FISCAL IMPACT REPORT

		ORIGINAL DATE	01/26/22		
SPONSOR	STBTC	**LAST UPDATED**	2/12/22	**HB**	
SHORT TITLE	Reducing Rates of Gross Receipts Tax			**SB**	5/STBTCS/44/49/108
				ANALYST	Torres/Faubion/Graeser

REVENUE (dollars in thousands)

Section 1 Social Security Exemption

Estimated Revenue					**Recurring or Nonrecurring**	**Fund Affected**
FY22	**FY23**	**FY24**	**FY25**	**FY26**		
--	($84,100.0)	($89,400.0)	($94,400.0)	($99,500.0)	Recurring	Section 1 Social Security Exemption -- General Fund – PIT
	($1,900.0)	($1,800.0)	($2,300.0)	($3,400.0)	Recurring	Section 2 New Solar Market Tax Credit General Fund OIT
--	($3,025.0)	($3,025.0)	($3,025.0)	($3,025.0)	Recurring	Section 3: Disclosed Agents General Fund – GRT
--	($188,100.0)	($194,100.0)	($199,900.0)	($206,200.0)	Recurring	Section 4:– GRT Rate Cut General Fund GRT
--	($3,300.0)	($3,400.0)	($3,400.0)	($3,500.0)	Recurring	Section 5: Comp Tax Rate Cut General Fund – Comp
	($280,425.0)	($291,725.0)	($303,025.0)	($315,625.0)	Recurring	General Fund Total
--	($2,100.0)	($2,100.0)	($2,100.0)	($2,100.0)	Recurring	Section 3: Local Governments – Disclosed Agents
--	($670.0)	($670.0)	($670.0)	($690.0)	Recurring	Section 5: Small City Assistance Fund – Comp Tax
--	($440.0)	($450.0)	($450.0)	($460.0)	Recurring	Section 5: Small County Assistance Fund – Comp Tax

Parenthesis ( ) indicate revenue decreases

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

Estimated Additional Operating Budget Impact*				**Recurring or Nonrecurring**	**Fund(s) or Agency Affected**
FY2022	**FY2023**	**FY2024**	**3 Year Total Cost**		
$30.0	$70.0	$70.0	$170.0	Recurring	EMNRD General Fund Operating
--	$5.2	--	$5.2	Nonrecurring	Section 1: Social Security: TRD - ITD
--	$60.9	$60.9	$121.8	Recurring	Section 2: Solar: RPD one FTE
--	$5.2	--	$5.2	Recurring	Section 2: Solar: ITD staff workload
$16.0	--	--	$16.0	Nonrecurring	Sections 4 - 5: GRT and Comp Tax Rates: ITD contractual services
$5.2	--	--	$5.2	Nonrecurring	Sections 4 - 5: GRT and Comp Tax Rates: ASD staff workload
$14.5	--	--	$14.5	Nonrecurring	Sections 4 – 5: GRT and Comp Tax Rates: RPD mailing

Section 1 conflicts with HB33, HB48, HB49, HB158, SB108, and SB121.
Provisions of Section 2 duplicate HB34.
Sections 3, 4 & 5 relate and affect numerous bills. See CONFLICTS, DUPLICATES, COMPANIONS

SOURCES OF INFORMATION
LFC Files: FIR for 2020 SB29 and TRD's 2021 Tax Expenditure Report

Responses Received From
Taxation and Revenue Department (TRD)
Energy, Minerals and Natural Resources (EMNRD) on SB44
New Mexico Attorney General (NMAG) on SB49 and SB108
Department of Health (DOH) [1] on SB49 and SB108
Aging and Long-Term Services Department (ALTSD) on SB49 and SB108
New Mexico Attorney General (NMAG) on SB5
Department of Finance and Administration (DFA) on SB5

SUMMARY

Synopsis of Bill

STBTC committee substitute for Senate Bills 5, 44, 49 and 108 provides for the following:

- Allows an exemption for all or a portion of social security benefits included in adjusted gross income. These exemptions would be equal to the amount included in adjusted gross income pursuant to the Federal Internal Revenue Code includable but for this exemption of $75 thousand for married filing separate, $100 thousand for single filers and $150 thousand for married filing jointly and heads of household.
- Extends the sunset on the new solar market development income tax credit by four years from December 31, 2027 to December 31, 2031. The cap on the credit is increased from $8 million to $12 million. The credit is made refundable and transferable rather than eligible for carry forward for five years. Refundability begins with solar systems installed on or after January 1, 2022.
- Provides a definition of "disclosed agency" for purposes of determining the gross receipts and compensating tax.
- Reduces the state gross receipts and compensating tax rate from five and one-eighth percent (5.125 percent) to four and seven-eighths percent (4.875 percent).
- Provides for restoration of the 5.125 percent state gross receipts tax if, in the next five years, the general fund transfer of revenues in any year is less than 95 percent of the amount transferred in the previous fiscal year. A determination would be made in February of the year following the end of a fiscal year and the restoration would be effective as of July 1 of the year of determination.

