TAXATION & REVENUE
NEW MEXICO

New Mexico 2024
Tax Expenditure Report

Presented to the
Revenue Stabilization and Tax Policy Committee

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What is a Tax Expenditure Report?

- Tax expenditure reports (TER) describe areas where the tax code provides for preferential tax treatment of a certain activity
- The TER includes an estimate of revenue foregone because of the preferential tax treatment due to:
  - Credits
  - Deductions
  - Exemptions
  - Preferential tax rates
- Every dollar of revenue foregone is a dollar that cannot be appropriated or added to reserves
- State appropriations are rigorously evaluated and reprioritized annually; tax expenditures should be similarly revisited
- TERs are important transparency tools that allow State policymakers, advocacy groups, and the public an opportunity to regularly evaluate the State's tax code

New Mexico's Tax Expenditure Report

- An annual TER has been produced by Tax & Rev since 2012
- 2023 legislation now requires TER in statute (7-1-84 NMSA 1978)
- Format has evolved over time
  - Separately identifies each "deviation" from the tax base
  - Categorizes each deviation as a tax expenditure, non tax expenditure, or "arguable"
  - Provides a description of each expenditure, the statutory reference, purpose, amendment history, estimated cost, evaluation, and recommendations
  - Tax & Rev constantly seeks to improve cost estimates
  - Categorizes each expenditure as existing for citizen benefit, economic development, environment, highly-specialized industries, or health care
- Reports can be found at www.tax.newmexico.gov, then under Forms & Publications, Publications, Tax Expenditure Reports

What are the Differences? Exclusions

- Exclusions – amounts of gross receipts, gross income, or other amount that is removed <u>to define the tax base</u>
  - Taxpayers exclude certain amounts of their “base income” to derive “net income” on which tax is imposed. § 7-2-2(N)
  - The property tax excludes personal property and has a 3% limit on annual value growth on residential property
  - For gross receipts tax, taxpayers exclude certain amounts to derive their “gross receipts” on which tax is imposed

What are the Differences? Exemptions

- Exemptions – usually eliminate a taxpayer's obligation to register, report, and pay tax
- Tax & Rev does not have visibility into income or receipts that are exempt because they are not reported on a tax return
- Exemptions can hinge on the nature or character of the taxpayer. For example:
  - Insurance companies are exempt from CIT because they pay premium tax
  - Nonprofits and disabled street vendors are exempt from GRT
  - Active-duty armed forces salaries and persons over 100 years of age are exempt from PIT
  - Certain disabled military veterans are exempt from motor vehicle excise tax
- Exemptions can hinge on the nature of the transaction. For example:
  - Commercial vehicles operating within 10 miles of the Mexico border are exempt from weight distance tax and trip tax
  - Receipts from sale and use of vehicles on which motor vehicle excise tax is imposed are exempt from GRT and compensating tax
- Generally, if the exemption is full and applies to the nature of the taxpayer, or if a taxpayer solely engages in exempt transactions, there is no registration or filing obligation

What are the Differences? Deductions

- Deductions - reduce tax liability by making certain transactions or income reported on returns deductible from taxable receipts/income
- Deductions and exemptions have the same effect on a taxpayer's tax liability, but differ in taxpayer reporting obligations
- Deductions lower the tax base before calculating tax due
  - For GRT, taxpayers report a gross amount of receipts, then subtract the amount of the receipts that are deductible to compute taxable gross receipts
  - Some deductions are combined on a return; others are separately reported
  - Many GRT deductions statutorily require the seller to be in possession of a Nontaxable Transaction Certificate (NTTC) or alternative evidence at the time the return is due for the receipts from the transactions or within sixty days of a Tax & Rev audit notice
- Examples
  - Back-to-School Tax-Free Weekend GRT receipts deduction
  - 40% capital gains deduction from PIT
  - Food for home consumption GRT deduction
  - Health care practitioner services GRT deduction
  - Sale of prosthetic devices GRT deduction

What are the Differences? Credits

- Credits – reduce a taxpayer's tax liability dollar for dollar
  - Many credits require an application for approval to either Tax & Rev or another certifying agency before the credit is allowed
  - Where deductions and exemptions apply to one tax program, credits can offset tax liabilities across several tax programs
  - Some credits can be transferrable
  - Some credits can be refundable or carried forward to future tax years if the amount of the credit exceeds the taxpayer's tax liability
  - Examples:
    - Working families tax credit for PIT
    - Angel investment PIT credit
    - Child care to prevent indigency PIT credit
    - Film tax credit against CIT and PIT
    - High-wage jobs credit against modified combined tax
    - Investment credit against GRT, Comp Tax, Withholding
    - Rural health practitioner PIT credit

Baseline System of Taxation

- Any tax program or baseline system of taxation is the application of a "tax rate" multiplied by a "tax base"
  - Common tax bases for New Mexico tax programs:
    - "Gross receipts" from sales of property or services or the "purchase value" of property (GRT/Comp)
    - "Net income" (CIT/PIT)
    - "Taxable value" (Severance-related taxes)
    - A percentage of "fair market value" for locally assessed property taxes
  - "Tax rate" is simply a percentage applied to the tax base

Tax Expenditures Must be a Deviation from the Tax Base

- Exclusions to derive the tax base are not considered deviations and are not considered tax expenditures
- Deviations can occur for many reasons:
  - “In lieu of” taxation
  - US constitutional prohibition or federal pre-emption
  - Government-to-government comity
  - To “true” a tax base – anti-pyramiding, bad debts
  - To provide special or preferential treatment to achieve a policy objective

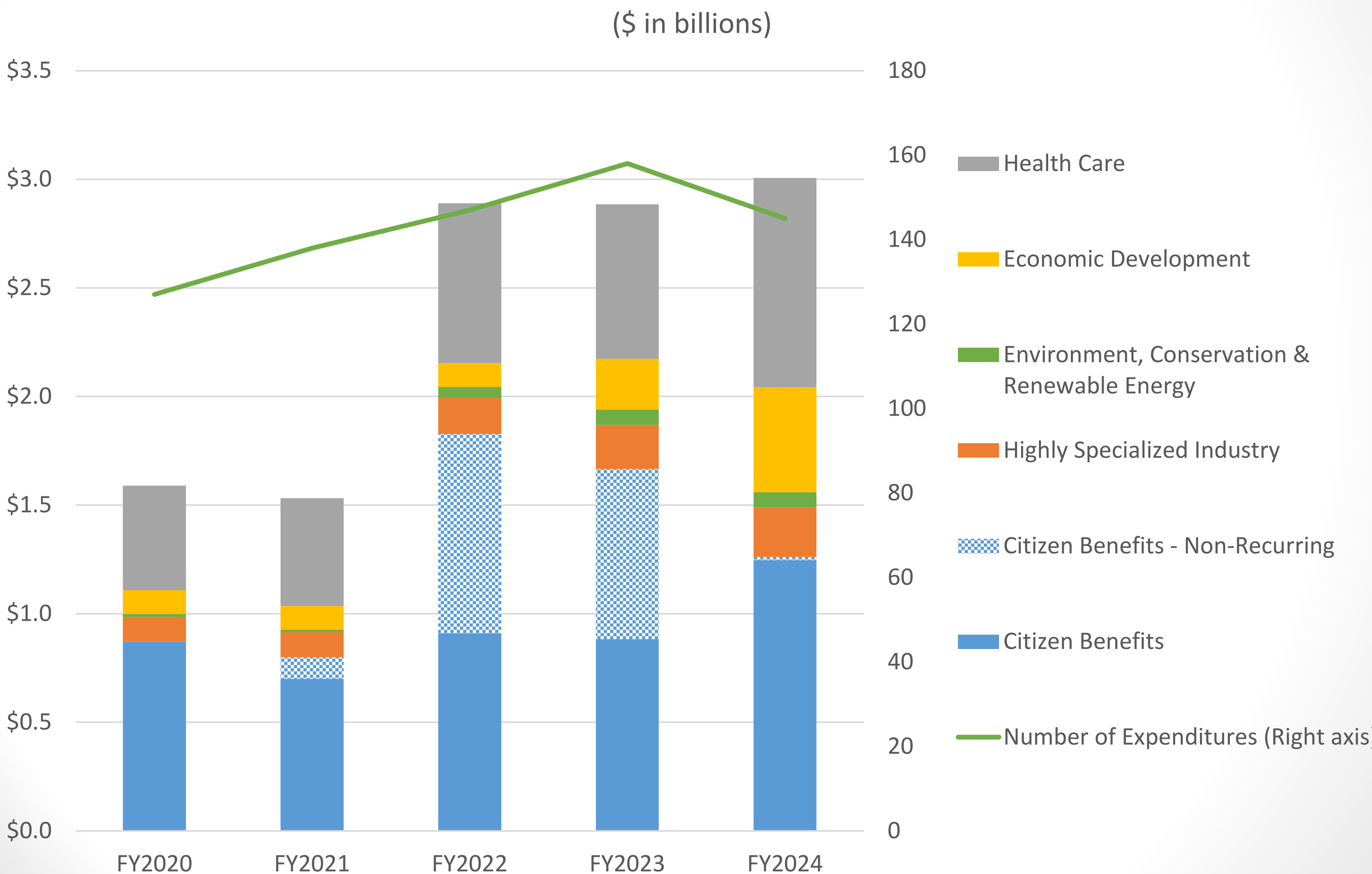
Tax Expenditures Must Convey Special Treatment

- Special treatment is typically evidenced by a policy choice regarding:
  - Benefitting a subset of the tax base
  - Benefitting a subset of the population or
  - Both
- Policy choices:
  - To benefit all, or a specific subset, of citizens
  - To induce economic development
  - To induce conservation
  - To aid specific industries
  - To encourage or discourage certain behaviors or activities, particularly related to health

