F I S C A L   I M P A C T   R E P O R T

SPONSOR M. Garcia

ORIGINAL DATE 1/23/16
LAST UPDATED

HB 126

SHORT TITLE Reduce Certain Income Tax Rates

SB

ANALYST Graeser

REVENUE (dollars in thousands)

Estimated Revenue				Recurring or Nonrecurring	Fund Affected
FY17	**FY18**	**FY19**	**FY20**		
$20,050	$20,890	$21,920	$23,070	Recurring	General Fund

Parenthesis ( ) indicate revenue decreases

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY16	FY17	FY18	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
Total	14	0	0	0	Recurring	General Fund/TRD Operating

Parenthesis ( ) indicate expenditure decreases

SOURCES OF INFORMATION
LFC Files

Responses Received From
Taxation and Revenue Department (TRD)

SUMMARY

Synopsis of Bill

HB-126 reduces the personal income tax rates for of the four existing brackets. It also adds two new brackets and higher tax rates, 6% and 7.1%, respectively, for two tiers of higher income earners as follow:

- For married individuals filing separately who have taxable income over $125,000 but not over $250,000 the rate is 6% , and for those over $250,000; 7.1%.
- For heads of household, surviving spouses and married individuals filing joint returns with taxable income over $250,000 but not over $500,000, and for those over $500,000; and

- For single individuals or estates and trusts with taxable income over $175,000 but not over $350,000, and for those over $350,000.

The effective date of this bill is 1/1/2017, (section) 2; however, section 1 provides for tax rate changes on 1/1/16. The fiscal analysis assures the bill changes withholding estimated payments and final settlements in FY 17. There is no sunset date. TRD recommends that the effective date of the bill be as soon as possible after signing so that the withholding tables could be adjusted. In any event, the July 2016 CRS withholding information packets can be changed to reflect the rate changes, but only if the effective date of the bill is changed.

FISCAL IMPLICATIONS

TRD used tax year 2012 data to estimate the impact. Personal income growth rates obtained from the General Fund Consensus revenue estimates (December 2015) were applied to estimate the impact. TRD applied the current rates to calculate the estimated taxes and then the proposed changes to obtain equivalent taxes. The difference between the proposed changes and the current law represents the revenue that will be generated if the proposed law is implemented and high wage earners remain in New Mexico. Integral to the fiscal impact estimates is the assumption that high wage earners do not migrate out of New Mexico. If high wage earners leave New Mexico, then the revenue potential is much lower.

To account for revenue flows from on-time filers and late/amended return filers as well as the time differential between tax year and fiscal year, the total revenues are divided 40% on-time and 60% delayed. Thus, the first year impact represents a partial year collection on a fiscal year basis.

LFC staff notes that this bill would partially restore the PIT rate cuts enacted in 2003 under Governor Richardson. Although not appreciated at the time, condensing the brackets and reducing the top rates caused a perhaps unexpected effect of reducing the progressive nature of the personal income tax. Prior to 2003, a 10% increase in personal income in the state resulted in a 13.4% increase in personal income tax. At present, a 10% increase in personal income results in a proportional 10% increase in personal income tax. Although the state has not conducted a formal tax burden study since the late 1980s, other studies have concluded that the state's reliance on the regressive gross receipts tax and removing an important progressive element of the state's tax structure in the 2003 changes to PIT made the state's tax structure more regressive overall.

