TAXATION & REVENUE
NEW MEXICO

New Mexico 2022
Tax Expenditure Report

Presented to the
Revenue Stabilization and Tax Policy Committee

December 19, 2022

Stephanie Schardin Clarke, Cabinet Secretary
Lucinda Sydow, Chief Economist

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
- Follows format that 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
- Past 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 – often eliminate a taxpayer's obligation to register, report, and/or pay
- 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:
  - 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:
  - 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
  - Credits can be transferrable
  - 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

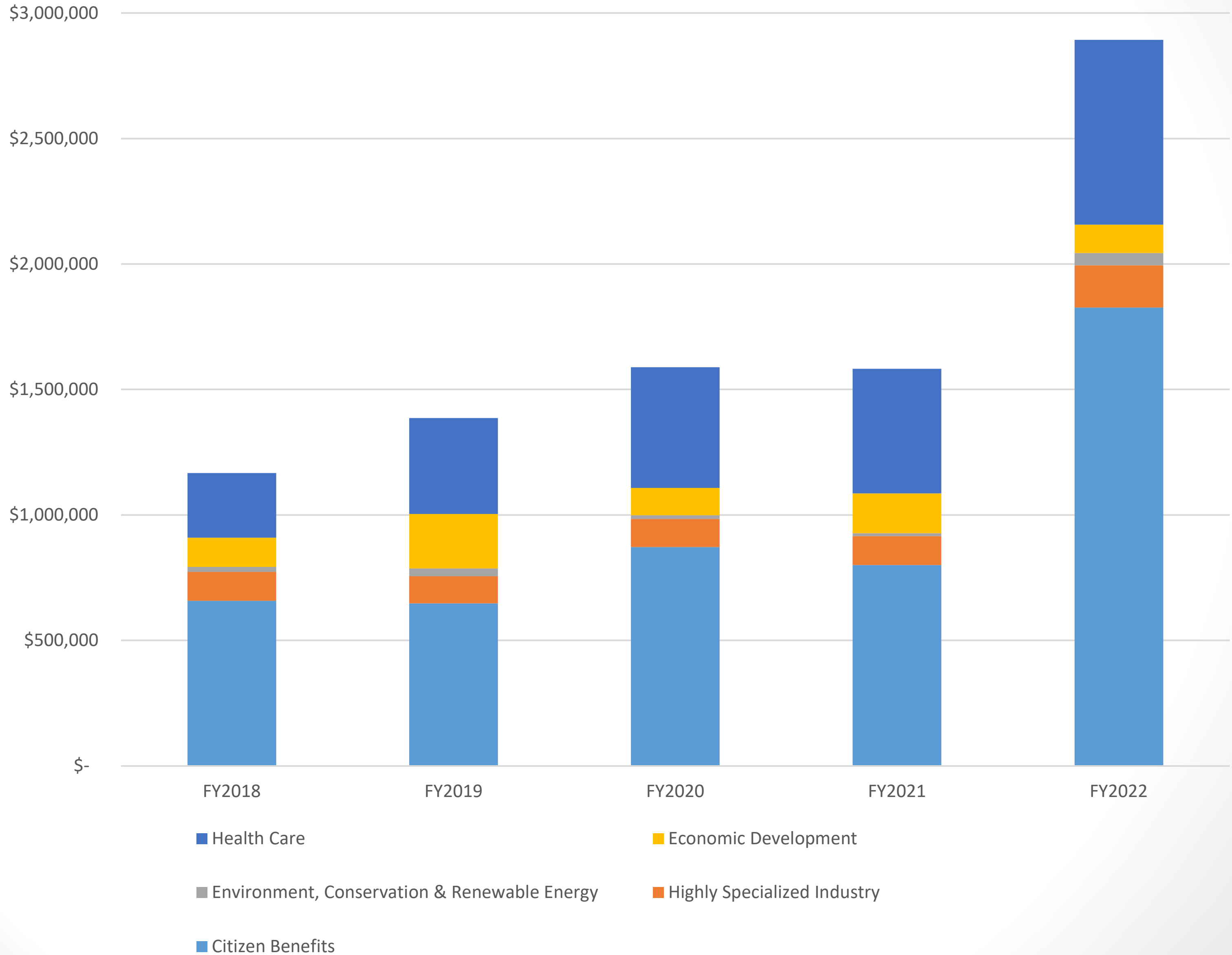
Tax Expenditures Must Convey Special Treatment

- 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

Tax Expenditures Categories

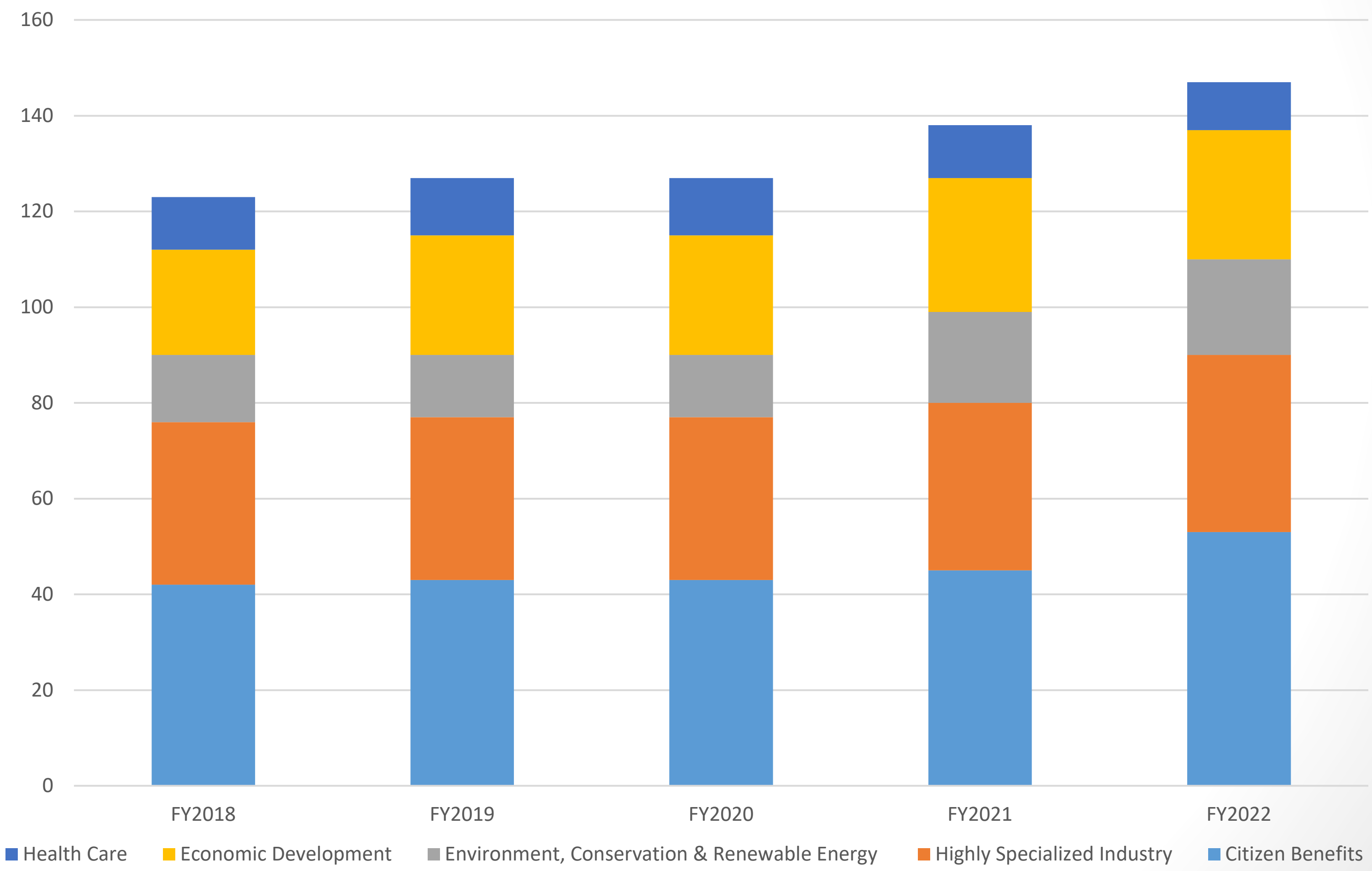
- Citizen Benefits: benefit all taxpayers or specific population (low-income, disabled, etc.), lessen the burden of taxation
- Economic Development: stimulate investment, job creation or job retention, attract industries
- Environment, Conservation, and Renewable Energy: support environmental health, 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