Tax Expenditure Categories

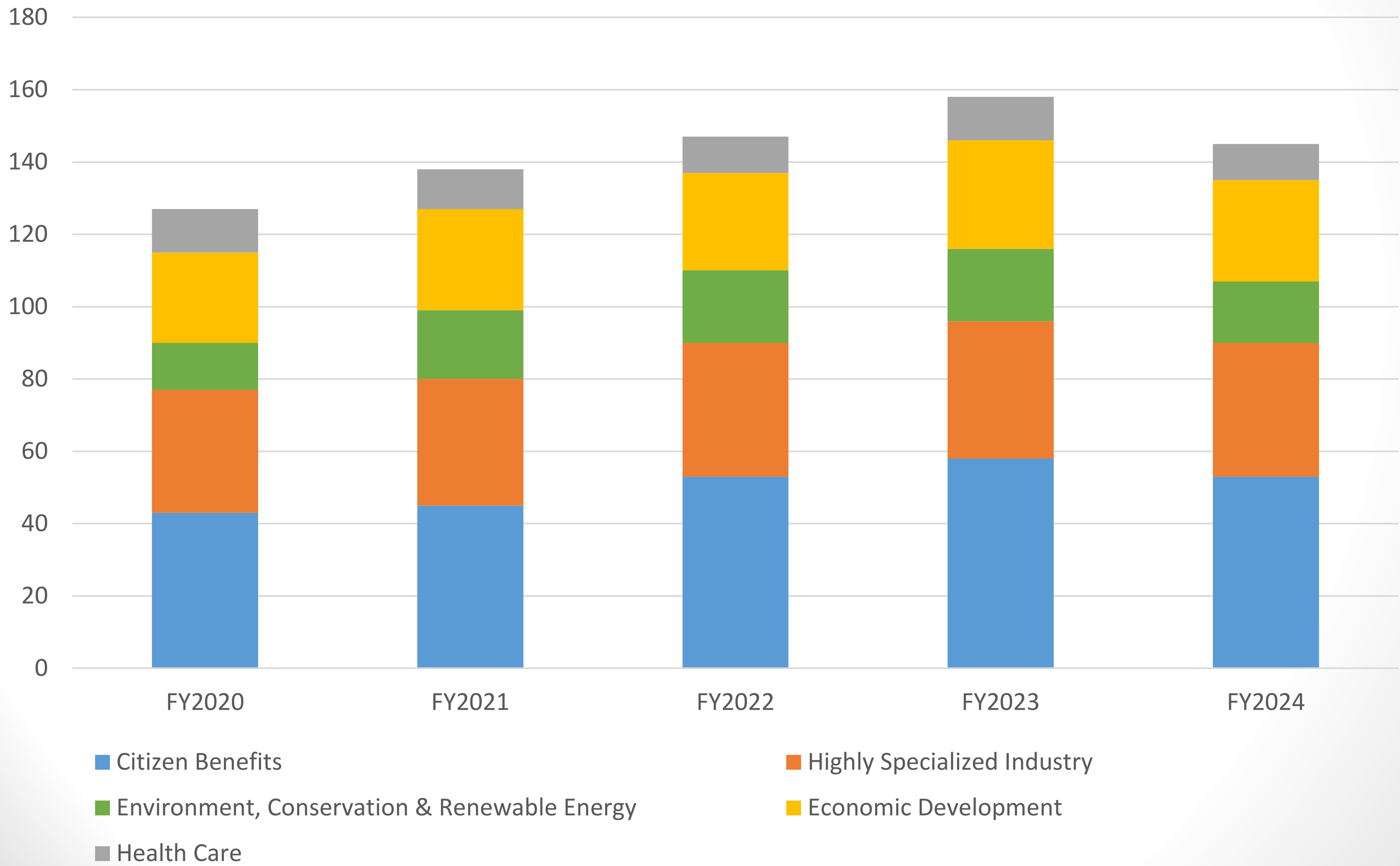
- Citizen Benefits: benefit all taxpayers or specific population (low-income, disabled, etc.), lessen the burden of taxation
- Economic Development: stimulate investment, job creation or job retention, attract industries
- Environment, Conservation, and Renewable Energy: support environmental health, promote conservation and renewable energy
- Health Care: increase access to or lower costs of health care
- Highly Specialized Industries: target specific or highly specialized industries

Tax Expenditures by Category ($ in thousands)



Number of Tax Expenditures by Category

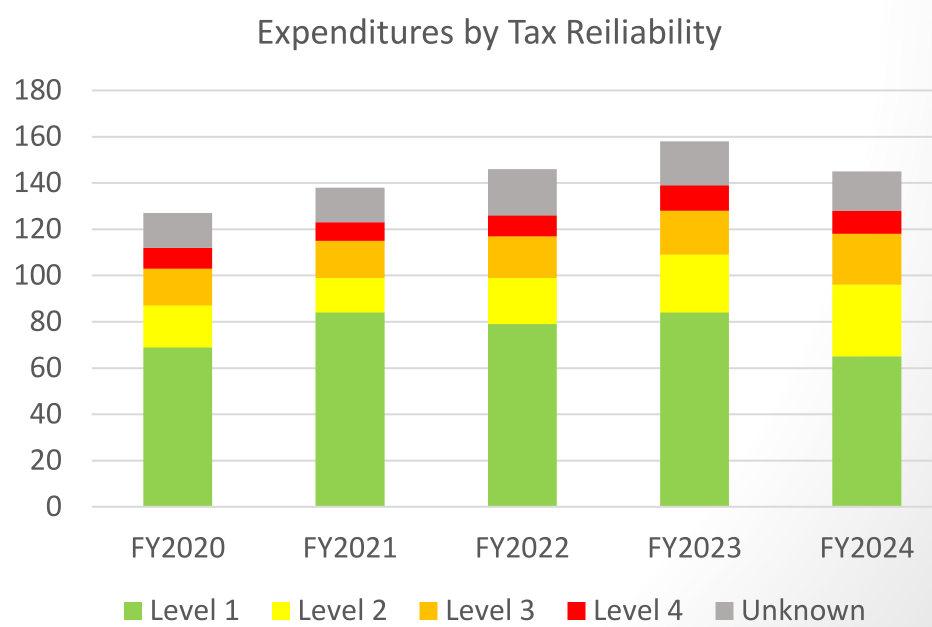
- 1 new citizen benefits tax expenditure – Child Income Tax Credit (2022 HB102, 2023 HB547)
- 15 expired/obsolete tax expenditures were repealed effective July 1, 2023 (2023 SB147)



Expenditure Estimates – Data Reliability

- The estimated revenue foregone should be evaluated in conjunction with reliability factor
- Reliability depends on data available to Tax & Rev
  - Exemptions that are not reported will have low reliability
  - Deductions that are separately reported (28) will have higher reliability than deductions that are reported together
  - Credits have high reliability

Reliability Factor	Description
1	Most reliable. No estimation
2	Estimated from GenTax data
3	Estimated from national data
4	Least reliable. Estimated from limited data
Unknown	No data available



Expenditure Estimates – Data Reliability

- <u>This year's report continues to have a special data reliability issue</u>
- In July 2021, Tax & Rev upgraded to Version 12 of the Gentax system
- The upgrade included a more extensive drop-down menu of GRT deduction codes in online filing system (TAP: Taxpayer Access Point)
- FY2022 & FY2023 data suggest taxpayers are mis-selecting GRT deduction codes
- Some GRT deductions are therefore likely overstated
- Tax & Rev implemented a new drop down menu effective for FY2024 that directs taxpayers to select the appropriate GRT deduction codes
- Taxpayers are not paying the wrong tax amount, only selecting the wrong deduction code

	Fiscal Year	2019	2020	2021	2022	2023	2024
Aircraft Sales or Services GRT Deduction	Taxpayers	<3	<3	0	56	50	69
	State General Fund Expenditure (thousands)	Redacted	Redacted	$0	$2,838	$1,667	$4,273
	Local Government Expenditure (thousands)	Redacted	Redacted	$0	$1,892	$1,066	$2,849

	Fiscal Year	2019	2020	2021	2022	2023	2024
Durable Medical Equipment Deduction	Taxpayers	102	104	235	150	110	245
	State General Fund Expenditure (thousands)	$744	$810	$669	$5,800	$5,600	$19,600
	Local Government Expenditure (thousands)	$433	$417	$375	$3,900	$3,600	$13,100

New Additions in 2024 Report

Expenditures	Legislative Session	Category	2024 Amount ($000's) (Local and State)
Child Income Tax Credit	2022 Reg. (amended 2023 Reg.)	Citizen Benefits	$131,233
Cigarette Tax Rate Reduction for Modified Risk Products	2019 Reg.	Highly Specialized Industries	$0

Not Tax Expenditures
Medical Cannabis exemption from Cannabis Excise Tax (7-42-3(C) NMSA 1978)
Net Income subject to entity-level tax credit against PIT and CIT (7-3A-10(H) NMSA 1978)
Premium Tax in lieu of all other taxes except Property Tax (59A-6-2 NMSA 1978)

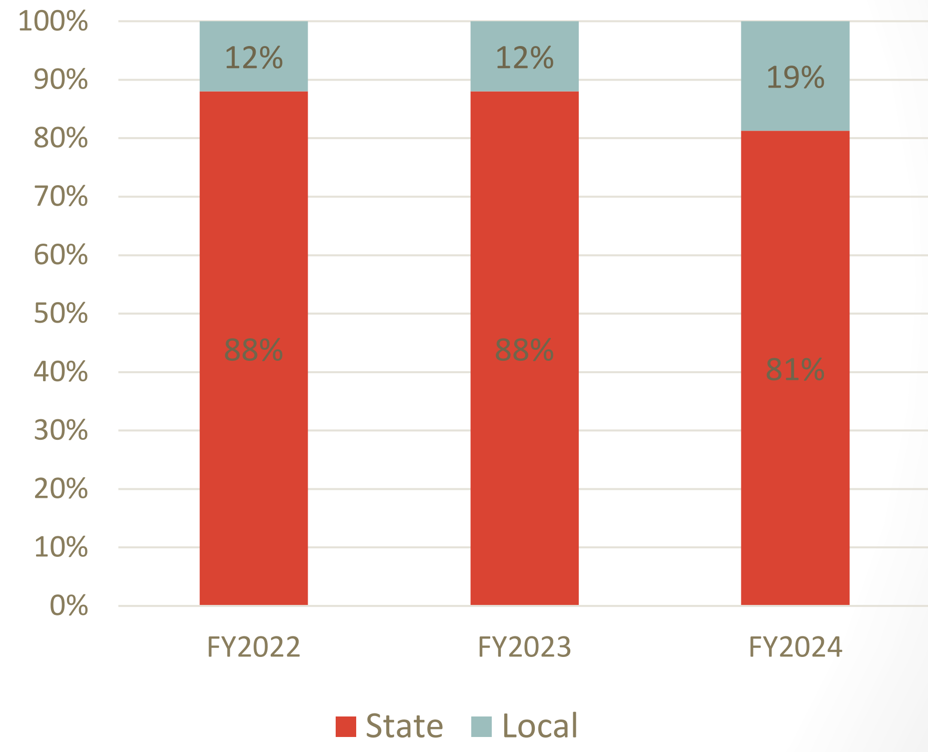
Top Ten Expenditures by Cost: 2024 compared to 2023

