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FISCAL IMPACT REPORT

ORIGINAL DATE 1/24/19

SPONSOR O'Neill LAST UPDATED _____ HB _____

SHORT TITLE Additional Upper-Tier Income Tax Brackets SB 98

ANALYST _____

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY19	FY20	FY21	FY22	FY23		
\$0.0	\$48,620.0	\$92,310.0	\$95,080.0	\$97,930.0	Recurring	General Fund (PIT)

Parenthesis () indicate revenue decreases

TRD indicates that these changes can be implemented in the regular course of maintenance prior to the TY2020 personal income tax processing cycle.

SOURCES OF INFORMATION

LFC Files

Responses Received From

Taxation and Revenue Department (TRD)

SUMMARY

Synopsis of Bill

Senate Bill 98 proposes a new upper-tier personal income tax bracket at 8.2 percent. This bracket would be set at \$350,000 for taxpayers filing as married joint and for heads of household, \$175,000 for married filing separately and \$250,000 for singles.

The effective date of the provisions of this bill is January 1, 2020. There is no applicability date, as is usual with personal income tax bills. See Fiscal Implications for further discussion.

FISCAL IMPLICATIONS

The fiscal impact of this bill was determined using the new LFC PIT model. This model uses TY16 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 20 percent cuts of Adjusted Gross Income (AGI). The following chart is an exhibit of the FY 16 base effects of the new rate structure. The model exhibits averages over a large number of taxpayers.

Residents Only\AGI	0-20%	20% to 40%	40% to 60%	60% to 80%	80% to 100%
Base Tax TY16					
Single - AGI	\$15,707	\$25,229	\$33,923	\$46,304	\$87,953
- Tax	\$76	\$314	\$671	\$1,295	\$3,086
MFJ - AGI	\$47,560	\$70,113	\$90,382	\$117,498	\$222,097
- Tax	\$650	\$1,739	\$2,720	\$3,999	\$8,568
HH - AGI	\$27,335	\$35,491	\$43,023	\$53,738	\$92,401
- Tax	-\$42	\$231	\$605	\$1,217	\$3,067
New Liability w/ Changes					
Single - AGI	\$15,707	\$25,229	\$33,923	\$46,304	\$87,953
- Tax	\$76	\$314	\$671	\$1,295	\$3,274
MFJ - AGI	\$47,560	\$70,113	\$90,382	\$117,498	\$222,097
- Tax	\$650	\$1,739	\$2,720	\$3,999	\$9,384
HH - AGI	\$27,335	\$35,491	\$43,023	\$53,738	\$92,401
- Tax	-\$42	\$231	\$605	\$1,217	\$3,120
Effect of Changes					
Single - AGI	\$0	\$0	\$0	\$0	\$0
- Tax	\$0	\$0	\$0	\$0	\$187
# Single TPs affected	0	0	0	0	1,863
MFJ - AGI	\$0	\$0	\$0	\$0	\$0
- Tax	\$0	\$0	\$0	\$0	\$816
# MFJ TPs affected	0	0	0	0	2,742
HH - AGI	\$0	\$0	\$0	\$0	\$0
- Tax	\$0	\$0	\$0	\$0	\$53
# HH TPs affected	0	0	0	0	146

TRD analyzed the bill using a different methodology that involved doing an SQL query on the current database, then using PIT growth rates from the December consensus estimate. TRD’s estimate is shown below. Note that TRD, unlike LFC staff, does not expect any FY20 impact, and the estimate of FY21 et seq is about 20 percent greater than the LFC model expects.

Estimated Revenue Impact*					R or NR **	Fund(s) Affected
FY2019	FY2020	FY2021	FY2022	FY2023		
\$0	\$0	\$115,370	\$118,831	\$122,396	R	General Fund

Neither model expects any behavioral change such as high income taxpayers leaving the state to Texas which has no personal income tax or fewer high-income retirees choosing New Mexico for their retirement location. The burden of this tax is split about equally between New Mexico residents and out-of-state residents. As shown in the LFC model impact table above, about 4,800 resident taxpayers bear the burden of \$46,000,000 in additional taxes, or almost \$10,000 in additional burden per taxpayer. The magnitude of this additional burden on very few taxpayers can be expected to trigger significant behavioral responses. This possibility is the reason that the Revenue table on page 1 shows the more conservative estimate of revenue gains.

Both models made different assumptions about the impact of using an effective date of January 1, 2020, rather than an applicability date similar to: “The provisions of this bill are applicable to taxable years beginning January 1, 2020.” The TRD model considers that the two concepts are the same; TRD would publish withholding tables in July, 2020 and there would be no fiscal impact during FY20. The LFC model acknowledges two points: (1) 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; (2) with an effective date rather than an applicability date, delinquent (late filed) returns from all prior years and amended returns might be subject to the new top rate.

SIGNIFICANT ISSUES

This bill may be counter to the LFC tax policy principle of equity. While generating substantial additional revenue, the principle of vertical equity seems to be violated by imposing a substantial additional burden on fewer than 3% of resident taxpayers.

PERFORMANCE IMPLICATIONS

The LFC tax policy of accountability is not met with the bill’s requirement to report annually to an interim legislative committee regarding the data compiled from the reports from taxpayers affected by the new rate structure.

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 an fixed applicability date.

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

HB-18 proposes a child income tax credit based on Adjusted Gross Income.

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.

SB-98 proposes a new 8.2 percent higher income tax bracket.

SB-300 proposes a new dependent deduction.

TECHNICAL ISSUES

The use of an effective date rather than an applicability date for an income tax is unusual. Since this has not happened previously, the intended and unintended consequences are somewhat speculative. LFC staff advise that the effective date should be replaced with an applicability date.

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.

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

In general, the provisions of this bill improve adequacy, but degrade equity, efficiency and simplicity.

LG/gb/al