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

		ORIGINAL DATE	01/6/2014		
SPONSOR	Keller	**LAST UPDATED**	2/19/2014	**HB**	
SHORT TITLE	Increase Working Families Tax Credit			**SB**	51/aSCORC
				ANALYST	Dorbecker

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY14	**FY15**	**FY16**	**FY17**	**FY18**		
	($35,800)	($36,900)	($38,000)	($39,000)	Recurring	General Fund (Working Families Tax Credit)
		$67,000	$71,000	$75,000	Recurring	General Fund (Capital Gains Deduction)
	($35,800)	$30,100	$33,000	$36,000	Recurring	TOTAL

(Parenthesis ( ) Indicate Revenue Decreases)

SOURCES OF INFORMATION
LFC Files

Responses Received From
Children, Youth and Families Department (CYFD)
Taxation and Revenue Department (TRD)

SUMMARY

Synopsis of SCORC Amendment

The Corporations and Transportation Committee amendment to Senate Bill 51 strikes Section 2 of the bill leaving Section 7-2-34 NMSA 1978 of the Income Tax Act regarding capital gains 50 percent deduction against PIT unchanged.

Synopsis of Original Bill

Senate Bill 51 amends the Income Tax Act to increase the Working Families' Tax Credit (WFTC) from ten percent of the federal income tax credit to seventeen percent. The bill also repeals Section 7-2-34 NMSA 1978 eliminating the capital gains deduction against PIT starting January 1, 2015.

There is no effective date of this bill. It is assumed that the new effective date is 90 days after this session ends. The provisions of this bill apply to taxable years beginning on or after January 1, 2014.

FISCAL IMPLICATIONS

The taxation and Revenue Department (TRD) used information from New Mexico personal income tax returns to estimate the fiscal impact of this bill. Approximately 200 thousand New Mexico taxpayers annually claim the WFTC at the 10 percent rate in the amount of $49.6 million according to Tax Year 2012 data. By increasing the rate to 17 percent, the credit amount increases by 70 percent. This amount would increase at a rate slightly below the rate of inflation year over year because the federal earned income tax credit (EITC) is indexed for inflation, and the population of eligible households will not grow as quickly as the total population according to TRD. Hence, the agency used a growth rate of 3 percent to calculate the subsequent fiscal year impacts.

New Mexico personal income tax data from tax year 2012 was used in the analysis from TRD. In 2012, about 73,500 people claimed net capital gain deductions that totaled $1,190 million. The future years' capital gain deductions were calculated by applying capital gain realizations projection growth rates from 2012, published by The Budget and Economic Outlook, to TY2012 New Mexico personal income capital gain deductions. TRD then forecasted the fiscal impact for repealing the capital gain deduction by applying a 4 percent average tax rate.

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.

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 tax expenditures 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

Unlike the federal government, New Mexico treats capital gains as income and provides a 50 percent deduction for the capital gains portion. TRD is quoted as saying "…raising taxes by eliminating the capital gains deduction is likely to discourage New Mexico income taxpayers from investing their money, even as the state is making significant efforts to encourage this very investment." Because paying taxes on capital gains is voluntary – that is, people can choose not to sell the assets – there is a very real possibility that investors will choose not to liquidate the assets and reinvest them, not for productive economic reasons, but for tax reasons; in those situations, New Mexico would receive no income tax revenue as opposed to the tax on 50 percent of the revenue that it currently receives.

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.

ADMINISTRATIVE IMPLICATIONS

TRD estimates a minimal impact. Both, the increase in the working families' tax credit and the repeal of the deduction for net capital gain income can be implemented as part of the annual renewal process for the personal income tax program. Forms, instructions, and publications will need to be modified.

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

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