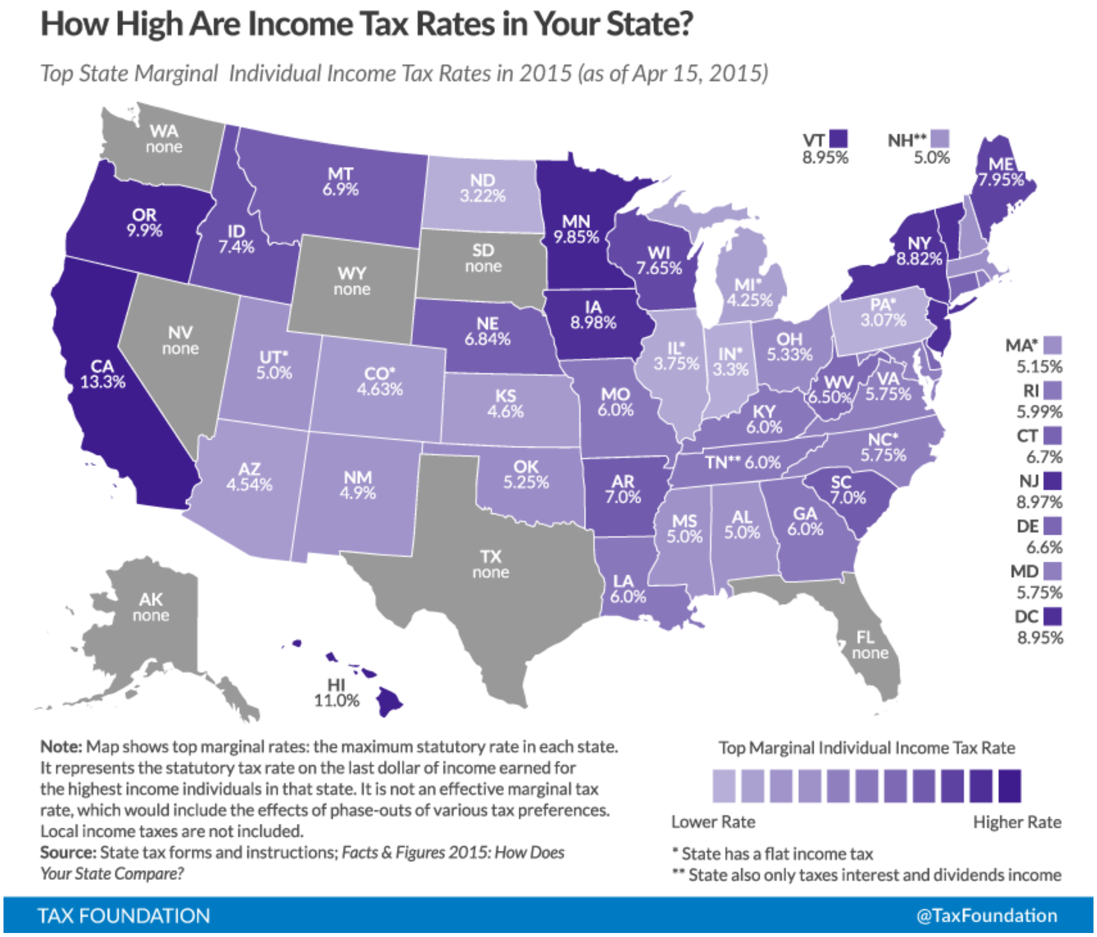
SIGNIFICANT ISSUES

According to TRD, this bill creates significant disincentives for higher wage earners, and it moves New Mexico from the bottom quartile (least expensive) to the top quartile (most expensive) in terms of PIT rates for high wage earners. A graphic of 2015 Income Tax Rates for the entire US, including the District of Columbia, is provided below. (www.taxfoundation.org)

To illustrate the impact of the proposed changes the following information is provided:

	Bracket	Old	New	Change
Married filing separate	Under 4K	1.70%	1.40%	-21.43%
	4K-8K	3.20%	2.90%	-10.34%
	8K-12K	4.70%	4.40%	-6.82%
	12K-125K	4.90%	4.60%	-6.52%
	125K-250K	4.90%	6.00%	18.33%
	250+K	4.90%	7.10%	30.99%
Married filing Jointly	Under 8K	1.70%	1.40%	-21.43%
	8K-16K	3.20%	2.90%	-10.34%
	16K-24K	4.70%	4.40%	-6.82%
	24K-250K	4.90%	4.60%	-6.52%
	250K-500K	4.90%	6.00%	18.33%
	500K +	4.90%	7.10%	30.99%
Single & Estates & Trusts	Under 5.5K	1.70%	1.40%	-21.43%
	5.5K-11K	3.20%	2.90%	-10.34%
	11K-6K	4.70%	4.40%	-6.82%
	16K-175K	4.90%	4.60%	-6.52%
	175K-350K	4.90%	6.00%	18.33%
	350K+	4.90%	7.10%	30.99%

As illustrated in the above table, this bill imposes tax rate increases of 18% and 31% to high wage earners and lowers tax rates as much as 21% for lower wage earners.



PERFORMANCE IMPLICATIONS

As noted above, this bill would change the relative tax burden by income class and would probably make the overall tax structure less regressive and more proportional.

TRD notes that a change of this magnitude may trigger some taxpayer behavioral response:

> **Policy Issues:** The bill implicates principles of revenue adequacy and vertical equity. It lowers the income tax rates for those earning incomes below $125,000 (filing single) or $250,000 (filing jointly), while raising the rates for those with incomes above those levels. The proposed bill has the potential to dissuade higher income earners from relocating to New Mexico or accepting employment in New Mexico due to the higher income tax rate. Further, the significant tax rate increase may incentivize emigration of high wage earners. There may also be some marginal increase in taxpayer activity to take advantage of certain tax credits or deductions at income levels above the $125,000 break-point.

ADMINISTRATIVE IMPLICATIONS:

Minimal IT Impact: Changes to GenTax tax rates and other minor re-configurations will be necessary for the PIT program.

High Administrative & Compliance Impact: Due to the conflict between the effective date for the rates and the effective date of the statute, the ability to apply a retroactive tax rate must be addressed. Numerous tax tables must be updated immediately upon passage and disseminated to facilitate taxpayer compliance.

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

HB-146 proposes an exemption from personal income tax for social security benefits.

TECHNICAL ISSUES:

TRD recommends a standard effective date with an applicability provisions to tax years beginning from and after January 1, 2016. As drafted, the new rates do not become effective until January 1, 2017. However, income tax withholding and estimated payments are made during the course of tax year 2016 and the correct rates for the tax year to payments or withholding made during the tax year.

LG/al/jle