Fiscal impact reports (FIRs) are prepared by the Legislative Finance Committee (LFC) for standing finance committees of the NM Legislature. The LFC does not assume responsibility for the accuracy of these reports if they are used for other purposes.

Current FIRs (in HTML & Adobe PDF formats) are available on the NM Legislative Website (www.nmlegis.gov). Adobe PDF versions include all attachments, whereas HTML versions may not. Previously issued FIRs and attachments may be obtained from the LFC in Suite 101 of the State Capitol Building North.

FISCAL IMPACT REPORT

SPONSOR Schmedes **ORIGINAL DATE** 02/08/21 **LAST UPDATED** **HB**

SHORT TITLE Withholding Wages For Taxes **SB** 161

ANALYST Graeser

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY21	FY22	FY23	FY24	FY25		
	See narrative				Recurring	General Fund – increased PIT delinquencies
	See narrative				Recurring	General Fund – Interest on Treasurer's Balances

Parenthesis ( ) indicate revenue decreases

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY21	FY22	FY23	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
Total		$5.2		$5.2	Nonrecurring	TRD-Information Technology Division
					Recurring	TRD collection function?

Parenthesis ( ) indicate expenditure decreases

SOURCES OF INFORMATION
LFC Files

Responses Received From
Taxation and Revenue Department (TRD)

SUMMARY

Synopsis of Bill

Senate Bill 161 amends the personal Income Tax Withholding Act to provide that if an employer has 50 or fewer employees, the employer may elect not to withhold an amount for state income tax purposes from those employee's wages. An employer that makes this election shall notify the department, on a form and in a manner prescribed by the Taxation and Revenue Department (TRD) and shall provide a copy of the notification to each employee.

There is no effective date of this bill. It is assumed 90 days following adjournment (June 18, 2021). Applicable to taxable years beginning on or after January 1, 2022. Note: this would be a permanent adjustment to the Withholding Act.

FISCAL IMPLICATIONS

TRD discusses the methodology for estimated revenue impact:

> The proposed legislation provides employers with 50 or fewer employees an option to not withhold wages on behalf of their employees for state personal income taxes. The legislation does not change the employees' or employers' tax liability. It simply shifts the burden of payment to the employees. This burden shifting, however, complicates tax collection and payment. See Technical Issues and Other Issues sections below for details.
>
> Because this bill would delay receipt of PIT into the general fund, it would cause the State Treasurer's general fund investment pool balances to be lower for certain periods within each fiscal year. Whereas employers remit withholding to TRD monthly, employees would remit estimated payments quarterly or with their final returns in April. Lower STO cash balances would result in a decrease in general fund investment earnings from State Treasurer's balances. TRD would defer to the State Treasurer's Office (STO) and the Department of Finance and Administration to estimate reduced general fund revenue associated with STO earnings.

LFC notes that personal income tax delinquencies would increase dramatically. In the only U.S. data point available, the IRS, fully or partially cancelled the 1942 tax year obligations[1]. This was necessary to accomplish the Federal Income Tax Withholding Act. The Current Tax Payment Act was signed into law on June 9, 1943. There may be analogs of this data in other countries, where the withholding is frequently known as "Pay as You Earn." Most wage-earning Americans routinely over-withhold and use the withholding system as a forced savings account. As a result of the Tax Cuts and Jobs Act (December 2017), starting in 2018, most wage earners got larger paychecks because the withholding tables were adjusted more than necessary. The result is that these taxpayers' refunds were substantially lower than they had previously received. If state taxpayers are in a situation of having no withholding, then there will likely be an increase in delinquencies. Taxpayers could estimate taxes quarterly, declare the full amount in April and borrow the money to pay (including penalty and interest). Some taxpayers might be able to pay their state obligation using some or all their federal refund.

SIGNIFICANT ISSUES

TRD notes the following significant features of this proposal:

> If enacted, the provisions of this bill would complicate the administration of the Tax Code and the Tax Administration Act, by reducing tax compliance burden on small employers but adding additional compliance burden on their employees. One goal of tax policy should be the simplification of taxation and tax administration for the greatest number of

---

[1] https://fee.org/articles/wartime-origins-of-modern-income-tax-withholding/#:~:text=Precedents%20for%20withholding%20U.S.%20taxes,exempted%20federal%20salaries%20from%20taxation.&text=Beginning%20in%201940%2C%20however%2C%20the%20tax%20burden%20increased%20enormously.

taxpayers. Whereas current law requires an employer to remit withholding monthly, the proposal would lead anywhere from 1 to 49 employees per employer who elects this option to individually remit estimated payments quarterly or with or after final returns are filed by April each year. Another goal of tax policy should be to place the burden of tax compliance on those best able to bear it. This bill goes against both these principles.

Withholding payments are submitted by an employer to approximate an employee's personal income tax liability. Then, when the employee files their tax return (typically by April 15 of each year), the employee either owes additional tax and makes a payment or is owed a refund and receives the refund from TRD. This bill would result in more workers owing a significant amount of tax at the time they file their return, whereas under current law an amount roughly equal to a worker's tax liability is paid smoothly over each pay period. This may cause financial hardship for workers who are not anticipating owing a large amount when they file their return. Those workers could borrow money to pay their taxes or could incur penalty and interest from TRD.

Withholdings are intended to make tax collection and payments easier – the employees file nothing except an annual return with a W-2 and either claim a refund or pay the tax owed once. If the employer elects to not withhold on behalf of the employees, now each of the employees must file quarterly estimated payments. However, the proposed legislation is only applicable to withholdings for state income taxes. The employers are still required to withhold for federal income taxes. This introduces a second means of collection and only complicates the collection process unnecessarily. Employees must be informed of their continued obligation to pay estimated taxes to avoid penalties and interest; even with the employer providing such information, the potential for confusion exists, and employees may fail to pay required estimated taxes, resulting in penalties and interest.

