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

SPONSOR Roybal Caballero **ORIGINAL DATE LAST UPDATED** ______ **HB** 117

SHORT TITLE Phased-in Supplemental Income Tax **SB** ______

ANALYST Graeser

REVENUE (dollars in thousands)

Estimated Revenue					R or NR**	Fund Affected
FY17	FY18	FY19	FY20	FY21		
$0.0	$17,200.0	$29,100.0	$47,500.0	$61,400.0	Recurring	General Fund

Parenthesis ( ) indicate revenue decreases. ** Recurring (R) or Non-Recurring (NR).

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY17	FY18	FY19	3 Year Total Cost	R or NR**	Fund Affected
Total		$36.0	$2.0	$38.0	Non-Recurring	Taxation and Revenue Operating

Parenthesis ( ) indicate revenue decreases. ** Recurring (R) or Non-Recurring (NR).

Duplicates, Relates to, Conflicts with, Companion to all other bills amending the personal income tax act. These include at this point: HB48, HB76, HB117, HB169, HB196, HB201 and SB50

SOURCES OF INFORMATION
LFC Files

Responses Received From
Taxation and Revenue Department (TRD)

SUMMARY

Synopsis of Bill

House Bill 117 provides for a phased-in supplemental income tax beginning in taxable year 2018. The supplemental tax would be an incremental rate addition to the tax imposed in Section 7-2-3 NMSA 1978. The income supplemental tax would be imposed on:

- individuals filing as married individuals filing separate returns and single individuals, estates and trusts with taxable income in excess of $100,000; and

- individuals filing as head of household, surviving spouse and married individuals filing joint returns with taxable income in excess of $150,000.

The supplemental rate of tax would begin to apply and would be phased in over a period of four tax years as follows:

- Taxable years beginning January 1, 2018 but prior to January 1, 2019 = .3% of taxable income;
- Taxable years beginning January 1, 2019 but prior to January 1, 2020 = .5% of taxable income;
- Taxable years beginning January 1, 2020 but prior to January 1, 2021 = .8% of taxable income; and
- Taxable years beginning on or after January 1, 2021 = 1% of taxable income.

The effective date of this bill is not specified. Assume 90 days following adjournment (June 16, 2017). Applicable for tax years beginning January 1, 2017. There is no sunset date. This is, apparently, a proposal to permanently reverse the 2003 phased-in rate reduction enacted under Governor Richardson.

FISCAL IMPLICATIONS

TRD staff prepared this estimate as follows:

TRD used GenTax taxpayer data from tax years 2010-2015 to estimate the revenue impact. Tax year 2014 is considered the most current dataset for this analysis. Personal income tax (PIT) growth rates forecast by the Consensus Revenue Estimating Group (CREG) in December 2016 were used to estimate out-year revenues. GenTax taxpayer data was divided into income groups based on filed returns. For taxpayers who do not file a PIT-B, the value of Line 17 of PIT-1 was used. For taxpayers who file a PIT-B, the value of Line 11B was used. For each future tax year the prescribed rate was applied to the difference between the extracted data and the income threshold.

Revenue calculations from each tax year were forecast by applying fiscal year collection estimates and growth rates used by the CREG. This process was repeated for each tax rate, and the appropriate future tax year estimate was recorded.

LFC notes that this proposal would partially restore the income elasticity that was 1.63 in the years prior to the 2003 rate reduction. It is somewhat speculative what this proposal would do to future growth rates, but it would restore progressivity to the tax.

SIGNIFICANT ISSUES

TRD notes the following: This legislation, although entitled supplemental tax, in practical terms creates new income brackets with new tax rates. The highest income brackets for Married filing Separately (SEP), Head of Household (HoH), and Singles (SNGL) are raised from $12,000, $24,000, and $16,000 to $100,000, $150,000, and $100,000 respectively. Similarly, the highest bracket tax rate will transition from 4.9 percent to 5.9 percent over 4 years.”

TRD also notes a concern with breaching traditional vertical and horizontal equity principles: "… this legislation implicates the policy principal of equity, or fairness, in two ways. First, the bill creates a horizontal equity concern because the income multiple of this legislation (1.0, 1.5, & 1.0) deviates from the statutory multiples for lower thresholds of (1.0, 2.0, & 1.5). Horizontal equity ensures similarly-situated taxpayers face similar tax burdens. To align the new brackets to the existing multiple schedule, the new thresholds would be $100,000, $200,000, and $150,000 for SEP, HOH, and SNGL respectively. Second, the legislation pits the tax policy principle of revenue adequacy against the principle of vertical equity, or fairness, by increasing the tax rate on certain New Mexico taxpayers."

PERFORMANCE IMPLICATIONS

This is not a new tax expenditure. To the contrary, it may be viewed as either a tax increase or restoring a 2003 tax cut. Thus, the LFC staff criteria to judge and evaluate tax expenditures does not apply to the provisions of this bill.

