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

ORIGINAL DATE 1/29/2020
SPONSOR Cadena/Dow **LAST UPDATED** **HB** 200

SHORT TITLE Early Childhood Worker Income Tax Credit **SB**

ANALYST Iglesias

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY20	**FY21**	**FY22**	**FY23**	**FY24**		
-	($5,000.0) or more	($5,000.0) or more	($5,000.0) or more	($5,000.0) or more	Recurring	General Fund (Income Tax Credit)
-	($7,195.0)	($7,555.0)	($7,935.0)	($8,330.0)	Recurring	General Fund (GRT Deduction)
-	($4,655.0)	($4,885.0)	($5,130.0)	($5,385.0)	Recurring	Local Governments (GRT Deduction)
-	**($12,195.0)**	**($12,555.0)**	**($12,935.0)**	**($13,330.0)**	**Recurring**	**TOTAL General Fund**
-	**($16,850.0)**	**($17,440.0)**	**($18,065.0)**	**($18,715.0)**	**Recurring**	**TOTAL**

Parenthesis ( ) indicate revenue decreases

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

FY20	FY21	FY22	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
	Unknown	Unknown	Unknown	Recurring	TRD and Early Childhood Education and Care Department

Parenthesis ( ) indicate expenditure decreases

Relates to HB 83, SB 3, SB 18, and HJR 1

SOURCES OF INFORMATION
LFC Files

No Response Received
Taxation and Revenue Department (TRD)
Children, Youth and Families Department (CYFD)

SUMMARY

Synopsis of Bill

House Bill 200 creates a refundable income tax credit for taxable years between January 1, 2020 and January 1, 2025 for childcare workers employed by a childcare provider that is licensed by or registered with the Early Childhood Education and Care Department (ECECD). Childcare workers claiming the credit must work at least 30 hours per week for 32 weeks per year. Qualified childcare workers with an early childhood certificate awarded by the ECECD may claim a credit of $1,500; those with an associate degree in early childhood education from an accredited post-secondary institution may claim a credit of $3,000; and those with a bachelor's degree in early childhood education from an accredited post-secondary education institution may claim a credit of up to $5,000.

This bill also creates a new gross receipts tax (GRT) deduction claimable prior to July 1, 2025 for childcare assistance services contracted by the Children, Youth and Families Department (CYFD). The bill requires separate reporting for the deduction and requires the Taxation and Revenue Department (TRD) to compile an annual report for presentation to interim committees.

TRD is required to compile an annual report on the income tax credit and the GRT deduction created by this bill. The report is to include the number of taxpayers claiming the credit and deduction and the aggregate amount claimed for each. The report is to be presented annually to the LFC and the interim Revenue Stabilization and Tax Policy Committee.

The effective date of this bill July 1, 2020.

FISCAL IMPLICATIONS

The fiscal impact estimate for the income tax credit uses data from the Bureau of Labor Statistics, which reported 2,380 childcare workers in New Mexico in 2018. Based on data from the American Community Survey on educational attainment of child day care service providers, the estimate assumes 70 percent of the workforce have or will obtain a certificate as required for this income tax credit, 20 percent have an associate's degree in early childhood education, and 10 percent have a bachelor's degree in early childhood education. Using these assumptions, the refundable income tax credit proposed in this bill would cost $5.1 million. If the credit were successful either in attracting more early childhood workers into the workforce or in incentivizing existing workers to obtain higher levels of education, the cost of the credit would increase over time.

The fiscal impact estimate for the GRT deduction uses data on childcare assistance funding sources and uses as documented in LFC's 2020 Volume III document.[1] In FY19, actual spending for childcare services was $133.7 million. The FY20 operating budget for childcare services is $148.5 million. Since this represents the amount spent on the licensed childcare assistance program, through which this bill proposes a deduction for those services, the estimate multiplies this amount by the FY20 year-to-date total statewide average GRT rate of 7.08 percent to arrive at a total cost of $11.9 million in FY21. The estimate assumes a 5 percent annual growth rate for each fiscal year thereafter. Since the bill proposes a deduction for childcare services, gross receipts will be reduced for the state and local governments, and the estimate uses current average effective rates to apportion the cost between the two.

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[1] Legislative Finance Committee, January 2020 for Fiscal Year 2021, Volume III, page 95, https://www.nmlegis.gov/Entity/LFC/Documents/Session_Publications/Budget_Recommendations/2021RecommendVolIII.pdf

Because childcare assistance provider rates are set by formula (Section 8.15.2.17 NMAC), there would be no cost savings to the Early Childhood Education and Care Department (ECECD) for the deduction, as providers are currently unable to pass on the tax burden to the agency.[2] Therefore, licensed providers participating in the childcare assistance program would realize the full benefit of the deduction.

