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

ORIGINAL DATE 2/6/17
SPONSOR Rubio **LAST UPDATED** **HB** 311

SHORT TITLE Increase Working Families Tax Credit **SB**

ANALYST Graeser

REVENUE (dollars in thousands)

Estimated Revenue					R or NR **	Fund Affected
FY17	**FY18**	**FY19**	**FY20**	**FY21**		
	(59,000.0)	(31,700.0)	(23,600.0)	(24,100.0)	Recurring	General Fund

Parenthesis ( ) indicate expenditure decreases. ** R = recurring; NR = non-recurring

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY17	FY18	FY19	3 Year Total Cost	R or NR **	Fund Affected
Total	Minimal	Minimal	Minimal	Minimal	Recurring	TRD Operating

Parenthesis ( ) indicate expenditure decreases. ** R = recurring; NR = non-recurring

Can be accomplished within the regular, annual maintenance cycle.

SOURCES OF INFORMATION
LFC Files

Responses Received From
Taxation and Revenue Department

SUMMARY

Synopsis

House Bill 311 increases the working families personal income tax credit from 10 percent of the federal earned income tax credit to 20 percent of the EITC. The bill also reduces the capital gains deduction against personal income taxable income from the greater of $1,000 or 50 percent of capital gains reported for federal income tax purposes to just a maximum of $1,000. This returns that deduction to the amount that was in effect prior to 2003.

There is no effective date of this bill. It is assumed that the new effective date is 90 days after this session ends (June 16, 2017); the increase in working families tax credit is applicable to tax years beginning January 1, 2017, while the reduction of the capital gains deduction is applicable to tax years beginning January 1, 2018.

FISCAL IMPLICATIONS

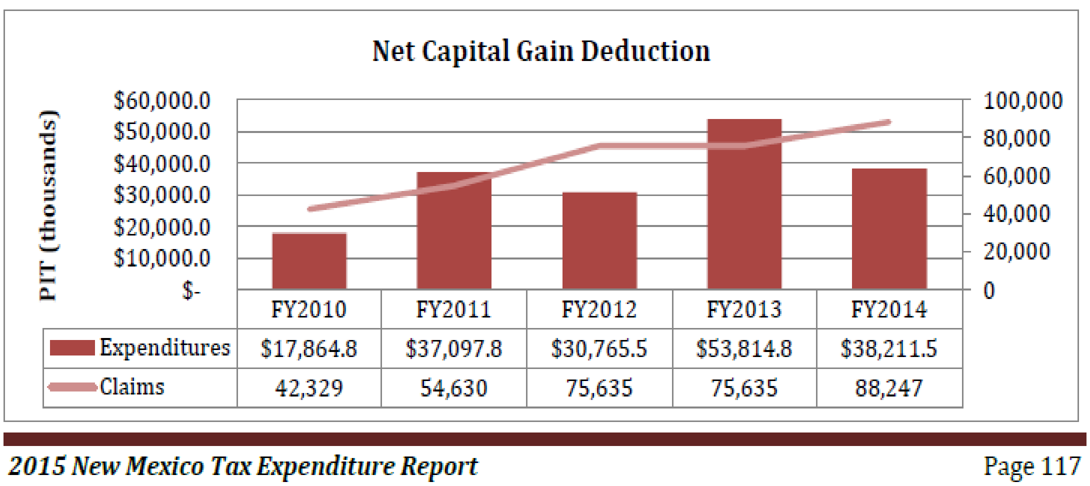
Capital Gains Deduction Reduction:

Estimated Revenue					R or NR **	Fund Affected
FY17	FY18	FY19	FY20	FY21		
$0.0	$0.0	$29,100.0	$39,000.0	$40,300.0	R	General Fund

Parenthesis ( ) indicate expenditure decreases. ** R = recurring; NR = non-recurring

(Note: the zero amount for FY 18 is caused by timing, not liability. The capital gains reduction is applicable for tax year 2018 and beyond. Few higher-income taxpayer will adjust their estimated payments for the April and June 2018 payments because of the existence of the so-called "safe-harbor" feature. If higher-income taxpayers pay as much in total estimated payments for TY 18 as they owed for TY17, there would be no penalty. The extra amount would be paid primarily as a final settlement in April 2019. Some taxpayers adjust withholding from salaried employment to account for the additional taxes accruing to capital gains.

LFC staff estimated the fiscal impact based on 2014 New Mexico federal taxpayer data and New Mexico tax expenditure data reported in the TRD 2015 Tax Expenditure Report (TER). The consensus revenue estimating group revenue projections show increasing personal income tax revenues over time, but the increases are dwarfed by historic swings in the cost of the tax expenditure. Although the LFC and TRD estimates are identical, market volatility could cause individual years to be higher or lower than the given range.



As reported in the 2015 TER, the cost of the deduction has varied; during the five-year period from FY10 - FY14, the expenditure was as low as $17.9 million (FY10) and peaked at $53.8 million (FY13). The five-year average expenditure for this period is $35.6 million, but there is also an upward trend as the country exited the recession and market began to recover.

