

Legislative Proposal – Personal Income Tax Simplification

**Jan Goodwin, Cabinet Secretary
and
Jim Nunns, Tax Policy Director
N.M. Taxation and Revenue Department**

**Presented to the
Revenue Stabilization and Tax Policy Committee**

**Seventh Meeting in 2007
December 12, 2007**

Personal Income Tax Simplification

Policy Goals

- **Reduce the time taxpayers devote to record keeping, tax return preparation, and return filing**
- **Reduce out-of-pocket payments to return preparers**
- **Increase fairness**

Current Law

- **New Mexico taxable income is computed as follows:**

Start with federal AGI

+ NM additions (e.g., interest on federally tax-exempt bonds)

- Federal standard or itemized deductions

- Federal personal exemption amount

- NM low- and middle-income exemption

- NM subtractions (e.g., interest on NM S&L bonds, capital gains)

- NM uncompensated medical care deduction

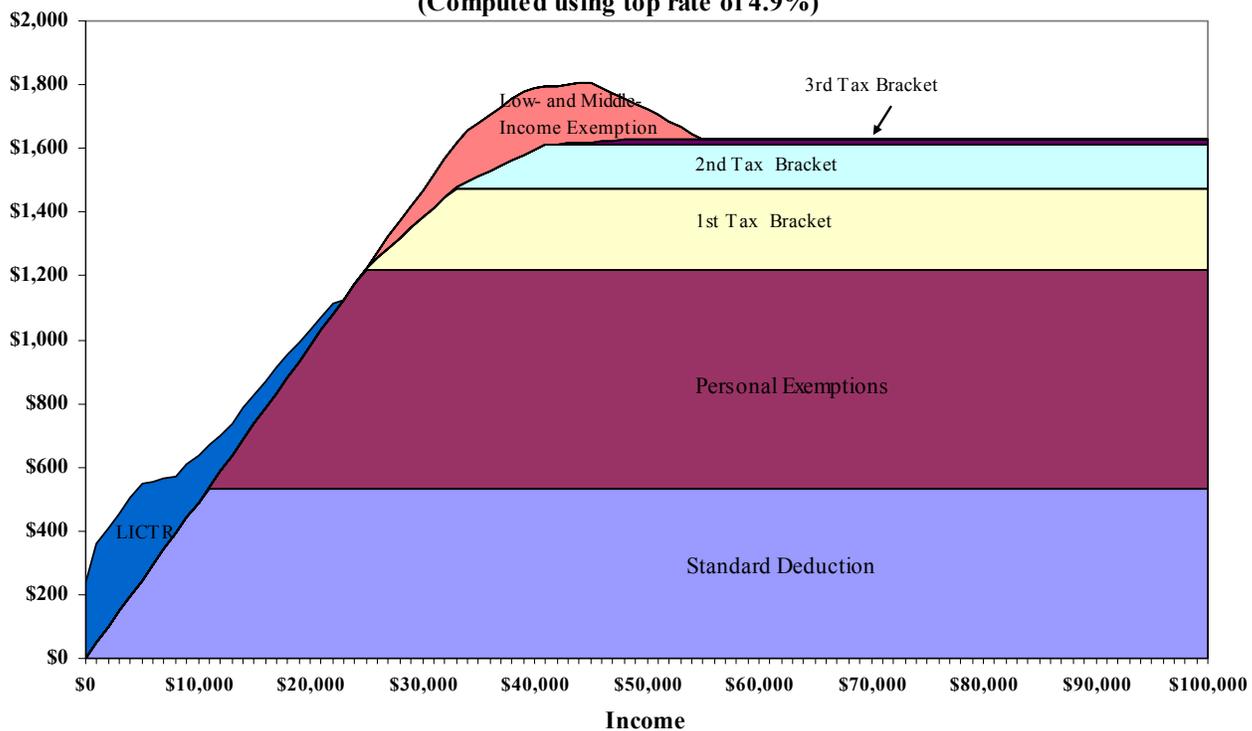
= NM taxable income

- **Tax liability is computed at graduated rates**
 - **Rates rise from 1.7% to 4.9% in 2008**
- **Tax rebates and credits are computed and applied**
 - **Most credits are nonrefundable**
 - **Refundable rebates and credits (except the new Working Families Tax Credit) are based on “Modified Gross Income” (MGI)**
- **Withholding and estimated payments are applied**
- **Taxpayers compute their tax due or refund**