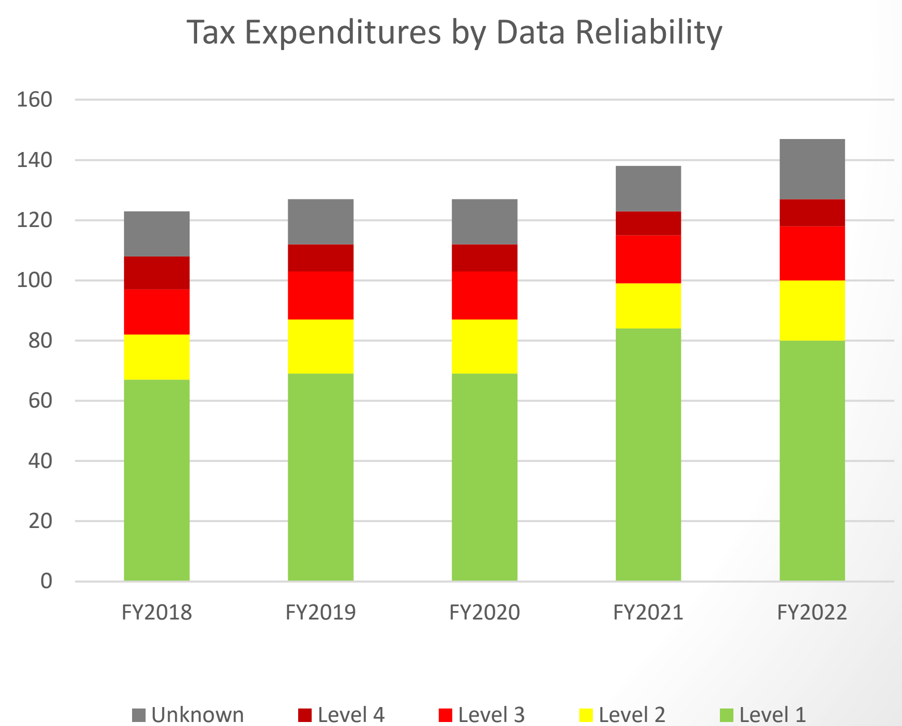
- Many of this year's new citizen benefits tax expenditures are property tax exemptions – not new in law, but included in the report for the first time



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 (26) 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 has a special data reliability issue</u>
- In July 2021, Tax & Rev upgraded to Version 12 of Gentax system
- The upgrade included a more extensive drop down menu of GRT deduction codes in online filing system (TAP: Taxpayer Access Point)
- FY2022 data suggest taxpayers are mis-selecting GRT deduction codes
- Some GRT deductions are therefore likely overstated
- Addressing this data issue will/would require taxpayers to amend returns
- Taxpayers are not paying the wrong tax amount, only selecting the wrong deduction code
- Examples:

	Fiscal Year	2018	2019	2020	2021	2022
Aircraft Sales or Services GRT Deduction	Taxpayers	<3	<3	<3	0	56
	State General Fund Expenditure (thousands)	-	-	-	$0	$2,886
	Local Government Expenditure (thousands)	-	-	-	$0	$1,845

	Fiscal Year	2018	2019	2020	2021	2022
Durable Medical Equipment Deduction	Claims	89	102	104	235	1,828
	State General Fund Expenditure (thousands)	$298	$744	$810	$669	$5,078
	Local Government Expenditure (thousands)	$188	$433	$417	$375	$3,383

Reporting by Tax Year & Fiscal Year

- Difference between
  - Tax Year (aka Calendar Year – Jan 1 to Dec 31) and
  - State Fiscal Year (July 1 to June 30)
- Income taxes are based on the tax year/calendar year
- But State budgeting is on a fiscal year basis
  - Assumption – revenues accompanying returns for a tax year go to the General Fund during the following fiscal year
  - Late filers and amended tax returns pose a challenge
- Issue most evident in the most recent tax year, when number of filers for that tax year may be smaller than usual, but revenue based on fiscal year maybe more or less stable due to filings for prior tax years trickling in.
- Example – Low Income Comprehensive Tax Rebate (LICTR) Tax Year vs Fiscal Year:

Tax Year (Calendar)	2017	2018	2019	2020	2021
Claims	228,504	220,386	218,750	217,955	357,871
Expenditure (thousands)	$18,048	$17,281	$17,170	$17,663	$50,966

Fiscal Year	2018	2019	2020	2021	2022
Claims	228,037	219,677	221,254	223,347	371,568
Expenditure (thousands)	$18,023	$17,239	$17,379	$18,125	$52,133

New Additions in 2022 Report

Expenditures	Legislative Session	2022 Amount ($000's) (Local and State)
Liquor License Holders Deduction from GRT	2021 Reg.	$168
Liquor License Holders Deduction from PIT and CIT	2021 Reg.	$27
2021 Sustainable Building Credit Against PIT and CIT	2021 Reg.	$0
Income Tax Rebate 2021 Tax Year Filing	2022 Reg.	$277,008
Supplemental Income Tax Rebate 2021 Tax Year	2022 Special	$634,882

New Additions in the 2022 Report - Reevaluations

Expenditures	Legislative Session	FY22 Amount ($000's)
Head-of-Family Exemption from Property Tax	1973	FY22 not yet available; FY21 $16,494
Veteran Exemption from Property Tax	1973	FY22 not yet available; FY21 $8,734
Sales of Certain Research and Development Services Exemption from GRT	1989	unknown
Disabled Veteran Exemption from Property Tax	2000	FY22 not yet available; FY21 $19,794
Disabled Veteran Exemption from Special Benefit Property Tax Assessment	2015	unknown
Property Valuation Limitation for Low-Income Seniors or Disabled Home Owners under Property Tax	2000	unknown
Veterans' Organization Exemption from Property Tax	2011	unknown

New Additions in the 2022 Report - Reevaluations

Not Tax Expenditures
Sale of Alternative Fuel to the Federal Government or New Mexico Tribes Exemption from Alternative Fuel Tax (7-16B-5 (A) and (C) NMSA 1978)
Sale of Gasoline to the Federal Government or New Mexico Tribes Deduction from Gasoline Tax (7-13-4 (B) and (C) NMSA 1978)
Sale of Special Fuel to the Federal Government or New Mexico Tribes Deduction from Special Fuel Excise Tax (7-16A-10 (B) and (D) NMSA 1978)
Sale of Alternative Fuel to the state of New Mexico Exemption from Alternative Fuel Tax (7-16B-5 (B) NMSA 1978)
Sale of Special Fuel to the state of New Mexico Deduction from Special Fuel Excise Tax (7-16A-10 (C) NMSA 1978
Sale of Tangible Personal Property or Services Exemption from GRT (7-9-13.2 NMSA 1978)
Tangible Personal Property Exemption from Property Tax (7-36-8 NMSA 1978)

