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FISCAL IMPACT REPORT

ORIGINAL DATE 02/15/13

SPONSOR Trujillo, J. LAST UPDATED _____ HB 389/aHJC

SHORT TITLE Exempt Certain Estates or Trusts From Tax SB _____

ANALYST Smith

REVENUE (dollars in thousands)

| Estimated Revenue | | | | | Recurring or Nonrecurring | Fund Affected |
|-------------------|-----------|-------------|-------------|-------------|---------------------------------|------------------|
| FY13 | FY14 | FY15 | FY16 | FY17 | | |
| \$0.0 | (\$625.0) | (\$1,300.0) | (\$1,375.0) | (\$1,450.0) | Recurring | General Fund |

(Parenthesis () Indicate Revenue Decreases)

SOURCES OF INFORMATION

LFC Files

Responses Received From

Taxation and Revenue Department (TRD)

SUMMARY

Synopsis of HJC Amendment

The House Judiciary Committee amendment to House Bill 389 adds that the amounts referred to in the definition of “net income” be permanently set aside for distribution.

Synopsis of Original Bill

House Bill 389 amends the definition of “net income” for purposes of the Income Tax Act to exclude for estates and trusts, amounts set aside for distribution to a nonresident individual under the terms of the governing instrument.

Effective Date: January 1, 2014

FISCAL IMPLICATIONS

The TRD used New Mexico fiduciary return data from tax years 2007 through 2010 in this analysis. On average, the amount of fiduciary tax paid by estates is approximately \$800 thousand per calendar year. It was assumed that 25 percent of this amount would be paid to beneficiaries

out-of-state. Also, it was assumed that OGP and PTE withholding for non-residents will no longer be required, (see Technical Issues for more detail) and thereby the amounts collected from withholding on PTEs and OGP will be reduced by 30 percent due to non-compliance. Personal income growth rates from Bureau of Business and Economic Research (BBER) were used to estimate the fiscal impact for the subsequent years

This bill may be counter to the Legislative Finance Committee (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.

Estimating the cost of tax expenditures is difficult. Confidentiality requirements surrounding certain taxpayer information create uncertainty, and analysts must frequently interpret third-party data sources. The statutory criteria for a tax expenditure may be ambiguous, further complicating the initial cost estimate of the expenditure's fiscal impact. Once a tax expenditure has been approved, information constraints continue to create challenges in tracking the real costs (and benefits) of tax expenditures.

SIGNIFICANT ISSUES

Although the fiscal impact of this bill is small, it encourages a perverse incentive. It allows non-residents of New Mexico generated income to receive that income tax free. However, New Mexico residents would still pay the tax. Therefore, recipients would be better off if they left New Mexico.

Recipients of trust income are seldom poor. The effect of this bill on the tax system is to promote regressivity. Absent a corresponding reduction in expenditures, it favors better-off out-of-state tax payers at the expense of New Mexico taxpayers.

PERFORMANCE IMPLICATIONS

The LFC tax policy of accountability is not met since the 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.

TECHNICAL ISSUES

This bill does not contain a sunset date. The LFC recommends adding a sunset date.

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

1. **Adequacy:** Revenue should be adequate to fund needed government services.
2. **Efficiency:** Tax base should be as broad as possible and avoid excess reliance on one tax.
3. **Equity:** Different taxpayers should be treated fairly.
4. **Simplicity:** Collection should be simple and easily understood.
5. **Accountability:** Preferences should be easy to monitor and evaluate