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

		ORIGINAL DATE	1/24/19		
SPONSOR	Sanchez	**LAST UPDATED**	3/11/19	**HB**	
SHORT TITLE	Income Tax Dependent Deduction			**SB**	300/aSFC
				ANALYST	Graeser

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY19	**FY20**	**FY21**	**FY22**	**FY23**		
$0.0	($23,000.0)	($24,000.0)	($25,000.0)	($26,000.0)	Recurring	General Fund (PIT)

Parenthesis ( ) indicate revenue decreases

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY19	FY20	FY21	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
Total		Significant	Significant	Significant	Recurring	TRD Operating

Parenthesis ( ) indicate expenditure decreases

TRD will indicate that these changes can be implemented in the regular course of maintenance prior to the TY2019 personal income tax processing cycle.

SOURCES OF INFORMATION
LFC Files

Sources of Information
Taxation and Revenue Department (TRD) on HB-6/HTRCCS

SUMMARY

Synopsis of SFC amendment

Senate Finance Committee's amendment to Senate Bill 300 allows a $4,000 deduction for one less than the number of dependents claimed on the taxpayer's income tax return. The amendment also removes the conflict between not allowing any deduction for married separate or single returns but allowing ½ the deduction for dependents claimed on a married filing separate return by deleting the deduction for married separate.

Synopsis of Bill

Senate Bill 300 proposes a $4 thousand deduction for each dependent. The deduction is contingent upon continued repeal of the personal exemption amount for federal purposes. The cost and coverage of the deduction must be reported annually to the interim legislative Revenue Stabilization and Tax Policy Committee (RSTPC). "Dependent" is defined by reference to Section 152 of the Internal Revenue Code.

There is no effective date of this bill. It is assumed that the effective date is 90 days after this session ends (June 14, 2019). The provisions of the bill apply to taxable years beginning on or after January 1, 2019. The tax returns claiming this credit would be filed by June 30, 2020.

FISCAL IMPLICATIONS

TRD has provided an estimate of the amended dependent deduction on HB-6/HTRCCS. This estimate has been used in the table above. The methodology is based on a SQL query on the PIT database. This is a superior methodology to the LFC methodology based on the new LFC PIT model, although work will continue to adapt the two methodologies.

The fiscal impact of this bill was independently 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 20 percent cuts of Adjusted Gross Income (AGI). The following chart is an exhibit of the FY 15 base effects of the dependent deduction. The model exhibits averages over a large number of taxpayers. If any particular taxpayer would like to calculate the effect of the bill on their net liability, that taxpayer should multiply $4,000 by the number of dependents (excluding taxpayer and spouse) and that product by the applicable marginal tax rate, which ranges from 1.7 percent to 4.9 percent, but averages 4.5 percent for most taxpayers. The deduction does not make reference to filing status, only to the number of qualifying children and other dependents.

Residents Only\AGI	0-20%	20% to 40%	40% to 60%	60% to 80%	80% to100%
Base Tax TY15					
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	$75	$312	$664	$1,288	$3,081
MFJ - AGI	$47,560	$70,113	$90,382	$117,498	$222,097
- Tax	$534	$1,537	$2,527	$3,823	$8,411
HH - AGI	$27,335	$35,491	$43,023	$53,738	$92,401
- Tax	-$109	$90	$392	$924	$2,774
Effect of Changes					
Single - AGI	$0	$0	$0	$0	$0
- Tax	-$1	-$2	-$7	-$7	-$6
MFJ - AGI	$0	$0	$0	$0	$0
- Tax	-$116	-$202	-$193	-$177	-$157
HH - AGI	$0	$0	$0	$0	$0
- Tax	-$67	-$141	-$214	-$293	-$292

Note that the reduction in tax is greater for higher income taxpayers than for lower income taxpayers.

SIGNIFICANT ISSUES

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.

However, the bill may be designed to reduce the unintended increase in overall state personal income tax (PIT) revenue attributed to the federal Tax Change and Jobs Act (TCJA) that is expected to increase PIT collections by roughly $55 million in fiscal year 2019. This increase is due to the repeal of the personal exemption in favor of a substantial increase in the standard deduction. New Mexico "piggy-backs" on these two changes. It does not, however, piggyback on the federal child credit that serves to balance the impact of the federal changes on taxpayers when they calculate their federal liabilities. This bill would create a state dependent deduction that would also serve to balance in revenue neutral terms the state liabilities.

Unlike the child credit proposed in HB18, this deduction is allowed for all dependents. These can include older relatives not living with the taxpayer or adult disabled dependent relatives living with the taxpayer. Neither concept will be easy for TRD to implement because the federal 1040 will no longer solicit the information pursuant to the changes pursuant to the Tax Change and Job Act (TCJA) of 2017. However, HB18 reduces the tax more for lower income taxpayers than for higher income taxpayers.

PERFORMANCE IMPLICATIONS

The LFC tax policy of accountability is met with the bill's requirement 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, although that purpose is not stated in the bill.

ADMINISTRATIVE IMPLICATIONS

TRD will indicate that these changes will be significant for IT which will have to modify the GenTax processing system. However, these changes can be implemented in the regular course of maintenance prior to the TY2019 personal income tax processing cycle.

However, TRD may experience difficulty ensuring that the number of dependents are accurately claimed. In previous years, the IRS audit and compliance efforts have been sufficient to ensure the accuracy of state personal income tax returns. This is largely because New Mexico "piggy-backs" on federal definitions with relatively few modifications between New Mexico taxable income and federal taxable income. Thus, TRD can use the federal audit program results to detect exceptions. This proposed deduction, however, may not be verified through federal filing or federal audit activities. Implementing an audit process to verify this substantial deduction would be quite expensive and is not budgeted.

Subsequent email discussion with TRD staff indicates that dependents will still be declared on federal and state income tax returns and that TRD is not particularly concerned about the LFC staff comment above.

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.
SB-98 proposes a new 6.5 percent higher income tax bracket.

TECHNICAL ISSUES

This bill does not contain a delayed repeal date. LFC recommends adding a delayed repeal date so that the legislature can periodically review if the dependent deduction is still serving a valid purpose, with minimal amounts of inaccuracy.

Pursuant to the current provisions of the TCJA, the personal exemption amounts will be restored after 2025. This might be a good date to use as a delayed repeal date for this bill, although this concept is implicit in the provisions of the bill.

ALTERNATIVES

The HB18 credit approach is probably more equitable than this deduction concept, since the credit is greater for lower income taxpayers. However, if the credit approach is adopted, the bill should probably include adult dependents pursuant to the federal definition in Section 152. Another concept in HB-18 that could be adopted is as follows:

> As used in this section, "qualifying child" means "qualifying" as defined by Section 152(c) of the Internal Revenue Code, as that section may be amended or renumbered, but includes any minor child or stepchild of the taxpayer who would be a qualifying child for

federal income tax purposes if the public assistance contributing to the support of the child or stepchild was considered to have been contributed by the taxpayer."

WHAT WILL BE THE CONSEQUENCES OF NOT ENACTING THIS BILL

The increase in personal income tax collections from $1,377.0 million in FY17 to $1,519.0 million in FY18 is attributed to a significant growth in state personal income, but also includes an increase in state PIT withholding attributable to the provisions of the TCJA, acting through the piggy-back mechanism. This roughly $55 million increase was unintended, but without this or similar bill will be a permanent burden on state taxpayers.

In general, the provisions of this bill improve equity and, with the reporting provisions improve accountability at the cost of degrading adequacy, efficiency and simplicity.

LG/al/sb/al