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

**SPONSOR** Gallegos **ORIGINAL DATE** 02/17/21 **LAST UPDATED** 02/18/21 **HB**

**SHORT TITLE** Rural Teachers Tax Credit **SB** 175

**ANALYST** Lobaugh/Torres

## REVENUE (dollars in thousands)

| Estimated Revenue | | | | | Recurring or Nonrecurring | Fund Affected |
|---|---|---|---|---|---|---|
| **FY20** | **FY21** | **FY22** | **FY23** | **FY24** | | |
| | | ($10,004.6) | ($10,004.6) | ($10,004.6) | Recurring | General Fund |

Parenthesis ( ) indicate revenue decreases

## ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

| FY21 | FY22 | FY23 | 3 Year Total Cost | Recurring or Nonrecurring | Fund Affected |
|---|---|---|---|---|---|
| | $139.5 | $55.0 | $194.5 | Recurring and Nonrecurring | General Fund- TRD |

Parenthesis ( ) indicate expenditure decreases

**SOURCES OF INFORMATION**
LFC Files

Responses Received From
New Mexico Attorney General (NMAG)
Taxation and Revenue Department (TRD)

No Response Received
Public Education Department (PED)

**SUMMARY**

Synopsis of Bill

Senate Bill 175 establishes the Rural Teachers Tax Credit for eligible New Mexico licensed teachers. A nonrefundable personal income tax credit of up to $1.5 thousand against tax liability may be claimed by full-time teachers in rural school districts. To qualify for the credit, the bill requires a taxpayer to be a full-time employee in a rural school district on at least a 9.5 month contract that ends in the taxable year.

SB175 requires a teacher wishing to claim the tax credit to submit an application to the Public Education Department ("PED"), including their employment contract and any other additional information required by PED. If PED determines the teacher is eligible for the tax credit, the department will provide the taxpayer with a certificate and provide the Tax and Revenue Department ("TRD") with appropriate information for all eligible teachers that were issued a certificate. The taxpayer claiming the credit must submit a copy of the certificate with their New Mexico income tax return for the taxable year. Although the tax credit is nonrefundable, a taxpayer may carry forward the tax credit for three consecutive years. Married individuals who file separate tax returns are only eligible to claim one-half of the credit. The bill also requires annual reporting by TRD on the number of claimants and aggregate cost of the credit and any other information to determine the credit's efficacy.

An eligible rural teacher is defined as a teacher who holds a level one, level two or level three-A license and whose primary job is classroom instruction or the supervision, below the school principal level, of an instructional program or whose duties include curriculum development, peer intervention, peer coaching or mentoring or serving as a resource teacher for other teachers and who teaches in a rural school district.

A rural school district is defined as a school district that either (1) has no more than four public schools to serve kindergarten through twelfth grades, (2) is located along the border with another state and can demonstrate to the public education department that it is losing public school teachers to school districts in that bordering state; (3) is more than thirty-five road miles from an urban cluster or urbanized area as those terms are used in the most recent federal decennial census; or (4) a public school of a geographically large school district whose central administration is located in an urban cluster or urbanized area but the public school is located more than thirty-five road miles from the school district's central administration building and the public school has a chronic critical teacher shortage.

SB175 applies to taxable years beginning on or after January 1, 2021.

## FISCAL IMPLICATIONS

LFC staff used National Center for Education Statistics (NCES) data from the U.S. Department of Education to develop revenue impact estimates. It is assumed that a "rural school district", as defined in the bill, may meet any one of the first three (3) criteria listed in Section 1.H of the proposed legislation. The estimate does not include any teachers that may qualify under the fourth criteria of a school whose central administration is located in an urban area but the school is 35 miles away. The table below illustrates the number of estimated teachers by category listed in the bill, totaling 6,670 teachers as eligible of the total 21 thousand teachers in the state. Given the number of identified teachers, the credit is estimated to cost $10 million per year. The estimate assumes the number of teachers who qualify remain constant, but the credit could grow as more teachers are hired in qualified school districts or as more districts are identified as qualifying according to subsection (d).

**Estimated Number of Eligible Rural Teachers (Unduplicated with no Overlap of Categories)**

| Category | Number of FY19 Teachers |
|---|---|
| Total New Mexico K-12 Teachers | 21,022 |
| Number of Teachers in School Districts with Fewer than Four Schools | 1,042 |
| Number of Teachers in a District Directly Bordering Another State minus those that qualify in another category to avoid duplication | 4,126 |
| Number of Teachers in a Census-designated rural territory more than 35 miles from an urbanized area and more than 10 miles from an urban cluster | 1,502 |
| **Total Qualifying Teachers** | **6,670** |

Source: LFC analysis of NCES data.