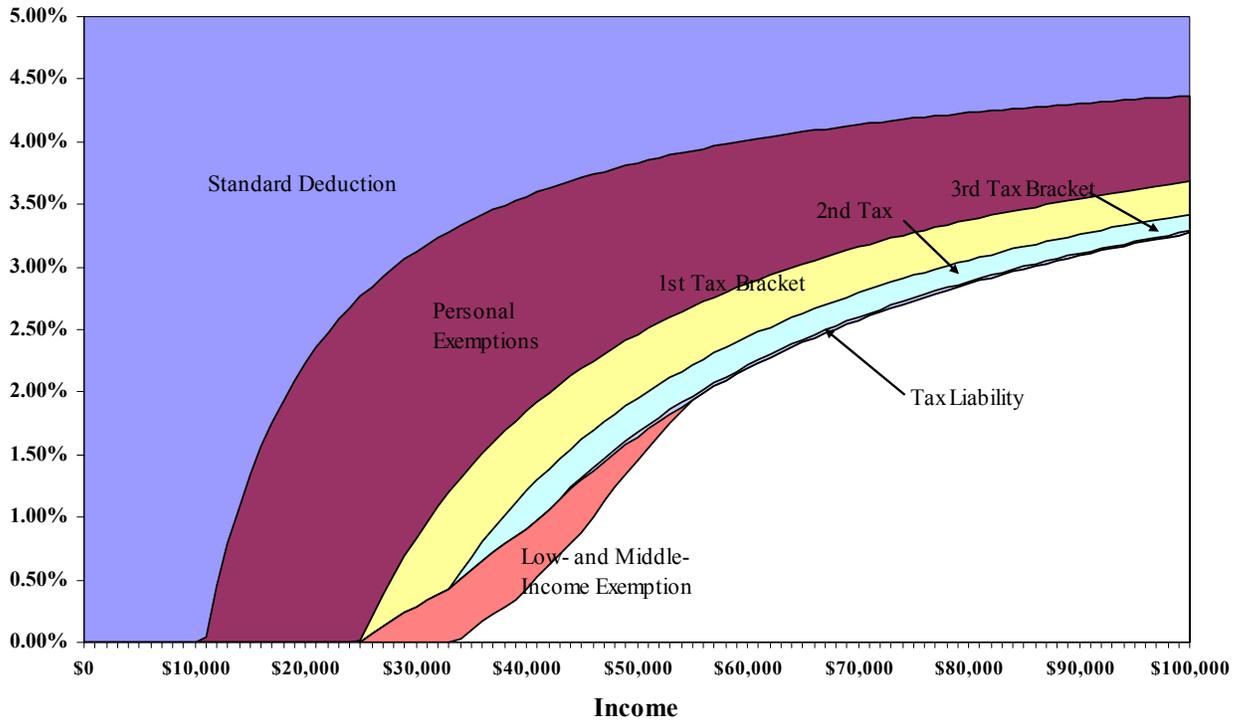
Family and Child Related Tax Benefits

- **Progressivity is achieved primarily through certain family and child related tax benefits:**
 - **Standard deduction**
 - **Personal exemptions**
 - **NM low- and middle-income exemption**
 - **Graduated rates**
 - **LICTR**
- **The following three graphs illustrate how these family and child related tax benefits contribute to progressivity**
 - **The first graph shows the dollar value of each of these benefits for a family of four at income levels up to \$100,000**
 - **The computations are made using the top 2008 rate of 4.9%**
 - **The second and third graphs show these dollar amounts expressed as a percentage of income**
- **Beginning in 2008, the Working Families Tax Credit will also add to progressivity**
 - **This credit is 8% of the federal EITC amount**
 - **Only families with earned income qualify**
 - **For these reasons, it cannot easily be integrated with the other benefits and therefore is omitted from the graphs and proposal**

