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

ORIGINAL DATE 2/06/17
SPONSOR McCamley **LAST UPDATED** **HB** 310

SHORT TITLE Income & Capital Gains Taxes **SB**

ANALYST Graeser

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY17	**FY18**	**FY19**	**FY20**	**FY21**		
$0.0	$108,000.0	$173,000.0	$204,600.0	$209,900.0	Recurring	General Fund

Parenthesis ( ) indicate expenditure decreases. ** R = recurring; NR = non-recurring

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY17	FY18	FY19	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
Total	Minimal	Minimal	Minimal	Minimal	Recurring	TRD operating

Parenthesis ( ) indicate expenditure decreases. ** R = recurring; NR = non-recurring

Duplicates, Relates to, Conflicts with, Companion to other bills affecting personal income tax rates, including: HB-117, HB-169, HB-201, HB-311 and SB-50

SOURCES OF INFORMATION
LFC Files

Responses Received From
Taxation and Revenue Department (TRD) on HB117

SUMMARY

Synopsis

House Bill 310 adds a top bracket at 5.9% marginal tax rate to each filing status for personal income tax. The bill also reduces the net capital gains deduction to $1,000 from the greater of $1,000 or 50 percent of the capital gains included on a federal tax return. The third section of the bill increases the motor vehicle excise tax from the current 3 percent to 5 percent.

The PIT rate and capital gains deduction change are applicable to tax years beginning January 1, 2018. The effective date of the motor vehicle excise tax change is July 1, 2017.

The floor amount for the higher 5.9 percent rate is as follows:

	Taxable income is
Married Filing Separate	Over $75,000
Heads of Household (HoH), Married Filing Joint (MFJ) and Surviving Spouse	Over $150,000
Single (SING) and estates and trusts	Over $100,000

FISCAL IMPLICATIONS

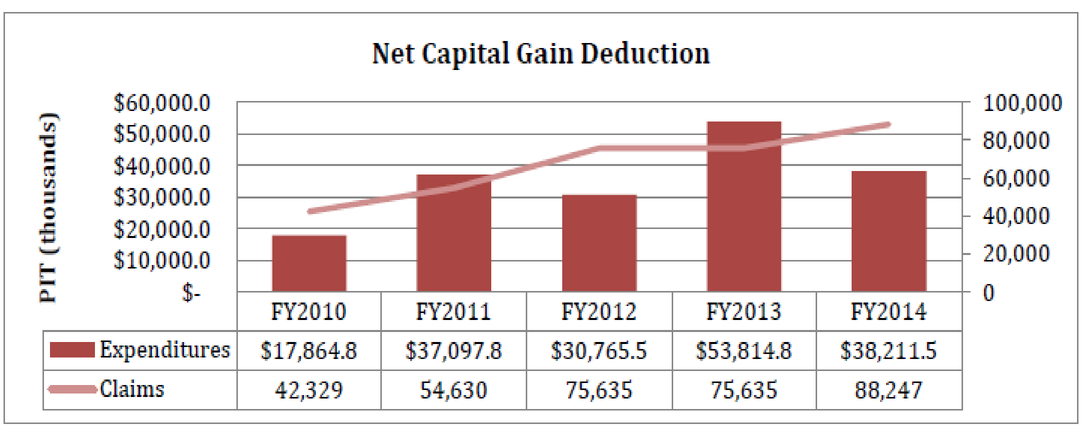
Capital Gains Deduction Reduction:

Estimated Revenue					R or NR **	Fund Affected
FY17	**FY18**	**FY19**	**FY20**	**FY21**		
$0.0	$0.0	$29,100.0	$39,000.0	$40,300.0	R	General Fund

Parenthesis ( ) indicate expenditure decreases. ** R = recurring; NR = non-recurring

(Note: the zero amount for FY 18 is caused by timing, not liability. The capital gains reduction is applicable for tax year 2018 and beyond. Few higher-income taxpayer will adjust their estimated payments for the April and June 2018 payments because of the existence of the so-called "safe-harbor" feature. If higher-income taxpayers pay as much in total estimated payments for TY 18 as they owed for TY17, there would be no penalty. The extra amount would be paid primarily as a final settlement in April 2019. Some taxpayers adjust withholding from salaried employment to account for the additional taxes accruing to capital gains.

LFC staff estimated the fiscal impact based on 2014 New Mexico federal taxpayer data and New Mexico tax expenditure data reported in the TRD 2015 Tax Expenditure Report (TER). The consensus revenue estimating group revenue projections show increasing personal income tax revenues over time, but the increases are dwarfed by historic swings in the cost of the tax expenditure. Although the LFC and TRD estimates are identical, market volatility could cause individual years to be higher or lower than the given range.



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As reported in the 2015 TER, the cost of the deduction has varied; during the five-year period from FY10 - FY14, the expenditure was as low as $17.9 million (FY10) and peaked at $53.8 million (FY13). The five-year average expenditure for this period is $35.6 million, but there is also an upward trend as the country exited the recession and market began to recover.

