F I S C A L   I M P A C T   R E P O R T

SPONSOR Ortiz y Pino **ORIGINAL DATE** 01/26/19 **LAST UPDATED** **HB**

SHORT TITLE Increase Working Families Tax Credit **SB** 183

ANALYST Iglesias

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY19	FY20	FY21	FY22	FY23		
$0.0	($53,215.0)	($54,811.0)	($56,455.0)	($58,149.0)	Recurring	General Fund

Parenthesis ( ) indicate revenue decreases

SOURCES OF INFORMATION
LFC Files

Responses Received From
Taxation and Revenue Department

SUMMARY

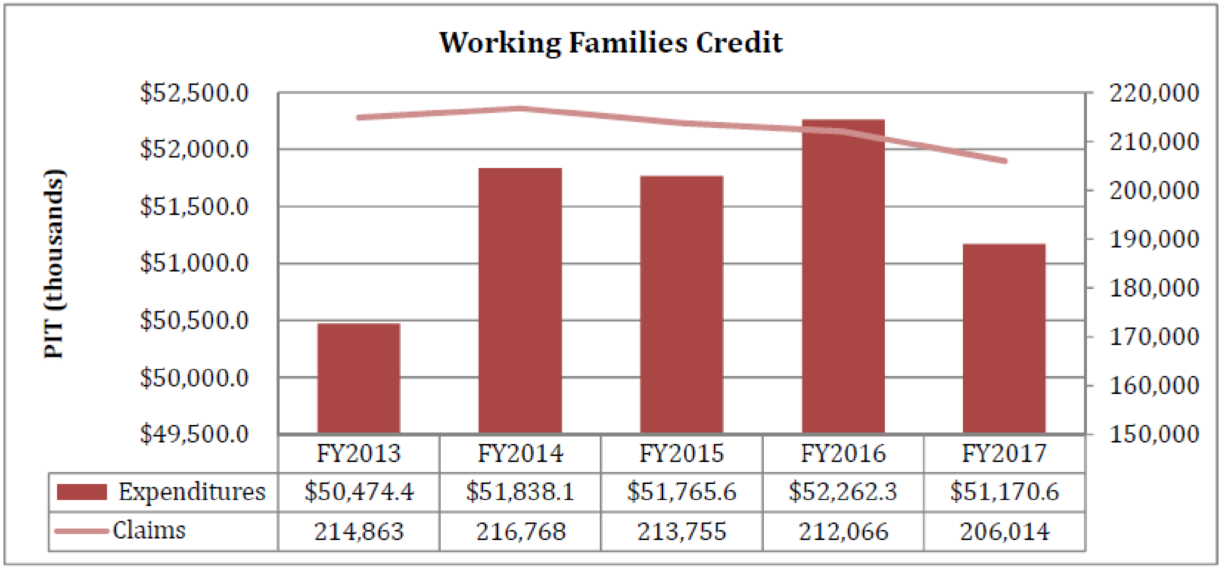
Synopsis of Bill

Senate Bill 183 amends Section 7-2-18.15 NMSA 1978 to increase the amount of the working families tax credit from 10 percent to 20 percent of the federal income tax credit for taxable years starting January 1, 2019. There is no effective date of this bill. It is assumed that the effective date is 90 days after this session ends.

FISCAL IMPLICATIONS

The fiscal impact estimate provided by the Taxation and Revenue Department (TRD) reviewed the working family tax credit (WFTC) expenditure for the last five years and calculated the 5-year average. The bill proposes to double the percentage of the federal income tax credit, thereby doubling the cost of the expenditure.

The 2017 Tax Expenditure Report published by TRD shows an annual average of about 210 thousand claims for the WFTC over the last five years, a cost to the state of about $51 million each year. Taxpayers separately report this credit on income tax forms and no estimation is required. Therefore, TRD's estimate for the proposed bill would bring the total annual cost of this tax expenditure to about $100 million.



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.

SIGNIFICANT ISSUES

Per the federal Internal Revenue Code, working families with a household income below $51,567 may claim this refundable credit against their income tax. This credit is based on the federal Earned Income Tax Credit (EITC), which pays recipients an amount based on their earned income and family size. This benefit is seen both as increasing the incentive to work and also as offsetting the regressive impacts of the federal payroll taxes.

Research indicates the EITC changes family income through three primary channels: the credit amount itself, induced earnings, and other income adjustments (such as public assistance). In a comprehensive literature review, a 2015 working paper by the National Bureau of Economic Research (NBER)[1] concluded the following:

> "Research in the last two decades has documented large positive impacts on net incomes for low-income families who work and dramatic improvements in well-being among children in those families. EITC expansions of the 1990's seem to have increased work among single parents, though they may have induced some secondary workers to cut back. Recent research has documented extremely important benefits for children's educational achievement and attainment."

Additional NBER research[2] found "the income increasing effects of the EITC are concentrated between 75 percent and 150 percent of income-to-poverty with little effect at the lowest income levels (50 percent poverty and below) and at levels of 250 percent of poverty and higher."

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[1] Nichols, A. & Rothstein, J. (2015). *The Earned Income Tax Credit (EITC),* National Bureau of Economic Research, retrieved from https://www.nber.org/papers/w21211.pdf

[2] Hoynes, H. & Patel, A. (2015). *Effective Policy for Reducing Inequality? The Earned Income Tax Credit and the Distribution of Income*, National Bureau of Economic Research, retrieved from https://www.nber.org/papers/w21340.pdf.

PERFORMANCE IMPLICATIONS

The LFC tax policy of accountability is not met since TRD is not required in the bill to report annually to an interim legislative committee regarding the data compiled from the reports from taxpayers taking the deduction and other information to determine whether the deduction is meeting its purpose.

However, since credits are separately reported, TRD is able to easily determine the cost of the WFTC. Currently, the cost of this credit included in TRD's annual Tax Expenditure Report.

ADMINISTRATIVE IMPLICATIONS

TRD recommends the following metrics to standardize the administration of credits: 1) credits should not be refundable, thereby limiting the State's investment to the economic value created by the taxpayer; 2) credit programs should sunset within five years so the efficacy of the incentive can be evaluated; 3) credits should have carry forward periods not exceeding three years to limit the fiscal expenditure and the term of the program; 4) programs requiring administration through multiple agencies other than TRD should employ E-Systems; 5) applications for credits shall be submitted electronically in a form prescribed by the Department; and 6) application for credits shall be made within one tax year of eligibility to limit the administrative and fiscal impacts of the expenditure.

Does the bill meet the Legislative Finance Committee tax policy principles?

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

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.

LFC Tax Expenditure Policy Principle	**Met?**	**Comments**
Vetted	✘	
Targeted		Not stated, but fairly clear the purpose is to reduce the tax burden on working families making below $51,567 (as defined by Internal Revenue Code) and/or to encourage more people to work, since only employed people can receive the benefits.
Clearly stated purpose	✔	
Long-term goals	✘	
Measurable targets	✘	
Transparent	✔	Annual reporting is not required; however, credits are separately reported.
Accountable		Credits are separately reported, allowing the department to know the exact number of claims and cost of the expenditure. However, statute does not require annual reporting to an interim legislative committee. As long as TRD continues to produce its annual tax expenditure report, the public will be able to know the number of claimants and cost of the expenditure.
Public analysis	✔	
Expiration date	✘	
Effective		Extensive research on the federal EITC shows positive impacts on net incomes for low-income families who work and improved well-being among children in those families.
Fulfills stated purpose	✔	
Passes "but for" test	?	
Efficient	?	
Key: ✔ Met ✘ Not Met ? Unclear		

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