Name	2023 ($000's State & Local)	2023 Rank	2024 ($000's State & Local)	2024 Rank	
Prescription Drugs, Oxygen and Medical Cannabis GRT and GGRT Deduction	392,500	2	506,500	1	Red
Sale of Food at Retail Food Stores GRT Deduction and Hold Harmless Distribution *	348,067	3	466,906	2	Green
DOH-Licensed Hospitals 60 Percent GRT Deduction	196,111	4	259,287	3	Yellow
Sales of Services to Manufacturing GRT Deduction	1,144	62	140,163	4	Yellow
Child Income Tax Credit against PIT	NA	NA	131,233	5	Green
Working Families Tax Credit against PIT	93,802	7	126,732	6	Green
Apportionment Election of CIT for Manufacturing	33,490	17	104,401	7	Yellow
Film and Television Credit against PIT and CIT	100,240	6	102,166	8	Green
Capital Gain Deduction From PIT	114,533	5	101,596	9	Yellow
Medical and Health Care Services GRT Deduction	54,840	15	92,585	10	Yellow

* Includes only the deduction portion in the $ amounts

State and Local Tax Expenditure Incidence

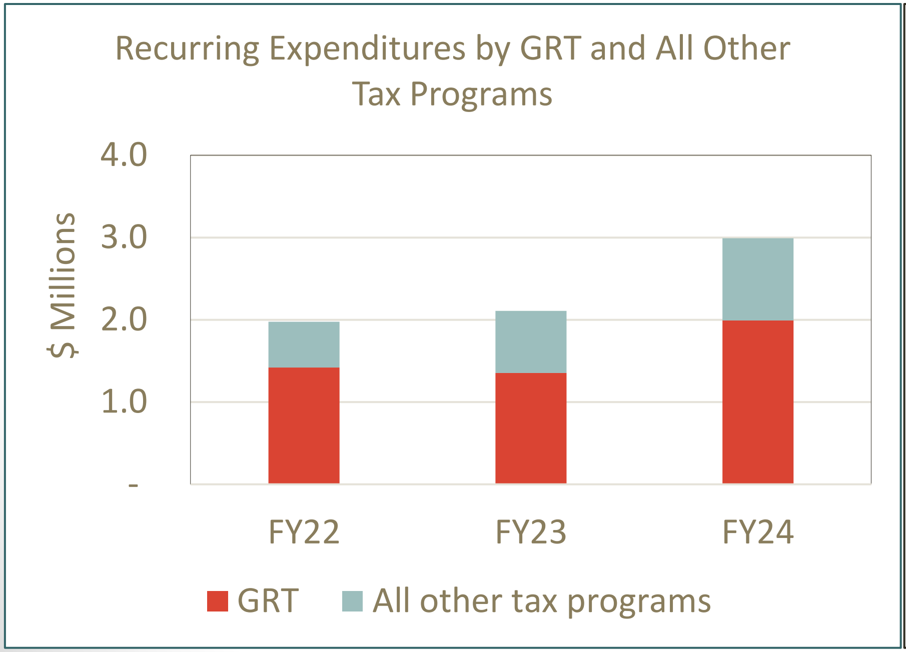
- GRT incidence for deductions and exemptions is shared between the State General Fund (GF) and local governments in most cases
- Tax expenditures for CIT, PIT, etc., generally impact only State General Fund directly
- Recent large PIT rebates only impacted State General Fund

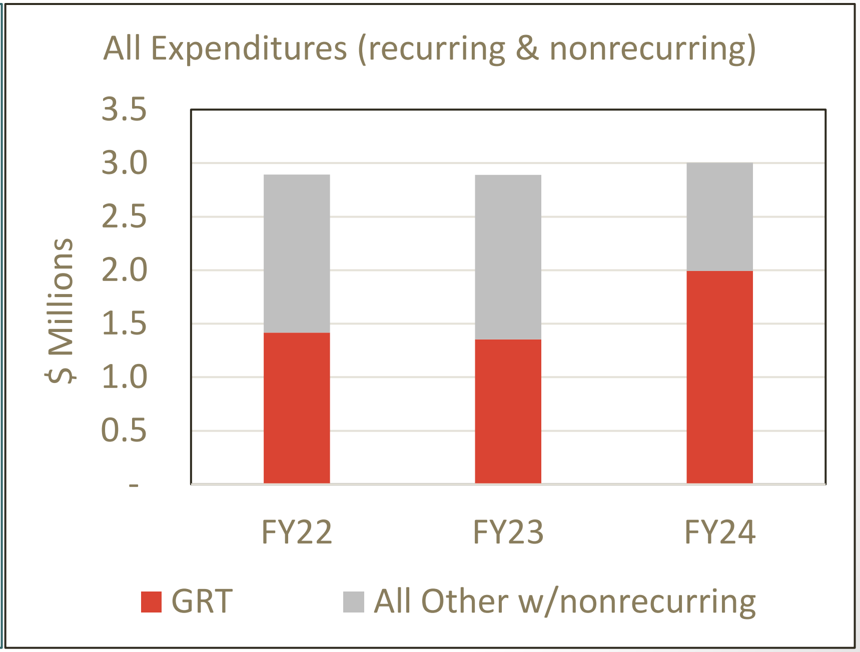


NOTE: DOES NOT INCLUDE PROPERTY TAX EXPENDITURES

Increased Incidence for Locals

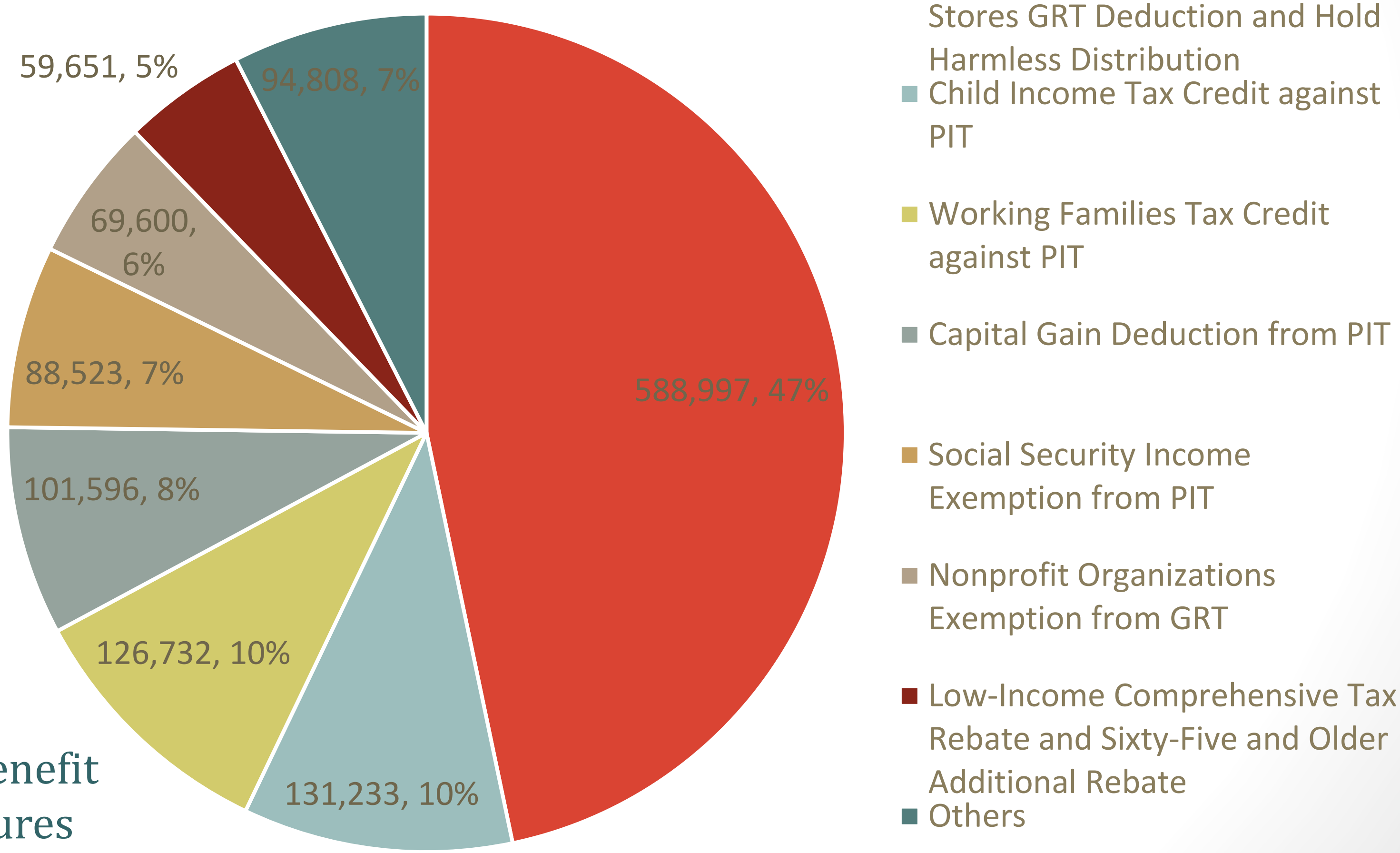
- Reducing the Statewide GRT rate by ¼% in FY2023 & FY2024 reduced the amount of revenue the State foregoes to GRT deductions and exemptions, causing Local Government share of tax expenditures to rise
- GRT expenditures increased by approximately 48% in FY24 while all other expenditures have contracted due to non-recurring expenditures (PIT rebates) diminishing.
  - Two large contributors to GRT expenditure growth were
    - Sales of Services to Manufacturing GRT Deduction
    - Prescription Drugs, Oxygen and Cannabis GRT and GGRT Deduction.