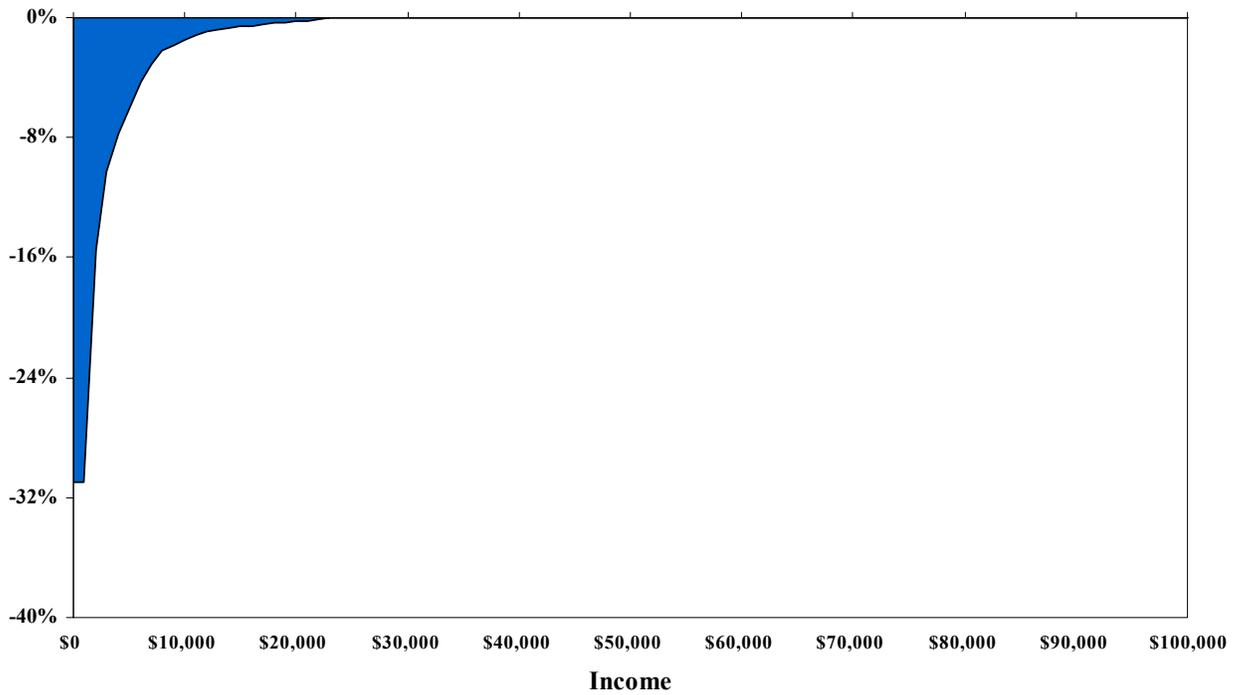
**Income Tax Benefits of Family and Child Related Tax Provisions
for a Married Couple with Two Children
(Computed using top rate of 4.9%)**



**Income Taxes as a Percentage of Income for a Married Couple with Two Children
(Computed using top rate of 4.9%)**



**Low Income Comprehensive Tax Rebate (LICTR) as a Percentage of Income for a
Married Couple with Two Children**



Proposal

- **Combine the family and child related tax benefits into a new credit**
- **The new credit would replace the standard deduction, personal exemptions, NM low- and middle-income exemption, graduated rates, and LICTR**
- **The new credit would be indexed for inflation**
- **Income for purposes of the new credit would be taxable income, so no taxpayer would need to calculate MGI to claim the credit**
 - **The new credit would replace the standard deduction, personal exemptions, and NM low- and middle-income exemption, so these deductions would not be needed under the proposal**
 - **Taxpayers who itemize deductions would be able to deduct the excess of their itemized deductions over their standard deduction amount**
 - **The portion of the new credit that replaces LICTR would begin at a constant amount (the maximum LICTR amount for the family size) to insure that very low income families do not lose benefits**
- **The single personal income tax rate would be 4.9%, since the first part of the new credit would replace the benefit of graduated rates**
- **If the new credit amount exceeded a taxpayer's income tax liability the excess would be refundable if the taxpayer was a resident of New Mexico and had taxable income of \$22,000 or less**
- **The definition of MGI would be greatly simplified**
 - **Few taxpayers would need to calculate MGI, and only for purposes of the remaining refundable credits**

Proposal – Cont.