Top Ten Expenditures by Cost: 2022 compared to 2021

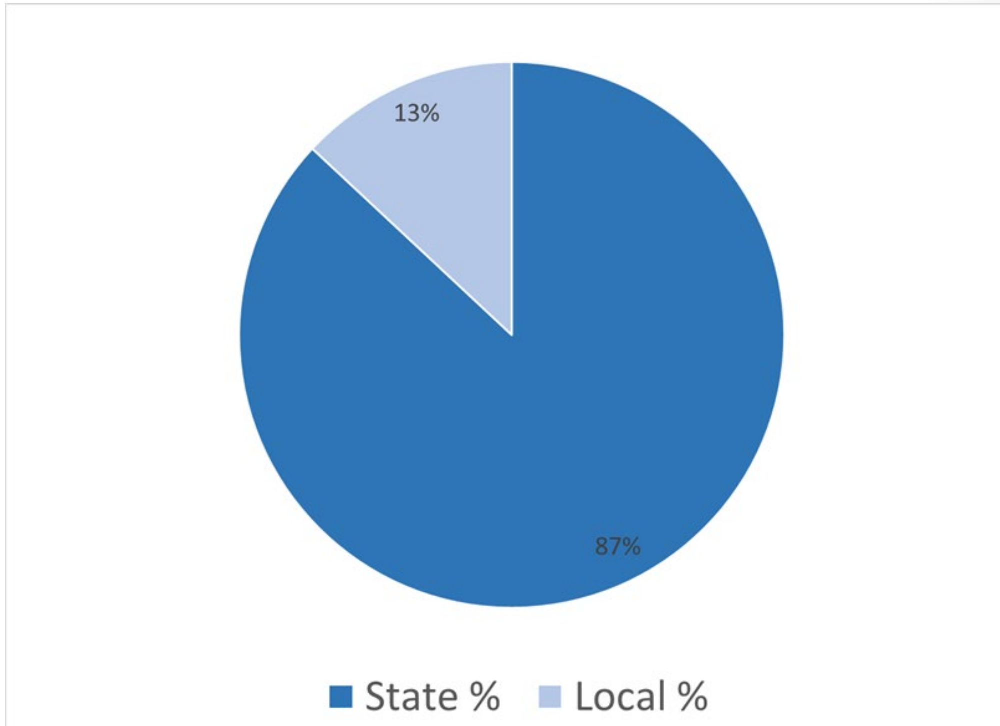
Name	2021 ($000's State & Local)	2021 Rank	2022 ($000's State & Local)	2022 Rank	
Supplemental Income Tax Rebate 2021 Tax Year	0	NA	634,882	1	Green
Sale of Food at Retail Food Stores GRT Deduction and Hold Harmless Distribution	434,759	1	422,671	2	Green
Prescription Drugs, Oxygen and Cannabis GRT and GGRT Deduction	320,100	2	371,700	3	Red
Income Tax Rebate 2021 Tax Year Filing		NA	277,008	4	Green
DOH-Licensed Hospitals 60 Percent GRT Deduction	227,147	3	201,975	5	Yellow
Nonprofit Organizations Exemption from GRT	108,330	4	129,370	6	Red
Working Families Credit against PIT	78,001	6	104,527	7	Green
Capital Gain Deduction From PIT	72,914	7	102,483	8	Green
Medical and Health Care Services GRT Deduction	6,630	22	*78,322	9	Yellow
Health Care Practitioner Services GRT Deduction and Hold Harmless Distribution	70,468	8	76,672	10	Green

*2022 claims for this deduction may be artificially high due to taxpayer misuse of deduction codes

Tax Expenditure Incidence

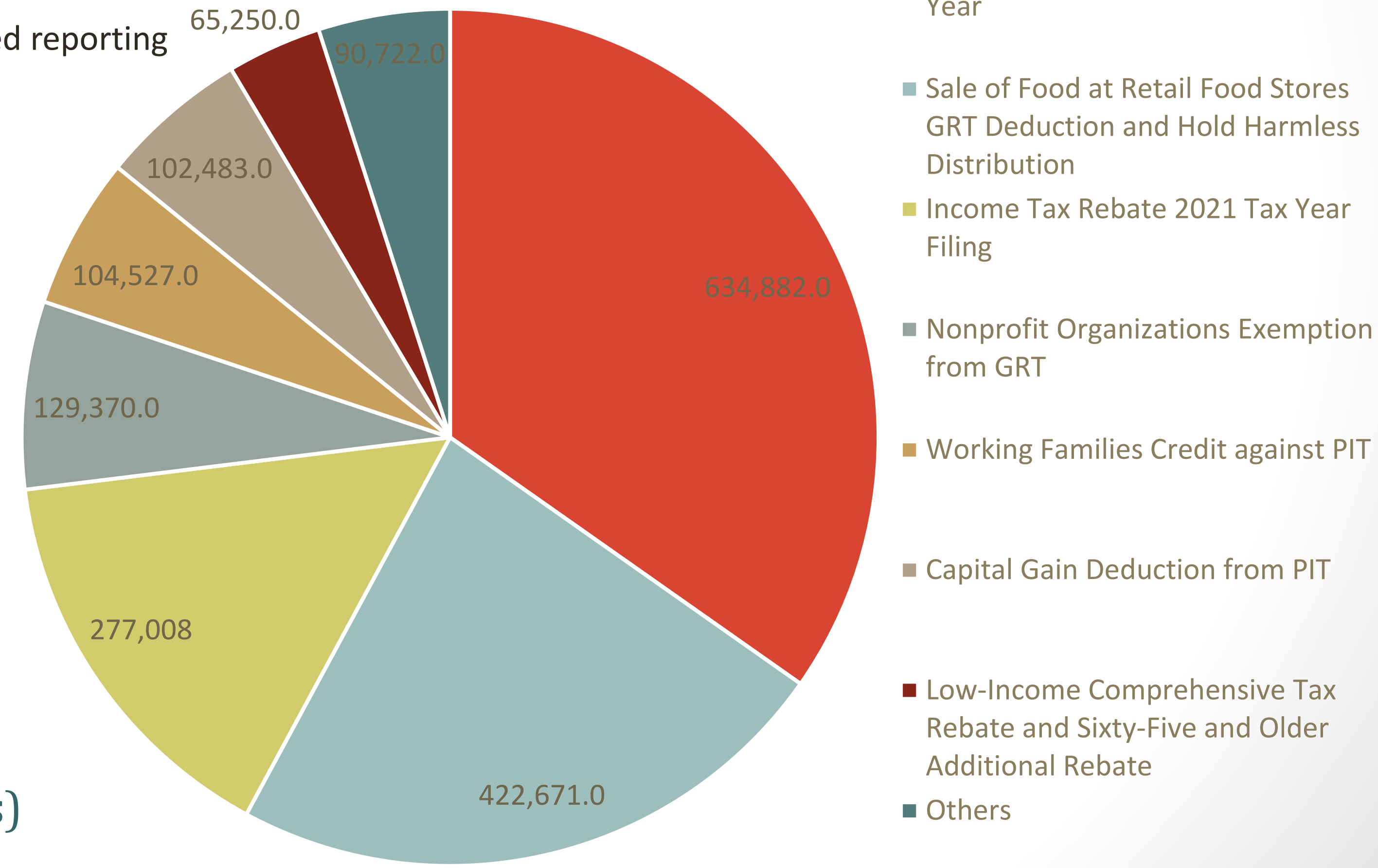
- GRT incidence for deductions and exemptions is shared between the State General Fund and local governments in most cases
- Tax expenditures for CIT, PIT, etc., generally impact only State General Fund directly
- Recent large rebates only impacted State General Fund