This bill narrows the gross receipts tax (GRT) base. See *Significant Issues* for more information.

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.

Estimating the cost of tax expenditures is difficult. Confidentiality requirements surrounding certain taxpayer information create uncertainty, and analysts must frequently interpret third-party data sources. The statutory criteria for a tax expenditure may be ambiguous, further complicating the initial cost estimate of the expenditure's fiscal impact. Once a tax expenditure has been approved, information constraints continue to create challenges in tracking the real costs (and benefits) of tax expenditures.

SIGNIFICANT ISSUES

Limited information is available about just who comprises the child care workforce in New Mexico. While some data is available through the Bureau of Labor Statistics (BLS), current data codes make it difficult to accurately capture data on caregivers in home- and center-based settings.

Childcare Assistance. The Childcare Assistance program is a subsidy program for families with children between the ages of 3 weeks and 13 years whose families make less than 250 percent of the federal poverty level and who work or attend training and education programs. Aside from income eligibility requirements, parents must also work or go to school. The vast majority of qualified parents use childcare assistance to support their employment.

Childcare is not an entitlement program and is funded through a combination of federal block grants (Childcare and Development Fund, and Temporary Assistance for Needy Families) and state appropriations (general fund). Historically, the largest source of funding for childcare assistance was from the federal Childcare and Development Fund (CCDF), however, in FY19, the general fund and CCDF revenue became nearly equal funding sources.

The bill does not include a purpose statement for the deduction; therefore, it is difficult to determine the intended goal of the deduction. The childcare assistance program already assists low-income families by subsidizing the cost of childcare; therefore, the childcare providers would receive the benefit of the deduction. The purpose of the deduction may be to provide tax parity among various providers of these services. Currently, for-profit childcare providers are subject to GRT, while similar services provided through the Public Education Department (such

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[2] Legislative Finance Committee, January 2019 for Fiscal Year 2021, Volume III, page 96. Formula for provider reimbursement rates: (Base Rate + Quality Differential) x Units of Service = Provider Rate. Additional differentials to the provider rate apply for non-traditional work hours.

as afterschool programs and prekindergarten) or by nonprofit providers receive the same provider reimbursement rates but are not subject to GRT.

Enrollment in childcare has grown the last three years but has leveled out in the current fiscal year. In FY20, childcare assistance average monthly enrollment was 20,016, an increase of .2 percent over FY19. The average monthly cost per child is $574, $9 more per child per month than FY19 and $77 more than FY17. Total direct spending for childcare assistance in FY19 was nearly $134.4 million. In FY19, childcare assistance received an additional $22 million from the general fund and $3 million from TANF.

Increased provider rates for the highest levels of quality care contributed to increased spending as more providers qualify for 5-STAR reimbursements. Childcare providers can qualify as a 5-STAR provider by either meeting quality standards in the state's tiered rating quality improvement system, Focus, or through an approved national accrediting body. Periodically, the state recertifies childcare providers to ensure they are meeting Focus standards, while accredited providers are endorsed by their accrediting body.

This bill narrows the gross receipts tax (GRT) base. Many of the efforts over the last few years to reform New Mexico's taxes focused on broadening the GRT base and lowering the rates. Narrowing the base leads to continually rising GRT rates, increasing volatility in the state's largest general fund revenue source. Higher rates compound tax pyramiding issues and force consumers and businesses to pay higher taxes on all other purchases without an exemption, deduction, or credit.

PERFORMANCE IMPLICATIONS

The LFC tax policy of accountability is met with the bill's requirement 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.

ADMINISTRATIVE IMPLICATIONS

The creation of new tax credits and deductions will have a cost to the Taxation and Revenue Department (TRD). Response from TRD is necessary to determine the full agency impact of this bill.

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	✘	Not heard in an interim committee of LFC or RSTP.
Targeted		
Clearly stated purpose	✘	
Long-term goals	✘	
Measurable targets	✘	
Transparent	✔	Bill requires to TRD to compile an annual report on the deduction, including the aggregate amount of deductions claimed and number of taxpayers claiming the deduction, and the department is to report a cost analysis to RSTP and LFC.
Accountable		
Public analysis	?	It is unlikely that simple reporting on the number of taxpayers and cost of deduction is sufficient for public analysis on the effectiveness of the deduction.
Expiration date	✔	The income tax credit has a delayed repeal date of December 31, 2024, and the GRT deduction has a delayed repeal date of June 30, 2025.
Effective		Because there is no stated purpose, staff cannot determine if this deduction is the most effective or efficient way to achieve the desired results.
Fulfills stated purpose	?	
Passes "but for" test	?	
Efficient	?	
Key: ✔ Met ✘ Not Met ? Unclear		

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