- **Low-income families are most likely to have differences between MGI and AGI because MGI includes total Social Security benefits and TANF, SSI and other benefits not included in AGI**
 - **Benefits other than Social Security tend to be relatively small and difficult for many families to track carefully and to verify**
- **The simplified definition would add to federal AGI only the non-taxable portion of Social Security benefits**
- **A separate new refundable credit for low-income elderly and blind individuals, based on MGI, would replace the additional exemptions they currently receive for purposes of LICTR**

Effect of Proposal

- **The new credit would simplify the personal income tax by:**
 - **Removing the need to include the standard deduction, personal exemptions, and the NM low- and middle-income exemption in the computation of income subject to tax**
 - **For most taxpayers, NM taxable income would be federal AGI**
 - **Itemizers would deduct the excess of their federal itemized deductions over the standard deduction**
 - **Simplify the computation of tax liability, since there would only be one tax rate of 4.9%**
 - **With only one tax rate, there would be no need for a separate calculation for lump-sum distributions**
 - **Most families would be able to compute their tax by simply:**
 - **Looking up their tax amount in a table based only on taxable income (which typically would be the same as AGI), and**
 - **Looking up their new credit amount in a table for their filing status based on taxable income and family size**
 - **Simplify the computation of MGI for purposes of remaining refundable credits**
 - **The attached marked-up forms illustrate how these changes would simplify tax forms**
- **The new credit would make the personal income tax fairer because it would be indexed for inflation**
 - **Currently, rate brackets, the NM low- and middle-income exemption, and LICTR lose value over time due to inflation**

Effect of Proposal-Cont.

- **The new credit would provide greater flexibility in designing New Mexico family and child related tax benefits by decoupling from the federal standard deduction and personal exemption amounts**
- **For nearly all taxpayers, the new credit would precisely replace the tax benefits from the standard deduction, personal exemptions, NM low- and middle-income exemption, graduated rates, and LICTR**
- **In certain circumstances, the credit would result in lower taxes**
 - **Some low-income families would have lower taxes or a larger refund because the new credit is based on taxable income, which excludes some income in MGI, and starts at a higher level**
 - **Some middle-income families would have lower taxes if they itemize deductions, since the new credit was calculated using the standard deduction amounts**
 - **Higher-income families generally would have lower taxes because the new credit does not phase down the value of personal exemptions (as does the federal income tax until 2010)**
- **In addition to the revenue loss due to lower taxes for some families, there would be a revenue loss after 2008 due to indexation of the new credit**
 - **TRD is completing revenue estimates for the proposal using a new “micro-simulation” model we’ve developed for detailed analysis of income tax proposals**

2007 PIT-1 NEW MEXICO PERSONAL INCOME TAX

For the year January 1 - December 31, 2007,

or other fiscal year beginning _____ 2007, ending _____ 2008.



If amending use Form 2007 PIT-X.

Check this box if address is new or changed.

Print your name (first, middle, last)	1. SOCIAL SECURITY NUMBER	Residency status: complete for each taxpayer. Enter "R" if RESIDENT; "N" if NON-RESIDENT; "F" if FIRST-YEAR RES.; "P" if PART-YEAR RES.	Check if taxpayer or spouse named on the return is deceased. Enter date of death. <input type="checkbox"/> _____ <input type="checkbox"/> _____
Print your spouse's name (first, middle, last) include spouse if married filing separately.			
Mailing Address	Enter claimant's name and SSN if the refund must be made payable to another person - Attach Form RPD-41083		
City, State and Zip Code	2. EXEMPTIONS Number of Qualified Exemptions. If you are a dependent of another taxpayer, enter 00. <input type="text"/> <input type="text"/>		

3. EXTENSION OF TIME TO FILE - Mark the box if you have a federal or state extension, and enter extension date. _____

4. FILING STATUS - Check only one box below.

(1) Single

(2) Married filing jointly

(3) Married filing separately (Enter spouse's social security number above)

(4) Head of household (Enter name of person qualifying you as head of household if that person is not courted as a qualified exemption on your federal return.) _____

(5) Qualifying widow(er) with dependent child

5. DEPENDENTS: As listed on your federal return

(1) First name	Last name	(2) Dependent's social security number

6. Check this box if federal Form(s) 8886, Reportable Transaction Disclosure Statement, is required to be attached.

7. FEDERAL ADJUSTED GROSS INCOME (From line 38 of federal Form 1040, line 22 of Form 1040A or line 4 of Form 1040EZ)

7		00
8		00
9		00
10		00
11		00
12		00
13		00
14		00
15		00
16		00
17		00
18		00
19		00

8. Additions to federal income (From line 4 of PIT-ADJ; attach PIT-ADJ) +

9. Federal standard or itemized deduction amount (From line 40 of federal Form 1040, line 24 of Form 1040A or line 5 of Form 1040EZ) -

9a. Check here if you itemized

10. Federal exemption amount (From line 42 of federal Form 1040, line 26 of Form 1040A, or leave blank if you filed Form 1040EZ) -

11. New Mexico low- and middle-income tax exemption (See PIT-1 Instructions) -

12. Deductions/Exemptions from federal income (Line 20 of PIT-ADJ; attach PIT-ADJ) -

[Line 12 will include itemized deductions in excess of standard deductions.]

