FISCAL IMPACT REPORT

		LAST UPDATED	
SPONSOR	HHHC	**ORIGINAL DATE**	3/6/23
SHORT TITLE	Special Needs Adoption Tax Credit	**BILL NUMBER**	CS/House Bill 308/HHHCS
		ANALYST	Graeser

REVENUE
(dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY23	**FY24**	**FY25**	**FY26**	**FY27**		
	($900.0)	($900.0)	($900.0)	($900.0)	Recurring	General Fund (PIT) – Current claimants of special needs adoption credit portion of the bill
	($2,030.0)	($2,030.0)	($2,030.0)	($2,030.0)	Recurring	General Fund (PIT) – New special needs adoption credit portion of the bill
	($2,030.0)	($2,030.0)	($2,030.0)	($2,030.0)	Recurring	General Fund (PIT) –Current regular adoptions credit portion of the bill
	($640.0)	($640.0)	($640.0)	($640.0)	Recurring	General Fund (PIT) –New Regular Adoptions Credit portion of the bill
	($3,100) to ($5,600.0)	($3,100) to ($5,600.0)	($3,100) to ($5,600.0)	($3,100) to ($5,600.0)	Recurring	General Fund (PIT) – Total

Parenthesis ( ) indicate revenue decreases.

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT
(dollars in thousands)

FY23	FY24	FY25	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
	$5.6	0.0	$5.6	Nonrecurring	TRD IT
	$0.3	0.0	$0.3	Nonrecurring	TRD-ASD

Parenthesis ( ) indicate expenditure decreases.

Sources of Information
LFC Files

Responses Received From
Children, Youth and Families Department (CYFD)
Early Childhood Education and Care Department (ECECD)
Taxation and Revenue Department (TRD)

SUMMARY

Synopsis of HHHC Substitute for House Bill 308

House Health and Human Services Committee Substitute for House Bill 308 expands an income tax credit Section 7-2-18.16 NMSA 1978 for the adoption of a special needs child.

- For currently qualifying special needs adoptions, the credit is increased from $1,000 to $1,500. The credit may persist under some circumstances for children over 18.

- Beginning with adoptions after January 1, 2023, the credit for adoption of a special needs child is increased from $1,000 to $7,000 for the tax year of the adoption. The definition of "special needs child" is unchanged.

Two new adoption credits are proposed:
- For current adoptions of a non-special needs child, the credit would be $1,000 and the credit would expire when the child turns 18.
- For adoptions of a non-special needs child after January 1, 2023, the credit will be $5,000 for the tax year of the adoption.

In all cases, the credit is limited to non-stepparent adoptions.

The state credit may be claimed as long as the child is claimed as a dependent for federal income tax purposes. (Note: there is no longer a dependent deduction in the federal code. It has been supplanted by a child credit, which is means-tested, with a limit of $200 thousand in taxable income for single filers or $400 thousand for couples filing a joint return).

This tax credit continues until the child turns 18. For the regular adoption portion of the bill, all adopted children of any age under 18 years would be eligible for their parents to claim the $1,000 refundable credit.

Other changes include:
- Section 1E replaces "a husband and wife" with "married individuals."
- Section 1F establishes reporting requirements by the taxpayer.
- Section 1G establishes reporting requirements by the department.
- Section 1H(1) further limits the definition of "child" as an individual under the age of 18 who is a resident of New Mexico at the time of the adoption.
- The definition of a "special needs child" remains the same as in current statute, applicable to individuals of any age who meet other requirements.

This bill does not contain an effective date, and as a result, would go into effect June 16, 2023, (90 days after the Legislature adjourns) if signed. The provisions of the bill apply to tax years beginning on or after January 1, 2023, affecting FY24 revenues.

FISCAL IMPLICATIONS

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.

This credit was first passed in 2007 and the amount has not been adjusted since.

The data sources for the special needs adoptions portion of this bill are the 2018, 2019-20, 2021, and 2022 editions of TRD's *Tax Expenditure Report*. The credit has been quite stable since 2017 and shows a slight decline in the number of claims. This, however, may be attributed to late filing.

