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

SPONSOR White **ORIGINAL DATE** 1/28/2020 **LAST UPDATED** **HB**

SHORT TITLE Refundable Tax Credit **SB** 82/ec

ANALYST Graeser

APPROPRIATION (dollars in thousands)

Appropriation		Recurring or Nonrecurring	Fund Affected
FY20	FY21		
$750.0	No Fiscal Impact	Nonrecurring	General Fund

(Parenthesis ( ) Indicate Expenditure Decreases)

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY20	FY21	FY22	FY23	FY24		
($59,000.0)	($5,000.0)				Nonrecurring	General Fund

Parenthesis ( ) indicate revenue decreases

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

Parenthesis ( ) indicate expenditure decreases

FY20	FY21	FY22	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
$540.0	$50.0		$590.0		TRD Operating

SOURCES OF INFORMATION
LFC Files

Responses Received From
Taxation and Revenue Department (TRD)

SUMMARY

Synopsis of Bill

Senate Bill 82 provides for an immediate refundable credit for all taxpayers who file a 2019 personal income tax return who are full-year or first-year residents of New Mexico and are not trusts, estates or dependents of another taxpayer, and were not inmates of a public institution for more than 6 months during 2019. The refundable credit is allowed even if the taxpayer does not have taxable income in 2019.

Interest that may be refunded shall only be allowed or paid if the amount is not refunded or credited within 120 days after the effective date or the applicable period already established for interest on overpayments, whichever is later.

This bill has a one-time appropriation of seven hundred fifty thousand dollars ($750,000) for fiscal year 2020 to administer this tax credit. Any remaining money at the end of the fiscal year will revert to the general fund.

The amount of the credit is determined by the tables that follow:

Married taxpayers filing jointly			
Adjusted Gross Income		Credit Amount for Taxpayer and Spouse	Additional Credit Amount for Each Dependent
Over	Not Over		
0	$50,000	$100.00	$50.00
$50,000	$75,000	$80.00	$40.00
$75,000	$100,000	$50.00	$25.00
$100,000		$0.00	$0.00

Taxpayers filing as single, head of household, married filing separately or as a surviving spouse			
Adjusted Gross Income		Credit Amount for Taxpayer	Additional Credit Amount for Each Dependent
Over	Not Over		
0	$50,000	$50.00	$50.00
$50,000	$75,000	$40.00	$40.00
$75,000	$100,000	$25.00	$25.00
$100,000		$0.00	$0.00

This bill contains an emergency clause and would become effective immediately upon signature by the governor. The provisions of the bill would be applicable to the 2019 taxable year. Returns for the 2019 year have already been filed with the department.

FISCAL IMPLICATIONS

This is a nonrecurring rebate to low- and middle-income taxpayers. Out-of-state residents who file New Mexico tax returns are eligible for this rebate. Trusts estates and persons who are the dependent of another taxpayer are not eligible (see Technical Issues).

Although this is a tax expenditure, it is a nonrecurring general fund expenditure and has no future revenue implications.

Since TRD has already received PIT returns for the 2019 tax years and this bill could only become effective at the earliest February 10 and the latest 10 days after the end of the session – roughly March 1, many taxpayers would have to file amended returns to take advantage of this rebate.

TRD explains the methodology for creating the revenue estimate:

> This refundable tax credit is a new proposed one-time credit applicable to 2019 income tax returns. The credit has two components: a credit amount for each taxpayer and spouse if filing jointly and an additional credit amount for each dependent. Based on the proposed resident and income eligibility criteria and the credits amounts, TRD estimated the impact with base year 2017. Base year 2017 was used due to being the most complete recent tax year. Given the population of New Mexico has had minimal growth, 2017 tax year is assumed to be representative of the 2019 tax year. TRD also assumed that while adjusted gross incomes naturally grow and that taxpayers lose and gain jobs, the overall distribution of taxpayers within the proposed adjusted gross income ranges for the credit will remain consistent in tax year 2019 from tax year 2017.

LFC staff note that the 2018 tax year was the first to reflect the profound changes embedded in the New Mexico filings from the federal changes of the Tax Cuts and Jobs Act (TCJA). Among other features, personal exemptions are no longer required to be reported and the restriction in this bill that the dependent of another taxpayer is not eligible for the credit may be difficult to administer fairly and accurately. It may be that the estimate above may be under the actual amount.

SIGNIFICANT ISSUES

TRD discusses several significant issues in this section and in the Technical Issues section:

> The bill language does not define the purpose of the tax credit, which TRD recommends for new credits to facilitate evaluating them. Because the credit has adjusted gross income (AGI) ranges and a maximum AGI of $100,000 there is a cliff effect for the benefit to taxpayers. The cliff effect refers to an abrupt decrease in benefits for a small increase in income. The cliff effect is more often studied for low-income individuals receiving public program assistance and tax incentives, but applies here to the structure of this credit. Taxpayers with similar income levels may see varying levels of benefit from the credit just on account of slightly higher incomes.
>
> In many other places in the Income Tax Act, heads of household and surviving spouses are grouped with married filing joint status, such as for the exemption for low and middle income taxpayers, Section 7-2-5.8 NMSA 1978, the tax rates, Section 7-2-7 NMSA 1978, and the dependent deductions, Section 7-2-39 NMSA 1978.