13. Medical care expense deduction (See PIT-1 Instructions) -

13a. Unreimbursed and uncompensated medical care expenses 13a 00

14. NEW MEXICO TAXABLE INCOME (Add lines 7 and 8, then subtract lines 9, 10, 11, 12 and 13) =

15. Tax on amount on line 14

If from the Rate Table, enter "R", If from line 15 of PIT-B, enter "B"

[Line 16 - New Credit.]

16. Additional amount for tax on lump-sum distributions (See PIT-1 Instructions) +

17. Credit for taxes paid to another state. You must have been a New Mexico resident during all or part of the year. (See PIT-1 Instructions. Include a copy of other state's return.) -

18. Non-refundable credits from Schedule PIT-CR (Line 15 of PIT-CR; attach PIT-CR) -

19. NET NEW MEXICO INCOME TAX (Add lines 15 and 16 minus lines 17 and 18) =

(Cannot be less than zero.)

Continue on the next page.

2007 PIT-RC (page 2)



YOUR SOCIAL SECURITY NUMBER

--	--	--	--

SECTION II: LOW INCOME COMPREHENSIVE TAX REBATE

(If line 13 is MORE than \$22,000, DO NOT COMPLETE this section.)

13. Enter Modified Gross Income from line 72. 13 /00

a. Enter total exemptions from line 3. 13a 00

14. Low Income Comprehensive Tax Rebate: On table 1 on page 5 RC, find the Modified Gross Income range that includes the amount on line 13, then move across to the column that matches the number of exemptions on line 13a. (Married couples filing separately must divide result by two.) 14 /00

[New tax rebate for persons age 65 or older or blind.]

SECTION III: FOR PERSONS 65 OR OLDER - PROPERTY TAX REBATE

(If line 13 is more than \$16,000, DO NOT COMPLETE this section.)

15. PROPERTY OWNED - Tax billed for the calendar year on principal place of residence. 15 00

16. PROPERTY RENTED 16a 00

a. Amount of rent paid during the tax year for principal place of residence. 16a 00

Check if the amount entered on line 16a includes rent paid on your behalf by a government entity. 16b 00

b. Multiply line 16a by .06 and enter the amount here. 16b 00

17. REBATE AMOUNT 17a 00

a. Add lines 15 and 16b and enter the total here. 17a 00

b. Find the Modified Gross Income range, table 2 on page 6 RC, that corresponds to the amount on line 13. Read across to the matching number in the Maximum Property Tax Liability table, and enter amount here. 17b 00

c. Property Tax Rebate: Subtract line 17b from 17a. Do not enter more than \$250, or more than \$125 if Married Filing Separately. 17c 00

SECTION IV: ADDITIONAL LOW INCOME PROPERTY TAX REBATE for Los Alamos County residents only.

(If line 13 is over \$24,000, DO NOT COMPLETE this section.)

18. REBATE AMOUNT 18a 00

a. PROPERTY OWNED only. - Tax billed for the calendar year on principal place of residence. 18a 00

b. Find the Modified Gross Income range, table 3 on page 7 RC, that corresponds to the amount on line 13, above. Read across to the matching percentage in the Property Tax Rebate Percentage column and enter here. 18b %

c. Multiply line 18a by line 18b and enter here. Do not enter more than \$350 or \$175 if Married Filing Separately. 18c 00

SECTION V: NEW MEXICO CHILD DAY CARE CREDIT (If Modified Gross Income on line 13 is \$21,424

or less, use the worksheet on page 10 RC of the instructions for 2007 PIT-RC Schedule to figure your available Child Day Care Credit. Attach the worksheet and Forms PIT-CG.)

