BILL ANALYSIS AND FISCAL IMPACT REPORT
Taxation and Revenue Department

February 10, 2025

Bill: SB-140 **Sponsor:** Senator Harold Pope

Short Title: Certain Income Tax Exemptions

Description: This bill adds a new section to the Income Tax Act providing an exemption from New Mexico income tax for taxpayers with the following modified gross incomes:

- Less than or equal to $40,000 for individuals;
- Less than or equal to $30,000 for married individuals filing separately;
- Less than or equal to $60,000 for married individuals filing joint returns.

Effective Date: Not specified; 90 days following adjournment (June 20, 2025). Applicable to taxable years beginning on or after January 1, 2025.

Taxation and Revenue Department Analyst: Sara Grubbs

Estimated Revenue Impact*					R or NR**	Fund(s) Affected
FY2025	FY2026	FY2027	FY2028	FY2029		
--	($92,300)	($92,300)	($92,300)	($92,300)	R	General Fund

* In thousands of dollars. Parentheses ( ) indicate a revenue loss. ** Recurring (R) or Non-Recurring (NR).

Methodology for Estimated Revenue Impact: The impact of the proposed income tax exemption was estimated using tax years 2021-2023 tax return data for New Mexico individual taxpayers. This bill's exemption is based on modified gross income (MGI); however, not all taxpayers report MGI. MGI can vary significantly compared to the taxpayer's adjusted gross income (AGI) and is not always taxable, as discussed in "Other Issues." For these reasons, the taxpayer's AGI is used as a proxy.

This analysis assumes that the filing status of Head of Household or Surviving Spouse would also qualify for this exemption under the Married Filing Joint filing status as it is not specified in the bill. See "Technical Issues." Due to the timing of this applying to tax year 2025 and very few taxpayers adjusting their withholding, Tax & Rev assumes full impact starting in FY2026 when refunds would be paid to taxpayers whose wages were withheld in excess. This fiscal impact is modeled using the new tax year 2025 tax brackets.

Policy Issues: Personal income tax (PIT) represents a consistent source of revenue for many states. For New Mexico, PIT is approximately 25 percent of the state's recurring general fund revenue. While this revenue source is susceptible to economic downturns, it is also positively responsive to economic expansions. New Mexico is one of 41 states, along with the District of Columbia, that impose a broad-based PIT (New Hampshire and Washington do not tax wage and salary income but do tax other forms of income). Like several states, New Mexico computes its income tax based on the federal definition of taxable income and ties the tax to other statues in the federal tax code. This is referred to as "conformity" to the federal tax code. PIT is an important tax policy tool that has the potential to further both horizontal equity, by ensuring the same statutes apply to all taxpayers, and vertical equity, by ensuring the tax burden is based on taxpayers' ability to pay.

As New Mexico PIT brackets are not indexed to inflation, prior to 2024's HB2452, taxpayers had gradually moved into higher tax brackets since 2005, a phenomenon described as “bracket creep. Over time, the effective PIT rate, which is the average tax rate paid by a taxpayer on their total gross income, increased from 2005 to 2024. In 2024, HB252 amended the tax brackets to lower all tax rates and expanded the 5 brackets into 6 brackets, effective from tax year 2025 forward. These amendments aided in correcting for “bracket” creep over time and reduced the tax liability for all PIT taxpayers. These changes to the tax brackets also increased the amount of progressivity in the PIT structure, meaning that as income increases, higher-income taxpayers are taxed at a higher rate to match their ability to pay. See table 1.

Table 1		
Current Tax Bracket	**Taxable Income Range**	**Rate**
Married Filing Separate		
1	Not over $4,000	1.50%
2	$4,000 -- not over $12,500	3.20%
3	$12,500 -- not over $25,000	4.30%
4	$25,000 -- not over $50,000	4.70%
5	$50,000 -- not over $157,500	4.90%
6	Over $157,500	5.90%
Married Filing Joint, Heads of Household		
1	Not over $8,000	1.50%
2	$8,000 -- not over $25,000	3.20%
3	$25,000 -- not over $50,000	4.30%
4	$50,000 -- not over $100,000	4.70%
5	$100,000 -- not over $315,000	4.90%
6	Over $315,000	5.90%
Single		
1	Not over $5,500	1.50%
2	$5,500 -- not over $16,500	3.20%
3	$16,500 -- not over $33,500	4.30%
4	$33,500 -- not over $66,500	4.70%
5	$66,500 -- not over $210,000	4.90%
6	Over $210,000	5.90%

By exempting all income below thresholds from taxation, both vertical equity and progressivity in the tax code are impacted. Vertical equity is eroded as middle- and higher- income taxpayers will shoulder all tax burden for paying PIT. The current tax brackets for lower income households still proportion a share of PIT liability to them but at a level that matches their ability to pay. Given the proposal to exempt all income below certain thresholds, the PIT tax brackets should also be amended if this bill passes to reflect the income level at which PIT will be incurred.

