FISCAL IMPACT REPORT

		ORIGINAL DATE	02/08/09		
SPONSOR	Sandoval	**LAST UPDATED**	03/12/09	**HB**	262
SHORT TITLE	Income Tax Credits			**SB**	
				ANALYST	Francis

REVENUE (dollars in thousands)

Estimated Revenue			Recurring or Non-Rec	Fund Affected
FY09	**FY10**	**FY11**		
	$2,224.0	$0.0	Recurring	General Fund
		*note: decreases revenue in out years		

(Parenthesis ( ) Indicate Revenue Decreases)

SOURCES OF INFORMATION

LFC Files

Responses Received From
Taxation and Revenue Department (TRD)

SUMMARY

Synopsis of Bill

House Bill 262 creates a new credit against personal income tax and a new tax rate that offsets the repeal of the personal exemption, the standard deduction, the bottom tax rates and the low income comprehensive tax rebate. The credit will be effective for tax years beginning on or after January 1, 2008.

1. Collapses all of the tax brackets for a flat tax of 4.9 percent on taxable income.
2. A credit that changes with income and dependents is added.
3. The low and middle income tax exemption and the low income comprehensive tax rebate are repealed.
4. Several definitions have been changed or updated and several technical changes have been made.

Section by Section Detail		
Section	**Change**	**Description**
Section 1:	New material	Establishes the formula for indexing in Section 7
Section 2:	Amends 7-2-2	Cleans up language on definitions of base income, modified income, filing status, and taxable income. Also deletes definitions no longer needed
Section 3:	Amends 7-2-3	Conforms to new definitions
Section 4:	New Material	Creates a section that defines the additions to federal AGI: this replaces what was deleted in the definition of "net income"
Section 5:	Amends 7-2-4	Amends to include exemptions previously included in definitions
Section 6:	Amends 7-2-5.2	Conforms to new definitions
Section 7:	Amends 7-2-5.5	Conforms to new definitions
Section 8:	Amends 7-2-5.6	Appropriate citing and conforming to new definition
Section 9	Amends 7-2-5.7	Conforms to new definitions
Section 10	Amends 7-2-5.9	Conforms to new definitions
Section 11	Amends 7-2-5.10	Conforms to new definitions
Section 12	Amends 7-2-5.11	Conforms to new definitions
Section 13	Amends 7-2-7	Sets single rate of 4.9 % and eliminates all other brackets
Section 14:	Amends 7-2-7.1	Conforms to new credit section
Section 15:	New Material	Creates a credit that combines current exemptions, deductions, rate brackets and state/local taxes
Section 16:	Amends 7-2-11	Conforms to new definitions and credit table and clarifies apportionment percentage
Section 17.	Amends 7-2-12	requires taxpayer to use federal filing status
Section 18.	Amends 7-2-12.1	Conforms to new credit section
Section 19:	Amends 7-2-32	Conforms to new definitions
Section 20:	Amends 7-2-34	Conforms to new definitions and cleans up unnecessary past phase-in
Section 21:	Amends 7-2-35	Conforms to new definitions
Section 22:	Amends 7-2-36	Conforms to new definitions
Section 23:	New Material	Allows additional deduction from taxable income for amount of itemize above standard
Section 24:	Repeals Section 7-2-5.8 and 7-2-14	7-2-5.8 is the low and middle income exemption and 7-2-14 is LICTR, both unnecessary with the new credit section.

FISCAL IMPLICATIONS

According to TRD, the revised fiscal impact estimate reflects a new forecast of inflation.

TRD reported to the Revenue Stabilization and Tax Policy interim committee that there would be a negative fiscal impact due to the indexing provisions primarily. The estimates are based on TRD's micro-simulation model which is able to aggregate changes to individual tax returns. The increase in taxes in FY10 comes from some taxpayers because the new calculation of taxable income will exceed adjusted gross income (due to additions to AGI) but the effects are reversed in FY11.

Estimated Revenue Impact*						R or NR**	Provisions of Bill
FY2009	**FY2010**	**FY2011**	**FY2012**	**FY2013**			
0	2,224	0	0	0		R	New Credit
0	0	0	(2,817)	(9,068)		R	Indexing
0	**2,224**	**0**	**(2,818)**	**(9,068)**		R	**Totals (all GF)**

Source: TRD

TRD:

The new credit would simplify the personal income tax by removing the need to include the standard deduction, personal exemptions, and the low- and middle-income exemption in the computation of income subject to tax. For most taxpayers, taxable income would be federal adjusted gross income (AGI). Itemizers would deduct the excess of their federal itemized deductions over the standard deduction, and the extra standard deductions for the elderly and blind would be preserved. For taxpayers eligible for refundable rebates or credits, the computation of modified gross income would be much easier and require less record keeping.

