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## FISCAL IMPACT REPORT

ORIGINAL DATE 1/30/17

SPONSOR Little LAST UPDATED 2/11/17 HB 169

SHORT TITLE Income Tax Deductions SB \_\_\_\_\_

ANALYST Graeser

### REVENUE (dollars in thousands)

Estimated Revenue					R or NR **	Fund Affected
FY17	FY18	FY19	FY20	FY21		
	(33,200.0)	(33,500.0)	(34,100.0)	(34,800.0)	Recurring	General Fund

Parenthesis ( ) indicate revenue decreases. \*\* R = recurring; NR = non-recurring

### ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY17	FY18	FY19	3 Year Total Cost	R or NR **	Fund Affected
<b>Total</b>	\$0.0	\$21.0	\$0.0	\$21.0	Nonrecurring	TRD Operating

Parenthesis ( ) indicate expenditure decreases

### SOURCES OF INFORMATION

LFC Files

#### Responses Received From

Taxation and Revenue Department (TRD)

### SUMMARY

#### Synopsis of Bill

House Bill 169 amends the definition of “net income” to allow the deduction of state and local income and sales taxes for New Mexico personal income tax (PIT) purposes. The provisions of the bill do not completely reverse the 2011 law because the exclusion of state tax refunds have not been included in the provisions of the bill.

There is no effective date of this bill. Assume 90 days following adjournment (June 16, 2017); Applicable to taxable years beginning on or after January 1, 2017.

### FISCAL IMPACT

TRD has estimated the fiscal impact of this bill: “...TRD used taxpayer data from GenTax to estimate the revenue impact. PIT-1, Page 1, Line 10 is the itemized amount attributed to the state

and local tax deduction allowed at the federal level. The aggregate sum of this line was calculated and multiplied by each taxpayer's tax rate. Because the bill proposes to deduct this sum from the taxable base, the result is a loss to the General Fund. Additionally, this legislation doubles the deduction currently available to taxpayers. A detailed explanation [of the methodology is offered in the [Other Substantive Issues] section below.”

This bill may be counter to the LFC tax policy principle of adequacy, efficiency, and equity. Due to the increasing cost of tax expenditures, revenues may be insufficient to cover growing recurring appropriations. This bill does not offer any reason for the proposed deduction, nor for ignoring the companion provision retaining the exclusion of adding back state tax refunds [Section 1, subsection N (9)] in the definition of exclusions from net income. The proposal does not contain any provisions for transparency or accountability. See tables of LFC policies at the end of this review.

### **SIGNIFICANT ISSUES**

The original exclusion of state taxes paid from state net income was passed in 2010 2<sup>nd</sup> special session as a revenue raiser. In tandem with the amendment to 7-2-2 N (2) NMSA 1978 which added the phrase, “and less the amount of state and local income and sales taxes included in the taxpayer's itemized deductions”, the 2011 amendment also added 7-2-2 N (9) NMSA 1978 which excludes any amount of state tax refunds attributed to amounts deducted the previous year. This bill does not repeal that exclusion. This addback of income tax refunds for itemizers has always been difficult to explain to taxpayers. In fact, the failure to repeal the exclusion of refunds from net income will mean that taxpayers will not pay tax properly on these refunds. This is not so much a revenue issue as an equity issue.

TRD notes the following: “... the bill implicates the principal of vertical equity. This legislation reduces the taxable income of the top 30% of New Mexico taxpayers.

### **PERFORMANCE IMPLICATIONS**

The LFC tax policy of accountability is not met since TRD is not required in the bill to report annually to an interim legislative committee regarding the data compiled from the reports from taxpayers taking the deduction and other information to determine whether the deduction is meeting its purpose. The TRD Tax Expenditure Reports do not contain information of the positive value to the general fund of this provision. It is not considered a tax expenditure. The bill does not require TRD to extract and prepare a report of the cost of this proposed tax expenditure.

### **ADMINISTRATIVE IMPLICATIONS**

TRD reports minimal administrative impact. Some reprogramming of information technology systems will be necessary. No significant issues arise. This deduction may be subject to disclosure requirements per GASB 77.

## CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

<a href="#">HB 61</a>	EXTEND SOLAR MARKET TAX CREDIT
<a href="#">HB 68</a>	RURAL HEALTH CARE PRACTITIONER TAX CREDIT
<a href="#">HB 82</a>	EXTEND SOLAR MARKET TAX CREDIT
<a href="#">HB 117</a>	SUPPLEMENTAL INCOME TAX
<a href="#">HB 169</a>	INCOME TAX DEDUCTIONS
<a href="#">HB 193</a>	SOLAR MARKET TAX CREDIT PERMANENT
<a href="#">HB 201</a>	NEW TOP INCOME TAX BRACKET
<a href="#">SB 41</a>	EXTEND SOLAR MARKET TAX CREDIT
<a href="#">SB 50</a>	ADDITIONAL UPPER-TIER TAX BRACKETS
<a href="#">SB 123</a>	TAX REFORM
<a href="#">SB 196</a>	SMALL BUSINESS INVESTMENT TAX CREDIT

## TECHNICAL ISSUES

LFC staff encourage the sponsor to repeal added 7-2-2 N (9) NMSA 1978, if the intent is to restore the personal income tax system to its provisions prior to the 2010 2<sup>nd</sup> addback of state income taxes to net income.

## OTHER SUBSTANTIVE ISSUES

TRD offers this detailed description of the methodology for this and other PIT bills.

New Mexico's PIT regime starts with Federal Adjusted Gross Income (AGI). The reader is best served by having a current copy of federal Form 1040 and New Mexico PIT-1 to easily follow the explanation. <https://www.irs.gov/pub/irs-pdf/f1040.pdf> and <https://s3.amazonaws.com/realFile34821a95-73ca-43e7-b06d-fad20f5183fd/7871d7a3-7550-4959-8224-ea8a99ae3665?response-content-disposition=filename%3D2016pit-1.pdf&response-content-type=application%2Fpdf&AWSAccessKeyId=AKIAJBI25DHBYGD7I7TA&Signature=ql6C%2FciMwbZA%2BCEPGiy%2FxfB2TDQ%3D&Expires=1485557927>

The input value on PIT-1, Line 9, page 1 is federal AGI. Federal AGI is obtained from Line 38 of federal Form 1040. Federal Form 1040 lines 7 through 21 are totaled on line 22; Line 22 is federal "total income." Federal Form 1040 lines 23 through 35 are deductions to total income, the sum totaled on line 36. Line 36 subtracted from line 22 is the difference input on line 37 and then copied to line 38.

Federal Form 1040 line 40 is "Itemized Deductions" computed as the sum of Schedule A. Lines 5 through 8 on Schedule A are "Taxes You Paid," and this sum is totaled on line 9. Line 5 on Schedule A is the greater of state income taxes or state general sales taxes paid. The value of this line is enumerated as an addback on New Mexico PIT-1 Line 10.

**Does the bill meet the Legislative Finance Committee tax expenditure policy principles?**

1. **Vetted:** The proposed new or expanded tax expenditure was vetted through interim legislative committees, such as LFC and the Revenue Stabilization and Tax Policy Committee (RSTP), to review fiscal, legal, and general policy parameters.
2. **Targeted:** The tax expenditure has a clearly stated purpose, long-term goals, and measurable annual targets designed to mark progress toward the goals.
3. **Transparent:** The tax expenditure requires at least annual reporting by the recipients, the Taxation and Revenue Department, and other relevant agencies.
4. **Accountable:** The required reporting allows for analysis by members of the public to determine progress toward annual targets and determination of effectiveness and efficiency. The tax expenditure is set to expire unless legislative action is taken to review the tax expenditure and extend the expiration date.
5. **Effective:** The tax expenditure fulfills the stated purpose. If the tax expenditure is designed to alter behavior – for example, economic development incentives intended to increase economic growth – there are indicators the recipients would not have performed the desired actions “but for” the existence of the tax expenditure.
6. **Efficient:** The tax expenditure is the most cost-effective way to achieve the desired results.

LFC Tax Expenditure Policy Principle	Met?	Comments
<b>Vetted</b>	✘	
<b>Targeted</b>		
Clearly stated purpose	✘	
Long-term goals	✘	
Measurable targets	✘	
<b>Transparent</b>	✘	
<b>Accountable</b>		
Public analysis	✘	
Expiration date	✘	
<b>Effective</b>		
Fulfills stated purpose	?	No stated purpose
Passes “but for” test	?	No economic development or other purpose stated
<b>Efficient</b>	?	No economic development or other purpose stated
Key:    ✓ Met    ✘ Not Met    ? Unclear		