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

SPONSOR Maestas **ORIGINAL DATE** 2/4/16 **LAST UPDATED** **HB** 292

SHORT TITLE Modify Personal Income Tax Brackets & Rates **SB**

ANALYST Graeser

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY16	**FY17**	**FY18**	**FY19**	**FY20**		
	$25,940.0	$45,750.0	$48,020.0	$50,539.0	Recurring	General Fund (PIT)

Parenthesis ( ) indicate revenue decreases

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY16	FY17	FY18	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
Total		23.0		23.0	Nonrecurring	TRD operating

Parenthesis ( ) indicate expenditure decreases

SOURCES OF INFORMATION
LFC Files

Responses Received From
Taxation and Revenue Department (TRD)

SUMMARY

Synopsis of Bill

House Bill 292 amends Section 7-2-7 NMSA 1978 to significantly modify the tax brackets and also modify the personal income tax rates. For married individuals filing separately, the lowest bracket will now extend to income not to exceed $15,000, and the highest bracket for those filers will be those with taxable income over $75,000. For heads of household, surviving spouses and married individuals filing joint returns, the lowest bracket will be for taxable income not over $30,000, while the top bracket will be for taxable income over $150,000. For single individuals and for estates and trusts, the lowest bracket will be for taxable income not over $20,000, while the highest bracket will be for taxable income over $100,000. The tax rates for the lowest income bracket and the highest two income brackets increase, while the rates for the middle income brackets slightly decrease.

There is no effective date of this bill. It is assumed that the new effective date is 90 days after this session ends (May 18, 2016). The provisions of the bill are applicable to tax years beginning January 1, 2017.

FISCAL IMPLICATIONS

TRD used direct taxpayer data to produce the fiscal estimate. Data from tax years 2011, 2012, and 2013 were analyzed. A model was created to apply the proposed tax rates to historical collection data. Due to tax collection challenges including late filing, amending returns, etc., the most complete tax data were years 2011 and 2012. Tax paid under the current rates was calculated, and then, the proposed rates were applied to the same data set. The difference between the two tax schedules model the gain/loss that would be realized.

This bill proposes rates that would increase taxpayer liability; the increased PIT rates results in an increase in tax revenue. The historical data resulted in a significant variance between tax years 2011 and 2012. Therefore, TRD uses the average of those two tax years as the 2012 baseline. PIT growth rates from the January 2016 consensus group forecast were applied to estimate the fiscal impact.

Although the bill makes the new rates retroactive to the beginning of tax year 2016, TRD does not forecast an impact for FY2016. During FY17 TRD assumes that 40% of the revenue due will be collected; the remaining 60% will be collected during the following fiscal year. This pattern continues throughout the estimate; this closely models that actual collection of tax receipts due to taxpayer delays, extensions, and amendments.

This bill sustains the LFC tax policy principles of adequacy, efficiency and equity.

SIGNIFICANT ISSUES

TRD notes that taxes can provide incentives to change economic decisions.

> The bill implicates principles of revenue adequacy and vertical equity. Compared to current law, it lowers the income tax rates for those earning incomes between $5,000-$60,000 (filing single) or $8,000-$90,000 (filing jointly), while raising the rates for those with incomes below $4,000 and above those levels. The proposed bill has the potential to dissuade higher income earners from relocating to New Mexico or accepting employment in New Mexico due to the higher income tax rate. Further, the significant tax rate increase may incentivize emigration of high wage earners.

The provisions of this bill largely restore the Governor Richardson tax cuts (Laws 2003, Chapter 2). The provisions also restore income elasticity to the personal income tax structure. In 2001, a 10% increase in overall personal income would generate a 13.4% increase in personal income tax collections. Since the 2003 rate reductions have been fully implemented, the income elasticity has been 1.0, so that a 10% increase in personal income generates a 10% increase in tax collections. This speaks to a concept known as vertical equity. Since the gross receipts tax is regressive with lower income residents pay a higher percentage of their income on the gross receipts tax than do higher income residents, the state's tax structure needs some element to render the overall system proportional.) In years prior to 2003, it was the personal income tax that functioned in that fashion.

ADMINISTRATIVE IMPLICATIONS

TRD reports a moderate Impact. The income tax rates will change for personal income taxes, fiduciary income taxes, employer withholding tables, and estimated tax publications. The Secretary of TRD will need to consider changing the withholding rate for oil and gas proceeds and pass-through entities. A 90-day notice would be required. There is a need for disseminating information on the rate increases quickly so that taxpayers can adjust to the higher or lower taxes. It would not be feasible to change the withholding tables until the CRS packets are mailed out effective July 1, 2016.

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

HB 126 and HB 255 also amend PIT rates.

TECHNICAL ISSUES

TRD notes an issue, "…there is a timing issue that impacts taxpayers. The effective date is towards the end of FY2016, but is retroactive to the beginning of tax year 2016. Some taxpayers realize tax decreases, but many taxpayers – including those with the least income – realize tax increases. Making the new structure applicable to tax years from an after January 1, 2016 may also adversely affect the correctness of withholding payments made thus far in 2016. A table, provided below, illustrates the impact of the rate changes by income bracket.

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

LG/jle

Policy Issues – Detailed Discussion: The table below illustrates the effective change to PIT rates by income brackets:

		Existing PIT Rates	Proposed PIT Rates HB0292	Change % NB: Red is Tax INCREASE Green is Tax DECREASE
Married Filing Separately	0-4000	1.70%	2.00%	17.65%
	4001-8000	3.20%	2.00%	-37.50%
	8001-12000	4.70%	2.00%	-57.45%
	12001-15000	4.90%	2.00%	-59.18%
	15001-30000	4.90%	3.00%	-38.78%
	30001-45000	4.90%	4.00%	-18.37%
	45001-75000	4.90%	5.00%	2.04%
	75001 +	4.90%	6.00%	22.45%
HoH, Surviving Spouse, & Married Filing Jointly	0-8000	1.70%	2.00%	17.65%
	8001-16000	3.20%	2.00%	-37.50%
	16001-24000	4.70%	2.00%	-57.45%
	24001-30000	4.90%	2.00%	-59.18%
	30001-60000	4.90%	3.00%	-38.78%
	60001-90000	4.90%	4.00%	-18.37%
	90001-150000	4.90%	5.00%	2.04%
	150001+	4.90%	6.00%	22.45%
Single Individuals, Estates & Trusts	0-5500	1.70%	2.00%	17.65%
	5501-11000	3.20%	2.00%	-37.50%
	11001-16000	4.70%	2.00%	-57.45%
	16001-20000	4.90%	2.00%	-59.18%
	20001-40000	4.90%	3.00%	-38.78%
	40001-60000	4.90%	4.00%	-18.37%
	60001-100000	4.90%	5.00%	2.04%
	100001+	4.90%	6.00%	22.45%

Explanation of table above: As noted in column 4, positive percentages indicate a tax INCREASE while negative percentages indicate a tax DECREASE. This tax scheme raises taxes on both higher income earners as well as the lowest income earners. Additionally, the income tax rate for the two highest income brackets is greater than the highest rate of our surrounding states (UT, CO, TX, & AZ), and is slightly lower than Oklahoma (5.25%).

In addition to other effects, there may be some marginal increase in taxpayer activity to take advantage of certain tax credits at higher income levels.