The effective date of the provisions of this bill is July 1, 2022. The Social Security exemption is applicable for tax years beginning January 1, 2022 and the Solar Market refundability provisions are applicable for systems installed after January 1, 2022.

[1] DOH analysis is adapted from proposed HB33 which also addresses cigarette and tobacco product taxes.

FISCAL IMPLICATIONS: SOCIAL SECURITY EXEMPTION

To estimate the impact of the proposed legislation of exempting Social Security income from income taxation, the Taxation and Revenue Department (TRD) utilized data from the Individual Master File/Individual Return Transaction File (IMF/IRTF) extracts received from the Internal Revenue Service (IRS) for tax years 2018 and 2019.

To scale the impact of this exemption to tax year 2022 and into the forecast horizon of this bill analysis, TRD utilized a combination of a) the growth in Social Security outlays forecasted by the Congressional Budget Office (CBO)[2], b) the growth rate of the population 65 years and older in New Mexico relative to the United States[3], and c) the cost-of-living-adjustment (COLA) to Social Security and Supplemental Security Income (SSI) benefits for calendar year 2022[4,5].

The estimate is based on the taxpayer population in IRS data who filed a New Mexico personal income tax (PIT) return. This population was further filtered to only include those with taxable social security benefits that were either R-filers or B-filers[6] and who were either residents, first-year residents or part-time residents in New Mexico. Non-resident B-filers do not allocate any of their pension/annuity/social security benefit income to New Mexico and hence were excluded. It was further assumed that taxpayers would select either this new exemption or the exemption pursuant to Section 7-2-5.2 NMSA 1978, depending on which decreased their tax liability the most. The fiscal impact also accounts for the higher top personal income tax (PIT) rate that is effective beginning tax year 2021.

In general, 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. In this case, the amount of taxable social security is not reported directly to TRD. If this bill passes and is implemented, the annual cost cannot be determined exactly, because the federally taxable social security amount will be reported to TRD as an exemption and not a credit. TRD will have to recalculate all returns claiming this deduction/exemption.

This bill creates a tax expenditure with a cost that is somewhat difficult to determine because the data on which the model is based are indirect. LFC has concerns about the risk to state revenues from tax expenditures and the increase in revenue volatility from erosion of the revenue base. 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.

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[2] https://www.cbo.gov/publication/57342

[3] Population Projections, United States, 2004 - 2030, by state, age and sex, on CDC WONDER Online Database, Sept. 2005.

[4] https://www.ssa.gov/cola/

[5] 2022 COLA adjustment at 5.9% was significantly higher than the average in the last five years of 1.6%. An adjustment was, therefore made to CBO's projected outlays to account for this higher than expected adjustment as well as to account for the current high inflationary expectations in FY2022 and FY2023.

[6] 'R' filers file based on the rate tables. 'B' filers file a PIT-B for New Mexico allocation and apportionment of income.

FISCAL IMPLICATIONS – NEW SOLAR MARKET DEVELOPMENT TAX CREDIT

EMNRD expects the provisions of this bill will stimulate an expansion of the market and a collateral expansion in the number of approved claims for refund. The potential fiscal revenue impact to the general fund could be an additional $4 million, if the solar installations continue to increase. Because the New Solar Market Development Tax Credit is quite new, there is only limited data available from EMNRD and TRD.

Summary of New Solar Market Development Credit Use Data from EMNRD and TRD

EMNRD	**TY20**	**TY21**
Installations	2,364	1,680
Expenditures	$6,682,831	$5,166,768
Average Credit Claim	$2,827	$3,075
Average Installation	$28,269	$30,755
Average size of installation in watts	6,800	6,800
Implying an installed price($ per watt)	$4.16	$4.52
TRD		
Claims	1,475	
Expenditures	$3,477	
Average Credit Claim	$2,357	
Average Installation	$23,573	
Percentage of approvals paid by TRD	52%	

Note that the claimed installed price of over $4.00 per watt is substantially higher than implied in the literature. Also note the significant discrepancy between EMNRD approvals and TRD paid claims. Only 52% of TY20 approved expenditure were claimed on 2020 returns. Finally, note that EMNRD expects claims to increase substantially, exceeding the current $8 million annual cap by TY21 and, perhaps, exceeding the proposed cap of $16 million by TY 2025.