Of further note, there is a loose correlation between the year-ending stock market price and the value of capital gains reported for a particular year. In January 2017, the Dow-Jones industrial average exceeded 20,000 for the first time in history and many observers are expecting President Trump to continue to execute policies favorable to job growth and growth in the economy and, concomitantly, the stock prices.

The savings from this bill would be nearly as great as if the deduction were eliminated altogether. Using the highest number of claims reported in the five-year period shown in the 2015 TER, and using an average tax rate for all filers of 4.3 percent, if all claimants qualified for the $1,000 maximum deduction in the bill, the cost to the state would be $3.8 million annually – an order of magnitude less than the current cost of the deduction.

New PIT 5.9 Percent bracket

This proposal is similar to that of HB117 of this session, except the increase in this bill would not be phased in over a four-year period.

Estimated Revenue					R or NR**	Fund Affected
FY17	FY18	FY19	FY20	FY21		
$0.0	$10,000.0	$52,000.0	$59,000.0	$61,600.0	Recurring	General Fund

A note here similar to the note on the receipt of revenues occasioned by the reduction of capital gains: In the case of the new top bracket (5.9% for MFJ with taxable income over $150,000), the withholding tables would be adjusted for January 2018. Thus, the state would receive the full amount of revenue from higher-income wage and salaried taxpayers beginning with FY 18. However, non-salaried or employed higher-income taxpayers affected by the new rate would probably not adjust their estimated payments and pay off the additional liability as a final settlement in April 2019. These estimates are similar to those calculated by TRD, with the exception that LFC expects a modest amount of revenue collections in FY 18 paid through the withholding system on wages and salaries paid.

Increase Motor Vehicle Excise Tax to 5%

Estimated Revenue					R or NR**	Fund Affected
FY17	FY18	FY19	FY20	FY21		
$0.0	$98,000.0	$102,000.0	$106,000.0	$108,000.0	Recurring	General Fund

These impacts have been derived from the February 2017 Consensus Revenue Estimating Group update. This assumes that a 2 percentage point increase in tax will have an insignificant impact on sales of new or used cars and light trucks.

SIGNIFICANT ISSUES

TRD notes on the capital gains portion of this bill: "…although 100 percent of New Mexico taxpayers are eligible to claim the net capital gains deduction (NCGD), a taxpayer must have qualifying income to apply it. Over 65 percent of the NCGD claimants have taxable incomes less than $100 thousand. These claimants account for approximately 30 percent of the total deduction amounts claimed. In contrast, the top 10 percent of wage earners claiming a NCGD account for over 66 percent of net capital gain income earned. To maximize this deduction, a taxpayer must have net capital gain income greater than $25 thousand. During tax year 2013, federal income tax data indicates that the average amount of net capital gain income earned by New Mexico taxpayers was $13.7 thousand, indicating that many New Mexico taxpayers are using this deduction based on small amounts of capital gain income, such as from the sale of a residence or from interim withdrawals from a retirement account. From a revenue adequacy perspective, this bill has the positive effect of increasing state revenues. However, [reducing] the deduction will have an adverse effect on a large segment of claimants whose income is under $100 thousand and may result in outward emigration of high wage earners."

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.

This bill can be viewed as decreasing two (or three, if the differential rate of 3% is considered a tax expenditure relative to the 7% average gross receipts tax rate) previously enacted tax expenditures. A tax expenditure occurs when a particular deduction or exemption (reducing revenue) is used to define a tax base that is normative compared to similar provisions in other states (or countries). Whether a personal income tax should be progressive, neutral or regressive is an interesting discussion of this principle. In history, New Mexico's personal income tax, with a succession of universal and low-income food and medical tax rebates served as a balance wheel. The progressive PIT rate structure balanced the moderately regressive gross receipts tax (which has become far more regressive as we enact tax expenditures relieving higher-income taxpayers of tax liability) and the proportional to regressive property tax. The income elasticity of the current tax is about 1.0, meaning that a 10 percent increase in personal income results in a 10 percent increase in personal income tax. Prior to the 2003 Governor Richardson era PIT rate reduction, the income elasticity was between 1.3 and 1.4, meaning that a 10 percent increase in personal income resulted in a 13 to 14 percent increase in personal income tax. Reestablishing the higher income top bracket will likely increase the income elasticity of the tax to about 1.15 to 1.2. This would help balance the budgets in future years. This possible effect has not been included in the fiscal impact reported in the summary table.

PERFORMANCE IMPLICATIONS

All of these tax provisions are adequately reported in the series of TRD Tax Expenditure Reports.

ADMINISTRATIVE IMPLICATIONS

Minimal

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, HB-310, HB-311 and SB-50

TECHNICAL ISSUES

Section 4 of this bill repeals the 2005 (1st SS) version of 7-2-7 NMSA 1978, the bill that adjusted the timing of the phase-down in PIT rates. These changes have now been in place more than three years plus the current year and returns from those years are not eligible for amendment. This repeal will modestly clean up current statute.

LG/sb