Citizen Benefits

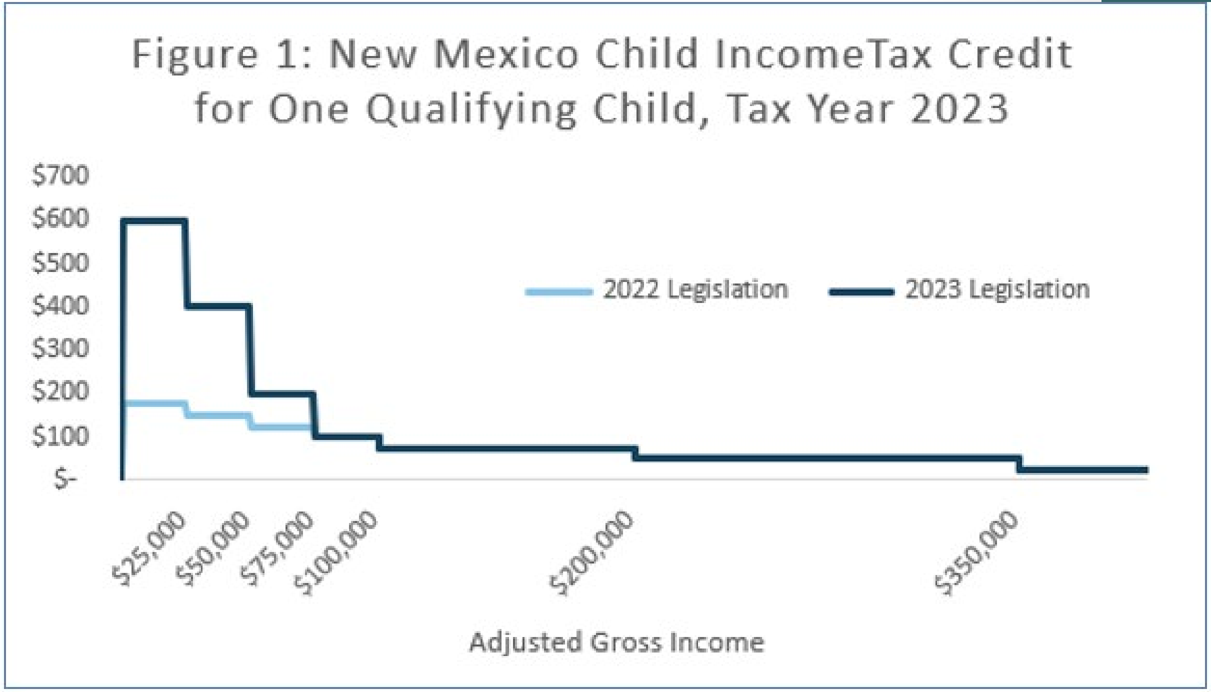
- Represent the largest share of tax expenditures in 2024 - $1.3 billion or 42%
  - Down from $1.7 billion or 58% 2023 due to diminished non-recurring PIT rebates
- Food deduction/Hold Harmless totaled $589.0 million up from $443.9 million in previous year
- New Expenditure: Child Income Tax Credit
- 53 Expenditures in this category



Citizen Benefit Expenditures (in $thousands)

New Mexico Child Income Tax Credit

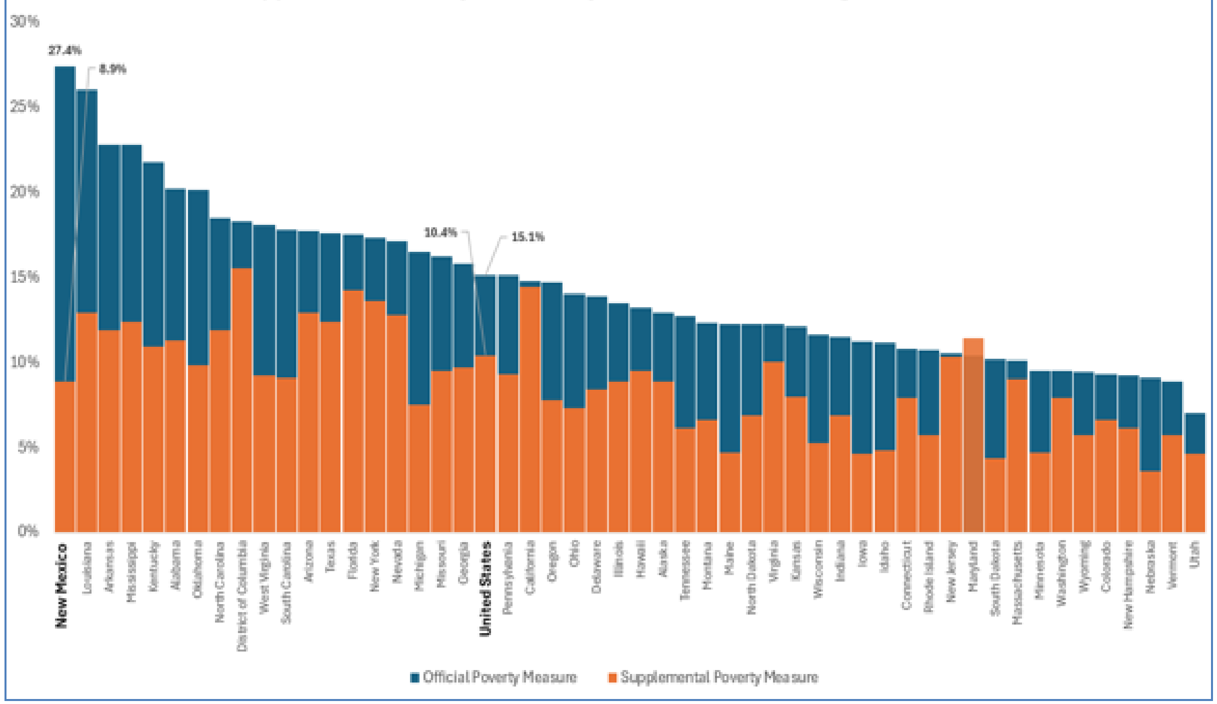
- 2023 NM Child Tax Credit amount ranged from $25 to $600 per qualifying child, depending on adjusted gross income
  - 2023 is first tax year available
  - Credit will be adjusted for inflation
  - Refundable
- For tax year 2023:
  - 238,630 New Mexico returns claimed the NM Child Tax Credit
    - 23% of 2023 filers claimed the credit
  - Aggregate expenditure: $131,233,000
  - Average amount per return: $550



How Poverty Measures Compare

- The U.S. Census Bureau provides two measures of poverty:
  - the Official Poverty Measure (OPM) – estimated using pretax income
  - the Supplemental Poverty Measure (SPM) - includes government benefits, tax relief, geographic cost of living adjustments
- OPM
  - US: 15.1%
  - New Mexico: 27.4%
- SPM
  - US: 10.4%
  - New Mexico: 8.9%
- New Mexico taxpayers did not receive the NM Child Tax Credit until CY 2024, so the credit impacts will be seen next year

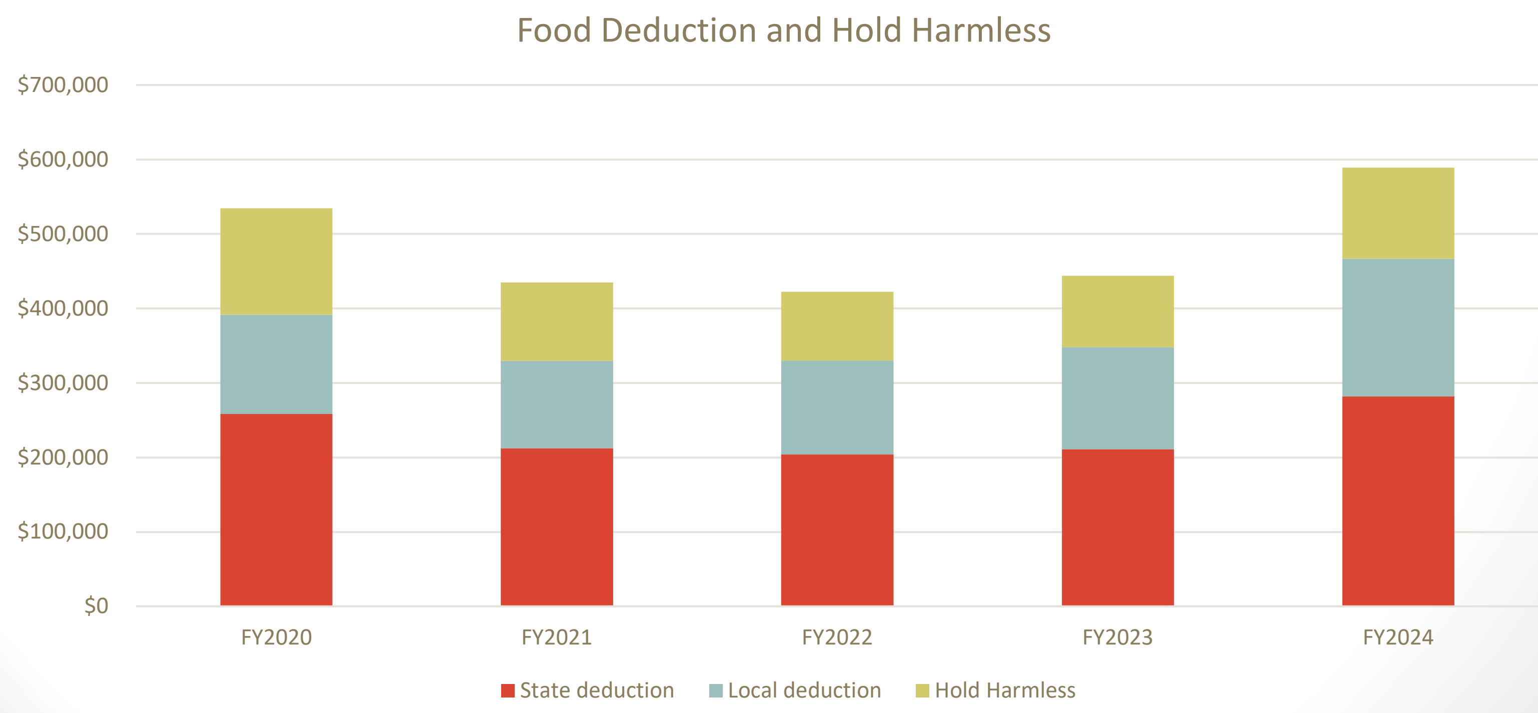
Figure 2: Percentage of People Under 18 in Poverty, Official Poverty Measure v. Supplemental Poverty Measure by US state; 3-Year Average, 2021-2023



