



Quick Facts on PIT Add Back - Closing the Federally Created State and Local Tax Deduction Loophole to the New Mexico Personal Income Tax

Intent: This reform to the New Mexico Personal Income Tax would close a loophole opened by the linkage of the federal and state income tax. This loophole is available only to taxpayers who utilize itemized deductions on their federal tax return. These are overwhelmingly wealthy taxpayers.

Problem: The New Mexico Personal Income Tax is linked to the federal income tax in several ways. Line 39 of the US Individual Income Tax return summarizes the deductions from federal taxable income itemized on Schedule A.

Line 5 through 9 of the 1040 Schedule A describes the state and local taxes that may be deducted. Line 7 of the New Mexico PIT-1 return picks up the deduction amount from Line 39 of the federal 1040 return, including the deduction of state and local taxes.

The present tax policy of the state of New Mexico allows federal decisions to preempt tax policy made in the best interests of the people of New Mexico. New Mexico lawmakers have not made this decision – the linkage of the federal and state income tax system makes policy for New Mexico in a passive manner.

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 taxable income. Currently, the New Mexico PIT-1 return simply allows the wholesale carryover of all these itemized deductions from Line 39 of the federal 1040 return to the New Mexico tax return. New Mexico should seize control of its own tax policy.

New Mexico is one of only 8 states with an income tax with a policy that allows itemizers to deduct state and local taxes paid in the previous year when calculating state taxable income. All other states with an income tax require taxpayers to add back this amount when calculating state taxable income.

The New Mexico Taxation and Revenue Dept. estimated that this provision to the NM tax code would have yielded roughly \$66 million in revenue in state fiscal year 2005, the current fiscal year. The provision would have limited the deduction of both income taxes (yielding \$44 million in revenues) and property taxes (\$22 million in revenues).

This provision would affect only a minority of New Mexico PIT taxpayers. Adding back this federal deduction would affect only that one quarter of New Mexico taxpayers that itemize deductions and deduct state taxes paid. Three quarters of deductions for state taxes are taken by New Mexicans with adjusted gross income of over \$75,000.