FISCAL IMPACT REPORT

		LAST UPDATED	
SPONSOR	Dow/Jones/Lujan/Vincent	**ORIGINAL DATE**	02/07/25
SHORT TITLE	Adoption Of Special Needs Child Tax Credit	**BILL NUMBER**	House Bill 207
		ANALYST	Graeser

REVENUE*
(dollars in thousands)

Type	FY25	FY26	FY27	FY28	FY29	Recurring or Nonrecurring	Fund Affected
PIT Credits	**$0**	**($9,200.0) to (19,200)**	**($9,500.0) to (19,200)**	**($9,800.0) to (19,200)**	**($10.100.0) to (19,200)**	Recurring	General Fund

Parentheses ( ) indicate revenue decreases.

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT*
(dollars in thousands)

Agency/Program	FY25	FY26	FY27	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
TRD	**No fiscal impact**	**$85.0**	**$85.0**	**$170.0**	Recurring	**General Fund**
TRD	**No fiscal impact**	**$19.9**	**No fiscal impact**	**$19.9**	Nonrecurring	**General Fund**

Parentheses ( ) indicate expenditure decreases.

Relates to House Bill 225 and Senate Bill 272.

Sources of Information
American Community Survey 2023
US Department of Health & Human Services, Children's Bureau Databases
LFC Files

<u>Agency Analysis Received From</u>
Children, Youth & Families Department (CYFD)
Taxation and Revenue Department (TRD)

SUMMARY

Synopsis of House Bill 207

House Bill 207 expands the special needs adoption income tax credit.
- The tax credits would apply to any adoption, not just of a child with special needs;
- The amount of annual credit would increase to $7,000 per child and that credit would be refundable.
- The credit is annual for up to 18 years depending on the age of the child when adopted.

This bill does not contain an effective date and, as a result, would go into effect 90 days after the Legislature adjourns, or June 20, 2025, if enacted. The provisions are applicable for tax years beginning January 1, 2025. There is no sunset date.

FISCAL IMPLICATIONS

This bill expands a tax expenditure with a cost that is difficult to determine but undoubtedly significant. LFC has serious concerns about the substantial risk to state revenues from tax expenditures and the increase in revenue volatility from erosion of the revenue base. The committee recommends the bill adhere to the LFC tax expenditure policy principles for vetting, targeting, and reporting or action be postponed until the implications can be more fully studied.

From the American Community Survey for 2023, there were 14.815 thousand New Mexico households with grandparents responsible for their own grandchildren under 18 years old. An unknown portion of this group have formally adopted their grandchildren. Approximately 300 to 400 of these receive care payments through the foster care system. With the substantial amount of tax credit proposed in this bill, the costs of adoption would be covered. LFC staff expect that 10 percent of these grandparents have adopted and that fraction will grow to 20 percent by FY29.

In their analysis, TRD used a database maintained by U.S. Department of Health & Human Service's Administration for Children & Families Children's Bureau entitled *Child Welfare Outcomes Report Data.*[1] These data indicated that an average of 287 new child adoptions occurred in New Mexico each year from 2018 to 2022. The data also included for that same sample period estimates of the age at adoption of the 287 children each year. LFC built a cohort model that indicates that a relatively constant 3,100 adopted children under 18 reside in New Mexico. The average age at adoption is about seven years.

From the Tax Expenditure Report, there are an average of 900 claimants per year for the current $1,500 per special needs child and an average of 1.75 children per claim. This is an average base of 1,750 children. This is about 50 percent of the total adopted children in the state.

National adoption statistics are that about 150 thousand children a year are newly adopted. New Mexico's income-weighted population ratio of .50 percent implies that there are approximately 750 children adopted each year – considerably more than indicated in the USDHHS data.

Tax Year	2025	2026	2027	2028	2029
Special needs	1,580	1,580	1,580	1,580	1,580
Grandparent Adoptions	1,480	1,850	2,220	2,590	2,960
Other Adoptions	1,540	1,540	1,540	1,540	1,540
Total Qualified Adopted Children	4,600	4,970	5,340	5,710	6,080
Credit Cost	($32,200.0)	($34,790.0)	($37,380.0)	($39,970.0)	($42,560.0)
Less Current Costs	($2,600)	($2,600)	($2,600)	($2,600)	($2,600)
Net Costs	($29,600.0)	($32,190.0)	($34,780.0)	($37,370.0)	($39,960.0)
Exclude Grandparent Adoptions	($21,800.0)	($21,800.0)	($21,800.0)	($21,800.0)	($21,800.0)
Less Current Costs	($2,600)	($2,600)	($2,600)	($2,600)	($2,600)

[1] https://cwoutcomes.acf.hhs.gov/cwodatasite/adopted/index/

Net Costs	($19,200.0)	($19,200.0)	($19,200.0)	($19,200.0)	($19,200.0)

TRD expects significantly lower net costs from this proposal:

Striking all references to "special needs" in Section 7-2- 18.16, NMSA 1978 makes parents of all adopted children eligible for this credit. The Taxation and Revenue Department (TRD) used children's adoption data by age in New Mexico from 2018 to 2022 to estimate the cost of expanding the credit to include any adopted child and increasing the credit from $1,500 to $7,000 per child.[2] TRD identified 564 adopted children who would be 18 or under in 2024 and applied the growth rate of adopted children from 2018 to 2022 to increase the population of adopted children. Then, TRD employed the 2024 Tax Expenditure Report and added the number of adopted children in the State to the 849 claims of the special needs child tax credit in FY2024 to calculate the fiscal impact. TRD assumes that all taxpayers currently eligible for the "special needs adopted child credit" remain eligible for this credit.

