FISCAL IMPACT REPORT

		LAST UPDATED	1/29/24
SPONSOR	Lente	**ORIGINAL DATE**	1/28/24
SHORT TITLE	Adjust Income Tax Brackets	**BILL NUMBER**	House Bill 252
		ANALYST	Faubion

REVENUE*
(dollars in thousands)

Type	FY24	FY25	FY26	FY27	FY28	Recurring or Nonrecurring	Fund Affected
PIT		($79,500.0)	($159,000.0)	($170,000.0)	($176,000.0)	Recurring	Genera Fund

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

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT*
(dollars in thousands)

Agency/Program	FY24	FY25	FY26	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
TRD	-	$24.4	-	$24.4	Nonrecurring	General Fund

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

Sources of Information

LFC Files

<u>Agency Analysis Received From</u>
Taxation and Revenue Department (TRD)

SUMMARY

Synopsis of House Bill 252

This bill 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:

Joint Filers		
Income Range ($)	Fixed Tax Owed	Rate
0 - 8,000		1.50%
8,000 - 25,000	$120.00	3.20%
25,000-50,000	$664.00	4.30%
50,000 - 100,000	$1,739.00	4.70%

100,000 - 315,000	$4,089.00	4.90%
315,000 +	$14,624.00	5.90%
Single Filers		
Income Range ($)	Fixed Tax Owed	Rate
0 - 5,500		1.50%
5,500 - 16,500	$82.50	3.20%
16,500 - 33,500	$434.50	4.30%
33,500 - 66,500	$1,165.50	4.70%
66,500 – 210,000	$2,716.50	4.90%
210,000 +	$9,748.00	5.90%
Married Separate Filers		
Income Range ($)	Fixed Tax Owed	Rate
0 - 4,000		1.50%
4,000 - 12,500	$60.00	3.20%
12,500 - 25,000	$332.00	4.30%
25,000 - 50,000	$869.50	4.70%
50,000 - 157,500	$2,044.50	4.90%
157,500 +	$7,312.00	5.90%

The effective date of this section is January 1, 2025, and the rate change is applicable for taxable years beginning on or after January 1, 2025.

FISCAL IMPLICATIONS

The impact of the proposed changes to the income tax brackets was estimated using tax years 2021-2022 tax return data for New Mexico taxpayers. Using the University of New Mexico's Bureau of Business and Economic Research (BBER) January 2024 forecast, the Taxation and Revenue Department (TRD) indexed the data to tax year 2025 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 this section would decrease taxes for all taxpayers, with the rate decreases targeted at the lowest income earners. Single filers with incomes below $66.5 thousand and married filers with incomes below $100 thousand would see a tax rate decrease. Those with incomes above those thresholds would maintain the same tax rate as currently in statute but would see a tax liability decrease due to the marginal structure of personal income tax. They would see lower taxes on their incomes up to $66.5 thousand for single filers and $100 thousand for married filers.

Currently, approximately 46 percent of all taxpayers are in the 4.9 percent bracket and 39 percent are in the 1.7 percent bracket. Each other bracket contains less than 7 percent of taxpayers. Under the proposed tax bracket changes, approximately 39 percent of taxpayers would be in the 1.5 percent tax bracket, the same as the current structure. Many of these taxpayers do not earn any income. The next four brackets with tax rates between 3.2 percent and 4.9 percent each contain between 11 percent and 16.8 percent of taxpayers. The highest tax bracket at 5.9 percent contains approximately 3.9 percent of taxpayers, the same as the current structure. This analysis illustrates that this proposal effectively redistributes taxpayers throughout the bracket 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. 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. Under the proposed structure, the share of overall state tax revenue paid per bracket never exceeds 43 percent for any single bracket while the old structure saw the majority of personal income tax (approximately 75 percent) paid by the 4.9 percent bracket. The lowest tax bracket taxpayers average a negative tax liability after claiming eligible credits and refunds under both the proposed and current structure.

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. This results in married filers moving into higher income tax brackets at lower incomes than single filers and therefore paying more taxes on the same income. As of tax year 2023, New Mexico is one of 15 states which has a "marriage penalty" built into its income tax brackets.

TRD notes the following:

> PIT represents a consistent source of revenue for many states. For New Mexico, PIT is approximately 25 percent of the state's recurring general fund revenue. While this revenue source is susceptible to economic downturns, it is also positively responsive to economic expansions. New Mexico is one of 41 states, along with the District of Columbia, that impose a broad-based PIT (New Hampshire and Washington do not tax wage and salary income). Like several states, New Mexico computes its income tax based on the federal definition of taxable income and ties to other statues in the federal tax code. This is referred to as "conformity" to the federal tax code. 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.
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> 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, HB6 added an additional 5.9 percent top 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, a phenomenon 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 therefore increased. The federal personal income tax indexes both the standard deduction and tax brackets. The revisions proposed in this bill will adjust New Mexico's PIT brackets for inflation since 2008. Further, the bill expands the five current brackets into six brackets. In addition, as the first bracket's income range has not been adjusted for inflation, taxpayers at the lowest income are most susceptible to bracket creep, reducing vertical equity, although their rate has decreased from 1.7 percent to 1.5 percent.
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> All taxpayers will see a decrease in their tax liability with most of the savings from this bill occurring for middle-income taxpayers as demonstrated in the table below. This is

achieved by both increasing the income ranges for the brackets but also applying a lower marginal rate for the proposed brackets 3 and 4. The lower marginal rate for brackets 1 through 4 reduces these taxpayers' share of their tax liability in proportion to their income. This supports the concept of vertical equity mentioned above.

Current Tax Bracket	Proposed Tax Bracket	Estimated No. of Taxpayers	Estimated Fiscal Impact for FY2026 ($ thousand)	Average Tax Relief Per Taxpayer
1	1	431,000	($480)	($1.11)
2	2	67,000	($830)	($12.39)
3	2	58,000	($3,270)	($56.38)
4	2	6,000	($680)	($113.33)
4	3	162,000	($29,900)	($184.57)
4	4	183,000	($59,880)	($327.21)
4	5	149,000	($57,200)	($383.89)
5	6	42,000	($7,230)	($172.14)

The proposed tax brackets 1 through 4 are still quite "compressed", meaning that only small amounts of income are sufficient to enter the next bracket. Although the table above shows that the lowest income taxpayers will experience smaller nominal savings, their savings are largest in percentage terms. For example, a married couple with an income of $8,000 currently pays 1.7 percent, for a tax liability of $136 annually. This proposal would reduce tax due to $120, representing savings of $16 or 12 percent. Conversely, a wealthier couple with an income of $400 thousand would currently owe $20,042, versus $19,489 under this proposal. The higher-income couple saves $553, representing savings of 2.8 percent.

ADMINISTRATIVE IMPLICATIONS

TRD will make information system changes and update forms, instructions, and publications. This bill will have a moderate impact on TRD's Information Technology Division (ITD), approximately 440 hours or about 2.5 months for an estimated staff workload cost of $24,420. The implementation will be included in the annual tax year changes.

OTHER SUBSTANTIVE ISSUES

In assessing all tax legislation, LFC staff considers whether the proposal is aligned with committee-adopted tax policy principles. Those five principles:

- **Adequacy**: Revenue should be adequate to fund needed government services.
- **Efficiency**: Tax base should be as broad as possible and avoid excess reliance on one tax.
- **Equity**: Different taxpayers should be treated fairly.
- **Simplicity**: Collection should be simple and easily understood.
- **Accountability**: Preferences should be easy to monitor and evaluate.

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