EMNRD estimates that because these changes will likely increase the number of applications, there will be an increased fiscal impact on the agency for staff support to expand the tax credit program to handle this increase. According to EMNRD there would be an estimated cost of $70 thousand, for a new staff position to support application processing and review and an additional approximately $30 thousand for program redesign, administrative, legal, and information technology staff to update the current application process.

TRD estimates the fiscal impact of the increased cap amounts and refundability as follows: "The New Solar Market Development Tax Credit was enacted beginning Tax Year 2020, while a prior solar market development credit program was available from tax years 2006 through 2016. Based on data received from EMNRD, an average of 1,000 photovoltaic systems received the previous solar market development credit and approximately 350 solar thermal systems received it. Given the $3 million maximum aggregate cap amount on the credit for photovoltaic systems and a weighted average total system cost of $28,640, photovoltaic system credits were hitting the cap by the third year of the previous credit."

TRD also highlights: "During the prior credit, the average cost per watt for an installed residential photovoltaic system dropped from $9.01 per watt in 2009 to $4.50 per watt in 2016. Estimated national median installed prices in 2020 for residential installations were at $3.80 per watt[7]. The average residential installation price in New Mexico would be around $24,700,

[7] Galen Barbose, Naïm Darghouth Eric O'Shaughnessy, and Sydney Forrester, Lawrence Berkeley National Laboratory, "Tracking the Sun – Pricing and Design Trends for Distributed Photovoltaic Systems in the United States", 2021 Edition, September 2021.

assuming national average per watt costs, a 14 percent decrease in system installation cost from the previous credit program. Further cost reductions are being sought by the U.S. Department of Energy's Solar Energy Technologies Office to maintain cost incentives over the lifetime of solar photovoltaic systems." The federal government continues a residential energy credit through tax year 2023 and a commercial credit beyond tax year 2022. The state solar energy systems gross receipts tax deduction, Section 7-9-112 NMSA 1978, also provides a deduction from the sale and installation of solar energy systems if used to generate power for on-site consumption."

"Lower installation prices and current solar market tax deductions and credits contribute to incentivizing continued growth in residential photovoltaic installations. U.S. Energy Information Administration data for solar photovoltaic net generation by sector indicates that between October 2015 and October 2021, New Mexico residential solar photovoltaic generation increased at an annual average rate of 31 percent and small-scale systems in the commercial sector increased at a rate of 9 percent[8]. In FY21, a total of 1,529 taxpayers claimed the New Solar Market Development Tax Credit from TRD. TRD assumes applications for this credit will continue to grow at an average annual rate of 20 percent to support the growth trend in solar photovoltaic generation seen between 2015 and 2021. However, with these assumptions while the state may reach the current cap of $8 million for aggregate credit in FY25, the state would not reach the proposed cap of $12 million in the forecasted timeframe."

LFC staff notes TRD analysis may not have included that the tax credit becomes refundable (and transferable) with 2022 tax returns filed by April 2023 because the applicability date of the changes affect the 2022 tax year. The current law carryover from prior years would persist but would not be repealed (See TECHNICAL ISSUES for discussion). Even with no expansion in installations and claims, the refundable tax credits will more closely approach the approvals. If there is an expansion in the number of claims, then this expansion will also increase the estimate. LFC staff found the current law is expected to lead to approximately $10.6 million in total credit approvals by TY26, while the proposed law would lead to $11.6 million in credit approvals and a decrease to the general fund of $4.1 million by TY26. The $12 million cap pursuant to this bill applies to refunds and rollovers from previous rollovers. It is not expected that the transferability provision will materially affect the fiscal impact estimate.

The average of the LFC staff and TRD estimates are shown in the table on page 1, assuming no significant difference between tax year and fiscal year values.

FISCAL IMPLICATIONS – GROSS RECEIPTS AND COMPENSATING TAX RATE DECREASE

The general fund revenue impact of reducing the GRT and compensating tax rate is estimated according to the December 2021 Consensus Revenue Estimating Group's (CREG) estimate. Furthermore, effective tax rates are assumed in the cost estimate and range from 4.07823 percent to 4.34727 percent. The effective rate less than the stated rate of 4.875 percent is attributed to the 1.225 percent state share distributed to municipalities. For this purpose, analysts have used the higher percentage. Compensating tax cost estimates are similarly calculated with a set rate of 5.125 percent. All calculations are shown in the revenue table on page 1.

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[8] U.S. Energy Information Administration, "Electric Power Monthly" available at: https://www.eia.gov/electricity/monthly/

According to the Taxation and Revenue Department, the disclosed agency changes have an additional impact to the general fund of $3.2 million in FY23. Out year impacts are assumed to grow at the rate of total taxable gross receipts.