FISCAL YEAR 2022 EXPENDITURES BY STATE AND LOCAL TAX INCIDENCE



Citizen Benefits

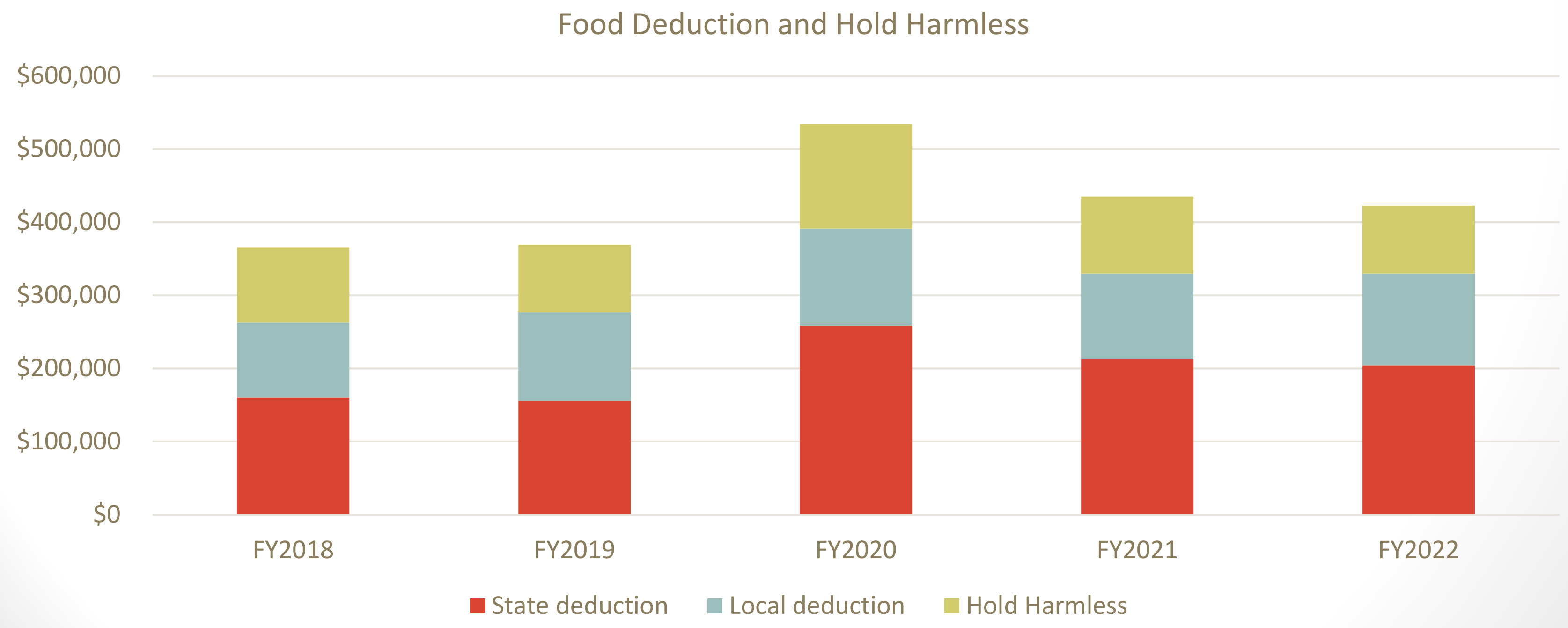
- Represent the largest share of tax expenditures in 2022 - $1.8 billion or 63%
- Large one-time 2021 tax year rebates increased this category significantly - $991.9 million total
- Food deduction totaled $422.7 million down slightly from previous year
- 53 Expenditures in this category
  - 9 with $0 fiscal impact
  - 8 with unknown costs
  - 1 with redacted reporting



Citizen Benefit Expenditures (in $thousands)

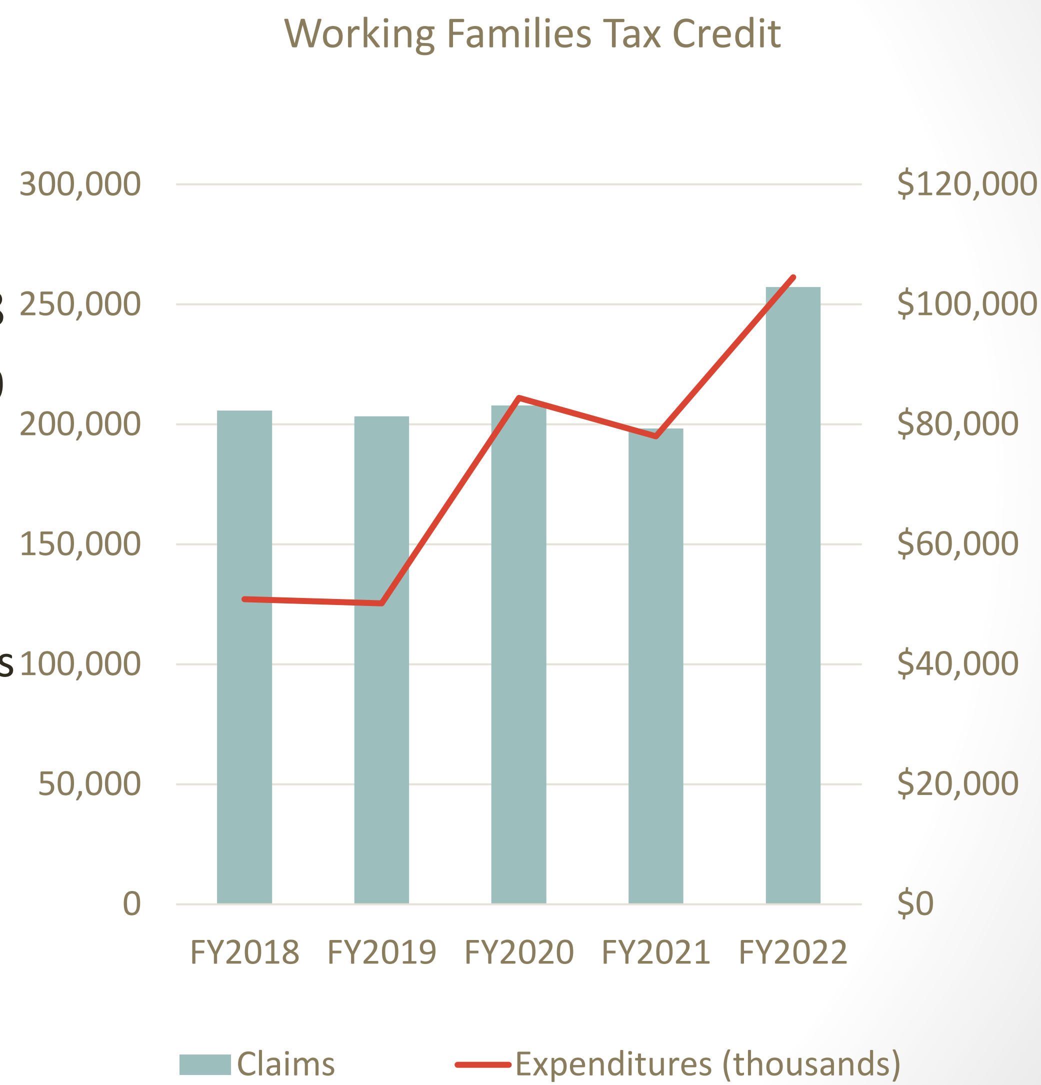
Citizen Benefits : Food GRT Deduction

- GRT deductions enacted in 2004 to reduce the cost of food and 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
- 2022 amendment froze hold harmless phaseout for certain municipalities
- COVID-19 had striking impacts on the Food GRT Deductions
  - The FY2020 and FY2021 amounts for food deduction increased as food consumption shifted away from restaurants and towards food purchased at grocery stores



