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

		ORIGINAL DATE	2/25/15		
SPONSOR	Little	**LAST UPDATED**	3/16/15	**HB**	372
SHORT TITLE	Allow Personal Income Tax Deduction for State Taxes Paid			**SB**	
				ANALYST	Graeser

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY15	**FY16**	**FY17**	**FY18**	**FY19**		
(4,000.0)	(56,500.0)	(48,000.0)	(49,500.0)	(52,500.0)	Recurring	General Fund

(Parenthesis ( ) indicate revenue decreases

Note: the estimate reported here is a simple average of an estimate provided by TRD and an independent estimate provided by LFC.

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY15	**FY16**	**FY17**	**3 Year Total Cost**	**Recurring or Nonrecurring**	**Fund Affected**
Total	14	0		14		TRD Operating

Parenthesis ( ) indicate expenditure decreases

SOURCES OF INFORMATION

LFC Files

Response Received From

Taxation and Revenue Department

SUMMARY

Synopsis of Bill

House Bill 372 reverses a portion of the 2010 2nd SS personal income tax reforms. In Laws 2010, Chapter 7, §7, the amounts of state income tax or state sales taxes that were deducted for federal purposes were disallowed for state purposes. The addition the following year of state tax refunds attributable to the deduction the previous year of state taxes was also repealed. This bill exactly reverses the provisions of the 2010 act and reinstates the close connection between federal taxable income and state taxable income.

The effective date of the act is not stated – assume 90 days after adjournment or June 19, 2015. The provisions of the act are applicable for tax years beginning on or after January 1, 2015.

FISCAL IMPLICATIONS

TRD estimates the impact of this bill as follows:

Estimated Revenue Impact*					R or NR**	Fund(s) Affected
FY2015	FY2016	FY2017	FY2018	FY2019		
0	(47,000)	(49,000)	(50,000)	(52,000)	R	General Fund

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

> "The TRD used tax year 2012 data to establish the base and then applied February 2015 General Fund Consensus revenue estimates of personal income growth rates to estimate the future impact. TRD added the deductions for state and local income and sales taxes to the taxable income to establish a new taxable income then applied the rates as per the filling status for each individual to calculate the new taxes as a result of adding the deduction back in. The impact of allowing the deduction is established by taking the difference between the new computed taxes and the existing taxes. Allowing the federal deduction on the state returns will decrease the general fund by about $50 million and decrease taxes for over 25 percent of taxpayers who currently take this deduction."

LFC staff has independently estimated the impact of this bill, with the following results:

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY15	FY16	FY17	FY18	FY19		
(8,000.0)	(66,000.0)	(47,000.0)	(49,000.0)	(53,000.0)	Recurring	General Fund

The estimated revenue impact reported here simply reverses the impact estimated in the Fiscal Impact Report for section 7 of CS/SB10, 12 & 13 of 2010 2nd SS. These estimates will be updated later by TRD input.

The small fiscal impact estimated for FY 2015 is caused by taxpayers who file estimated taxes adjusting those estimates for their April and June payments.

The significant FY 2016 impact is the value of the deduction. The smaller amount of FY 2017 impact is because any state tax refunds of itemizers are added back into income in the year following the claimed deduction. Since this addback would occur every year, the lower amount is grown by the anticipated growth in total personal income taxes.

The amount reported in the initial table is a simple average of these two independent estimates.

This bill may be counter to the LFC tax policy principles of adequacy, efficiency, accountability 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 can be difficult. This particular deduction will not be reported directly to TRD. TRD can get access to detailed data from the IRS, but the data are highly confidential and voluminous. Extracting information from the mass of data is difficult.

SIGNIFICANT ISSUES

In most states and the federal structure, the personal income tax adds a progressive element to the overall tax mix. New Mexico adjusted rates and brackets in the years since 2003 to reduce the top marginal rate to 4.9 percent and reduce progressivity, since the top marginal rate kicks in at $24,000 in taxable income. Over the years, the effective elasticity has been reduced through successive statutory changes from 1.65 in the era prior to 1994's mini-reform, to 1.35 until the 2003 rate reductions to an estimated 1.0 until the 2010 repeal of state and local taxes. This feature probably increased the progressivity of the tax to, perhaps, 1.1. This bill would, once again, reduce the New Mexico personal income tax to a proportional tax.

A rough analysis of the impact of this bill in terms of percentage of the total tax reductions incurred by taxpayers in the following income levels and status as follows:

	0-50,000 AGI	$50,000 to $100,000 AGI	Over $100,000 AGI
Single	3.3%	6.0%	9.3%
Married Joint and H/H	3.7%	16.7%	61.0%

PERFORMANCE IMPLICATIONS

The LFC tax policy of accountability is <u>not</u> met since TRD is <u>not</u> 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. This is known as a passive tax expenditure because it piggybacks on a deduction allowed to determine federal taxable income.

ADMINISTRATIVE IMPLICATIONS

TRD reports a minimal impact --200 hours. This bill requires changes to personal income tax Gentax and Taxpayer Access Point documents. This can be part of annual year end change. Line 10 on 2014 PIT-1, page 1 will be removed during the annual tax return modifications. This change can be done at minimal incremental cost with the annual renewal of the income tax forms.

LG/bb/je