Fiscal Year	2017	2018	2019	2020	2021	2022
# Claims	1,013	1,026	1,097	1,081	985	907
Credit ($1,000)	$1,826	$1,861	$2,022	$1,985	$1,767	$1,592
Avg Amount per claim	$1,803	$1,814	$1,843	$1,836	$1,794	$1,755

The special needs adoption credit amount for current claimants is increased from $1,000 to $1,500 in this bill and is applicable for the 2023 tax year. Returns for the 2023 tax year are due in April 2024 and will affect FY24 revenues. The estimate on the first line in the Fiscal Impact Table is an average of historical amounts increased by a factor of 50 percent, after subtracting the current cost of the credit. Because of the increases proposed in this bill, the $1,500 credit will gradually phase out for new special needs adoptions.

Estimating the other provision of the bill is somewhat more difficult. The *Tax Expenditure Report* indicates that a stable 1,800 children qualify their parents for the $1,000 refundable special needs adoption credit. However, CYFD data implies that at least half of taxpayers who could qualify for this credit do not claim it.

CYFD indicates that during calendar years 2019 through 2022, a total of 1,329 children were adopted out of foster care. Overall, 87 percent of children receiving an adoption subsidy in any given month (for September 2022, the total number of children receiving an adoption subsidy was 3,895) have a determination of special needs as determined by the federal guidelines of the Fostering Connections Act.

These data indicate that about 330 children a year are adopted out of foster care and 87 percent of these adoptees qualify for the current credit.

According to the adoption network[1], about 135 thousand children are adopted in the United States each year. Of non-stepparent adoptions, about 59 percent are from the child welfare (or foster) system, 26 percent are from other countries, and 15 percent are voluntarily relinquished American babies. Sixty-two percent of children were placed with their adoptive families within a month of birth.

Since neither foreign adoptions nor stepparent adoptions would be covered by the provisions of this bill, we can infer that about 560 qualifying adoptions are done each year and 290 would qualify as special needs kids. That implies 270 new nonspecial needs children would be adopted each year after January 1, 2023.

	FY23	FY24	FY25	FY26	FY27
Increase from $1,000 to $1,500 current S.N.		(900.0)	(900.0)	(900.0)	(900.0)
S.N. Adoptions after 1/1/23 -- $7,000 but only for one year		(2,030.0)	(2,030.0)	(2,030.0)	(2,030.0)
Current regular adoptions total $1,000		(2,030.0)	(2,030.0)	(2,030.0)	(2,030.0)
Regular Adoptions after 1/1/23 -- $5,000 but only for one year		(640.0)	(640.0)	(640.0)	(640.0)
Total		(5,600.0)	(5,600.0)	(5,600.0)	(5,600.0)

The credit is refundable. The purpose of this credit may be to incentivize regular adoptions. A child adopted at birth would generate $2,300 thousand in adoption credits over the period

[1] https://adoptionnetwork.com/adoption-myths-facts/domestic-us-statistics/

in which the child qualified the parents for the tax credit. According to the Washington Post, the average cost of raising a child from birth to 18 is currently estimated to cost $310,605. The credit would, on average cover less than one percent of the total cost.

TRD also estimated the fiscal impact of this bill and came up with a smaller impact than did LFC. This lesser impact is shown as the smaller impact on the General Fund total line on the table on page 1:

> TRD used the average number of current special needs adopted child credit claims spanning FY2019 – FY2022, as reported in the 2022 Tax Expenditure Report[2], to calculate the revenue loss that results from increasing the current tax credit from $1,000 to $1,500. Data from the Adoption and Foster Care Analysis and Reporting System from the U.S. Department of Health and Human Services indicate that since FY2012, almost 100 percent of adopted children in New Mexico have been classified as special needs.[3,4] To qualify for the special needs credit the adoption would need still need to meet the definition in the statute of being certified by the Children, Youth and Families Department (CYFD) as a special needs adopted child. TRD assumes though that these adoptions would meet CYFD certification. To account for the first taxable year credit of $7,000, TRD used the average number of adoptions between FY2019 – FY2021 to estimate the fiscal impact of new adoptions for each fiscal year. This average number is assumed to be constant throughout the analysis. Considering that since FY2012, 100 percent of the adoptions are special needs, it is reasonable to conclude that the law enacted in 2007 incentivized the adoption of special needs children. This suggests that taxpayers might respond equally to the new credit for non-special needs children. TRD cannot anticipate how many non-special needs children will be adopted in response to this new incentive, but it can be expected an even further impact on the general fund.

