BILL ANALYSIS AND FISCAL IMPACT REPORT
Taxation and Revenue Department

February 11, 2025

Bill: HB-14 **Sponsor:** Representatives Derrick J. Lente and Javier Martínez

Short Title: Earned Income Tax Credit

Description: This bill replaces the State's Working Families Tax Credit (WFTC) in Section 7-2-18.15 NMSA 1978 with a new State earned income tax credit that will be more independent of the federal credit of the same name. The credit is calculated based on a taxpayer's earned income, taking into consideration a credit percentage and phaseout percentage that vary based on the number of qualifying children. If the greater of an eligible individual's earned income or adjusted gross income (AGI) is less than the earned income amount and the amount of credit is less than $100, the credit will be $100. Otherwise, the credit is worth a percentage of the taxpayer's income that does not exceed the threshold. The bill also provides that for the 2026 and subsequent tax years the earned income amounts and phaseout amounts will be adjusted for inflation. Any portion of the credit that exceeds a taxpayer's tax liability will be refunded, and that refund will not be treated as income for state income taxation purposes.

Effective Date: Not specified; 90 days following adjournment (June 20, 2025). Applicable to taxable years beginning on or after January 1, 2025.

Taxation and Revenue Department Analyst: Sara Grubbs

Estimated Revenue Impact*					R or NR**	Fund(s) Affected
FY2025	**FY2026**	**FY2027**	**FY2028**	**FY2029**		
--	$137,900	$144,000	$149,400	$155,200	R	General Fund – PIT - repeal of WFTC
--	($165,400)	($172,700)	($179,100)	($186,100)	R	General Fund – PIT - Proposed State EITC, current population
--	($15,200)	($15,900)	($16,500)	($17,100)	R	General Fund – PIT - Proposed State EITC, expanded population
--	($42,700)	($44,600)	($46,200)	($48,000)	R	General Fund – PIT - Total

* In thousands of dollars. Parentheses ( ) indicate a revenue loss. ** Recurring (R) or Non-Recurring (NR).

Methodology for Estimated Revenue Impact: The Taxation and Revenue Department (Tax & Rev) used TY2023 New Mexico tax returns to evaluate the fiscal impact of this proposal. Just under 197,000 taxpayers claimed the WFTC in TY2023. For these taxpayers, Tax & Rev calculated the incremental increase they would receive under this bill. These taxpayers currently receive 25% of the federal Earned Income Tax Credit (EITC). This bill would increase these taxpayers' credit to an average of 30% of the EITC. Tax & Rev estimates that for current recipients of the WFTC, the aggregate increase to this new credit is approximately $24.7 million, or an average increase of $125.49 per taxpayer.

Tax & Rev then estimated the number of taxpayers that would be eligible to receive this new credit, but currently do not meet the federal EITC qualifications, and therefore do not receive the current WFTC. Under the proposed bill, the income range for a taxpayer to qualify is wider than for the current WFTC which allows more New Mexico taxpayers to qualify.

Tax & Rev used adjusted gross income (AGI) as a proxy for earned income. The amount of the credit was calculated for each taxpayer under Section 1(B)(C) and (D) on page 2. Taxpayers without a qualifying dependent and over the age of 65 were excluded per Section 1(K)(2)(a), on page 4, as an individual is eligible under the federal Earned Income Tax Credit eligibility standards[1]. The table below details the number of additional taxpayers estimated to receive this credit, the aggregate expenditure, and the average projected claim per taxpayer.

Filing Status	Number of Taxpayers	Proposed State EITC Total Expenditure ($1000)	Proposed State EITC per Taxpayer ($/taxpayer)
Single	84,542	$10,800	$127.75
Head of Household	8,021	$1,500	$187.01
Married Fiing Joint	9,302	$1,300	$139.75
Total	101,865	$13,600	$133.51

Tax & Rev estimates that 101,865 New Mexico taxpayers would be newly eligible for the expanded state earned income tax credit under this proposal, with 80% of the benefit of the proposed expansion going to single tax filers who have no dependents.

Using the University of New Mexico's Bureau of Business and Economic Research (BBER) January 2025 forecast, the Taxation and Revenue Department (Tax & Rev) grew the estimate annually by BBER's New Mexico's wage and salary growth.

