F I S C A L   I M P A C T   R E P O R T

ORIGINAL DATE 1/25/16
SPONSOR McCamley **LAST UPDATED** 2/2/16 **HB** 79

SHORT TITLE Working Families Tax Credit and Gains Deduction **SB**

ANALYST McIntyre

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY16	FY17	FY18	FY19	FY20		
	($14,660)	($15,090)	($15,550)	($16,010)	Recurring	General Fund

Parenthesis ( ) indicate revenue decreases

SOURCES OF INFORMATION
LFC Files

Response Received From
Taxation and Revenue Department (TRD)

SUMMARY

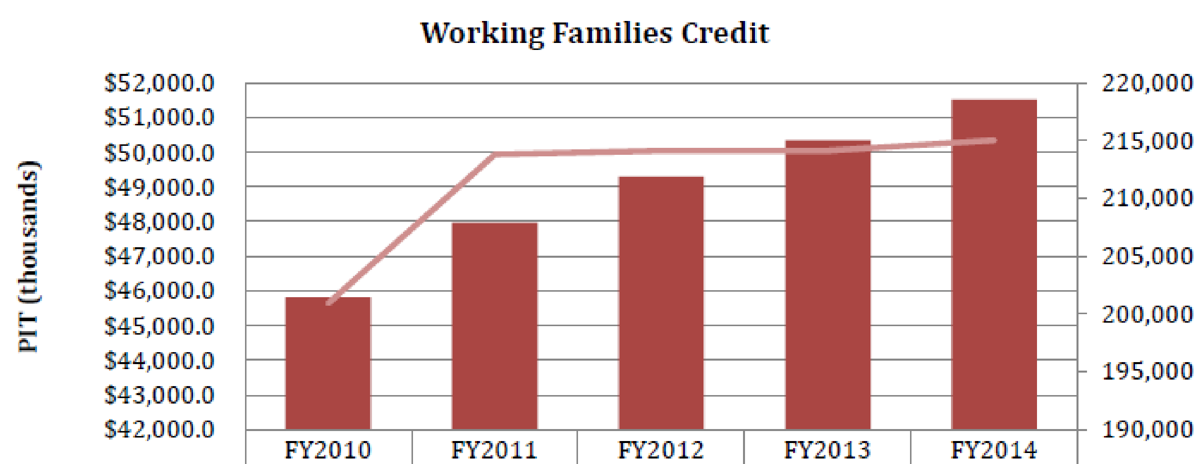
House Bill 79 amends the Income Tax Act to increase the Working Families Tax Credit (WFTC) from 10 percent of the federal Earned Income Tax Credit to 20 percent of the federal Earned Income Tax Credit. The bill also repeals the New Mexico net capital gains tax deduction (NCGD) under Section 7-2-34 NMSA 1978.

The provisions of the bill apply to taxable years beginning on or after January 1, 2016.

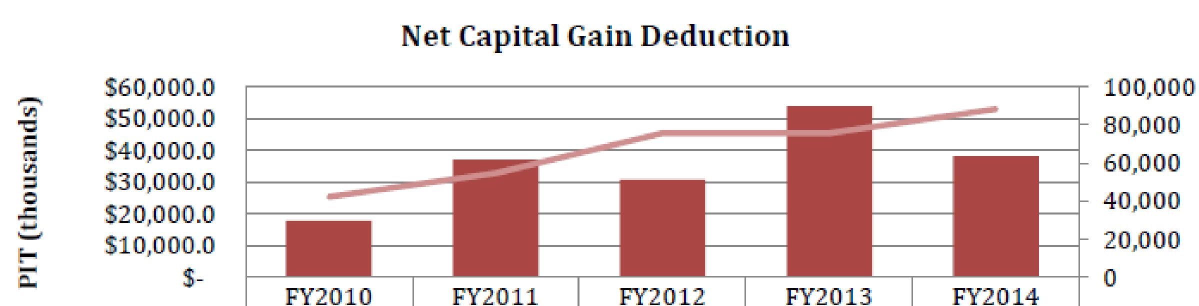
FISCAL IMPLICATIONS

The 2015 Tax Expenditure Report illustrates the expenditure difference between the current WFTC and the NCGD. Using historical data, the WFTC exceeds the expenditure of the NCGD by $13.4 million on average. TRD estimates the fiscal impact as the average difference between WFTC and NCGD times the average WFTC growth rate. The average growth rate for WFTC is 2.98 percent annually.