PERFORMANCE IMPLICATIONS

The LFC tax policy of accountability is <u>not</u> met since TRD is <u>not</u> required in the bill to report 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 purpose of this tax credit/rebate is not stated.

ADMINISTRATIVE IMPLICATIONS

TRD advises that there will be significant difficulties administering the refunds and that the bulk of the effort will not be able to be done within the 2020 fiscal year:

The issuance of a one-time refundable tax credit will place additional burden on TRD return processing and customer service. TRD staff will need to process the mailing out of additional refund checks outside of the annual tax year processing. TRD cost estimates below include postage, supplies, temporary staffing and overtime for current employees.
With past experience administering the energy rebate, the amount of taxpayer correspondence via e-mail and phone will increase. TRD will need to shift resources to the Audit and Compliance Division call center to respond to increased levels of taxpayer questions. Additional staff resources will also need to be devoted to researching and resolving undeliverable mail returns.

To process the credit through TRD's GenTax system will require almost four months of planning, system programming and testing of the final issuance of refunds. This will require business and information technology Division (ITD) staff to devote time to a one-time credit issuance. Included in the TRD cost estimate below is the ITD workload costs associated with completing this credit for tax year 2019.

Given the administrative cost and time burden, TRD reiterates the suggestion in the technical issues section above to apply this credit instead to tax year 2020.

TECHNICAL ISSUES

TRD notes a number of technical issues involved with this tax credit rebate. TRD's comments follow:

The filing of personal income tax (PIT) 2019 returns will have already started at the time this bill could become effective. The bill implies but does specifically state that the credit will be automatically issued by the department rather than applied for by the taxpayer. It should be clear what action triggers the issuance of the credit and if the taxpayer needs to take any action other than filing a return. The word "allowed" could be replaced with "entitled to" on page 2, line 7 to further clarify that the department should issue a refund in response to the return, not in response to an application for the credit. TRD will need to initiate a system generated process to administer this one-time credit. To minimize confusion for taxpayers, minimize the cost of implementing this credit and more effectively administer this credit, TRD suggests applying this credit instead to tax year 2020.

There are many factors to consider including this credit after the tax year 2019 filing season has started. PIT tax year 2019 documents have already been programmed for the calendar year and are now in use for submission. As discussed above, it is unclear if taxpayers will need to take action to benefit from this credit. Implementing this change will cause challenges for taxpayers filing on paper forms and electronically. Approximately 90 percent of NM PIT returns are submitted electronically through Modernized Electronic File/Filers (MeF) vendor software. MeF vendors follow set industry standards for shared networked transmission and certification. MeF vendors developed their tax software for 2019 last year and went through 2 ½ months of MeF vendor validation with TRD. MeF vendors would need to update their software and repeat system validation to include the new refundable credit. Additionally, any taxpayer who submits their return prior to the change will need to amend their PIT return or submit an application to take advantage of the refundable credit. If the bill is amended so that the credit is deemed to be automatically triggered with the submission of a 2019 tax return, TRD will need to generate the tax credit as a one-time system generated credit based on PIT returns under the current process. TRD will need to issue public notices to avoid confusion among taxpayers and vendors as to how this credit will be administered.

LFC staff concerns relate to the issuance of refundable credits to any person who has no tax liability. Although it has never been litigated, a refundable credit or rebate to persons with no tax liability who file a tax return only to claim the rebate may raise constitutional questions because of phrasing in the anti-donation clause of the New Mexico Constitution. The related exception to the anti-donation clause is to allow benefits to individuals as tax deductions, exceptions or tax credits. A refundable tax credit to a person with no tax liability is not just an adjustment to a tax obligation, but is a cash contribution. The purpose and explanation of the Low-Income Comprehensive Tax Rebate (LICTR) could be used to clarify that the purpose of this rebate is to return to resident citizens a portion of other taxes paid, including the gross receipts tax.

Another LFC staff concern is the restriction of the tax credit to full-year or first-year residents of New Mexico. This restriction, in the absence of an explanation that the purpose of the tax credit is to rebate taxes otherwise paid, may violate the commerce clause of the US Constitution.

OTHER SUBSTANTIVE ISSUES

TRD has experience with managing vast quantities of refunds when administering the energy rebate from the 2005 legislative session and the personal income tax credit for tax year 2007. One consequence is that because refunds were not tied to the original PIT return where a refund may be directly deposited into a bank account, refund checks had to be sent out. TRD received a large number of undeliverable refund checks for the energy rebate due to taxpayers moving after they filed their return. Approximately 13,000 of these returned checked were turned over to unclaimed property after 13 months. Those one-time rebates also increased the Board of Finance Division of the Department of Finance's fiscal agent contract costs by requiring issuance of a large quantity of warrants.

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, 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	✘	Purpose is implicit – a return to taxpayers of a portion of the announced surplus created by the OGAS industry -- but not stated.
Long-term goals	✘	Non-recurring
Measurable targets	✘	Non-recurring
Transparent	✓	
Accountable		
Public analysis	✘	
Expiration date	✓	Non-recurring
Effective		
Fulfills stated purpose	✘	No purpose stated
Passes "but for" test	✘	
Efficient	?	Very difficult to administer.
Key: ✓ Met ✘ Not Met ? Unclear		

LG/sb