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

SPONSOR	Ortiz y Pino	**ORIGINAL DATE** **LAST UPDATED**	2/13/2020	**HB**	
SHORT TITLE	Increasing the Working Families Tax Credit			**SB**	87/aSCORC
				ANALYST	Torres

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY20	**FY21**	**FY22**	**FY23**	**FY24**		
	($29,300.0)	($29,600.0)	($30,000.0)	($30,300.0)	Recurring	General Fund

(Parenthesis ( ) Indicate Revenue Decreases)

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY20	FY21	FY22	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
Total		$10.3		$10.3	Nonrecurring	General Fund

(Parenthesis ( ) Indicate Expenditure Decreases)

Conflicts with HB148.

SOURCES OF INFORMATION
LFC Files

Responses Received From
Taxation and Revenue Department (TRD)

SUMMARY

Synopsis of SCORC Amendment

The Senate Corporations and Transportation Committee amendment to SB87 clarifies that the claimed dependent must be a qualifying child under the federal earned income tax credit.

Synopsis of Original Bill

Senate Bill 87 (SB87) increases the Working Families Tax Credit (WFTC) from 17 percent to 20 percent of the corresponding federal earned income tax credit (EITC), and increases the WFTC to 30 percent for taxpayers claiming a qualifying child under the age of six. These provisions are applicable for taxable years beginning after January 1, 2020. There is no effective date of this bill. It is assumed that the effective date is 90 days after this session ends. There is no delayed repeal date but LFC recommends adding one.

FISCAL IMPLICATIONS

LFC and TRD estimate increasing the WFTC to 20 percent would cost the state an additional $16 million a year. This is calculated based on increasing the five-year average cost by the proportional increase in the credit. Furthermore, the current Consensus Revenue Estimating Group (CREG) December 2019 forecast, includes the revenue impact of increasing the WFTC percentage from 10 percent to 17 percent, which took effect for tax year 2019 and impacts revenue starting in FY20. The additional revenue impact for FY22 over the estimated impact included in CREG estimates is $16 million.

The population who can claim 30 percent under SB87, are those with a qualifying child under the age of six in the respective tax year. TRD estimated that 87 percent of the current expenditures for WFTC are for taxpayers with dependent children. Based on census data, TRD and LFC estimate that approximately 29 percent of these families would have a child under the age of six. Given the population estimates, LFC and TRD determined the relevant associated revenue impact to be $13.3 million.

The annual revenue impacts are increased based on the personal income tax growth rates in the December 2019 CREG estimate. This rate is then discounted by approximately 1% based on average population decline for taxpayers currently receiving the credit as reported in TRD's 2018 Tax Expenditure Report[1]. The federal EITC is annually adjusted based on the chained-consumer price index for urban consumers (C-CPI-U.) The CREG growth rates are a proxy for the federal indexing.

Estimating the cost of tax expenditures is difficult. For this bill, the difficulty is both in timing and magnitude. Confidentiality requirements surrounding certain taxpayer information create uncertainty, and analysts must frequently interpret third-party data sources. Once a tax expenditure has been approved, information constraints continue to create challenges in tracking the real costs (and benefits) of tax expenditures.

This bill expands a tax expenditure with a cost that is difficult to determine but likely significant. LFC has serious concerns about the significant 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 be held for future consideration.

SIGNIFICANT ISSUES

The WFTC is based on the Federal Earned Income Tax Credit 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. The capital gain deduction exists to incentivize savings and investment.

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[1] New Mexico Taxation and Revenue Department, 2018 Tax Expenditure Report, http://www.tax.newmexico.gov/forms-publications.aspx

The following issues were identified by TRD:

> There is an element of eroding horizontal equity within the WFTC by extending a larger percentage credit (30 percent vs. 20 percent proposed) to families with children under 6 years of age. The federal EITC is scaled to extend more credit based on family size and thus the increased financial costs of supporting more people. By basing the percentage amount on the age of children, taxpayers in similar economic circumstances are no longer treated equally. As discussed below under "Other Issues", this also diminishes TRD's administrative efficiency of taking a straight percentage of the EITC for all taxpayers.
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> The federal EITC faces critiques given differential treatment for "childless workers" versus individuals of the same age with dependent children. Adults who are not claimed as a dependent and are under the age of 25 are ineligible for the EITC if they have no children. Adults over the age of 25 can receive an EITC but the benefit is scaled to a much lower credit than those taxpayers who have dependents. The Center of Budget and Policy Priorities states that this group under the federal tax code is taxed into poverty or deeper into poverty.2 They detail that statement by explaining that families with children are ensured no net federal tax liability if they earn poverty-level wages through the standard deduction, EITC and Child Tax Credit (CTC). Single childless adults, on the other hand, owe federal income tax starting with earnings below the poverty line with very little or no EITC. In addition, given these individuals are working they have social security and Medicare payroll taxes deducted from their paychecks. Their disposable income is significantly lessoned given income tax and payroll tax liabilities.
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> Due to states basing their state earned income credits on the federal EITC, no state currently extends the credit to taxpayers who file under an ITIN. California in its last legislative session proposed an expansion of their state credit to this population but it was not enacted. ITIN taxpayers are immigrant non-citizens who pay taxes including PIT and often their children are U.S. citizens. Thus, the WFTC is not currently horizontally equitable to New Mexico taxpayers of similar income levels and incurs a wider gap for families with children.

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.

ADMINISTRATIVE IMPLICATIONS

As discussed under "Other Substantive Issues", the administrative complexity of the WFTC will increase with a component based on the age of the child dependents. These returns will require increased review at processing. Audit procedures will need to be updated to ensure proper reporting and training for auditors. TRD will need to make information system changes, and update forms, publications and regulations. These changes will be incorporated into annual tax year implementation and represent $10.3 thousand in Information Technology Division (ITD) workload costs.

CONFLICT

House Bill 148 makes changes to the WFTC that are in conflict with SB 87. HB 148 does not include a 30 percent provision for filers with qualifying children and adds eligibility for filers age 18-24 and those without social security numbers who otherwise qualify.

OTHER SUBSTANTIVE ISSUES

Of the 28 states that have a version of a state EITC, all but one take a percentage of the federal credit, presumably for ease of administration and tax preparation and filing. Minnesota calculates the credit as a percentage of income. Wisconsin bases the percentage amount on the number of qualified children where filers with no children are not eligible for their state version of the EITC. The calculation of the WFTC proposed in the bill would place New Mexico with Wisconsin, where the simplicity of applying and administering the credit is reduced.

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	**Met?**	**Comments**
Vetted	✓	The issue was discussed at the Revenue Stabilization and Tax Policy Committee prior to the Legislative Session.
Targeted Clearly stated purpose Long-term goals Measurable targets	 ✗ ✗ ✗	 No purpose, targets or goals established.
Transparent	?	The bill includes no reporting requirements. However, credits are separately reported, which enables TRD to easily determine the cost of the WFTC. The cost of the WFTC and the capital gains deduction are included in TRD's annual Tax Expenditure Report.
Accountable Public analysis Expiration date	 ✗ ✗	 The bill does not contain provisions for reporting. The bill does not include an expiration date.
Effective Fulfills stated purpose Passes "but for" test	 ? ?	Without a purpose statement, it is not possible to determine if the exemption fulfills intended outcomes.
Efficient	?	Without a purpose statement, it is not possible to determine if it is the most efficient means of achieving a desired outcome.
Key: ✓ Met ✗ Not Met ? Unclear		

IT/sb/al/rl