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## FISCAL IMPACT REPORT

LAST UPDATED 2/17/23

SPONSOR Schmedes ORIGINAL DATE 1/20/23

SHORT TITLE Adjust Income Tax Brackets BILL NUMBER Senate Bill 85

ANALYST Faubion

### REVENUE\* (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY23	FY24	FY25	FY26	FY27		
	(\$2,400)	(\$54,400)	(\$56,500)	(\$58,300)	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
TRD/ITD	--	\$5.5	--	\$5.5	Recurring	General Fund
<b>Total</b>		<b>\$5.5</b>		<b>\$5.5</b>		

Parentheses ( ) indicate expenditure decreases.

\*Amounts reflect most recent analysis of this legislation.

Conflicts with HB119.

### Sources of Information

LFC Files

#### Responses Received From

Taxation and Revenue Department (TRD)

## SUMMARY

### Synopsis of Senate Bill 85

Senate Bill 85 (SB85) changes the income tax brackets beginning in the 2023 tax year for those filing as heads of household, surviving spouse, or married individuals filing joint returns, increasing the income threshold for each bracket and changing the amount of tax imposed. The bill also removes the separate brackets for married individuals filing separately and combines this filing status with the single filing status; the bill does not change these brackets.

This bill does not contain an effective date, and as a result, would go into effect June 16, 2023, (90 days after the Legislature adjourns) if signed.

## FISCAL IMPLICATIONS

The impact of the proposed changes to the income tax brackets in this legislation 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) October 2022 forecast, TRD indexed the data to tax year 2023 and then grew the estimate annually by BBER’s New Mexico’s wage and salary growth.

To implement SB85, TRD would need to make information system changes and update forms and publications. These changes would be incorporated into annual tax year implementation and represent \$5,554 in workload costs for the Information Technology Division (ITD).

Estimating the cost of tax expenditures is difficult. Confidentiality requirements surrounding certain taxpayer information create uncertainty, and analysts must frequently interpret third-party data sources. The statutory criteria for a tax expenditure may be ambiguous, further complicating the initial cost estimate of the expenditure’s fiscal impact. Once a tax expenditure has been approved, information constraints continue to create challenges in tracking the real costs (and benefits) of tax expenditures.

## SIGNIFICANT ISSUES

This bill increases the number of married filing jointly, head of household, and surviving spouse taxpayers that fall within the lower income tax brackets by raising the upper bounds of the income brackets for these taxpayers. This also results in a tax cut for all taxpayers, even high-income filers who remain in the 5.9 percent bracket. This is because high earners will pay a lower tax rate on their incomes up to \$420 thousand. This increases the progressivity of the New Mexico income tax by giving a larger relative tax cut to lower income earners than higher income earners. A progressive tax involves a tax rate that increases as taxable income increases. It imposes a lower tax rate on low-income earners and a higher tax rate on those with a higher income.

TRD notes the proposed combining of the married individuals filing separately into the single individuals tax bracket aligns their income to the same federal standard deduction taken by both filing types. The income range adjustment to the brackets for the heads of household and married individuals filing joint returns exactly doubles the income ranges for the single filers, which remain unchanged. This eliminates 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 that has a “marriage penalty” built into its income tax brackets.<sup>1</sup> Eliminating the marriage penalty will result in a tax cut for joint and head of household filers, with lower earners having a larger share of their tax liability eliminated than higher earners.

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

**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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