Both the number of claimants and the value of the WFTC expenditure are increasing as shown below. According to data reported in the 2015 Tax Expenditure Report, the five year average for this credit is an expenditure of $48.9 million. By comparison, while the number of claimants for the NCGD has been increasing, the value of the expenditure swings erratically, as shown below. The NCGD has a five year average expenditure of $35.6 million.



	FY2010	FY2011	FY2012	FY2013	FY2014
Expenditures	$45,818.3	$47,968.1	$49,299.8	$50,338.5	$51,513.4
Claims	200,920	213,788	214,120	214,120	215,020



	FY2010	FY2011	FY2012	FY2013	FY2014
Expenditures	$17,864.8	$37,097.8	$30,765.5	$53,814.8	$38,211.5
Claims	42,329	54,630	75,635	75,635	88,247

Source: TRD

The steady increase in expenditure for the WFTC allows for a more predictable estimate of the impact of increasing the credit to 20 percent of the federal Earned Income Tax Credit. The impact of the increase is calculated in the table below. The impact of repealing NCGD is harder to estimate because the expenditure has varied from less than half the WFTC in FY10 to greater than the WFTC in FY13, as can be seen by comparison of the two charts above. While it is possible that repealing the NCGD will pay for the WFTC in any given year, it is not something that can necessarily be counted on happening, and so the fiscal impact is estimated to be net negative, as described by the TRD analysis mentioned above.

Estimated Revenue from WFTC					
($ thousands)	FY16	FY17	FY18	FY19	FY20
WFTC (current law)	($54,610.0)	($56,412.1)	($58,330.1)	($60,430.0)	($62,529.9)
WFTC (proposed law)	($54,610.0)	($112,824.2)	($116,660.2)	($120,860.0)	($125,059.8)
Difference	$0.0	($56,412.1)	($58,330.1)	($60,430.0)	($62,529.9)

Source: LFC analysis of TRD data

This bill may be counter to the LFC tax policy principle of adequacy, efficiency and equity. Due to the increasing cost of tax expenditures revenues may be insufficient to cover growing recurring appropriations.

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

A possible issue with this bill exists because of the piggyback on the Internal Revenue Code and the earned income tax credit (EITC). According to the IRS, approximately 21 to 26 percent of all EITC claims are paid in error. While the Improper Payments Elimination and Recovery Act of 2010 was intended to reduce the rate of improper payments, the Treasury Inspector General for Tax Administration reports that improper EITC payments in 2013 ranged between $13.3 billion and $15.6 billion dollars at the federal level. In short, improper payments made at the federal level will flow through to New Mexico because of the piggyback system. TRD recommends that policy makers may want to consider alternative methods of providing relief to low income taxpayers until the IRS can reduce the percentage of improper payments.

Conversely, New Mexico Voices for Children notes that more than 40 percent of claims found erroneous in audits were determined to be correct on appeal according to analyses by the National Taxpayer Advocate, and that the overpayment amount does not account for the underpayment from unclaimed eligible taxpayers.

ADMINISTRATIVE IMPLICATIONS

TRD claims high impact, needing to update forms, instruction publications, and documentation. Additionally, revisions to TRD's electronic filing system will be necessary. All changes will require additional resources to redesign, retest, and implement. Personnel across all divisions, software developers, electronic filing applications, GenTax, and taxpayers will be impacted.

TECHNICAL ISSUES

Language in the bill states that the provisions of the act apply to taxable years beginning on or after January 1, 2015. This FIR assumes the applicable date to be January 1, 2016, and the bill's language should be changed accordingly.

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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