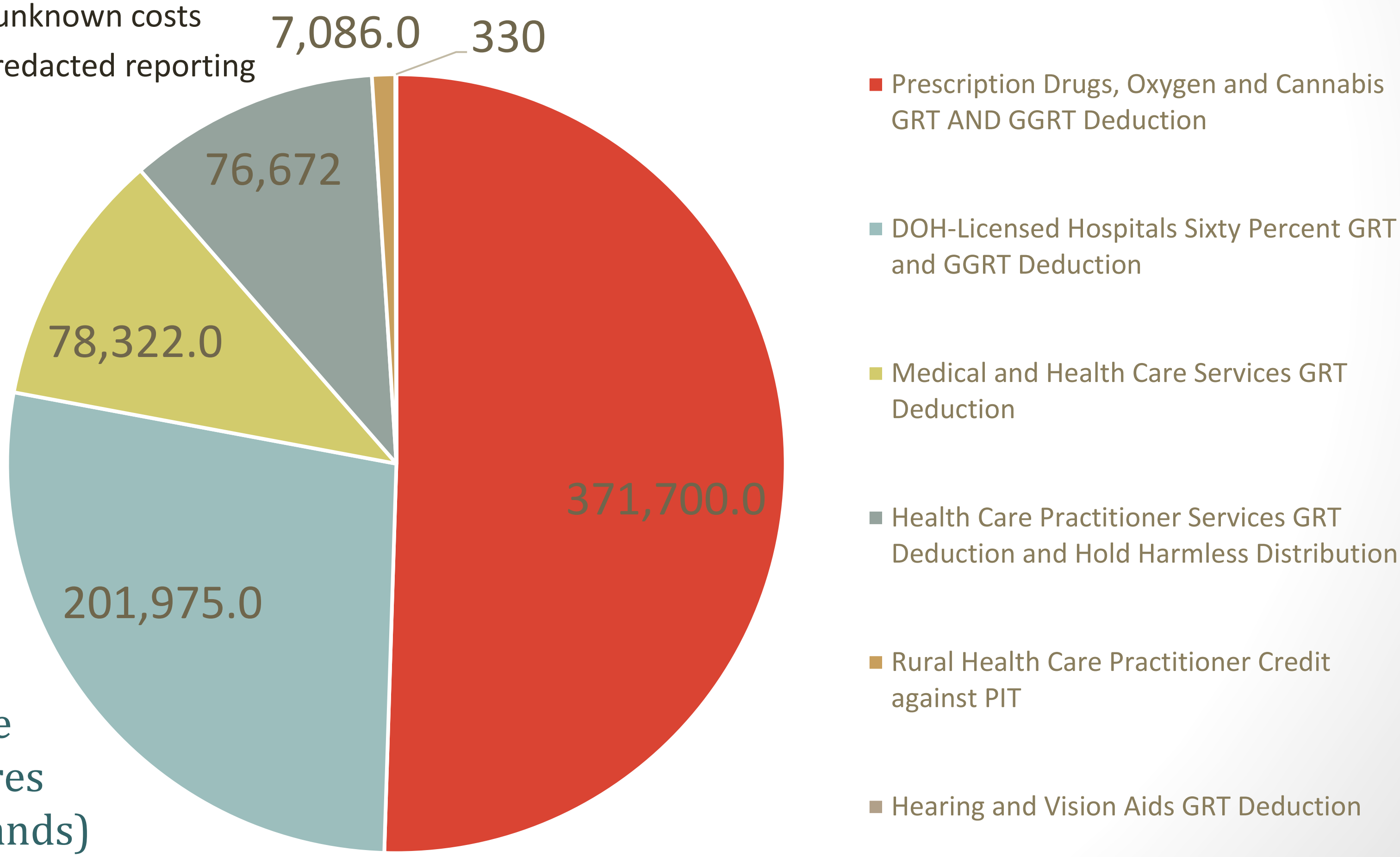
Citizen Benefits: Working Families Tax Credit

- 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



Health Care

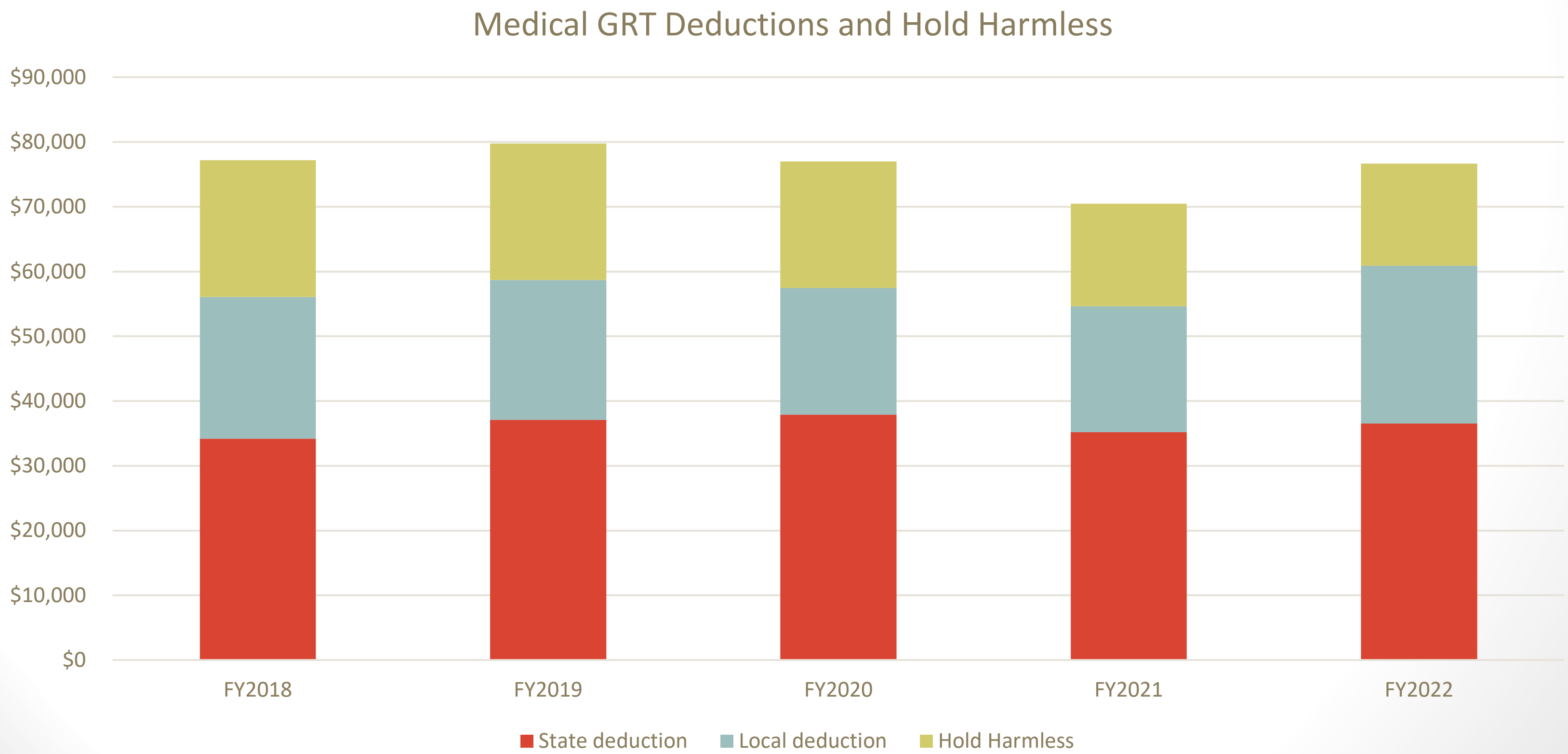
- Represents the second largest share of tax expenditures in FY22 - $736 million or 25%
- The largest reported contributor is the DOH-Licensed Hospitals 60 Percent GRT Deduction at $227 million.
- 10 Expenditures in this category
  - 4 with $0 fiscal impact
  - 0 with unknown costs
  - 0 with redacted reporting