Lowering the gross receipts tax reduces the state's revenue diversification, contributing to revenue volatility. This bill's fiscal impact is estimated to increase the general fund's reliance on oil- and gas-related revenues.

SIGNIFICANT ISSUES: SOCIAL SECURITY EXEMPTION

States that tax social security benefits broadly fall into four categories: (1) states that fully exempt social security benefits from their state income tax; (2) states that tax social security benefits the same way in which the federal government taxes them; (3) states that base benefit exemptions on certain factors such as age or income; and (4) states that do not tax income at all. Twelve states tax social security benefits to some extent (see Attachment D). New Mexico is one of two states that follow the federal rules for including a portion of social security benefits as part of taxable income, and the state also provides a deduction for persons over age 65 to help offset the tax on social security benefits.

At the federal level, if the taxpayer's adjusted gross income (AGI) including half of social security benefits totals less than $32 thousand for married couples filing jointly or $25 thousand for single filers, none of the benefit amount is included in gross income. Accordingly, none of it is subject to federal income tax or state income tax. For AGI including half of social security benefits that exceeds $44 thousand for married joint and $34 thousand for single, then 50 percent to 85 percent of social security income is taxable.

The Aging and Long-Term Services Department (ALTSD) points out that seniors with adjusted gross income levels less than two to three times the poverty standard, do not pay taxes and will see no impact from this bill. Three times the poverty standard for 2022 is $38,640 for one person, $52,260 for two. However, seniors and adults with disabilities who receive social security and have additional income sources, putting them into a taxable income bracket, will be affected by this bill.

See the *Other Significant Issues: Social Security Exemption* section of this FIR for additional discussion.

SIGNIFICANT ISSUES – NEW SOLAR MARKET DEVELOPMENT TAX CREDIT

According to EMNRD, the agency "has seen a measurable increase in applications submitted for tax credit certificates under the New Solar Market Development Income Tax Credit. This has resulted in an increased workload at EMNRD. The amendments to increase the cap to $12 million and make the credit refundable will likely increase volumes and may encourage low- or middle-income homeowners and fixed income applicants to install solar systems, which would represent an expansion of the applicant pool."

"EMNRD's data indicates that the Solar Tax Credit became effective on March 1, 2020, and for that nine-month period over 2,364 solar installations were certified for a tax credit. The total amount of tax credit certificates for 2020 was $6,682,831. To date, the 2021 tax credit certificates are at 1,680 with a tax credit amount certified of $5,166,768. Applications for 2021 can be submitted until December 31, 2022. Based on the rate of applications received to date, it is likely that the current annual cap will be reached for 2022 applications."

TRD provides the following: "The bill extends the end date for the credit from 2028 to 2032. TRD supports sunset dates for legislators to review the impact of a credit before extending them, if a sufficient timeframe is allotted for tax incentives to be measured."

"The broader question of subsidizing solar energy has many economic factors to consider including job creation, impacts to established markets, and environmental concerns. A credit is a tax expenditure which gives preferential tax treatment to certain taxpayers. Some economists would argue that energy costs should include indirect impacts of energy use such as environmental impacts. Thus solar energy, which is often expensive to start-up, should be given tax incentives due to its low environmental impact and health and social benefits for the current and future populations. The long-term environmental, health and social benefits outweigh the short-term revenue cost. New job opportunities are associated with solar energy generation, such as solar photovoltaic installers, engineers, and managers. But job displacement also occurs with the shifting incentives for energy production away from traditional fossil fuels. Employees of both the San Juan Generating Station and associated coal mines face losing jobs with the closing of the station and care must be taken to ensure economic stability for those workers."

Given the uncertainty of the federal tax credit for residential solar continuing beyond tax year 2023, this state solar credit would provide a partial replacement for the federal credit. The proposed credit would support continued consumer demand and stability for the solar energy market. The credit aligns with Executive Order 2019-003, which aims to address climate change and energy waste prevention.

In previous personal income tax credits, including the former solar market development credit, the Legislature chose to implement a collateral corporate income tax credit. The current law does not allow a solar credit to be claimed on regular corporate income tax returns. However, the advent of virtually universal acceptance and use of pass-through entities (PTEs), including Sub-S corporations, Limited Liability Companies (LLCs), partnerships, limited liability partnerships, and others is critical. This credit can be claimed on personal income tax returns reporting income and liability from PTEs.

