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FISCAL IMPACT REPORT

SPONSOR <u>Chandler/Shendo/Wirth</u>	LAST UPDATED <u>1/31/23</u>	ORIGINAL DATE <u>1/26/23</u>
SHORT TITLE <u>Income Tax Bracket Changes</u>	BILL NUMBER <u>House Bill 119</u>	ANALYST <u>Faubion</u>

REVENUE* (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY23	FY24	FY25	FY26	FY27		
--	--	(\$18,700)	(\$19,500)	(\$20,300)	Recurring	General Fund

Parenthesis () indicate revenue decreases
 *Amounts reflect most recent analysis of this legislation.

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT* (dollars in thousands)

	FY23	FY24	FY25	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
	--	\$5.5	--	\$5.5	Recurring	General Fund – TRD/ITD
Total		\$5.5		\$5.5		

Parentheses () indicate expenditure decreases.
 *Amounts reflect most recent analysis of this legislation.

Conflicts with Senate Bills 28 and 85.

Sources of Information

LFC Files

Responses Received From
 New Mexico Attorney General (NMAG)
 Taxation and Revenue Department (TRD)

SUMMARY

Synopsis of House Bill 119

House Bill 119 (HB119) restructures the personal income tax rates and income brackets to increase the number of brackets, adjust the rates, and change the income range within each bracket. The proposed income tax structure is as follows:

Table 1					
Current Tax Brackets	Taxable Income Range	Rate	Proposed Tax Brackets	Taxable Income Range	Rate
Married filing separate					
1	Not over \$4,000	1.7%	1	Not over \$4,000	1.5%
2	\$4,000 – not over \$8,000	3.2%	2	\$4,000 – not over \$12,500	3.2%
3	\$8,000 – not over \$12,000	4.7%	3	\$12,500 – not over \$25,000	4.3%
4	\$12,000 – not over \$157,500	4.9%	4	\$25,000 – not over \$50,000	4.7%
5	Over \$157,500	5.9%	5	\$50,000 – not over \$100,000	5.5%
			6	\$100,000 – not over \$250,000	6.5%
			7	Over \$250,000	6.9%
Married Filing Jointly, Heads of Households					
1	Not over \$8,000	1.7%	1	Not over \$8,000	1.5%
2	\$8,000 – not over \$16,000	3.2%	2	\$8,000 – not over \$25,000	3.2%
3	\$16,000 – not over \$24,000	4.7%	3	\$25,000 – not over \$50,000	4.3%
4	\$24,000 – not over \$315,000	4.9%	4	\$50,000 – not over \$100,000	4.7%
5	Over \$315,000	5.9%	5	\$100,000 – not over \$200,000	5.5%
			6	\$200,000 – not over \$500,000	6.5%
			7	Over \$500,000	6.9%
Single					
1	Not over \$5,500	1.7%	1	Not over \$5,500	1.5%
2	\$5,500 – not over \$11,000	3.2%	2	\$5,500 – not over \$16,500	3.2%
3	\$11,000 – not over \$16,000	4.7%	3	\$16,500 – not over \$33,500	4.3%
4	\$16,000 – not over \$210,000	4.9%	4	\$33,500 – not over \$66,500	4.7%
5	Over \$210,000	5.9%	5	\$66,500 – not over \$133,500	5.5%
			6	\$133,500 – not over \$333,500	6.5%
			7	Over \$333,500	6.9%

The effective date of this bill is January 1, 2024.