Of further note, there is a loose correlation between the year-ending stock market price and the value of capital gains reported for a particular year.

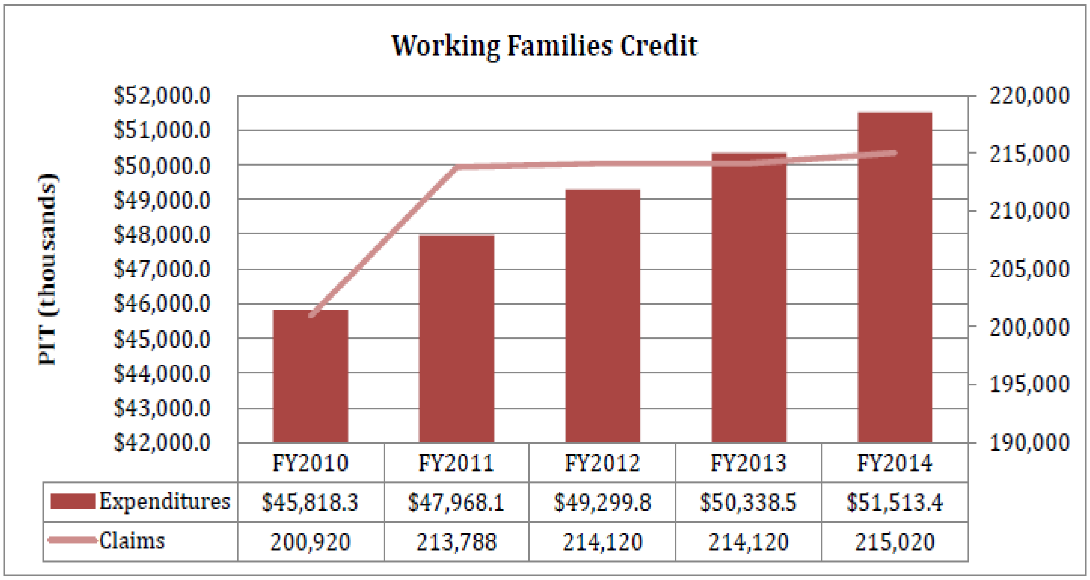
The savings from this bill would be nearly as great as if the deduction were eliminated altogether. Using the highest number of claims reported in the five-year period shown in the 2015 TER, and using an average tax rate for all filers of 4.3 percent, if all claimants qualified for the $1,000 maximum deduction in the bill, the cost to the state would be $3.8 million annually – an order of magnitude less than the current cost of the deduction.

Working Families Tax Credit

	FY 10	FY 11	FY 12	FY 13	FY 14	FY 15	FY 16
EITC	226,304	223,783	199,334	222,270	223,560	220,440	226,064
Returns	$495,863	$491,256	$456,768	$511,475	$528,239	$529,254	$560,585
Average	$2,191	$2,195	$2,291	$2,301	$2,363	$2,401	$2,480
Predicted WFTC	$49,586	$49,126	$45,677	$51,148	$52,824	$52,925	$56,059
Actual/Predicted Claims	200,920	213,788	214,120	214,120	215,020	213,500	218,940
Actual/Predicted WFTC	$45,818	$47,968	$49,300	$50,339	$51,513	$52,317	$55,413
Actual/Predicted WFTC	$228	$224	$230	$235	$240	$245	$253
Claims Ratio	88.8%	95.5%	107.4%	96.3%	96.2%	96.8%	96.8%
Average Ratio	1.04	1.02	1.00	1.02	1.01	1.021	1.021

	FY 17	FY 18	FY 19	FY 20	FY 21
EITC	228,321	230,578	232,835	235,092	237,349
Returns	$578,675	$596,764	$614,853	$632,942	$651,032
Average	$2,534	$2,588	$2,641	$2,692	$2,743
Predicted WFTC	$57,867	$59,676	$61,485	$63,294	$65,103
Actual/Predicted Claims	221,130	223,310	225,500	227,690	229,870
Actual/Predicted WFTC	$57,202	$58,988	$60,777	$62,567	$64,353
Actual/Predicted WFTC	$259	$264	$270	$275	$280
Claims Ratio	96.8%	96.8%	96.8%	96.8%	96.8%
Average Ratio	102.1%	102.1%	102.1%	102.1%	102.1%
Extra cost of increasing to 20% of EITC		$59,000	$60,800	$62,600	$64,400

The working families tax credit is currently 10 percent of the federal Earned Income Tax Credit (EITC). The tables above show the historical relationship between the EITC and the WFTC for the period FY 2010 through FY 2014. The data shown for the EITC is for one year earlier tax year. Thus the EITC data for FY 10 are the federal (IRS/SOI) data for tax year 2009. Note that the ratios are quite consistent. Data in the table for FY 15 and FY 16 are 10-year trend (TY 2005 through TY 2014). In the second table, these trends are continued. The cost to the general fund of increasing the WFTC to 20% of the EITC is also shown. Note that the applicability date of the WFTC change is for tax years beginning January 1, 2017. The earliest that TRD could notify taxpayers and employers is July 1, 2017. Thus, any revenue impact of the provisions of this bill would be delayed until FY 18. The first year impact is due solely to the WFTC. The decrease in the capital gains deduction is delayed until the following tax year.