SIGNIFICANT ISSUES – GROSS RECEIPTS AND COMPENSATING TAX RATE INCREASE

If FY24, FY25, FY26, FY27 or FY28 gross receipts tax revenue transfers to the general fund are less than 95 percent of the previous year's corresponding transfers, then the state gross receipts tax rate would be restored back to the 5.125 percent level. In February 2025, the DFA Secretary would compare FY24 general fund gross receipts tax receipts (including year-end audit adjustments) to final FY23 comparable general fund receipts. If the FY24 amounts were less than FY23, the 5.125 percent rate would be restored for FY25, which would begin July 1, 2025. Similar calculations, determinations and restoration would occur for the next four fiscal years.

The definition of disclosed agent would make it easier for companies such as temporary staffing companies and other similar companies to claim the exemption from the GRT and Compensating tax on the wages they collect from employers and pass on to the temporary employees. Data from the RP-80, a report generated by the Taxation and Revenue Department reflecting sector-based GRT activity was used to determine the fiscal impact.

By lowering the state GRT rate, New Mexico could increase its business tax climate competitiveness nationally and with surrounding states. Arizona, Colorado, and Texas have average combined state and local tax rates of 8.4 percent, 7.72 percent, and 8.19 percent, respectively. By lowering the state GRT rate by a quarter percent, New Mexico could have the lowest average combined state and local tax rate of 7.58 percent. It should be noted, however, that the Gross Receipts tax is imposed on most services, including construction, as well as the more conventional sales tax base that includes most tangible personal property and building materials but not construction services.

According to the Tax Foundation's *2021 State Business Tax Index*, New Mexico ranks 41st in the nation for its gross receipts tax when compared with other state tax rates. For all taxes, New Mexico is in the middle of the pack, ranking 23rd, due to better rankings for personal income taxes, a top 10 ranking in corporate and unemployment insurance taxes, and best in the nation for property taxes.

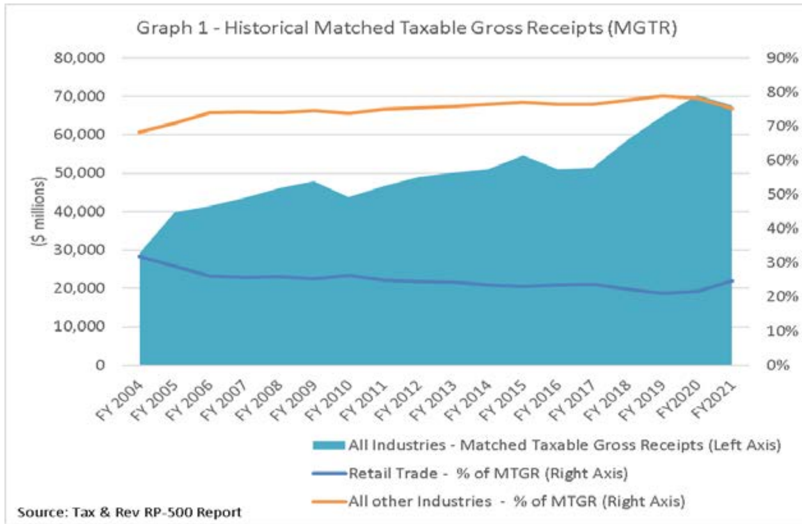
The increase in GRT rates over the years has exacerbated the effect of tax pyramiding, still an issue in many industries despite multiple exemptions and deductions attempting to mitigate the impact. Lowering GRT rates would not change the mechanism of pyramiding, but it would provide some relief for the impact of pyramiding and reduce the effective rate more than the rate reduced in the bill.

The Department of Finance and Administration Reports:

> To maintain revenues in the wake of the Great Recession, the statewide GRT rate increased by 1/8 percent (or 0.125 percent to 5.125 percent in 2010. According to the Taxation and Revenue Department, New Mexico has not decreased its statewide gross receipts tax rate since 1981. This tax decrease of 2/8 percent (or 0.25 percent) is more than double the increase in 2010.
>
> Since the GRT effectively functions as New Mexico's sales tax as well, consumers and businesses may see a decrease in the net costs of taxable goods and services if this bill is enacted and other variables remain constant.

The Taxation and Revenue Department reports:

> Good tax policy begins with taxing a broad base and imposing a low rate. Since 2019, New Mexico's GRT base has been broadened to include internet sales and a broader type of hospital receipts. Graph 1 below demonstrates this recent expansion of the GRT base (Matched Taxable Gross Receipts). Since the Great Recession, although the total GRT base had increased steadily, retail trade had been declining as a share of the base. Some of this decline reflected consumers choosing non-taxable internet sales. With taxation of internet sales beginning July 1, 2019, retail trade's share of the tax base increased significantly. With the broader base, a lower rate is justified benefiting all New Mexicans. Although reducing the GRT and compensating tax rates reduces General Fund revenues, this comes after significant increases in revenue from the expansion of the tax base over the last few years.