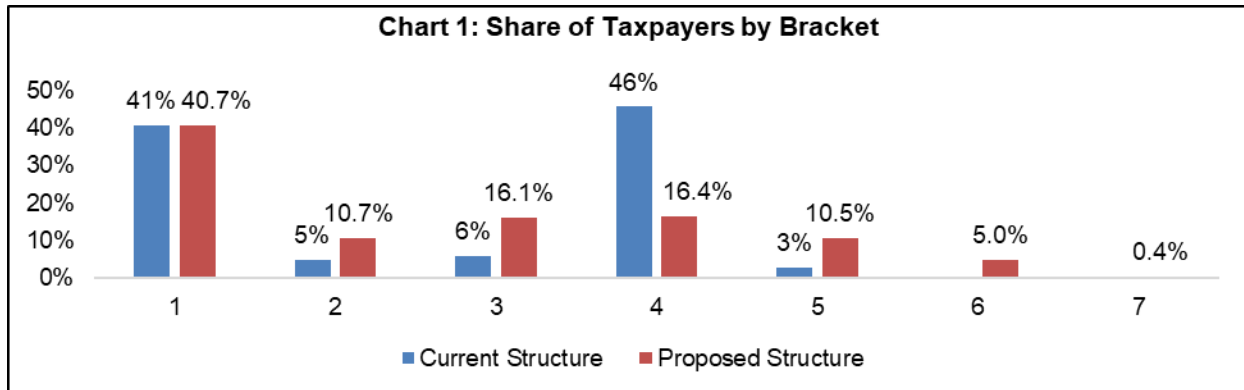
FISCAL IMPLICATIONS

The impact of the proposed changes to the income tax brackets was estimated by the Taxation and Revenue Department (TRD) using tax year 2021 tax return data for New Mexico taxpayers. Using the University of New Mexico’s Bureau of Business and Economic Research (BBER) January 2023 forecast, TRD indexed the data to tax year 2024 and then grew the estimate annually by BBER’s New Mexico’s wage and salary growth.

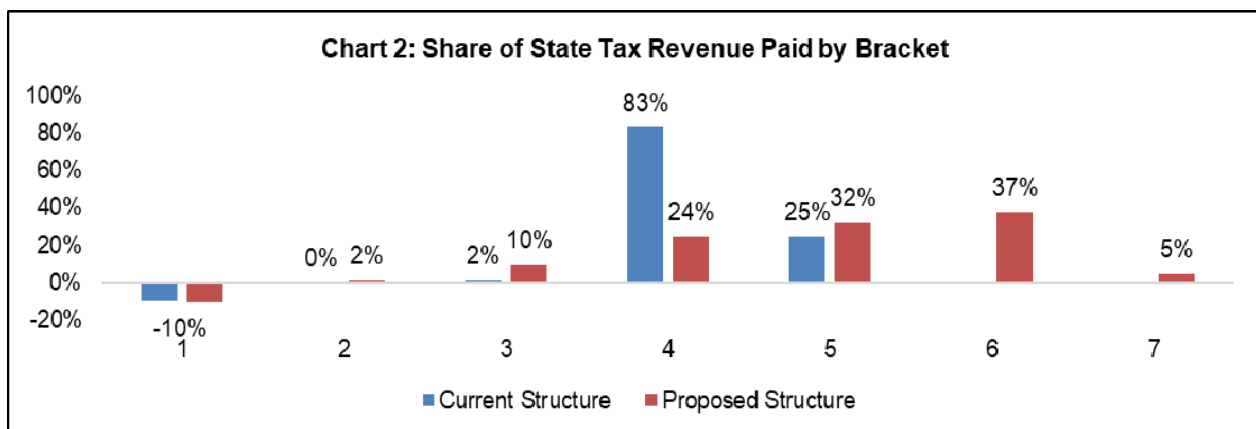
SIGNIFICANT ISSUES

The personal income tax structure proposed in HB119 will decrease taxes for the lowest-earning taxpayers by lowering the bottom rate and including a wider range of incomes in the lower-rate brackets. The bill also raises the effective tax rate for high-income earners by increasing the top rate from 5.9 percent to 6.9 percent, as well as adding a 6.5 percent bracket. LFC analysis estimates that single filers with income less than \$110 thousand will experience a tax liability decrease, and those with incomes over \$110 thousand will experience a tax increase. For joint filers, that threshold is approximately \$170 thousand.

Under the proposed tax bracket changes, approximately 41 percent of taxpayers will be in the 1.5 percent tax bracket, the same as the current structure. The next four brackets with tax rates between 3.2 percent and 5.5 percent each contain 10.5 percent and 16 percent of taxpayers. The sixth tax bracket at 6.5 percent contains approximately 5 percent of taxpayers, and the top bracket contains 0.5 percent of taxpayers. This analysis illustrates this proposal effectively redistributes taxpayers throughout the bracket structure. See Chart 1 for a comparison of taxpayer distribution between the current structure and the proposed structure.