If the intent of the bill is to provide a higher take home pay for the employees of small employers, it must be noted that the proposed legislation does not change the employee's tax liability or their disposable income. It simply changes the frequency at which the employee makes the tax payment from monthly to quarterly or even annually (or never) and shifts the burden of remitting tax from the employer to the employee.

The bill only applies to state income taxes and cannot relieve employers from their duty to withhold federal taxes, including federal income taxes, Social Security Insurance taxes, and Medicare taxes. Because such taxes form the bulk of taxes withheld from employees' paychecks, and state income tax rates are low for most taxpayers, the amount of additional income temporarily retained by employees will be low or minimal for a large proportion of taxpayers. Furthermore, because employers must still withhold federal taxes, allowing employers not to withhold other taxes may complicate the withholding process, and lead to confusion and error in withholdings.

LFC notes that the withholding for personal income makes that tax largely non-transparent. When small amounts are deducted from periodic paychecks, it doesn't seem to hurt as much as when the entire amount is due in April or even in quarterly installments.

PERFORMANCE IMPLICATIONS

The LFC tax policy of accountability is possibly met with the bill's requirement for employers to report to TRD the taxpayer's intention to cease collecting withholding. TRD is not required to report annually to an interim legislative committee regarding the data compiled from the reports from taxpayers taking advantage of the provision and whether the deduction is meeting its unstated purpose.

ADMINISTRATIVE IMPLICATIONS

TRD will need to make information system changes and create new publications, forms and regulations. These changes will be incorporated into annual tax year implementation and represents $5,164 in workload costs. It is expected that there will be an increase in delinquencies and the collection function of TRD will need to be expanded.

TECHNICAL ISSUES

TRD points out some technical issues with the provisions of this bill:

> The proposed legislation requires the eligible employers that elect to not withhold on behalf of their employees, to notify TRD and their employees of the election. The bill, however, is silent on the frequency of such notification.
>
> Further, if an eligible employer elects to not withhold wages for their employees, they should be required to not only notify the employees of the fact but also that the employees are now responsible for quarterly estimated payments to TRD per Section 7-2-12.2(A) NMSA 1978. The employer must also notify the employees that if they fail to make the estimated payments, they will be subject to penalty and interest. In the absence of such notification, compliance and tax collection may suffer.

This bill does not contain a delayed repeal date. LFC recommends adding a delayed repeal date.

OTHER SUBSTANTIVE ISSUES

https://fee.org/articles/wartime-origins-of-modern-income-tax-withholding/#:~:text=Precedents%20for%20withholding%20U.S.%20taxes,exempted%20federal%20salaries%20from%20taxation.&text=Beginning%20in%201940%2C%20however%2C%20the%20tax%20burden%20increased%20enormously.

An extract…

> Before World War II individuals who owed federal tax on their income earned in a particular year paid the tax during the following year in quarterly installments. In those days relatively few people paid income taxes. As late as 1939 fewer than four million individual returns were filed, and the filers' total tax bill came to less than $1 billion, or less than 4 percent of their net taxable income. When so few people paid income tax and the amounts due in most cases were so small, the system of deferred payment imposed no great burden and gave rise to few taxpayer complaints.
>
> Beginning in 1940, however, the tax burden increased enormously. As the government began to mobilize for participation in a gigantic global war, its revenue demands grew apace. Federal spending burgeoned from $9 billion in fiscal year 1940 to more than $98 billion in

fiscal year 1945. Although the greater part of this spending upsurge was financed by borrowing, huge increases in tax collections also took place. In 1945, 50 million individual income-tax returns were filed, and the filers owed more than $19 billion, or almost 20 times the amount that Americans had coughed up for this tax just five years earlier.

Milton Friedman was an economist at the Treasury during the early part of the war. In his 1998 memoirs, Two Lucky People, written with his wife Rose, he observed: "It was clear to all of us at the Treasury, as we set out to multiply the amount of revenue to be collected from the personal income tax, that it would be impossible to do so unless we could develop a system to collect the taxes as the income was earned, not a year later."

The main problem connected with switching to a "pay-as-you-go" system was that when the switch was made, the taxpayers would have to pay two years' taxes in a single year—the amount due under the old system on the previous year's earnings and the amount due under the new system on the current year's earnings. Apart from the vociferous complaints such double-taxation was sure to produce, many people would simply be unable to make all the payments, especially when tax obligations were being increased drastically.

The transition problem sparked a great deal of debate in the government and among the public. Perhaps the leading proposal in 1942 came from Beardsley Ruml, the treasurer of R. H. Macy & Co., who was also the chairman of the Federal Reserve Bank of New York. Ruml proposed to "forgive" the previous year's tax liability completely when the switch to the pay-as-you-go system was made. The Treasury objected to allowing such a great amount of "forgiveness" and proposed an alternative, less-forgiving design.

After more than a year of wrangling in the bureaucracy and in Congress, the Current Tax Payment Act was signed into law on June 9, 1943. It provided for a complicated partial-forgiveness transition. As Friedman described it, the law basically "canceled . . . one year's tax obligations of $50 or less and 75 percent of the required tax on the lower of 1942 or 1943 income, requiring the remaining 25 percent to be paid in two equal annual installments." After the system became fully operational, employers withheld almost $8 billion for income taxes in 1944 and more than $10 billion in 1945.

LG/sb/rl