Health Care Expenditures (in $thousands)

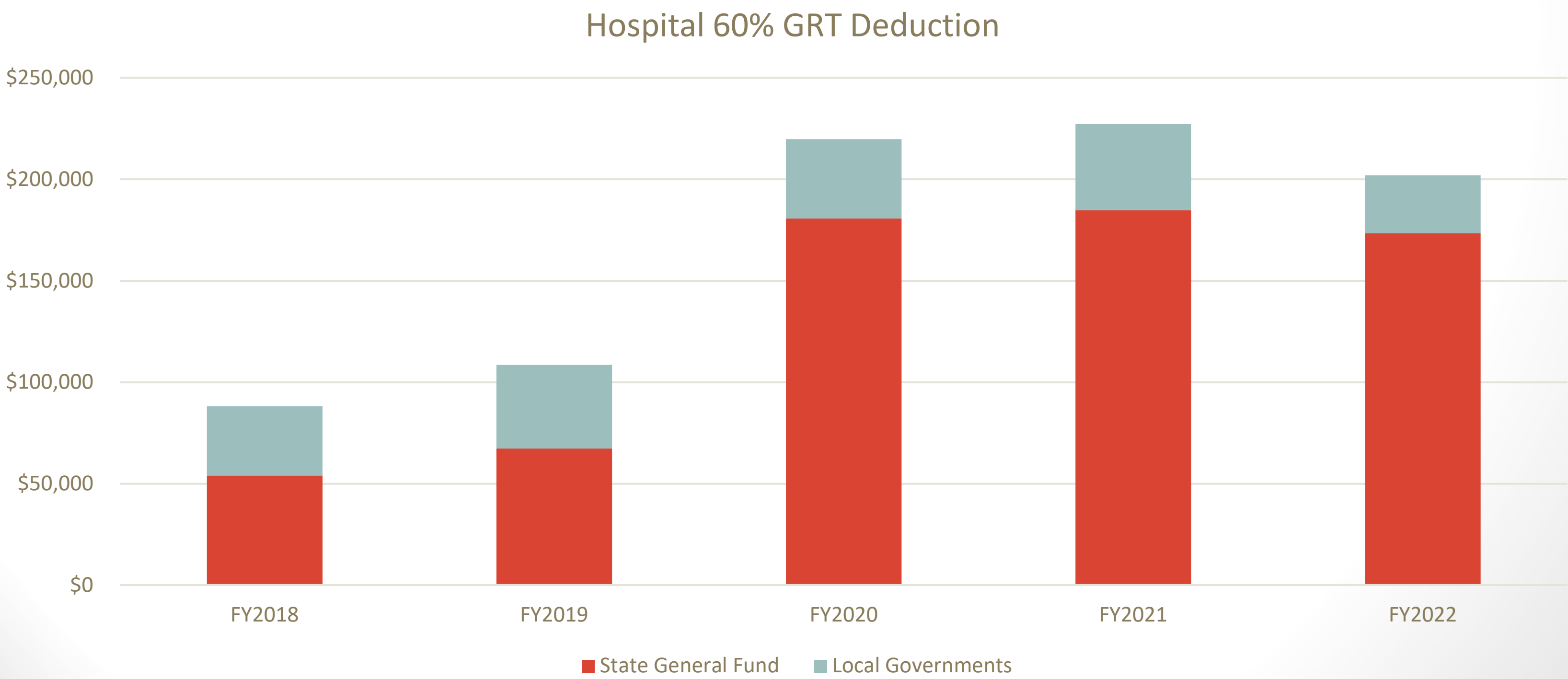
Health Care: Medical GRT Deductions

- GRT deductions enacted in 2004 to reduce the cost of food and 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
- 2022 amendment froze hold harmless phaseout for certain municipalities
- COVID-19 decreased medical deductions in FY20 and FY21 as individuals delayed medical care



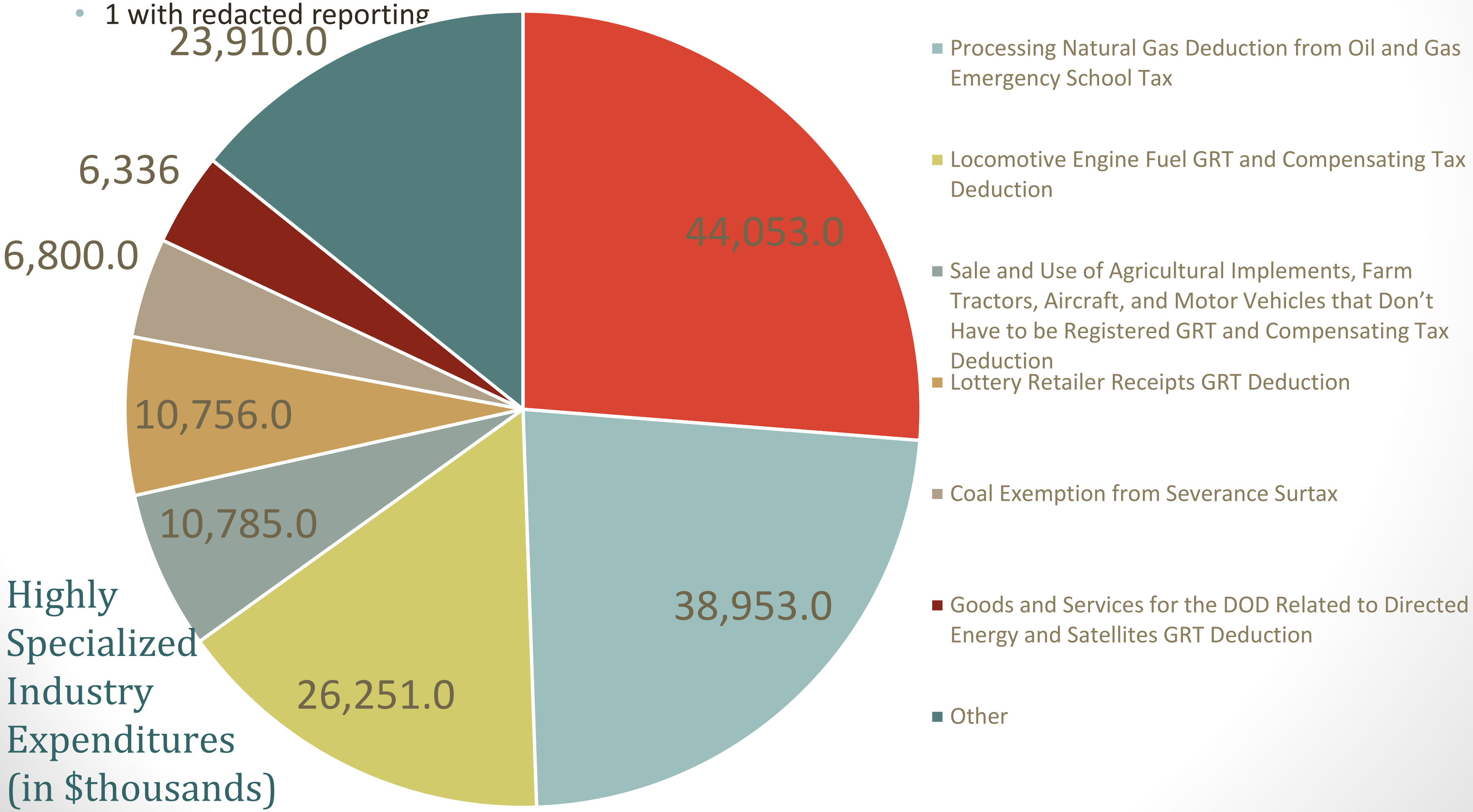
Health Care: Hospital GRT Deductions & Credits

