



## New Mexico Fiscal Policy Project

### POLICY BRIEF – PIT ADD-BACK

#### PLUGGING A FEDERAL DRAIN ON NEW MEXICO'S INCOME TAX REVENUES

2010

#### INTENT

The so-called "PIT add-back" would reform the New Mexico personal income tax (PIT) code to shut down a perk that is available only to taxpayers who take itemized deductions on their federal tax return. Overwhelmingly, these are higher-income taxpayers.

#### PROBLEM

It's estimated that this perk will drain \$65 million from the general fund in fiscal year 2010.<sup>1</sup> That's a significant amount, especially in a year when the state is facing a large revenue shortfall and deep budget cuts to vital programs and services like education, health care, and public safety.

What's more, because this perk is only available to filers who itemize, it does not benefit the vast majority of New Mexicans filing state tax returns. This makes New Mexico's already-regressive tax system even less fair.

#### BACKGROUND

The New Mexico personal income tax is linked to the federal income tax in several ways. When the federal government changes the PIT code, it can affect the state's tax code unless the state Legislature acts on the matter.

The federal Schedule A allows the deduction of all state and local taxes—including income taxes, sales taxes, real

estate taxes, and personal property taxes—from federal taxable income. These deductions lower a filer's taxable income—and, in turn, their federal income tax payment.

Filers who itemize can use this lower taxable income amount on their New Mexico PIT-1 return form—thereby lowering their state tax payment.

Of all the states that collect income tax, only eight allow itemizers to use the full federal deduction when calculating state taxable income. Most other states with an income tax require taxpayers to "add-back" this amount when calculating state taxable income. New Mexico is one of the states that doesn't.

#### CONCLUSION

A PIT add-back provision would affect only the one quarter of New Mexico taxpayers who itemize deductions. Three quarters of the deductions for state taxes are taken by New Mexicans with adjusted gross income of more than \$75,000.

New Mexico has allowed federal decisions to preempt state tax policy, which should be made in the best interests of the people of New Mexico. New Mexico lawmakers have not made this decision—they've simply not addressed it. New Mexico should seize control of its own tax policy and institute a PIT add-back.

<sup>1</sup> General Fund Revenue Update and Outlook for 2010 Legislative Session, Legislative Finance Committee, January 10, 2010