19. Enter either the total of Column G or \$1,200, WHICHEVER IS LESS. 19 00

20. Number of qualified dependents under age 15 receiving child day care. 20 00

21. Enter portion of Federal Child Care Credit applied against your federal tax from Form 1040 or 1040A. 21 00

22. New Mexico child day care credit: Subtract line 21 from line 19. (Married couples filing separately must divide result by two.) 22 00

SECTION VI: REFUNDABLE TAX CREDITS

23. Refundable medical care credit for persons 65 or older. (See PIT-RC Instructions) 23 00

24. Approved film production tax credit claimed. (Attach RPD-41228) 24 00

25. Working families tax credit. 25 00

25a. The amount of Federal Earned Income Credit reported on your 2007 Federal Income Tax return. 25a 00

26. Special needs adopted child tax credit. 26 00

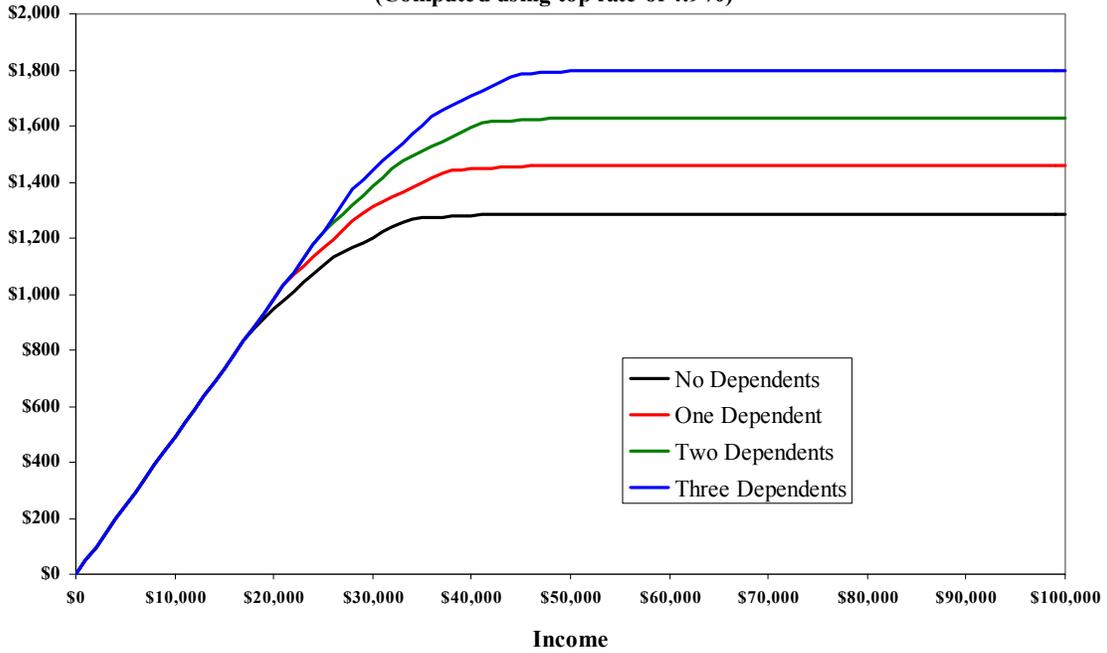
SECTION VII: TOTAL REBATES AND CREDITS CLAIMED

27. Add lines 14, 17c, 18c, 22, 23, 24, 25, and 26. Enter here and on line 21 of the Form PIT-1. 27 00

Draft Legislation

- **TRD completed draft legislation for this proposal just this week, so there is no LCS draft available yet**
- **The most significant legislative change is the addition of the new credit (section 15, starting on page 22 of the draft legislation)**
 - **The new credit has three parts:**
 - **The first part replaces the standard deduction, personal exemptions and graduated rates**
 - **This part varies in a systematic way by filing status for each personal exemption (see top graph on next page)**
 - **The second part replaces the NM low- and middle-income exemption**
 - **This part does not vary in a systematic way for each personal exemption (see bottom graph on next page)**
 - **Because it does not vary systematically, a separate credit schedule is required for each filing status and number of personal exemptions**
 - **The third part replaces LICTR**
 - **This part uses the current LICTR table, except that it uses a constant amount at very low income levels**
 - **LICTR varies by income and the number of personal exemptions, but not by filing status**
- **For taxpayers, the three parts of the credit will be combined in lookup for each filing status that will show the total credit by level of taxable income level and number of personal exemptions (see illustrative table on page 15)**

Income Tax Benefits of the Standard Deduction, Personal Exemptions and Graduated Rates for a Married Couple with No, One, Two and Three Dependents
(Computed using top rate of 4.9%)



Income Tax Benefits of the Low- and Middle-Income Exemption for a Married Couple with No, One, Two and Three Dependents
(Computed using top rate of 4.9%)