Policy Issues: Personal income tax (PIT) represents a consistent source of revenue for many states. For New Mexico, PIT is approximately 25 percent of the state's recurring general fund revenue. While this revenue source is susceptible to economic downturns, it is also positively responsive to economic expansions. New Mexico is one of 41 states, along with the District of Columbia, that impose a broad-based PIT (New Hampshire and Washington do not tax wage and salary income). Like several states, New Mexico computes its income tax based on the federal definition of taxable income and ties to other statues in the federal tax code. This is referred to as "conformity" to the federal tax code. The 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 taxpayers' ability to pay. There is additional horizontal erosion by basing this tax credit on the number of dependents and age of the taxpayer.

While tax incentives can support specific industries or promote desired social and economic behaviors, the growing number of such incentives complicate the tax code. Introducing more tax incentives has two main consequences: (1) it creates special treatment and exceptions within the code, leading to increased tax expenditures and a narrower tax base, which negatively impacts the general fund; and (2) it imposes a heavier compliance burden on both taxpayers and Tax & Rev. Increasing complexity and exceptions in the tax code is generally not in line with sound tax policy.

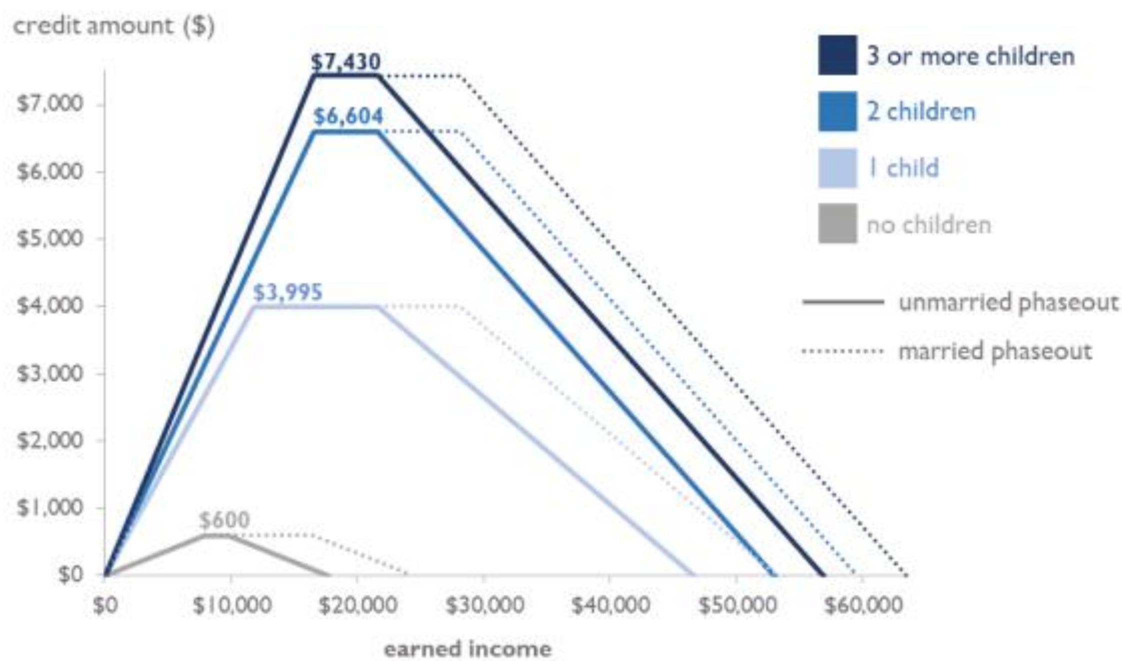
The Earned Income Tax Credit is one of several tax incentives that provides tax relief to families to help offset the costs of raising children and can effectively reduce poverty rates. 2023 U.S. Census data reports

[1] https://www.irs.gov/credits-deductions/individuals/earned-income-tax-credit/who-qualifies-for-the-earned-income-tax-credit-eitc#basic

that although New Mexico has the highest official poverty rate in the nation for those under 18, supplemental measures at the federal and state level reduced poverty in New Mexico dramatically[2]. New Mexico's supplemental poverty rate for those under 18, taking into account the federal child tax credit, and federal and state tax provisions and programs is 8.9%, compared to New Mexico's official poverty rate of 27.4%[3]. No other state saw as dramatic a reduction between the two measures for the period 2021 through 2023.