Tax burden is also effectively redistributed across incomes under this proposal, increasing the personal income progressivity as rates and tax burden rises with incomes. Used in tax analysis, progressivity is a measure of tax share by income and does not connote ideological alignment of the tax proposal. A progressive tax means, as income rises, a larger share of one’s income is paid to that tax, as one’s ability to pay increases. For example, under the proposed structure, the share of overall state tax revenue paid per bracket never exceeds 37 percent for any single bracket while the old structure saw the majority of personal income tax paid by a single bracket. The lowest tax bracket taxpayers average a negative tax liability after claiming eligible credits and refunds under both the proposed and current structure. See Chart 2 for a comparison of tax burden between the current structure and the proposed structure. Note that given the negative liability of the first bracket, total shares equal approximately 110 percent.



The current tax structure is extremely compact at the lower income levels with taxpayers quickly reaching the 4.9 percent tax rate as incomes rise. See Table 1 for a comparison of the current and proposed rate structure.

TRD notes the following:

Personal income tax (PIT) represents a consistent source of revenue for many states. While this revenue source is susceptible to economic downturns, it is also positively responsive to economic expansions. New Mexico is one of 42 states, along with the District of Columbia, that impose a broad-based PIT. The PIT is an important tax policy tool that has the potential to further both horizontal equity, by ensuring the same statutes apply to all taxpayers, and vertical equity, by ensuring the tax burden is based on taxpayers' ability to pay.

The last substantial amendment to the PIT brackets was passed in 2005, though the changes made by that amendment were not fully implemented until tax year 2008. (In 2019, an amendment was passed adding an additional 5.9 percent income bracket to each filing status, effective from tax year 2021.) As New Mexico PIT brackets are not indexed to inflation, taxpayers have gradually moved into higher tax brackets, described as “bracket creep”, despite the fact that their “real income”, or the purchasing power of their income, has not changed. Over time, the effective PIT rate, which is the average tax rate paid by a taxpayer on their total gross income, has increased. The federal personal income tax indexes both the standard deduction and tax brackets. The revisions proposed in this bill, Table 1 above, appear reflective of indexing the brackets for inflation since 2008. Without annual indexing of the tax brackets though, taxpayers are at risk of future bracket creep.

The majority of the savings for taxpayers from this bill occurs for low and middle-income taxpayers as demonstrated in Table 2 below. This is achieved by both increasing the income ranges for the brackets but also applying a lower marginal rate for the new proposed brackets 1 through 5. Taxpayers in the new proposed brackets 6 and 7, will see an increase in tax liability due to higher marginal rates for these brackets. These changes increase the progressivity of PIT, progressivity being where higher-earning taxpayers pay a larger share of their income in tax compared to lower-earning taxpayers. This supports the concept of vertical equity mentioned above.

The proposed brackets changes maintain the so-called “marriage penalty”. As defined by the Tax Foundation, a marriage penalty exists when a state’s income brackets for married taxpayers filing jointly are less than double the bracket widths for single filers. As of tax year 2022, New Mexico is one of 15 states which has a “marriage penalty” built into its income tax brackets.¹

¹ <https://taxfoundation.org/state-marriage-penalty-2022/>

Table 2			
Current Tax Brackets	Proposed Tax Brackets	Estimated No. of Taxpayers	Estimated Fiscal Impact for FY2025 (\$ thousands)
1	1	432,000	(\$560)
2	2	66,000	(\$930)
3	2	56,000	(\$3,580)
4	2	6,000	(\$740)
4	3	158,000	(\$31,180)
4	4	187,000	(\$55,160)
4	5	113,000	(\$17,370)
4	6	29,000	\$18,490
5	6	14,000	\$18,660
5	7	21,000	\$52,670

ADMINISTRATIVE IMPLICATIONS

TRD will need to make information system changes and update forms and publications. These changes will be incorporated into annual tax year implementation and cost \$5,554 in workload costs for the Information Technology Division (ITD).

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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