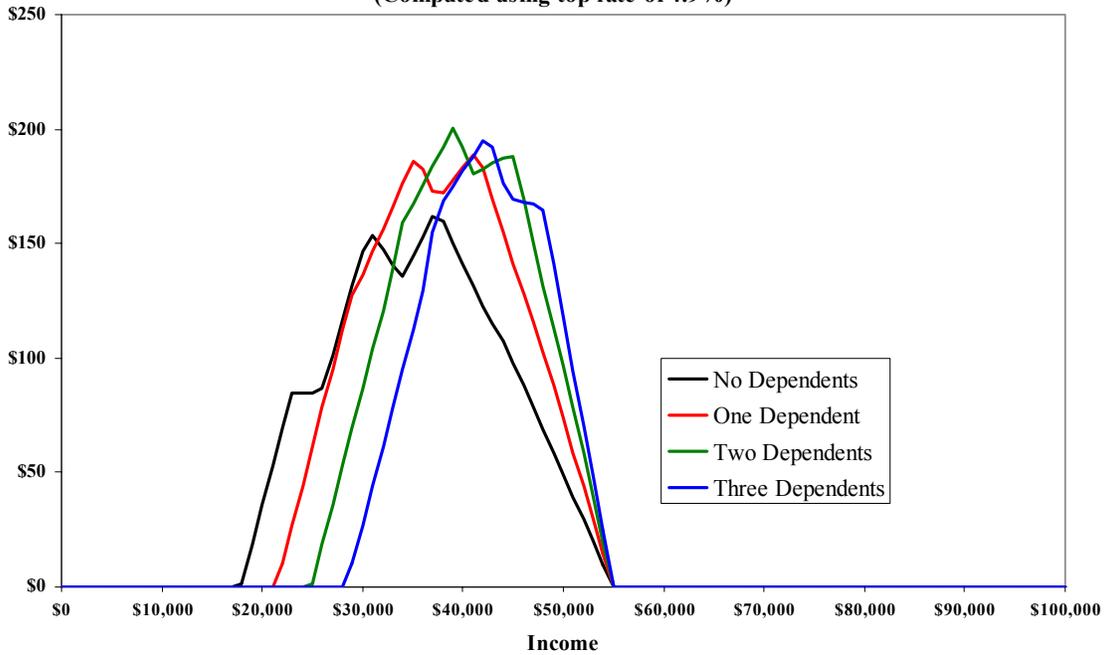


Illustration of New Credit Lookup Table for Married Couples Filing Jointly

If Taxable Income Is:		And the Number of Personal Exemptions Is:							
Over	But Not Over	2	3	4	5	6	7	8	9
0	500	\$195	\$250	\$310	\$355	\$450	\$450	\$450	\$450
500	1,500	244	299	359	404	499	499	499	499
1,500	2,500	293	348	408	453	548	548	548	548
2,500	3,500	342	397	457	502	597	597	597	597
3,500	4,500	391	446	506	551	646	646	646	646
4,500	5,500	440	495	555	600	695	695	695	695
5,500	6,500	469	524	589	649	724	724	724	724
6,500	7,500	473	513	563	618	713	713	713	713
7,500	8,500	507	537	572	617	687	687	687	687
8,500	9,500	546	576	611	636	681	681	681	681
9,500	10,500	585	605	635	665	695	695	695	695
10,500	11,500	619	639	669	694	724	724	724	724
11,500	12,500	658	678	698	723	748	748	748	748
12,500	13,500	702	722	737	752	777	777	777	777
13,500	14,500	751	771	786	801	826	826	826	826
14,500	15,500	795	810	825	840	855	855	855	855
15,500	16,500	839	854	869	879	894	894	894	894
16,500	17,500	883	898	913	918	938	938	938	938
17,500	18,500	927	942	952	962	977	977	977	977
18,500	19,500	966	981	991	1,001	1,011	1,011	1,011	1,011
19,500	20,500	1,010	1,020	1,030	1,040	1,045	1,045	1,045	1,045
20,500	21,500	1,054	1,059	1,069	1,079	1,084	1,084	1,084	1,084
21,500	22,500	1,098	1,103	1,113	1,118	1,123	1,123	1,123	1,123
22,500	23,500	1,125	1,127	1,127	1,127	1,127	1,127	1,127	1,127
23,500	24,500	1,157	1,176	1,176	1,176	1,176	1,176	1,176	1,176
24,500	25,500	1,189	1,225	1,225	1,225	1,225	1,225	1,225	1,225
25,500	26,500	1,221	1,274	1,274	1,274	1,274	1,274	1,274	1,274
26,500	27,500	1,253	1,323	1,323	1,323	1,323	1,323	1,323	1,323
27,500	28,500	1,285	1,372	1,372	1,372	1,372	1,372	1,372	1,372
28,500	29,500	1,317	1,419	1,421	1,421	1,421	1,421	1,421	1,421
29,500	30,500	1,349	1,451	1,470	1,470	1,470	1,470	1,470	1,470
30,500	31,500	1,373	1,478	1,519	1,519	1,519	1,519	1,519	1,519
31,500	32,500	1,384	1,505	1,568	1,568	1,568	1,568	1,568	1,568
32,500	33,500	1,395	1,532	1,617	1,617	1,617	1,617	1,617	1,617
33,500	34,500	1,405	1,559	1,654	1,666	1,666	1,666	1,666	1,666
34,500	35,500	1,416	1,586	1,679	1,715	1,715	1,715	1,715	1,715
35,500	36,500	1,426	1,599	1,705	1,764	1,764	1,764	1,764	1,764
36,500	37,500	1,437	1,607	1,730	1,813	1,813	1,813	1,813	1,813
37,500	38,500	1,437	1,614	1,755	1,843	1,862	1,862	1,862	1,862
38,500	39,500	1,430	1,621	1,780	1,867	1,911	1,911	1,911	1,911
39,500	40,500	1,422	1,629	1,789	1,890	1,960	1,960	1,960	1,960
40,500	41,500	1,415	1,636	1,793	1,914	1,997	2,009	2,009	2,009