The proposed bill increases the administrative burdensome for Tax & Rev and taxpayers. While the State's current WFTC is easily administered because it mainly ties directly to a taxpayer's federal EITC credit, this bill introduces varying credit and phaseout percentages based on the number of qualifying children and is similar to the criteria for the federal EITC. The graphic below shows the credit amounts available for the federal EITC for 2023 under different filing statuses, number of dependents, and income levels. Instead of leaving the complex calculation in the federal Internal Revenue Code, this proposal creates a new graphical representation (similar to the one below) for the state EITC and requires Tax & Rev to expand the PIT returns and instructions for taxpayers to calculate their credit amount.

EITC Amount by Number of Qualifying Children, Marital Status, and Income, 2023



Source: CRS calculations based on IRS Revenue Procedure 2022-38 and Internal Revenue Code §32.

This complexity can create confusion for taxpayers, as they will need to accurately determine their eligible credit percentage and phaseout amount based on their specific circumstances when they file their New Mexico personal income tax returns. While the state will provide tables for taxpayers to estimate their credit, taxpayers will be estimating two different credits at the federal and state level. This variation increases the likelihood of errors in reporting and claiming the credit, which can lead to incorrect or fraudulent claims and place additional burdens on both taxpayers and Tax & Rev. The different credit percentages and phaseout amounts complicate the calculation.

[2] The U.S. Census Bureau provides two measures of poverty: the official poverty measure and the Supplemental Poverty Measure (SPM). The official poverty measure is estimated using pretax money income. The SPM extends the official poverty measure by accounting for several government programs and geographic variations in housing expenses.

[3] U.S. Census Bureau, Current Population Survey, 2022-2024 Annual Social and Economic Supplements (CPS ASEC)

This bill contrasts with a straightforward percentage-based approach, such as linking the state credit to the federal EITC, which already accounts for the number of qualifying children and simplifies the calculation process. To simplify administration and reduce errors, this bill could continue to align with the federal EITC and add expansion language for the new population as was done in 2021 to expand the population eligible for the credit. By using similar eligibility criteria and credit calculations, the state can leverage existing data and verification mechanisms, making the process more efficient and accurate.

Technical Issues: The only filing status identified in Section 1 (D) is married filing joint. In New Mexico's PIT tax code, married filing joint is often combined with head of household filing status. It is possible this may cause confusion to taxpayers and increase the likelihood of amended returns.

Other Issues: None.

Administrative & Compliance Impact: Tax & Rev will update forms, instructions and publications and make information system changes. This update to publications includes creating new lookup tables for the credit amount at income brackets of $50. Staff training to administer the credit will take place. This implementation will be included in the annual tax year changes.

Tax & Rev's Administrative Services Division (ASD) will test credit sourcing and perform other systems testing. It is anticipated this work will take approximately 40 hours split between 2 FTE of a pay band 70 and a pay band 80 at a cost of approximately $2,500. Pay band 70 hours are estimated at time and ½ due to extra hours worked required for implementation.

For Tax & Rev's Information Technology Division (ITD), implementation of this bill will have a low impact, with approximately 750 hours or about 5 months and $49,980 of staff workload costs.

Tax & Rev estimates 25 hours of administrative impact on Tax & Rev's Office of the Secretary (OOS) to create new tax reference tables for the PIT publications for tax year 2025. In subsequent years, an estimated 5 hours is estimated for the recurring staff workload costs to update the tables for inflation.

Implementing and enforcing the new credit structure will place an additional administrative burden on the return process for Tax & Rev. This includes the need for system updates, additional documentation requirements, and increased verification procedures. Systematic verifications to determine eligibility may be required, adding further complexity to the administration process.

Estimated Additional Operating Budget Impact*				**R or NR****	**Fund(s) or Agency Affected**
FY2025	**FY2026**	**FY2027**	**3 Year Total Cost**		
--	$2.5	--	$2.5	NR	Tax & Rev – ASD – Staff workload
--	$49.9	--	$49.9	NR	Tax & Rev – ITD – Staff workload
--	$1.4	--	--	NR	Tax & Rev – OOS – Staff workload
--	--	$0.4	$0.4	R	Tax & Rev – OOS (recurring staff workload)

* In thousands of dollars. Parentheses ( ) indicate a cost saving. ** Recurring (R) or Non-Recurring (NR).