- 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 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 recent years due to COVID-19 hospitalizations



Highly Specialized Industry

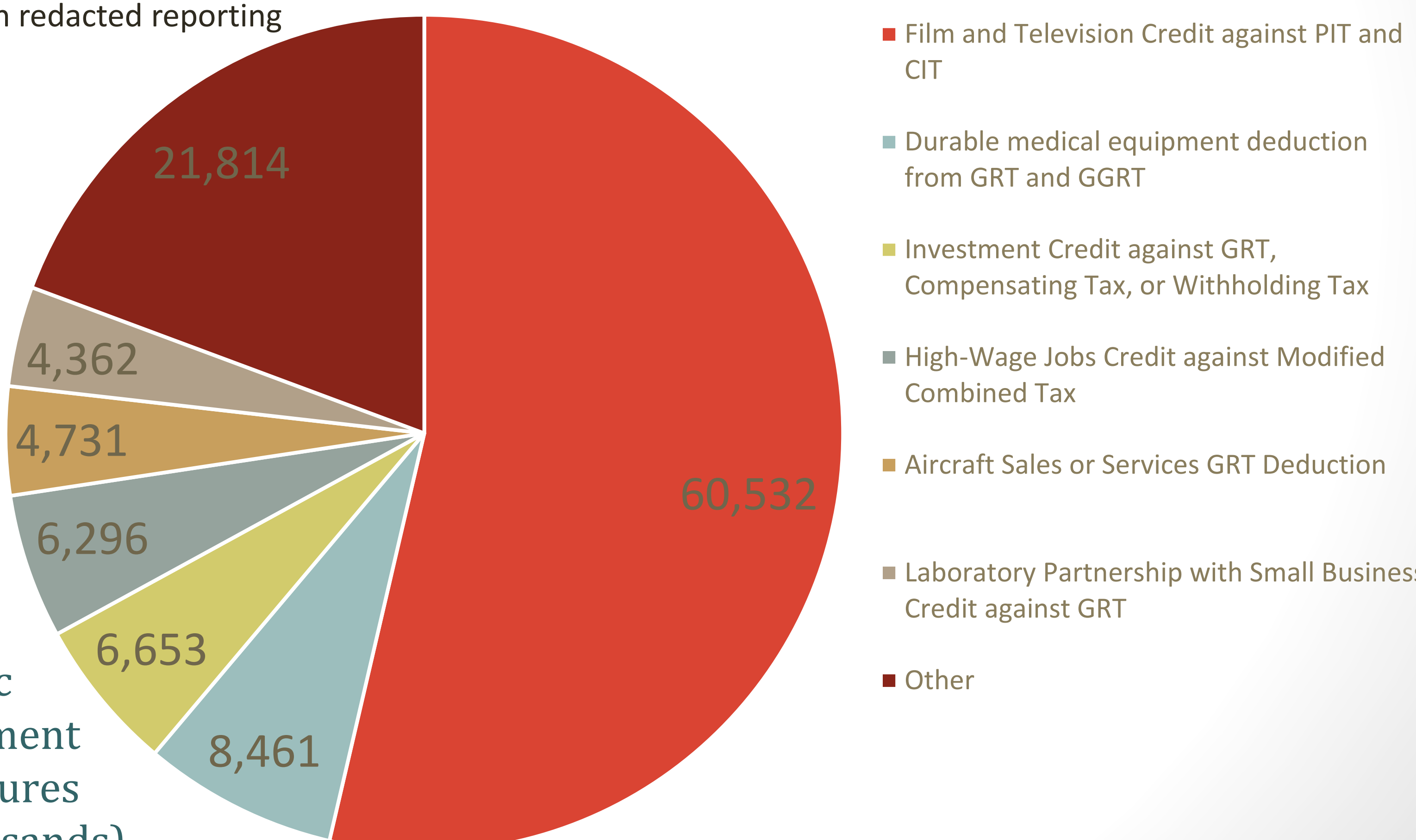
- Represent 6% of tax expenditures in FY22 or $168 million
- The largest reported contributor is the Transportation of Natural Gas Deduction from Oil and Gas Emergency School tax at $44 million
- 37 Expenditures in this category
  - 6 with $0 fiscal impact
  - 6 with unknown costs
  - 1 with redacted reporting



Highly Specialized Industry Expenditures (in $thousands)

Economic Development

- Represents 4% of tax expenditures in FY22 - $113 million
- The largest reported contributor is the Film and Television Credit Against PIT and CIT at $60.5 million
- 27 Expenditures in this category
  - 2 with $0 fiscal impact
  - 3 with unknown costs
  - 1 with redacted reporting



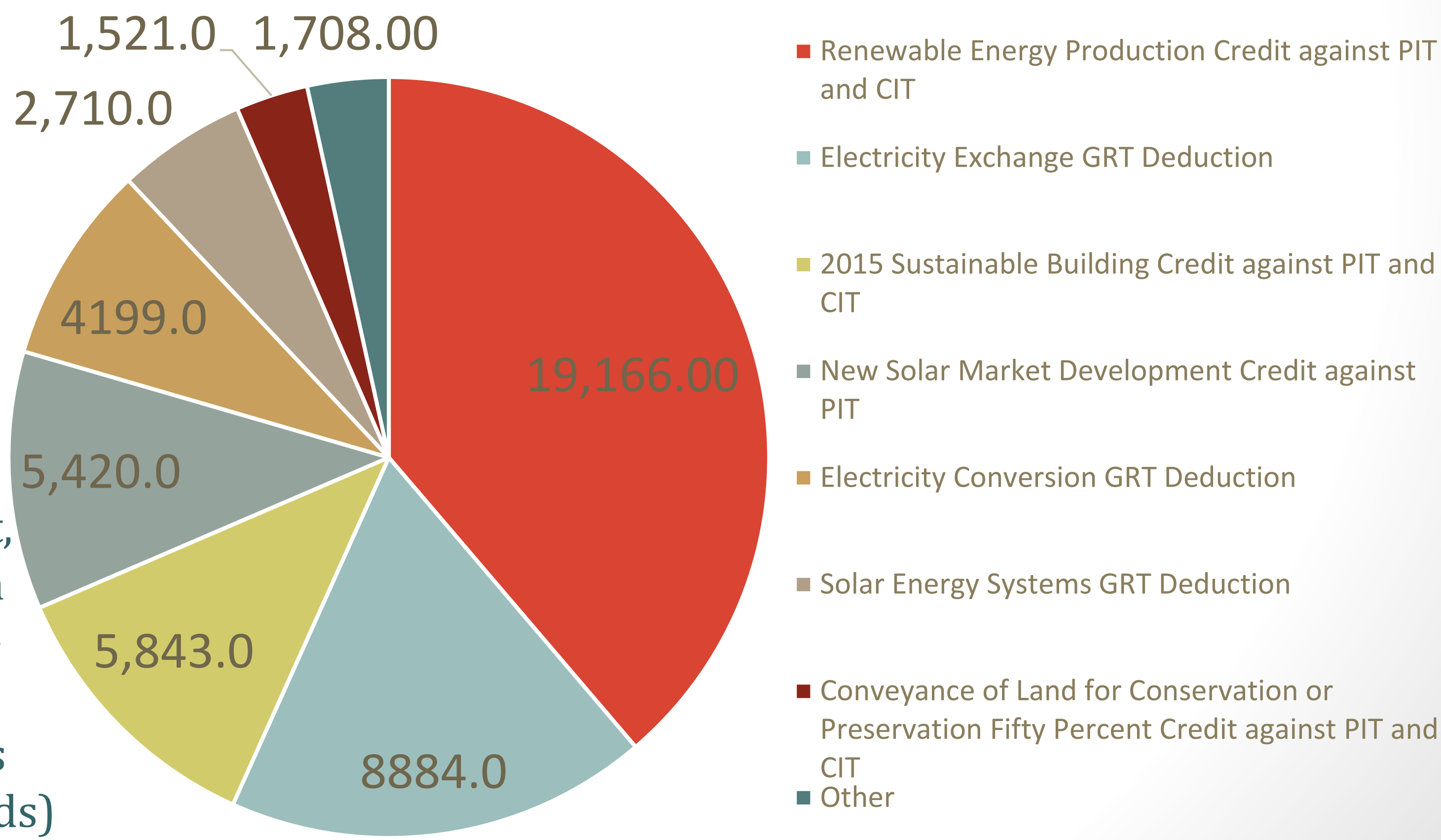
Economic Development Expenditures (in $thousands)