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

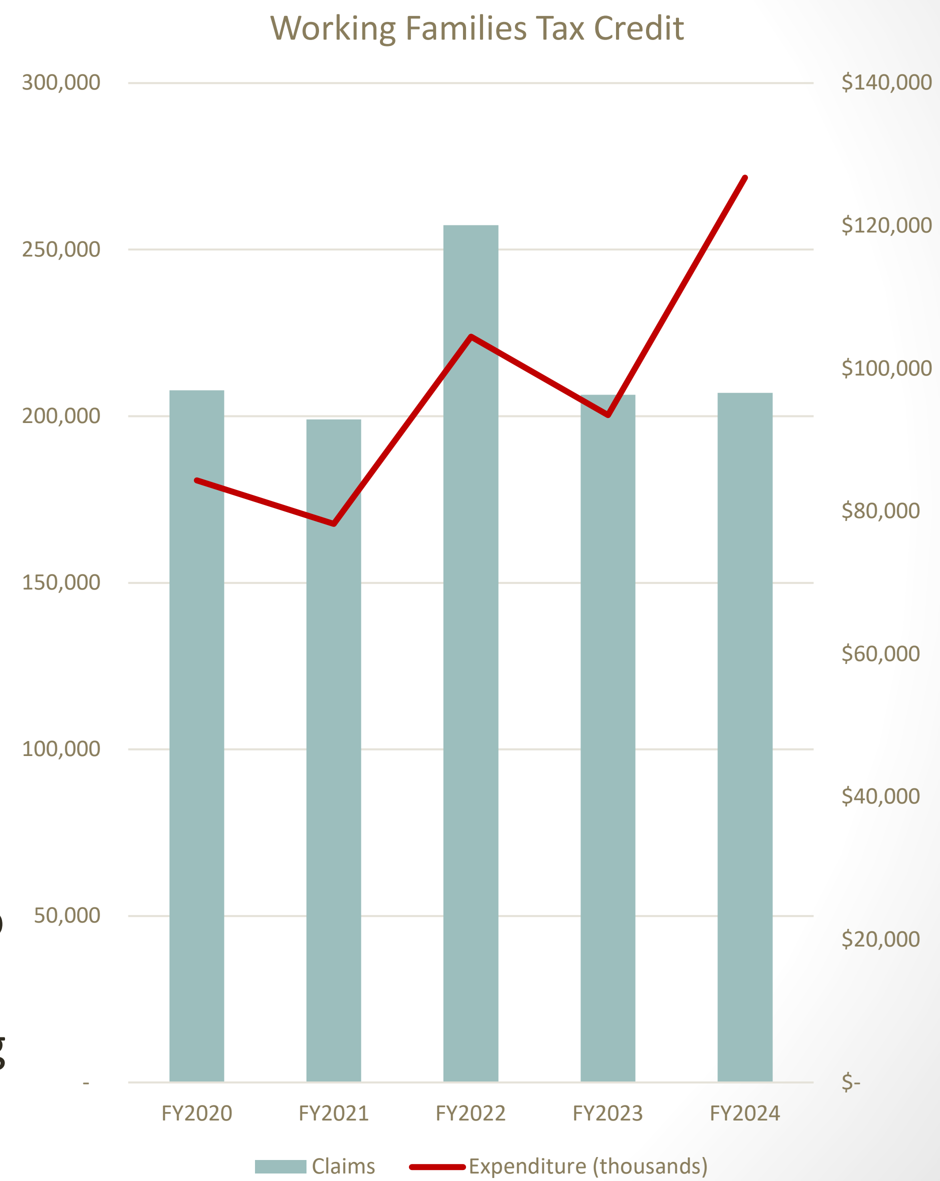
Citizen Benefits : Food GRT Deduction

- GRT deductions enacted in 2004 to reduce the cost of food
- Hold harmless provisions partially offset foregone local tax revenue as a result of the deductions
- 2013 legislation began a phase-out of the hold harmless payments to larger local governments scheduled to end in 2030
- 2022 amendment froze hold harmless phaseout for certain municipalities
- FY2024 saw an increase due to taxpayer filing behavior and not from consumption increase



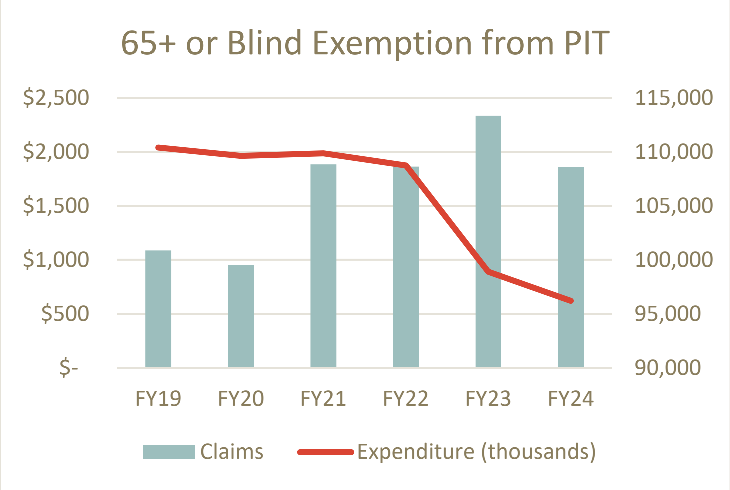
Citizen Benefits: Working Families Tax Credit

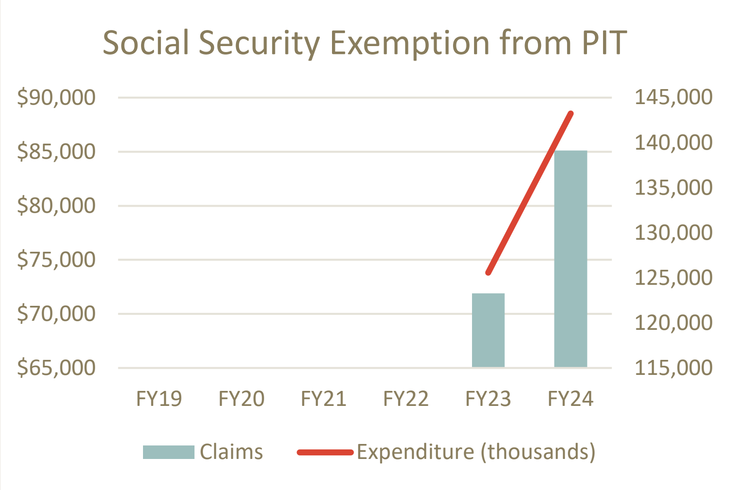
- Refundable PIT credit
- Enacted in 2007 at 8% of federal earned income tax credit (EITC)
- Increased to 10% EITC in 2008
- Increased to 17% EITC in 2019
- 2021 amendment:
  - Increased to 20% EITC for tax years 2021 and 2022
  - Increased to 25% EITC tax years 2023 and on
  - Expanded eligibility to workers aged 18 to 25
  - Expanded eligibility to ITIN filers
- FY2022 increase reflects more individuals filed in tax year 2021 to qualify for PIT rebates
- FY2024 increase reflects increasing the credit to 25%