ADMINISTRATIVE IMPLICATIONS

TRD note the following administrative & compliance impacts: "… minimal impact for processing. Modification of forms, instructions, and publications related to the Income Tax Act would be necessary. Modifications to the Gentax business rules will be required. All modifications can be done with minimal cost to the department as part of the annual renewal of the tax program. Minor changes to audit procedures will be required."

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP: relates to all other bills amending the personal income tax act. These include at this point: HB-48, HB-76, HB-117, HB-169, HB-196, HB-201 and SB-50

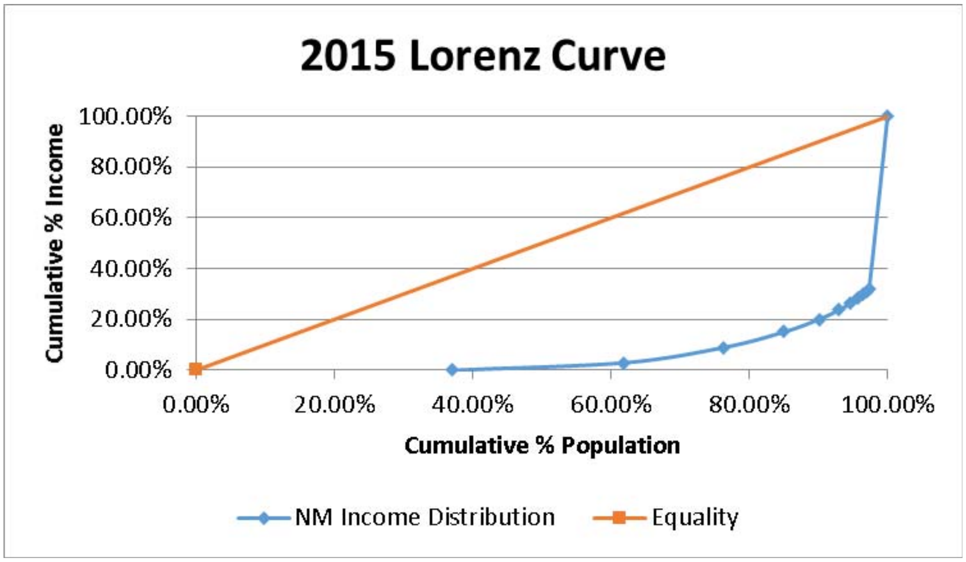
TECHNICAL ISSUES

This bill does not contain a delayed appeal. Although not a tax expenditure, the LFC recommends adding one. With this modest proposal, the legislature would be allowed to determine if this tax increase materially affected economic development efforts in the state.

OTHER SUBSTANTIVE ISSUES

TRD engaged in an interesting analysis to determine the number of taxpayers at each of the new bracket levels:

"The Lorenz Curve included below illustrates the distribution of taxable income in New Mexico. Approximately 90% of New Mexico PIT tax filers for tax year 2015 have taxable income less than or equal to $100K. New Mexico PIT tax filers with taxable income over $150,000 account for approximately 75% of the taxable income available."



"**Note:** A Lorenz Curve, developed in 1905 by Economist Max Lorenz, is a graph on which the cumulative percentage of total income is plotted against the cumulative percentage of the corresponding population (ranked in increasing size of share). The extent to which the curve sags below a straight diagonal line indicates the degree of inequality of distribution."

"Aligning the income thresholds with the historical multipliers will enhance horizontal equity. TRD taxpayer research indicates that taxpayers with taxable incomes over $150,000 account for approximately 75 percent of the taxable income in New Mexico, while taxpayers with incomes less than or equal to $100,000 account for 20 percent of the total taxable income. Approximately 90 percent of New Mexican tax filers – approximately 900,000 – earn $100,000 or less."

LFC staff note that this bill clearly proposes a tax increase. On the other hand, it can be seen as partially restoring a previous (2003) PIT rate cut. The 2003 cut was enacted in an attempt to make the state more attractive to businesses seeking to relocate or expand. The current state of the economy make essentially prove that many, if not all, of the tax changes enacted since 2003 have not been effective in stimulating job growth and economic opportunities.

The following LFC model reinforces the TRD analysis and distributes this new burden for the 2017 Tax year to the filing status. Note that married joint returns with Taxable income in excess of $150,000 will pay about 79 percent of the increased taxes, while singles and married separate taxpayers will pay the remaining 21 percent. Also note that this model predicts somewhat less tax than the TRD model for two reasons: (1) the LFC model is based on TY 2014 data and has not been increased for an increase from 2014 to 2017 in personal income in the state; and (2) the TRD model includes the effect on out-of-state taxpayers who will pay the supplemental income tax based on their income everywhere apportioned to New Mexico based on the proportion of personal income earned in New Mexico compared to income earned everywhere.

	Singles		MFJ & HoH		MFS		Total	
	Returns	$ Additional Tax	Returns	$ Additional Tax	Returns	$ Additional Tax	Returns	$ Additional Tax
Tax Year 2017 Impact	8,002	$2,714,909	25,600	$11,333,283	877	$310,158	34,479	$14,358,349
Avg per return		$339		$443		$354		$416

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