Table 2 below demonstrates the number of qualified taxpayers that will see a decrease in their tax liability with most of the savings from this bill occurring for middle-income taxpayers. Low-income taxpayers do not see as big a savings due to progressivity in the tax code through the tax brackets and other low-income credits, rebates and deductions. The table also illustrates the "cliff effect" that this legislation introduces. The "cliff effect" is the sudden loss of benefits when going over an applicable threshold by even $1. This "cliff effect" will erode horizontal equity as those at very similar income levels may see different PIT liability. This may also induce labor market disruptions as taxpayers may change their behavior to meet the exemption thresholds.

Table 2			
Current Tax Bracket	**Estimated No. of Taxpayers**	**Estimated Fiscal Impact for FY2026 ($ thousand)**	**Average Tax Relief Per Taxpayer**
1 – 1.50%	416,575	($3,521)	($8.45)
2 – 3.20%	119,917	($34,814)	($298.65)
3 – 4.30%	116,919	($52,693)	($450.68)
4 – 4.70%	251	($320)	($1,227.59)
5	0	--	--
6	0	--	--

New Mexico will continue to see growth in aggregate wages. As a taxpayer's income increases, the taxpayer moves into a higher income tax bracket. If a taxpayer's income surpasses the income threshold for this exemption, the taxpayer would no longer qualify and would have a tax burden and feel the "cliff effect". This, potentially, may reduce the fiscal impact of this exemption over time. Given this, policymakers may want to consider adjusting the income threshold for inflation.

Taxpayers whose income is exempted from New Mexico income tax will likely still file a New Mexico PIT return to be eligible for significant refundable tax credits. For example, a taxpayer with no PIT liability who is eligible for a child tax credit of $600 would receive a refund of $600. The same applies for refundable working families tax credit and the low-income comprehensive tax rebate.

Taxpayers also may be more likely to claim the proposed exemption as it is less complex than other exemptions. For example, the low- and middle-income exemption is more administratively complicated as it requires different calculations based on several ranges of income. The proposed bill may negate the impact of the low- and middle-income exemption from PIT. For these reasons, Tax and Rev recommends that the tax code be adjusted to account for different interactions among exemptions, deductions and credits if this bill is enacted.

Technical Issues: The filing status of "Heads of Household" or "Surviving Spouses" is omitted from this bill. Tax & Rev suggests adding ", heads of household and surviving spouses" after "returns" on line 25. So that it reads "C. married individuals filing joint returns, heads of household and surviving spouses with . . ."

Other Issues: New Mexico uses AGI for the starting point to calculate state taxable income. This bill exempts income based on MGI, which adds a layer of complication for exempting income. MGI is used mostly for determining eligibility under 7-2-14 NMSA 1978, low-income comprehensive tax rebates. MGI includes income that may already not be taxable, like public assistance, alimony payments, railroad retirement, social security, etc. (see definition below).

MGI should be reconsidered as the type of income that is exempt, this might be better replaced with "federal adjusted gross income" (FAGI). Most states use FAGI for the starting point of returns[1].

"Modified gross income" (7-2-2 L. NMSA 1978) means all income of the taxpayer and, if any, the taxpayer's spouse and dependents, undiminished by losses and from whatever source, including: compensation; net profit from business; gains from dealings in property; interest; net rents; royalties; dividends; alimony and separate maintenance payments; annuities; income from life insurance and endowment contracts; pensions; discharge of indebtedness; distributive share of partnership income; income in respect of a decedent; income from an interest in an estate or a trust; social security benefits; unemployment compensation benefits; workers' compensation benefits; public assistance and welfare benefits; cost-of-living allowances; and gifts.

Administrative & Compliance Impact: Tax & Rev will make information system changes and update forms, instructions, and publications. This implementation will be included in the annual tax year changes.

This bill will have a low impact on Tax & Rev's Information Technology Division (ITD), approximately 220 hours or about 1.5 months for an estimated staff workload cost of $14,661. This update will impact GenTax, the tax system of record, Taxpayer Access Point (TAP), where taxpayers interact and file electronically and Modernized E-File (MeF), the Internal Revenue Service (IRS) filing system.

Estimated Additional Operating Budget Impact*				**R or NR****	**Fund(s) or Agency Affected**
FY2025	**FY2026**	**FY2027**	**3 Year Total Cost**		
--	$14.6	--	$14.6	NR	ITD – Staff Workload

* In thousands of dollars. Parentheses ( ) indicate a cost saving. ** Recurring (R) or Non-Recurring (NR).

[1] https://taxadmin.org/state-individual-income-tax-federal-starting-points