One expenditure can impact another: Social security and other 65+ population

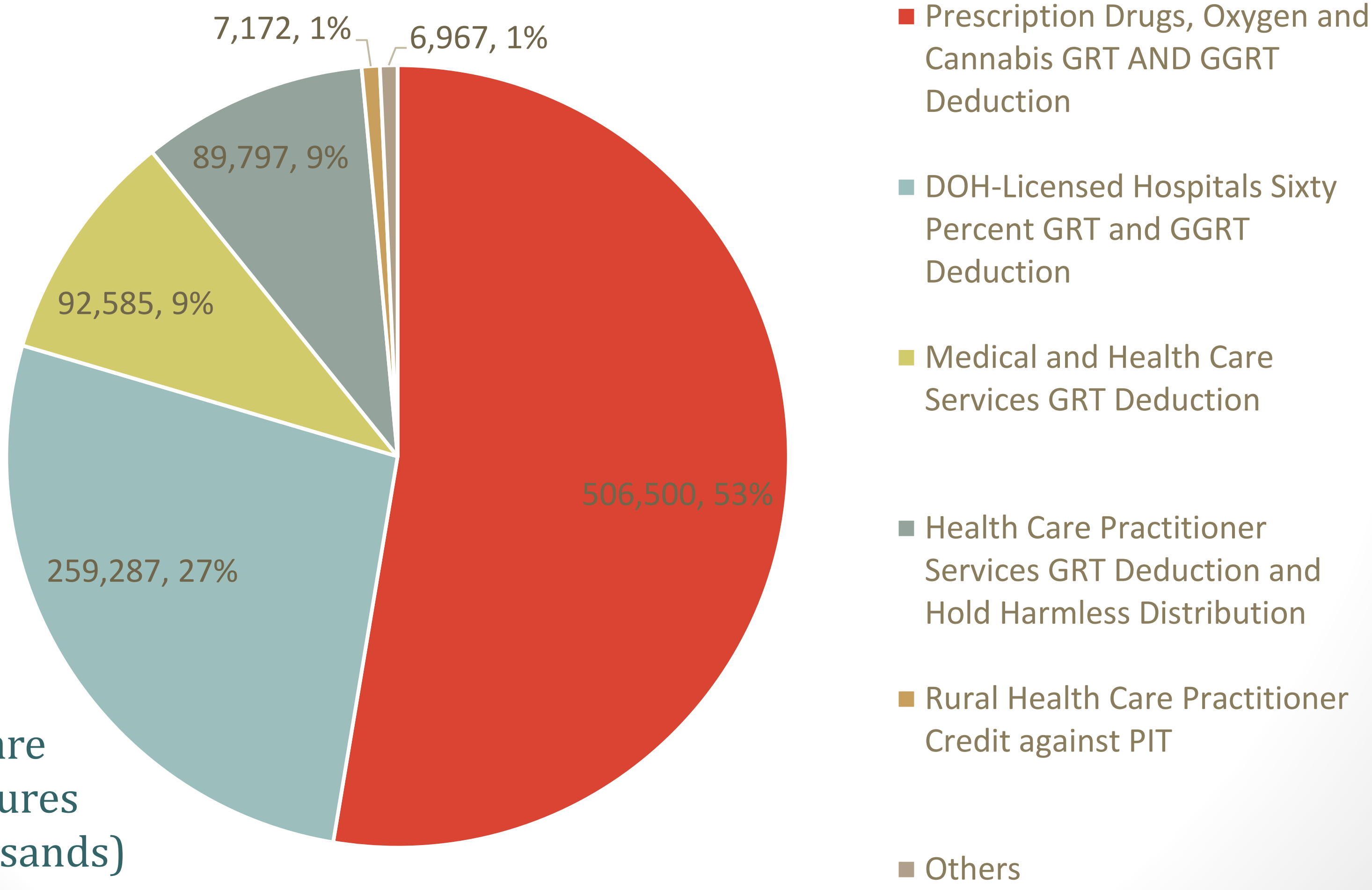
- Persons 65+ or blind exemption (7-2-5.2 NMSA 1978) originally enacted in 1985
  - An individual who is 65 years or older or who is blind may claim an exemption from PIT based on a sliding scale, not to exceed $8,000
- Social security exemption (7-2-5.14 NMSA 1978) originally enacted in 2022
  - An exemption from PIT in an amount equal to the social security income, based on AGI and filing status
- The social security exemption reduces taxable income to $0 in some cases, negating the impact of the 65+ or blind exemption





Health Care

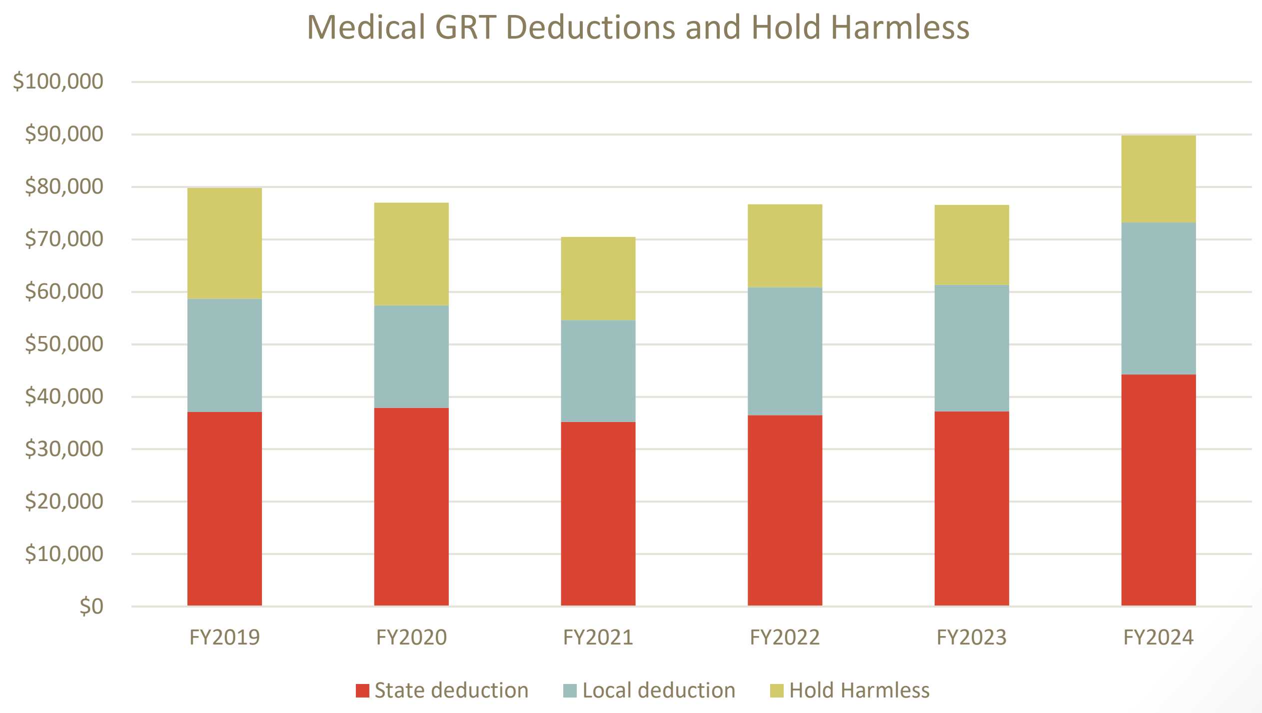
- Represents the second largest share of tax expenditures in FY24 - $968 million or 32%
  - Up from $717 million or 25% from 2023 due to growth in all top 4 expenditures below
- The largest reported contributor is the Prescription Drugs, Oxygen and Medical Cannabis GRT & GGRT Deduction at $507 million.
- 10 Expenditures in this category



Health Care Expenditures (in $thousands)

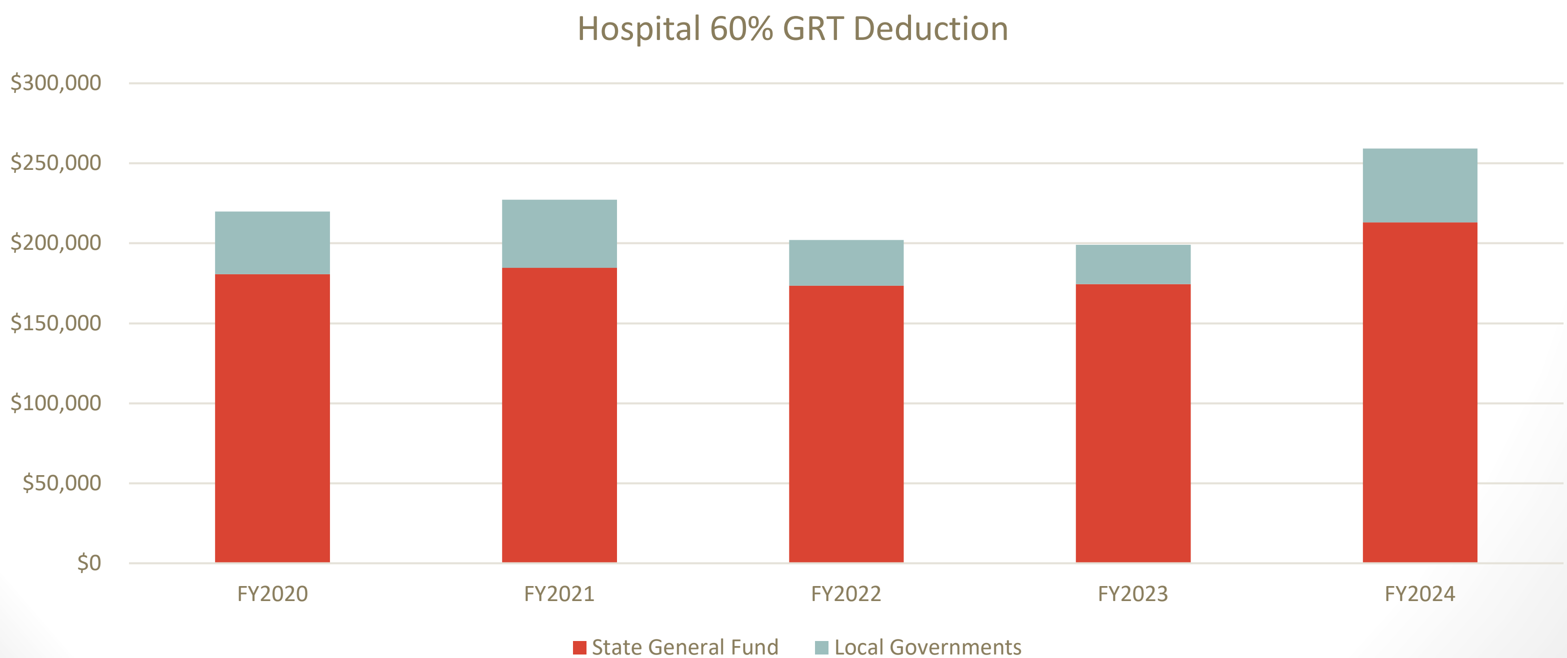
Health Care: Medical GRT Deductions

- GRT deductions enacted in 2004 to reduce the cost of medical services
- Hold harmless provisions partially offset foregone local tax revenue as a result of the deductions
- 2013 legislation began a phase-out of the hold harmless payments to larger local governments scheduled to end in 2030
- COVID-19 decreased medical deductions in FY20 and FY21 as individuals delayed medical care
- 2022 amendment froze hold harmless phaseout for certain municipalities
- 2023 amendment expanded the deduction to include copays and deductibles