With only one tax rate, most taxpayers would be able to simply use a lookup table based on their filing status, number of exemptions, and taxable income to find their net income tax (tax liability reduced by the new credit). An illustrative lookup table for married couples filing jointly is attached.

For most taxpayers, the new credit would precisely replace the tax benefits in 2009 from the standard deduction, personal exemptions, the low- and middle-income exemption, graduated rates, and LICTR. In certain circumstances, however, the credit would result in lower taxes. Some low-income families would have lower taxes or a larger refund because the refundable portion of the new credit is somewhat higher at very low income levels to insure that no taxpayer has a reduced credit due to the new definition of modified gross income. Some middle-income taxpayers who itemize deductions or receive the extra standard deduction for the elderly and blind would have lower taxes, since the part of the new credit that replaces the low- and middle-income exemption would phase out with taxable income rather than AGI. Some taxpayers would have a tax increase. Tax increases occur for a small number of taxpayers for whom new taxable income exceeds AGI (due to such additions to AGI as tax-exempt interest on non-New Mexico bonds), so they are phased out more quickly in the new credit that replaces the low- and middle-income exemption. Because of the expected pattern of price changes next year, certain initial credit amounts were adjusted slightly so that the credits would remain constant in 2010, rather than decline in value. The effect of these adjustments to the initial (2009) credit amounts, is that higher-income taxpayers will generally have small tax increases in 2009 but these increases will be reversed in 2010.

The new credit would make the personal income tax fairer over time because it would be indexed for inflation. Currently, rate brackets, the low- and middle-income exemption, and LICTR lose value over time due to inflation, effectively imposing a tax increase due to inflation. Indexing of the credit would begin in 2010, with 2009 as the base year for indexing. However, because of the expected pattern of changes in the consumer price index, the indexing formula is expected to result in no changes to credit values until 2011 (the federal standard deduction and personal exemption amounts in 2011 are expected to be unchanged from their 2009 levels). Credit amounts are therefore not expected to increase due to the inflation adjustment until 2012.

The new credit would provide greater flexibility in designing New Mexico family- and child-related tax benefits by decoupling from the federal standard deduction and personal exemption amounts.

SIGNIFICANT ISSUES

This credit is an effort to simplify the tax code for the majority of New Mexican taxpayers. Instead of several pages of schedules and attachments and instructions, the average taxpayer will take his or her adjusted gross income from the federal 1040, make a few additions/deductions to arrive at a taxable income and look up the tax on one table (page 10 of TRD analysis). All taxpayers will benefit from the new structure with most of the benefit going to lower income taxpayers (see page 11 of TRD analysis).

Although the new structure is a flat rate tax, the credit mimics the progressivity of a graduated tax structure more smoothly than constant exemptions and credits. Also, even thought the low income comprehensive tax rebate (LICTR) is repealed, the essence of LICTR is captured by the new credit and is more efficient due to the indexing of the credit to inflation.
The Working Families Credit (state level earned income tax credit based on the federal) is not changed and will still be available to low income working taxpayers.

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

The provisions in HB262 conflict with other proposed legislation that alters the personal income tax rates. HB64 and HB346 both change the rates and amend the same section.

OTHER SUBSTANTIVE ISSUES

TRD reports that despite a single income tax rate there will still be significant progressivity in the personal income tax structure:

Progressivity is achieved primarily through certain family- and child-related tax benefits:

- Standard deduction
- Personal exemptions
- NM low- and middle-income exemption
- Graduated rates
- LICTR

The Working Families Tax Credit also adds to progressivity. This credit is 10% of the federal EITC amount, and is only available to families with earned income.

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The Legislative Finance Committee has adopted the following principles to guide responsible and effective tax policy decisions:

1. ***Adequacy:*** *revenue should be adequate to fund government services.*
2. ***Efficiency:*** *tax base should be as broad as possible to minimize rates and the structure should minimize economic distortion and avoid excessive reliance on any single tax.*
3. ***Equity****: taxes should be fairly applied across similarly situated taxpayers and across taxpayers with different income levels.*
4. ***Simplicity***: *taxes should be as simple as possible to encourage compliance and minimize administrative and audit costs.*
5. ***Accountability/Transparency:*** *Deductions, credits and exemptions should be easy to monitor and evaluate and be subject to periodic review.*

More information about the LFC tax policy principles will soon be available on the LFC website at www.nmlegis.gov/lcs/lfc