A lower tax rate supports all industries in the economy, providing relief to local businesses and consumers, and makes New Mexico more competitive with other states. The reduction in the GRT and compensating tax rates reduces the impact of pyramiding, where the same final good or service is taxed multiple times in the production process and can result in effective tax rates significantly higher than the current 5.125 percent state GRT rate. This increases the cost of New Mexico exports, providing a significant obstacle to the manufacturing sector.

Consumers will receive the benefit especially among lower-income families because the GRT is a regressive tax; the lower a person's income, the higher percent of their income is spent on GRT. The tax relief provided to New Mexico families may be used to increase savings, pay off debt, and improve quality of life. Lower income New Mexicans will circulate these tax savings back into the economy.

This bill creates a definition of "disclosed agency" in the Gross Receipts and Compensating Tax Act. Disclosed agency has been a frequent source of tax litigation in New Mexico since the 1990s, and this definition will provide clarity to prevent disputes. Tax protests and litigation are costly both for taxpayers and TRD, and this bill will create savings on both sides of tax disputes. This definition will also prevent tax pyramiding on receipts an agent receives on behalf of the agent's principal

PERFORMANCE IMPLICATIONS

Pertaining to the New Solar Market Development Tax Credit, the LFC tax policy of accountability is met with the bill's requirement to report annually to an interim legislative committee regarding data compiled from reports from taxpayers taking the deduction and other information to determine whether the deduction is meeting its purpose. The actual report from TRD to the Legislature is likely to be in the form of the annual update of the TRD Tax Expenditure Report. However, note refundability makes this tax credit different from the 2020 enactment. TRD might be able to separately detail the amount of carryover.

TRD recommends all tax incentive legislation include specific standardizations to facilitate operational efficiency. This includes: (1) Tax credits programs should be limited to five year periods. This term facilitates a market-facing analysis, whereby market changes can be acted upon by legislators; (2) Credits should not be refundable, but they should incorporate a standardized carryforward period of three years. This limits the evaluation period of any tax credit incentive to a total of eight years, and limits the fiscal obligation to a period of three years after expiration; and (3) Legislation should require tax filers to apply for any credit within 12 months of the calendar year the filer qualified for the credit. This incentivizes the filer to use the credit program timely, or risk losing eligibility due solely to their nonfeasance.

The Social Security exemption will probably be reported in TRD's annual Tax Expenditure Report. The Gross Receipts and Compensating tax reductions will not be reported by TRD in the annual Tax Expenditure Report, but it is expected that TRD and LFC will separately calculate the reduction in the quarterly updates of the revenue estimates conducted by the Consensus Revenue Estimating Group (CREG).

ADMINISTRATIVE IMPLICATIONS -- EMNRD

EMNRD states ongoing staff resources are required to manage, redesign electronic application processes, provide system reviews, certify systems for tax credit eligibility, collect data, and maintain a database. Based on feedback from past applicants, many struggled with electronic submissions. In anticipation of increased volumes, EMNRD will need to revise the electronic platform to ensure continued struggles do not increase paper applications which further slowdown processing and significantly increase administrative workloads.

ADMINISTRATIVE IMPLICATIONS -- TRD

Section 1: Social Security: TRD will make information system changes and create new publications, forms and regulations. These changes will be incorporated into annual tax year implementation and represents $5,164 in workload costs.

Section 2: Solar Tax Credit: TRD will need to make information system changes and update forms and publications. These changes will be incorporated into annual tax year implementation. Currently, all certifications must be entered manually, so if increasing the cap and making the credit refundable leads to an increase in the number of claims received, the administrative workload for TRD will increase.

RPD assumes that electronic transfer of credit information will not occur before the effective date of the bill and thus an additional FTE will be required to process additional credit claims. The recurring budget estimate for Tax Rev is based on a Tax Examiner-A

The Information Technology Division (ITD) will need to update GenTax and the Taxpayer Access Point (TAP) to implement the provisions of this bill. ITD will work approximately 100 hours or approximately 1 month for an estimated $5,164 of staff workload costs.

Sections 3 through 5: GRT and Comp Tax Rates: TRD will make information system changes and update forms and publications. The Information Technology Division (ITD) will update GenTax and the Taxpayer Access Point (TAP) to implement the provisions of this bill. ITD will work approximately 80 hours or approximately 1 month for an estimated $16,000 of contractual resources. The Administrative Services Division (ASD) will work with ITD to implement the new rates and test distributions. ASD will have $5,200 in associated staff workload costs.

GRT filer's kits will have already been mailed with older GRT rates to paper filers before the effective date of the bill. The Revenue Processing Department (RPD) estimates mailing costs of $14,479 to send a letter to all taxpayers that receive filer's kits explaining the rate change.