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
- FY19: $127 million in film credit backlog accrued under the previous $50 million cap was repaid in FY19 and FY20
- FY21: Film projects delayed as a result of COVID-19

Environment, Conservation & Renewable Energy

- Represent 2% of tax expenditures in FY22 or $49 million
- The largest reported contributor is the Renewable Energy Production Tax Credit against PIT and CIT at $19 million
- 20 Expenditures in this category
  - 6 with $0 fiscal impact
  - 3 with unknown costs
  - 0 with redacted reporting



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

Environment, Conservation & Renewable Energy: New Solar Market Development Credit

- New credit enacted in 2020, amended in 2022 to increase cap to $8 million
- Taxpayers who purchase and install a solar thermal system or photovoltaic system may apply for a $6,000 credit against PIT
- New credit can apply for full cost of purchase and installation versus 10% in original credit
- EMNRD certified full $8 million cap in tax yar 2021, but claims are less because credit is not refundable

Recommendation for Repeal

Name	Rationale for repeal	2022 ($000's)
Advanced Energy GRT and Compensating Tax Deduction	No claims to date. Construction of facility required prior to Dec. 31, 2015.	$0
Advanced Energy Credit Against GRT, Compensating Tax, Withholding Tax, PIT, or CIT	No claimants in Tax Year 2021. Fiscal impact in FY22 due to prior tax years. Construction of facility required prior to Dec. 31, 2015.	$800
Blended Biodiesel Fuel Credit against PIT and CIT	Credit has expired and carry-forward period ended in tax year 2017.	$0
Business Facility Rehabilitation Credit against PIT and CIT	No claims to date, there are no enterprise zones to establish eligibility.	$0
Electronic ID Reader Credit against PIT and CIT	Credit has never been claimed.	$0
Hybrid Vehicle Exemption from MVX	Exemption was effective until June 2009.	$0
Nonprofit Elderly Care Facility Exemption from GRT	Non-profit entities already qualify for GRT exemption based on status.	$10,780

Recommendation for Repeal (continued)

Name	Rationale for repeal	2022 ($000's)
Penalty Pursuant to Section 7-1-71.2 NMSA 1978 Credit Against GRT, Compensating Tax and Withholding Tax	Credit has not been available since July 1, 2010.	$0
Physician Participating in Cancer Treatment Clinical Trials Credit against PIT	Credit applied to tax years 2014-2016. The time period this credit could have been claimed has expired.	$0
Research and Development Small Business Credit Against GRT or Fifty Percent Credit against Withholding Tax	Credit expired in 2015.	$0
Sales to Qualified Film Production Company GRT and GGRT Deduction	This deduction cannot be claimed by a film production company if they claim the film production tax credit.	Unknown
Vehicles Titled Before July 1, 1991 Exemption from Leased Vehicle GRT	At this point, this exemption applies to very few, if any, vehicles.	Unknown, but likely small
Venture Capital Investment Credit against PIT	No taxpayers have claimed this credit. It appears to compete with the net capital gain income deduction.	$0
Veteran Employment Credit against PIT and CIT	Credit applied to tax years 2012-2016 with carry forward of three years. Credit can no longer be claimed.	$0
Welfare-to-Work Credit against PIT and CIT	Tied to a federal program that no longer exists.	$0

Expenditures Recently Expired

Name	Detail	Sunset Date	2022 ($000's)
Income Tax Rebate 2020 Tax Year Filing	$600 rebate for resident taxpayers who receive the working families tax credit on 2020 tax return below certain income thresholds	June 30, 2022	$4,521
Military Construction Services GRT Deduction (7-9-106 NMSA 1978)	Deduction for receipts from military construction services located in Curry and Otero counties for fighter aircraft training mission pilot project	July 1, 2022	$1,308

Look Ahead – Expenditures with Sunsets next 5 years

Name	Note	Sunset Date	2022 ($000's)
Supplemental Income Tax Rebate 2021 Tax Year	Enacted 2022. Two rebates to 2021 resident filers that are not dependents, regardless of income.	May 31, 2023	$634,882
Income Tax Rebate 2021 Tax Year Filing	Enacted 2022. One rebate to 2021 resident filers that are not dependents meeting certain income limits.	June 30, 2023	$277,008
Future Distribution to a Nonresident Beneficiary Deduction from PIT (7-2-38 NMSA 1978)	Recently enacted 2019 regular legislative session.	Jan. 1, 2025	$3,308
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	$5,468
Military Transformation Acquisition Program GRT Deduction (7-9-94 NMSA 1978)	Enacted 2005. Previously extended twice.	June 30, 2025	$1,295
Small Business Saturday Thanksgiving Weekend GRT Deduction (7-9-116 NMSA 1978)	Enacted 2018. Previously extended once.	July 1, 2025	$186

Look Ahead – Expenditures with Sunsets next 5 years

Name	Note	Sunset Date	2022 ($000's)
Angel Investment Credit against PIT	Enacted in 2007. Previously extended once.	Jan. 1, 2026	$799
Liquor License Lessor Deduction from PIT and CIT	Enacted 2021. Provides temporary relief to taxpayers affected by liquor license reform.	Jan. 1, 2026	$27
Liquor License Holders Deduction from GRT	Enacted 2021. Provides temporary relief to taxpayers affected by liquor license reform.	July 1, 2026	$168
High-Wage Jobs Credit against Modified Combined Tax	Sunset is tied to definition of 'new high-wage' which must be created before July 1, 2026	July 1, 2026	$6,296
Military Retirement Income Exemption from PIT	Enacted in 2022.	Jan. 1, 2026	$0
Technology Readiness Credit against GRT (7-9-96.3 NMSA 1978)	Enacted 2020. Previously extended once.	June 30, 2027	$264
Nonathletic Special Event at New Mexico State University GRT Deduction (7-9-104 NMSA 1978)	Enacted 2007. Previously extended three times	June 30, 2027	$87

Concluding Thoughts

- Legislative Thoughts
  - Purpose not always defined – difficulty to then evaluate
  - Sunset clause – forces evaluation of the expenditure where that is appropriate
  - Reporting requirements – electronic reporting: ease in working with other departments when cross-collaboration of expenditures; allows transparency; ability to evaluate expenditure cost
  - Reassessment of expenditures: have expired but remain in statute, $ 0 fiscal impact as no claimants, or cannot be claimed due to statutory language
- 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!

StephanieS.Clarke@tax.nm.us

Lucinda.Sydow2@tax.nm.us

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