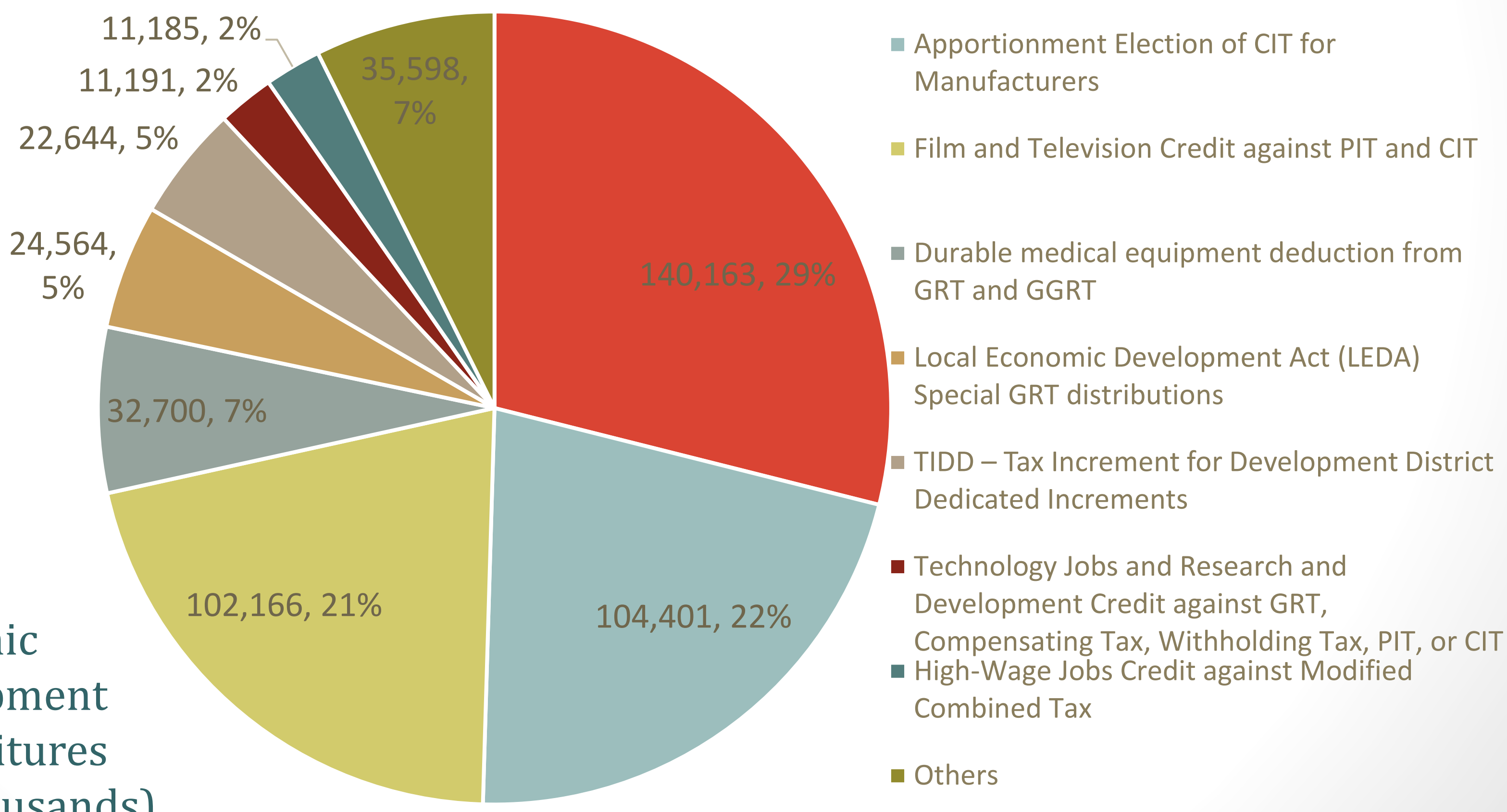
Health Care: Hospital GRT Deductions & Credits

- HB6 (2019) reformed hospital taxation to level the playing field between public, private and non-profit hospitals
  - Increased GRT deduction for private hospitals for medical services from 50% to 60%
  - Added non-profit and governmental hospitals into the tax base, allowing them the 60% deduction
  - Non-profit and governmental hospitals are not subject to local government gross receipts taxes, so only the State General Fund deduction increased
  - Repealed a 5% credit to for-profit hospitals against their post-deduction gross receipts
- Hospital receipts rose in FY2020 and FY2021 due to COVID-19 hospitalizations



Economic Development

- 16% of tax expenditures in FY24 - $485 million
  - Up from 8% of tax expenditures in FY23 - $235 million
  - Growth due to new GRT deduction for Sales of Services to Manufacturing and Apportionment Election of CIT for Manufacturers
- The largest reported contributor is now the Sales of Services to Manufacturing GRT Deduction at $140.2 million
- 28 Expenditures in this category



Economic Development Expenditures (in $thousands)

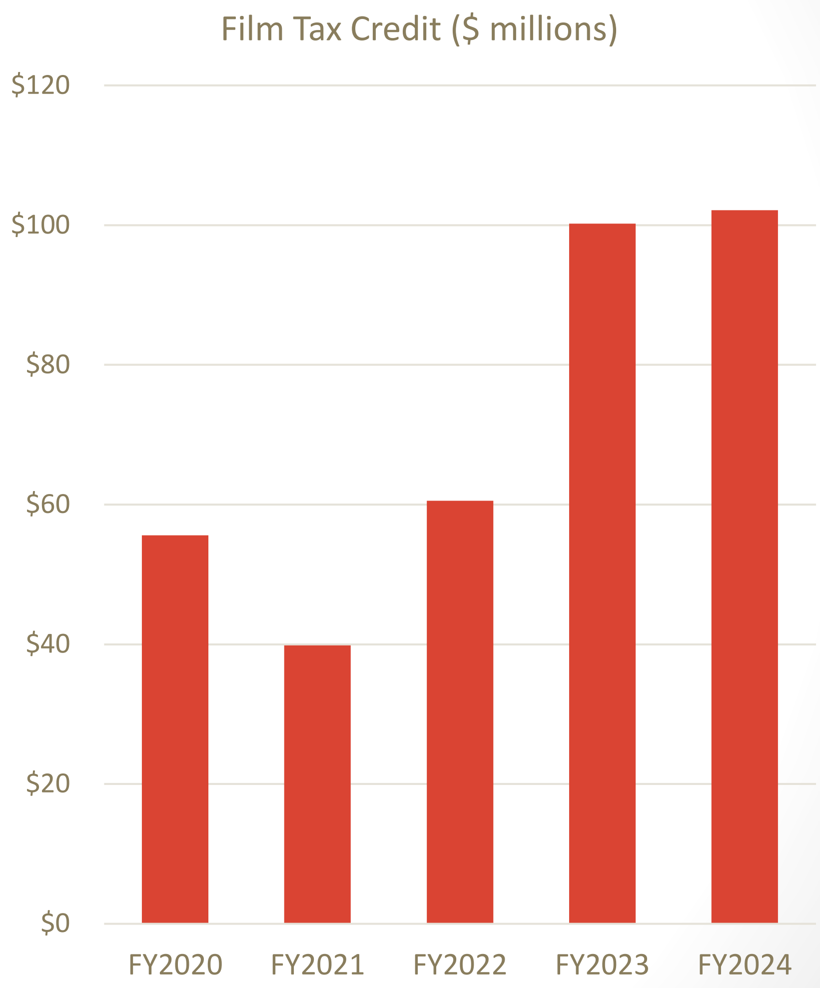
GRT and GGRT Deduction for Selling Professional Services to Manufacturers

- The deduction has grown 12,155% from FY23 to FY24.
  - Some taxpayers likely claim this deduction under the assumption that they qualify.
- The deduction has contributed significantly to the overall increase in FY24 expenditures.
- Per CREG analysis, the deduction is expected to continue to grow but at a slower pace.

	Fiscal Year	2023	2024
Sales of Services to Manufacturing GRT Deduction	Taxpayers	133	2986
	State General Fund Expenditure (thousands)	$698	$84,098
	Local Government Expenditure (thousands)	$446	$56,065