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

Section 1 conflicts with HB33, HB48, HB49, HB158, SB108, and SB121.
Transferability provisions of Section 2 conflict with HB34.
Gross Receipts and Compensating Tax Rate Reduction – sections 3, 4, & 5 relate to and affect:
HB14 Bonds and GRT Deduction for Electric Storage;
HB15 Tribal Gross Receipts Tax Rates;
HB32 Feminine Hygiene Gross Receipts;
HB39 GRT Deduction for Nonathletic Special Events;
HB47 Exclude Home Health Care from DSB Sourcing;
HB67 Tech Readiness Gross Receipts Tax Credit;
HB72 Space Ticket Gross Receipts;
HB82 Dialysis Facility Gross Receipts;
SB30 Regional Transit GRT Distributions; and
SB60 Film Company Security Gross Receipts.

TECHNICAL ISSUES

Relative to Section 2 -- New Solar Market Development Tax Credit -- TRD is somewhat concerned about the effect of eliminating carryover provisions in favor of refundability. The concern is with the substantial carryover for systems installed in TY20 and TY21. It is unclear whether the carryover provisions have been repealed and collaterally whether any amount of carryover is automatically converted into a claim for refund in excess of tax liability. The issue is an administrative decision made by EMNRD for both the old Solar Market Development Tax Credit and this New Solar Market Development Tax Credit. With the old credit, EMNRD would roll the claim to the next year when the cap was exceeded. Statute implied that all claims in excess of the cap would be cancelled. Apparently, EMNRD will apply this same procedure to NSMDTC claims in excess of the $12 million cap, if total claims should exceed this.

TRD suggests the carry forward information is not removed but that the refundable portion of the credit is clarified as follows on page 4 starting on line 1. “That portion of a new solar market development income tax credit that exceeds a taxpayer’s liability in the taxable year in which the credit is claimed may be carried forward for a maximum of five consecutive taxable years. Starting for those credits issued with the first claimable tax year starting January 1, 2022, any credit that exceeds a taxpayer’s liability in the taxable year in which the credit is claimed shall be refunded to the taxpayer.” This will prevent confusion as to which time period’s credits are refundable and individuals who have carry forward credit available to them prior to this bill’s changes will not be able to get the amount refunded based on current law. This will also make this change easier to administer and easier to estimate the amount of credit that will need to be refunded from this credit. Without this change, it is possible that individuals who have received this credit in the past will file amended returns for prior years and request refunds of any unused credit.

This bill contains an implicit delayed repeal date for installation, but may allow rollovers to continue for some time. The bill does not require taxpayers to file the claim for refund in the year of the installation. In addition, in the case of the previous Solar Credit that was limited by the cap, EMNRD apparently rolled over applications for certification in excess of the cap – in effect allowing these applications in excess of the cap to be first in the queue for the following year. If the total amount of approved credits should exceed the $16 million cap, there may well be rollover. LFC usually recommends adding a delayed repeal date. In this case, however, the credit should not be repealed until the expiration of the rollover period.

OTHER SUBSTANTIVE ISSUES – NEW SOLAR MARKET DEVELOPMENT TAX CREDIT

TRD notes implementation of the New Solar Market Tax Credit has been somewhat difficult. At least some of the discrepancy noted between EMNRD approvals and TRD's payment of tax credit claims can be explained by this difficulty. Tax year 2020 is the first year TRD received tax credit claims for the New Solar Market Credit. Many returns were not able to be processed at time of receipt due to incomplete information. Some issues were attributed to backlogs at EMNRD. This added to TRD's Revenue Processing Division inventories of returns suspended and this suspension caused taxpayer frustration. To better serve the taxpayers and to create department efficiencies, the smooth flow of certification data to TRD is necessary. TRD recommends adding language requiring electronic information sharing for EMNRD certificates awarded. Receiving electronic files of awarded certificate data improves return processing efficiency and accuracy and supports annual reporting by allowing for process automation and avoiding time delays associated with manual processing.

OTHER SIGNIFICANT ISSUES: SOCIAL SECURITY EXEMPTION

New Mexico began taxing social security benefits in 1990. The action was contained in an omnibus bill enacted in response to the "Davis v. Michigan" and "Burns v. New Mexico" problems. At that time, state retiree's pensions were 100 percent exempt from personal income tax, but federal retirees only were allowed a $3,000 deduction. The Supreme Court of the United States found that this differential treatment was in violation of federal law ensuring that state and federal workers must be treated equally and equitably. Per the Supreme Court opinion, retiree income was covered by the federal statute. In the relevant bill, New Mexico repealed both the federal and state differential deductions. In addition, other source-specific deductions were included in the fix. These included the total exemption for social security income.