41,500	42,500	1,408	1,633	1,797	1,937	2,019	2,058	2,058	2,058
42,500	43,500	1,400	1,621	1,801	1,952	2,041	2,107	2,107	2,107
43,500	44,500	1,393	1,609	1,806	1,953	2,062	2,141	2,156	2,156
44,500	45,500	1,383	1,597	1,808	1,954	2,084	2,161	2,205	2,205
45,500	46,500	1,373	1,585	1,791	1,955	2,095	2,181	2,254	2,254
46,500	47,500	1,364	1,573	1,775	1,956	2,093	2,201	2,274	2,303
47,500	48,500	1,354	1,560	1,758	1,955	2,091	2,221	2,293	2,352
48,500	49,500	1,344	1,545	1,741	1,934	2,089	2,220	2,311	2,381
49,500	50,500	1,334	1,530	1,724	1,912	2,087	2,215	2,329	2,397
50,500	51,500	1,324	1,515	1,706	1,891	2,074	2,209	2,334	2,414
51,500	52,500	1,315	1,501	1,687	1,869	2,048	2,204	2,326	2,431
52,500	53,500	1,305	1,486	1,667	1,848	2,022	2,196	2,317	2,435
53,500	54,500	1,295	1,471	1,648	1,824	1,995	2,165	2,309	2,424
54,500	55,500	1,285	1,457	1,628	1,800	1,969	2,134	2,298	2,412

Draft Legislation-Cont.

- **The definition of taxable income is changed to remove the deductions for the standard deduction, personal exemptions and NM low- and middle-income exemption, which are replaced by the new credit**
 - **The steps in arriving at taxable income have also been changed to take directly into account all exemptions and deductions**
 - **“Net income” is no longer used to define taxable income, so some conforming changes are required in several sections of the Income Tax Act**
- **The tax rate schedules are replaced with a flat rate of 4.9%, the top rate beginning in 2008, since the new credit replaces the lower rates**
 - **The special tax rate calculations for lump-sum amounts is removed, since there is now only one tax rate**
- **LICTR is repealed, since the new credit replaces it**
 - **A new rebate replaces the additional personal exemptions allowed under LICTR for elderly and blind individuals**
 - **The allowance of a LICTR exemption for children who are not dependents because the taxpayer does not meet the support test due to public assistance is no longer needed due to changes in the federal definition of a dependent child**
- **A new section of the TAA is added describing general rules for indexing of tax parameters for inflation**
 - **The new credit is indexed according to these rules, beginning in 2009**
- **The definition of MGI for refundable rebates is greatly simplified**
- **Several definitions are added, while some are deleted and some other obsolete language (e.g., concerning pre-1991 net operating losses) is removed**