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

TRD identified the following issues:

> PIT represents a consistent source of revenue for many states, including New Mexico. While this revenue source is susceptible to economic downturns, it is also positively responsive to economic expansions. The PIT is an important tax policy tool that has the potential to further both horizontal equity, by ensuring the same statutes apply to all taxpayers, and vertical equity, by ensuring the tax burden is based on taxpayer's ability to pay.
>
> A rural teacher's tax credit will erode horizontal equity in state income taxes. By basing the credit on profession and location of work, taxpayers in similar economic circumstances are no longer treated equally. Thus, two teachers who earn the same salary may have different tax liability given where they work. A tax-credit for rural teachers may be seen as a way to reduce teacher turnover and teacher quality gaps between urban and rural areas, and also to increase supply of teachers in the rural areas. However,

providing a tax credit to attract teachers to move to rural schools may be only one requirement necessary to address the problem of attracting teachers to rural areas. Teacher quality and retention is a statewide concern that impacts all students. Providing a tax incentive for only rural teachers may add stress to the already strained statewide education system. In addition, tax expenditures narrow the tax base and may result in reductions of governmental services, an increase in taxes, or both.

This new proposed credit does not include a sunset date. TRD supports sunset dates so that policymakers may review the impact of a credit before extending it if a sufficient timeframe is allotted for tax incentives to be measured. Given the cost to the state, a sunset date would force an examination of the benefit of this credit versus the cost.

## PERFORMANCE IMPLICATIONS

The creation of a rural teacher tax credit could encourage or support filling teacher vacancies in rural districts which could improve educational outcomes.

## ADMINISTRATIVE IMPLICATIONS

TRD will need to make information system changes and create new publications, forms and regulations. These changes will be incorporated into annual tax year implementation and represents $15,492 in workload costs.

Without an electronic data sharing requirement, when and how the certification data are received is imperative. This requires establishing a Memorandum of Understanding (MOU) with PED to facilitate exchange of certification data. The workload costs for RPD to facilitate MOU discussions is $67 thousand. An MOU, by facilitating automation and real-time data certification sharing, will save potential FTE impact. TRD assumes that electronic transfer of credit information will not occur before the effective date of the bill and thus an additional FTE will be required. RPD will require a Tax Examiner-O as without automation certifications must be entered manually. In addition, as returns with the credit are submitted, they will need to be manually reviewed.

TRD expects to be able to absorb the impact of these changes as outlined in this standalone bill with one additional FTE. However, if several bills with similar effective dates become law there will be a greater impact to TRD and additional FTE or contract resources may be needed in order to complete the changes specified by the effective date(s) of each bill.

## TECHNICAL ISSUES

The credit is structured so that the amount “shall not exceed” $1,500 per filer, yet it is unclear how any amount less than $1,500 will be determined. If the bill intends to set each credit equal to $1,500 it should be clarified, or further guidance included on how to determine the credit amount less than the maximum.

For clarity, under the definition of a “rural school district”, TRD suggests that the qualifiers are separated by an “or” if that is the bill’s intent. This report assumes an “or” for the qualifiers when estimating the revenue impact.

Page 2, line 16 of the proposed legislation requires certification from PED. However, the timeline and method of the certification is not noted. TRD also recommends adding a requirement for certification information to include the taxpayer name, taxpayer identification number, taxable year awarded, and amount awarded. It is recommended that this data sharing is facilitated electronically from PED to TRD to allow for real time data exchange and efficient tax returns and credit claim processing. It should be noted that without authority under Section 7-1-8.8 NMSA 1978, TRD will not be able to share specific taxpayer information with PED.

It is unclear whether PED would be required to certify each taxpayer in each year for which the taxpayer wishes to claim the credit. This likely must occur annually to avoid fraud, and should be stipulated in the bill.

This bill does not contain a delayed repeal date. LFC recommends adding a delayed repeal date.

**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** | | |
| Clearly stated purpose | ✘ | |
| Long-term goals | ✘ | |
| Measurable targets | ✘ | |
| **Transparent** | ✓ | |
| **Accountable** | | |
| Public analysis | ✓ | |
| Expiration date | ✘ | |
| **Effective** | | |
| Fulfills stated purpose | ✘ | |
| Passes "but for" test | ? | |
| **Efficient** | ✘ | |
| Key: ✓ Met ✘ Not Met ? Unclear | | |

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