PIT represents a consistent source of revenue for many states. While this revenue source is susceptible to economic downturns, it is also positively responsive to economic expansions. New Mexico is one of 42 states along with the District of Columbia that impose a broad-based PIT. PIT is an important tax policy tool that has the potential to further both horizontal equity by ensuring the same statutes apply to all taxpayers and vertical equity by ensuring the tax burden is based on taxpayer's ability to pay.

New Mexico statutes for state personal income tax are linked to the federal tax code. This is also termed "conformity." As the federal tax code changes, such as under the 2017 Tax Cuts and Jobs Act (TCJA), states see impacts on their revenue collection from PIT, depending on their level of conformity. New Mexico's level of conformity is currently high, given that PIT starts with federal adjusted gross income (AGI), applies federal standard deductions, and uses Internal Revenue Service (IRS) definitions such as the definition for "dependents". With that conformity, New Mexico's treatment of social security benefits follows the federal application.

Since 1984, a portion of Social Security benefits have been subject to federal income taxes. The taxable portion is dependent on the level of the taxpayer's combined income, which includes 50 percent of the Social Security benefits, plus income from other sources, including interest on tax exempt bonds. Because the combined income thresholds for taxation of benefits have remained unchanged since they were introduced in 1984 and 1993, but wages have increased over the years, the proportion of beneficiaries paying tax on their benefits has risen over time.

OTHER SUBSTANTIVE ISSUES – NEW SOLAR MARKET DEVELOPMENT TAX CREDIT

1. Any tax expenditure reduces revenue. In this case, a personal income tax credit only reduces general fund revenue, whereas gross receipts tax expenditures tend to reduce both state level taxes and local taxes.
2. Economic efficiency is also suspect, since this tax expenditure serves to subsidize a particular form of economic activity.
3. Overall, the purchase of a 5 or 6 Kilowatt solar array for around $28 thousand puts this option out of the price range of about 80 percent of New Mexicans. It is, perhaps, still a luxury good, which may raise equity issues.
4. Because of the desirable feature of this tax expenditure that minimizes abuse but requires at least three state agencies to be involved (Construction Industries Division of RLD, TRD and EMNRD) and an Investor-Owned Utility (in case of grid-tied systems and the potential of REC), soft costs and approval delays add between $3,200 and $4,700 to the costs of a typical 5 Kw system.
5. Accountability is preserved with this credit because of the required TRD reporting to the legislature.

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.

Relative to the New Solar Market Development Tax Credit

LFC Tax Expenditure Policy Principle	Met?	Comments
Vetted	✓	This is an expansion of an existing credit.
Targeted		
Clearly stated purpose	✓	The solar industry in New Mexico can hardly be considered new. Zomeworks began business in New Mexico in 1969 and is still in business. The purpose is clearly to incentivize the expansion of the industry
Long-term goals	✗	None stated.
Measurable targets	✗	None stated
Transparent	✓	
Accountable		
Public analysis		

Expiration date	✓ ✓	
Effective Fulfills stated purpose Passes “but for” test	✗ ✗	No purpose stated The industry has been continuously growing, but may be in a saturation phase.
Efficient	✗	Credit serves to subsidize a particular but socially beneficial industry. This may be a way of internalizing positive externalities because of the non-polluting nature of solar-generated electricity.
Key: ✓ Met ✗ Not Met ? Unclear		

Relative to the Social Security Exemption (Section 1)

LFC Tax Expenditure Policy Principle	**Met?**	**Comments**
Vetted	?	It is unknown if the issue has been discussed at an interim committee recently. The issue was discussed in 2019 at the Revenue Stabilization and Tax Policy Committee prior to the 2020 Legislative Session, but without endorsement.
Targeted Clearly stated purpose Long-term goals Measurable targets	✗ ✗ ✗	No purpose, targets, or goals established.
Transparent	?	TRD will likely publish a cost estimate in its annual Tax Expenditure Report; however, no specific reporting on this exemption to interim committees is required.
Accountable Public analysis Expiration date	✗ ✗	The bill contains no provisions for reporting. The bill does not include an expiration date.
Effective Fulfills stated purpose Passes “but for” test	? ?	Without a purpose statement or required reporting, it is not possible to determine if the exemption fulfills intended outcomes.
Efficient	✗	Without a purpose statement or required reporting, it is not possible to determine if the exemption is the most efficient means of achieving desired outcomes. However, current data and recent studies indicate this exemption would be inefficient in providing tax relief to low-income households receiving social security benefits and may not be a meaningful recruitment tool for retirees to the state.
Key: ✓ Met ✗ Not Met ? Unclear		

IT/JF/LG/al