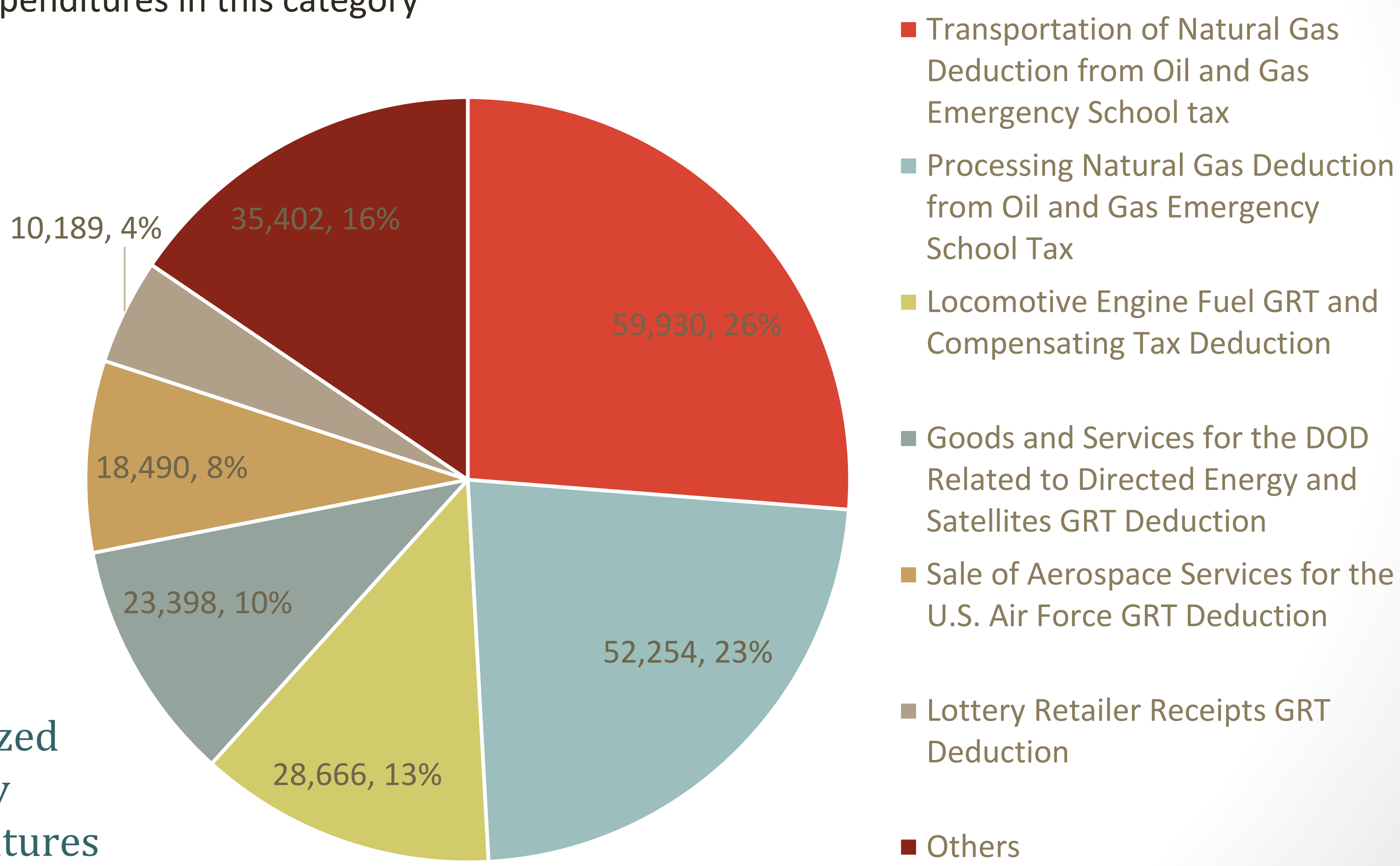
Economic Development: Film Tax Credit

- 2019 Legislation
  - Increased film credit cap from $50 million to $110 million
  - Created new category of film partners that are not subject to the cap
- FY21: Film projects delayed as a result of COVID-19
- FY22 – FY23: Resumption of film projects and resulting credits
- 2023 Legislation
  - Increases the annual cap by $10 million for fiscal years 2024 through 2028, until a cap of $160 million



Highly Specialized Industry

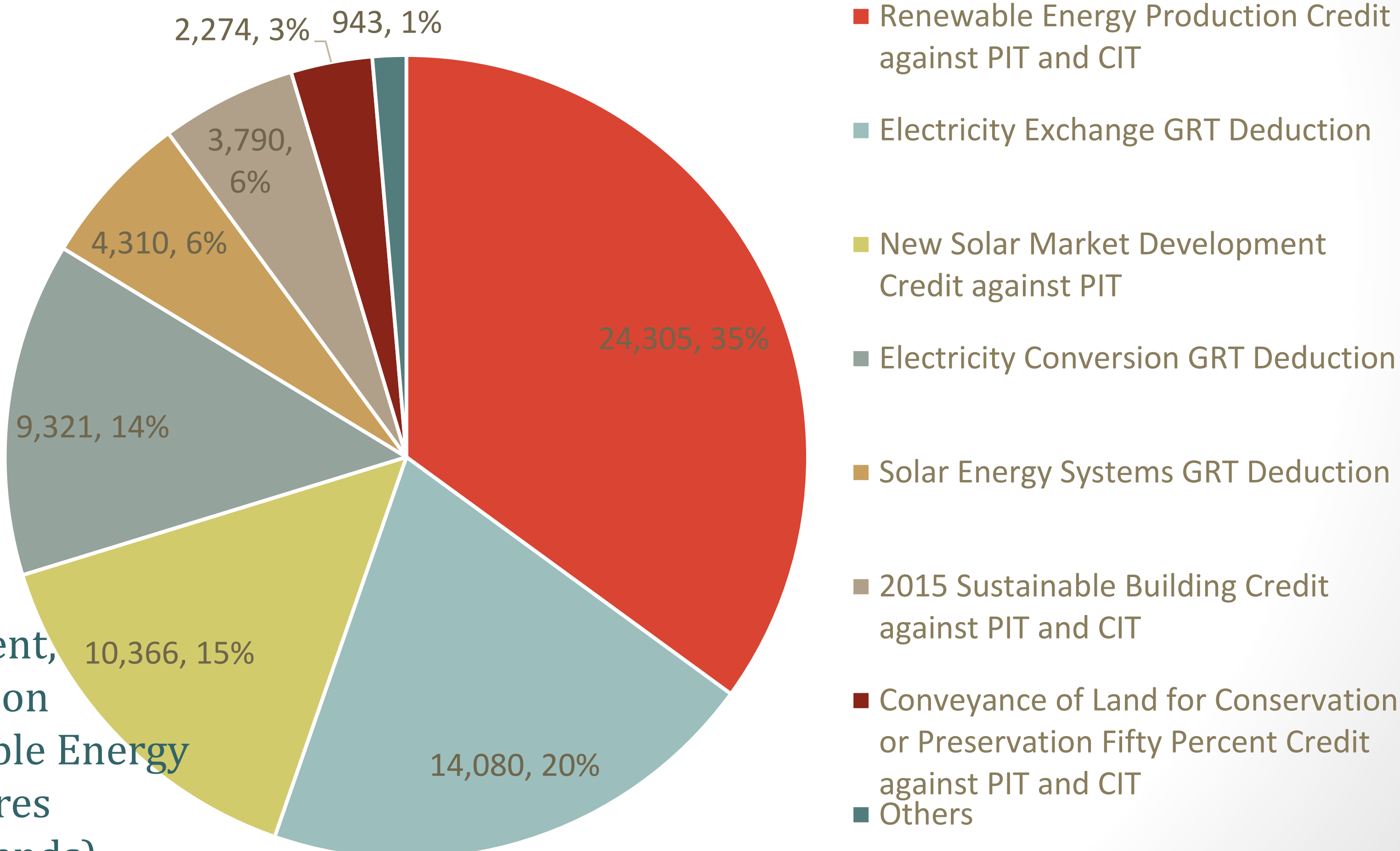
- Represents 8% of tax expenditures in FY24 or $228 million
  - Slightly up from FY23 at $203 million and 7%
- The largest reported contributor is the Transportation of Natural Gas Deduction from Oil and Gas Emergency School tax at $60 million
- 38 Expenditures in this category



Highly Specialized Industry Expenditures (in $thousands)

Environment, Conservation & Renewable Energy

- Represent 2% of tax expenditures in FY24 or $69 million
  - Down from $71 million in FY23, was also 2% in FY23
- The largest reported contributor is the Renewable Energy Production Tax Credit against PIT and CIT at $24 million
- 18 Expenditures in this category



Environment, Conservation & Renewable Energy Expenditures (in $thousands)

Look Ahead – Expenditures with Sunsets next 5 years

Name	Note	Sunset Date	2024 ($000's)
Future Trust Distribution to a Nonresident Beneficiary Deduction from PIT (7-2-38 NMSA 1978)	Enacted 2019	Jan. 1, 2025	$1,852
Unreimbursed or Uncompensated Medical Care Expenses Deduction From PIT (7-2-37 NMSA 1978)	Enacted 2015. Similar Credit and Exemption for Unreimbursed or Uncompensated Medical Care Expenses do not have sunsets	Jan. 1, 2025	$5,928
Military Transformation Acquisition Program GRT Deduction (7-9-94 NMSA 1978)	Enacted 2005. Previously extended twice	June 30, 2025	$4,999
Small Business Saturday Thanksgiving Weekend GRT Deduction (7-9-116 NMSA 1978)	Enacted 2018. Previously extended once	July 1, 2025	$903
Liquor License Lessor Deduction from PIT and CIT (7-2-40 & 7-2A-31 NMSA 1978)	Enacted 2021. Provides temporary relief to taxpayers affected by liquor license reform	Jan. 1, 2026	$3
Liquor License Holders Deduction from GRT (7-9-119 NMSA 1978)	Enacted 2021. Provides temporary relief to taxpayers affected by liquor license reform	July 1, 2026	$6,108
High-Wage Jobs Credit against Modified Combined Tax (7-9G-1 NMSA 1978)	Sunset is tied to definition of 'new high-wage' which must be created before July 1, 2026	July 1, 2026	$11,185

Look Ahead – Expenditures with Sunsets next 5 years

Name	Note	Sunset Date	2024 ($000's)
Technology Readiness Credit against GRT (7-9-96.3 NMSA 1978)	Enacted 2020. Previously extended once.	June 30, 2027	$93
Nonathletic Special Event at New Mexico State University GRT & GGRT Deduction (7-9-104 NMSA 1978)	Enacted 2007. Previously extended three times	June 30, 2027	$95

Concluding Thoughts

- Legislative Thoughts
  - Purpose not always defined – difficult to then evaluate performance
  - Sunset clause – forces evaluation of the expenditure where appropriate
  - Reporting requirements – electronic reporting of tax credit certifications: ease in working with other departments when cross-collaboration of expenditures; allows transparency; ability to evaluate expenditure cost
  - Individual statutes no longer need to state that Tax & Rev will report on the expenditure annually since Tax & Rev is now statutorily required to publish the Tax Expenditure Report
- Other Resources
  - National Conference of State Legislatures has a State Tax Incentive Evaluations Database (worked with Pew Charitable Trusts)
    - http://www.ncsl.org/research/fiscal-policy/state-tax-incentive-evaluations-database.aspx
  - Can compare different incentives across states, years, analysis, incentive type
  - U.S. Department of the Treasury, Federal Expenditure Reports
    - https://home.treasury.gov/policy-issues/tax-policy/tax-expenditures

Thank you!

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http://www.tax.newmexico.gov/

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