLICATIONS

TRD indicates that these changes can be accomplished in the regular course of maintenance prior to the TY2020 personal income tax processing cycle. This assumes that the effective date/applicability date issue is resolved in favor of a fixed applicability date.

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

HB-6 proposes a restructuring of rates and brackets for personal income tax and a return to a maximum of $1,000 deduction for capital gains.
HB-335 proposes a top marginal rate of 5.9 percent
HB-18 proposes a child income tax credit based on Adjusted Gross Income.
SB-98 proposes a new 8.2 percent higher income tax bracket.
SB-300 proposes a new dependent deduction.
HB-365 proposes a top marginal rate of 7.9 percent, an increase to 9 brackets for each filing status and an increase in the low income comprehensive tax rebate.

TECHNICAL ISSUES

In past years, the relationship between the three filing status rates and brackets was as follows:

- For whatever brackets were adopted, the marginal rates for the first, second, third, etc. brackets were always the same;
- The single brackets were about 2/3rd of the married joint bracket amounts;
- The married separate brackets were ½ the married joint bracket amounts;
- The head-of-household brackets were the same as the married joint bracket amounts.

This bill establishes different rates for the different brackets by status. LFC staff advise that this makes the changes less transparent and the sponsor could consider conforming to historical practice.

This bill does not contain a delayed repeal date. LFC recommends adding a delayed repeal date so that the legislature can periodically review whether the possible damage to the state's economy are moderate or severe and that the higher income tax rate is serving a valid purpose, with minimal amounts of inaccuracy.

METHODOLOGY APPENDIX:

LFC PIT Model

The fiscal impact of this bill was determined using the new LFC PIT model. This model uses TY15 data compiled by TRD and divides this data in percentiles of taxpayers in 20 classes. These are:

- Single, Single EZ, Married Joint, Married Joint EZ, Married Separate and Head of Household all New Mexico resident non-itemizers
- Single, Married Joint, Married Separate and Head of Household all New Mexico resident itemizers
- Single, Single EZ, Married Joint, Married Joint EZ, Married Separate and Head of Household all non-New Mexico resident (Schedule B) non-itemizers

- Single, Married Joint, Married Separate and Head of Household non-New Mexico resident (Schedule B) itemizers

The model captures most of the line items included on the PIT-1, PIT-RC and Schedule B. The model has been updated for an assumed (but perhaps partial) estimate of the effects of the Tax Change and Jobs Act (TCJA) that will affect federal and state liabilities for the soon-to-be-filed 2018 tax year.

Once the fiscal effects in percentage terms for changes based on total tax year liabilities, these changes are applied to the fiscal year liabilities using an assumed breakdown among the typically three fiscal years involved in collections of any particular tax year liabilities.

The model also calculates a matrix of average costs or savings of individual taxpayers based on 10 percent cuts of Adjusted Gross Income (AGI). The following chart is an exhibit of the FY 15 base effects of the new rate structure. The model exhibits averages over a large number of taxpayers.

The LFC model does not include any behavioral change such as high income taxpayers leaving the state and relocating to Texas which has no personal income tax or fewer high-income retirees choosing New Mexico for their retirement location. The model does, however, calculate the relative impact on state residents and non-residents as shown in the following table.

	Fiscal Impact	TP's Affected	Average Impact
FY20 Impact	$247,500.0		
Resident Filers	$168,900.0	647,619	$260.80
Sch B Filers	$78,600.0	98,449	$798.38

Residents Only\AGI	0-10%	10%-20%	20% to 30%	30% to 40%	40% to 50%	50% to 60%	60% to 70%	70% to 80%	80% to 90%	90% to100%
Effect of Changes										
Single - AGI -- Base amt	$12,228	$19,187	$23,228	$27,229	$31,470	$36,377	$42,344	$50,264	$62,573	$113,333
- Tax	$0	$0	$0	$1	$10	$23	$42	$73	$149	$915
# Single TPs affected	0	0	0	3,110	6,212	6,210	6,210	6,210	14,995	27,911
MFJ - AGI - base amt	$40,069	$55,054	$65,270	$74,955	$84,896	$95,870	$108,971	$126,025	$153,166	$291,028
- Tax	-$30	-$44	-$31	$1	$38	$97	$193	$402	$808	$3,874
# MFJ TPs affected	18,558	21,017	21,280	21,280	21,280	21,272	21,270	21,270	21,270	21,270
MFS - AGI - base amt	$16,930	$26,019	$31,543	$36,591	$41,980	$47,800	$54,424	$63,998	$78,026	$166,340
- Tax	-$16	-$47	-$72	-$75	-$63	-$43	-$19	$52	$189	$1,943
# MFS TPs affected	262	660	660	660	660	660	660	651	640	640
HH - AGI -- base amt	$24,647	$30,022	$33,785	$37,197	$40,894	$45,153	$50,155	$57,321	$69,315	$115,491
- Tax	-$12	-$30	-$41	-$50	-$60	-$72	-$86	-$86	-$60	$419
# HH TPs affected	5,124	6,690	6,690	6,690	6,690	6,690	6,682	6,680	6,671	6,670

LFC LICTR Model

The LFC LICTR is still in the draft stage, since it does not conform to the total number of returns claiming the LICTR rebates. However, the model does conform to the dollar amount of LICTR claimed. The model is constructed from the American Community Survey 5-year estimates for household and individual income, status of households (married couple family, single-parent households, non-households with persons living alone or with others) and household income by number of persons in each household and with the householder 65 or older and under 65. There were a total of 187,558 households with ACS income <$22,000 which is the current limit of the LICTR table. In a subsequent round of development, the 2001 LICTR table was used to determine the relative occupation of household size by income of each bracket. The 2001 table was heavily weighted by single claimants – particularly at the lower end of the income range. The 2001 LICTR populations were increased by 17 percent and the bracket levels were increased by 38 percent to account for the growth of SSI income from 2000 to 2017. Even with these modifications, however, the fiscal impact was no greater than that of the simpler model. LFC staff will continue to refine this work. Subsequent development of this model will focus on refining the model to account for the additional exemptions allowed for each person over 65 years of age or blind.

TRD Methodology for Estimated Revenue Impact:

The Taxation and Revenue Department used GenTax taxpayer data to calculate the fiscal impact. For the PIT rate changes, the new schema was applied to historical data; the difference between the 5-year averages was calculated, and consensus revenue estimating group (CREG) growth rates applied to the out years.

For LICTR, the new schema was applied to historical data. However, New Mexico modified gross income is a unique calculation that includes revenue sources not taxed at the federal level. Thus, the TRD used federal adjusted gross income; this will overestimate the number of recipients, as adjusted gross income will only include revenue sources taxable at the federal level. In calculating the LICTR impact, the difference between the 5-year averages of current and proposed law was estimated, and CREG growth rates were applied to the out years.

By expanding the eligibility for and size of the LICTR, the bill provides additional personal income tax relief to residents with incomes under $34,060. The LICTR changes expand the program from an average of 293,000 recipients to approximately 589,000 recipients; the total size of the tax rebate increases over six-fold.

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