Estimated Revenue Impact*					R or NR**	Fund(s) Affected
FY2025	FY2026	FY2027	FY2028	FY2029		
--	($9,200)	($9,500)	($9,800)	($10,100)	R	General Fund

The range shown in the revenue table is the TRD estimate on the low side and LFC's estimate on the high side. If this credit is included in the tax package, TRD & LFC will settle on a single estimate which might be the average of the two estimates.

SIGNIFICANT ISSUES

TRD notes several significant issues involved :

The increment in the adopted child tax credit will erode horizontal equity in the state income taxes. By basing the credit on the number of qualifying children, taxpayers with the same level of income are no longer treated equally. Thus, two New Mexico residents who earn the same salary may have different tax liability given the number of children they adopt. While most adoption tax benefits go to affluent families, children from lower-income families are more likely to benefit from adoption.

The adopted child tax credit helps taxpayers offset some of the costs of adopting a child. The credit amount increased in 2024 from $1,000 to $1,500, providing inflation relief for the families. An increase of more than 300%, as this bill proposes, might merely reduce general fund revenues and have little or no effect on adoptions. There is little evidence that adoption tax benefits are an effective policy tool to increase adoptions. Instead, data suggest that adoption tax benefits are often a windfall to families that would have adopted in their absence.[3]

The social benefits of adoption have been well documented. For example, adopted people are less likely to engage in criminal behavior, become homeless, become addicted to drugs, and are more likely to have better health, pursue an education, and secure a job. As well as being

[2] https://cwoutcomes.acf.hhs.gov/cwodatasite/adopted/index/

[3] https://crsreports.congress.gov/product/pdf/R/R44745

a moral good, keeping children in a family setting may reduce social costs over the long-term by reducing social, economic, and psychological problems that children who remain unadopted, or in foster care, may experience. In this sense, the bill is expected to have a positive future social impact. If the purpose of the tax credit is to increase the number of New Mexican children being adopted, there should be language distinguishing that it was an adoption of a child in New Mexico.

The current special needs adopted child tax credit can be claimed by non-residents who have income sourced to New Mexico to receive the credit. Hence, this credit could be claimed by adopting parents for children who do not reside in New Mexico. Adding language that requires the credit to be apportioned or available only for adopted children who reside in New Mexico would prevent non- residents who do not have income in New Mexico from filing for the tax credit while not allocating or apportioning income to New Mexico.

PERFORMANCE IMPLICATIONS

The LFC tax policy of accountability is met with the bill's requirement to include data compiled from the tax returns filed by taxpayers taking the credit and include that analysis in the annual Tax Expenditure Report.

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

Relates to House Bill 225 and Senate Bill 272, both of which provide income tax deductions or exemptions primarily to increase financial support for foster families. Foster families would not qualify for the HB207 tax credits, but the value of the HB207 tax credits might encourage some foster families to take the next step and adopt the foster children.

TECHNICAL ISSUES

TRD has several suggestions regarding technical issues:

Subsection C on page 2, states an adopted child tax credit may be claimed for each tax year the child may be claimed as a dependent. But the definition of a "child", in subsection H, on page 3 lines 10-19, conflicts with that subsection, as individuals over eighteen years of age may still be claimed as a dependent if they have special needs. Under the current language of the bill, taxpayers who adopted special needs children who can be claimed as dependent for life but are over the age of 18 will no longer qualify for this tax credit. TRD suggests maintaining in Subsection A, "special needs" so that on lines 22 and 23 it reads: "and who adopts a special needs child or child on or after January 1, 2007 or has adopted a special needs child prior to January 1,…" Then maintain the current definition of "special needs child" under subsection H, and amend the definition of "child" in a new subsection I, "As used in this section 'child' means an individual, other than a special needs child, under the age of eighteen."

Under subsection H., TRD suggests the following definition of "dependent" be added to clarify this credit, "As used in this section, "dependent" means" dependent" as defined in Section 152 of the Internal Revenue Code." On page 2, lines 11 and 12, then delete after dependent, "for federal taxation purposes by the taxpayer."

TRD suggests for clarity of credit eligibility, that a definition of "adopted" be included under subsection H on page 3.

OTHER SUBSTANTIVE ISSUES

In assessing all tax legislation, LFC staff considers whether the proposal is aligned with committee-adopted tax policy principles. Those five principles:

- **Adequacy**: Revenue should be adequate to fund needed government services.
- **Efficiency**: Tax base should be as broad as possible and avoid excess reliance on one tax.
- **Equity**: Different taxpayers should be treated fairly.
- **Simplicity**: Collection should be simple and easily understood.
- **Accountability**: Preferences should be easy to monitor and evaluate

In addition, staff reviews whether the bill meets principles specific to tax expenditures. Those policies and how this bill addresses those issues:

Tax Expenditure Policy Principle	Met?	Comments
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.	X	**This is a major change to this existing credit.**
Targeted: The tax expenditure has a clearly stated purpose, long-term goals, and measurable annual targets designed to mark progress toward the goals. Clearly stated purpose Long-term goals Measurable targets	 ? X X	The implicit goal of this expansion is to incentivize more adoptions. However, there are no measurable targets
Transparent: The tax expenditure requires at least annual reporting by the recipients, the Taxation and Revenue Department, and other relevant agencies	: ✓	Statutorily required and included in the bill's provisions
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. Public analysis Expiration date	 ? X	Utilization data will be published annually by TRD and this data will allow a calculation of the cost of new adoptions
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. Fulfills stated purpose Passes "but for" test	 ? ?	This cannot be answered a priori. If the bill passes, then the effectiveness over time can be calculated.
Efficient: The tax expenditure is the most cost-effective way to achieve the desired results.	?	
Key: ✓ Met ✗ Not Met ? Unclear		

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