A similar bill was introduced last session. The WFTC calculated in that bill analysis was:

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)

Updating the analysis by one year yields virtually identical estimates to those obtained here.

Estimated Revenue					**R or NR ****	**Fund Affected**
FY17	**FY18**	**FY19**	**FY20**	**FY21**		
	($59,000.0)	($60,800.0)	($62,600.0)	($64,400.0)	R	General Fund

SIGNIFICANT ISSUES

This bill attempts to balance a revenue gainer (the reduction of the capital gains deduction) with a revenue decrease attributed to the doubling of the working families tax credit.

The increase in the tax expenditure portion of the 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.

PERFORMANCE IMPLICATIONS

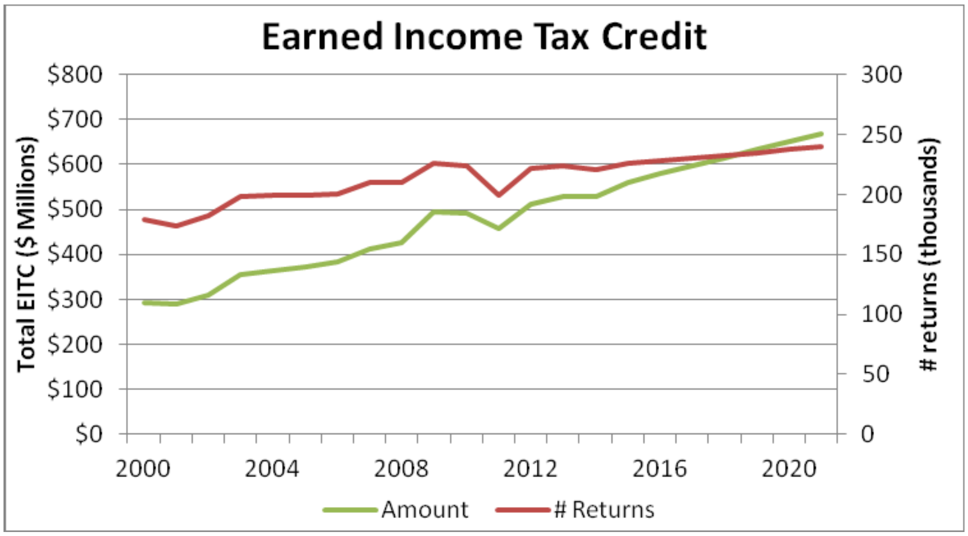
The LFC tax policy of accountability is met with the bill's requirement to report annually to an interim legislative committee regarding the data compiled from the reports from taxpayers taking the deduction and other information to determine whether the deduction is meeting its purpose. The Taxation and Revenue Department will soon release the 2016 TRD Tax Expenditure Report. The cost of this and other personal income tax deductions and credits will be reported and analyzed in that document.

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP: relates to all other bills amending the personal income tax act. These include at this point: HB 48, HB 76, HB 117, HB 169, HB 196, HB 201, HB 310, HB 311 and SB 50. In addition, this increase in the working families tax credit has been proposed in HB 80 and SB 51 in the 2014 session, HB 293 and SB 261 in the 2015 session and HB 79 in the 2016 session.

TECHNICAL ISSUES

This bill does not have a delayed repeal date. LFC recommends one.

OTHER SUBSTANTIVE ISSUES



WHAT WILL BE THE CONSEQUENCES OF NOT ENACTING THIS BILL

Does the bill meet the Legislative Finance Committee tax expenditure policy principles?

1. **Vetted**: The proposed new or expanded tax expenditure was vetted through interim legislative committees, such as LFC and the Revenue Stabilization and Tax Policy Committee (RSTP), to review fiscal, legal, and general policy parameters.
2. **Targeted**: The tax expenditure has a clearly stated purpose, long-term goals, and measurable annual targets designed to mark progress toward the goals.
3. **Transparent**: The tax expenditure requires at least annual reporting by the recipients, the Taxation and Revenue Department, and other relevant agencies.
4. **Accountable**: The required reporting allows for analysis by members of the public to determine progress toward annual targets and determination of effectiveness and efficiency. The tax expenditure is set to expire unless legislative action is taken to review the tax expenditure and extend the expiration date.
5. **Effective**: The tax expenditure fulfills the stated purpose. If the tax expenditure is designed to alter behavior – for example, economic development incentives intended to increase economic growth – there are indicators the recipients would not have performed the desired actions "but for" the existence of the tax expenditure.
6. **Efficient:** The tax expenditure is the most cost-effective way to achieve the desired results.

LFC Tax Expenditure Policy Principle	**Met?**	**Comments**
Vetted	✘	
Targeted		
Clearly stated purpose	✘	
Long-term goals	✘	
Measurable targets	✘	
Transparent	✓	
Accountable		
Public analysis	✓	
Expiration date	✘	
Effective		
Fulfills stated purpose	?	
Passes "but for" test	?	
Efficient	?	
Key: ✓ Met ✘ Not Met ? Unclear		

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