SIGNIFICANT ISSUES

CYFD notes:

> This bill will benefit families adopting children because it will further increase resources available to them for their commitment to providing permanency for children and youth. Also, by producing an annual report, Tax and Revenue will provide CYFD with a valuable resource for monitoring the successes of placing children for adoption, which would further validate the importance of having this resource available for adoptive parents and their families. This bill also supports CYFD's efforts to recruit, retain, and support resource parents because it would help adoptive parents with unexpected costs due to the child's needs.
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> This bill does not differentiate between public and private adoptions of children without special needs.

Although quoting old data, the State Policy Advocacy and Reform Center (SPARC)[5] indicates 353 children were adopted from foster care in New Mexico in 2012. Another 838

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[2] New Mexico Taxation and Revenue Department, 2022 Tax Expenditure Report, https://www.tax.newmexico.gov/forms-publications/, 2022.

[3] https://www.acf.hhs.gov/sites/default/files/documents/cb/special_needs2012_2016.pdf

[4] https://www.acf.hhs.gov/cb/report/trends-foster-care-adoption

[5] http://childwelfaresparc.org/wp-content/uploads/2015/02/New-Mexico-ADOPTION-FACTS.pdf

children in foster care in New Mexico were waiting to be adopted. Adoption provides children with a lifetime of emotional and legal connections to a family. For children waiting to be adopted in New Mexico in 2012, the average stay in care was 2.4 years (28.8 months). On average, children who were adopted in 2012 spent 2.8 years (33.8 months) in care before the adoption was finalized.

TRD notes the following policy issues:

> The increase to the special needs adopted tax credit and the creation of a new credit for adopting other children will erode horizontal equity in the state income taxes. By basing the credit on the number of qualifying children, taxpayers with the same level of income are no longer treated equally. Thus, two New Mexico residents who earn the same salary may have different tax liability given the number of children they adopt.
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> However, the special needs adopted tax credit provides economic aid to families whose adopted children may require specialized long-term care and supports them remaining in a family setting. In addition, as the definition of special needs adopted child includes "difficult to place child", this credit may incentivize more individuals to adopt children who need more specialized attention as these attributes tend to lower the probability of adoption. The credit amount has not been increased since it was enacted in 2007, thus the increase to $1,500 from $1,000 per child, with the first-year expansion to $7,000, provides inflation relief for the cost of raising these children. As well as being a moral good, keeping special needs children in a family setting may reduce social costs over the long-term by reducing social, economic, and psychological problems that children who remain unadopted, or in foster care, may experience.
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> There remains, however, a policy issue with adding a new tax credit for an adopted child who is not a special needs child. This new tax credit increases the number of choices for taxpayers, which might affect the adoption rate of special needs children. While this new credit may increase aggregate rates of adoptions, it may also entice potential parents to pursue adoption generally and feel discouraged from adopting children with special needs. The bill adds a new choice for taxpayers by including children with no special needs, and the proposed incentives may not outweigh potential parents' desires for young and healthy children. Since the difference between credits is just $2,000 for the first fiscal year and $500 onwards, foster parents might consider the difference is not worth the added cost of adopting a child who needs more specialized attention. Tax policy is a mechanism designed to motivate a concrete behavior in taxpayers, and in order to do so, it must reduce the number of choices given. In this regard, if this bill's aim is, for example, to increase the number of adoptions of special needs children, it should exclude adoptions of other children. If, instead, the aim is to increment overall adoptions, there should be only one credit without distinctions among children, which would reduce the administration costs for TRD.
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> TRD could not find any justification for two different credits; one for the first fiscal year and one for all other taxable years. Besides adding complexities to the tax code, this may add complexity for taxpayers' financial planning, as they may be unaware they will lose the higher tax credit following the first year, and expect the high first-year tax credit for all taxable years.

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 credit and other information to determine whether the credit is meeting its purpose.

CYFD has performance measurements concerning placement stability for children, which may be positively affected by this bill.

ADMINISTRATIVE IMPLICATIONS

For TRD notes a minimal administrative impact:

> TRD will need to update forms, instructions, and publications and make information system changes. This bill will have an impact on TRD's Information Technology Division (ITD) of approximately one month and a half for an estimated staff workload cost of $11,108. TRD's Administrative Services Division (ASD) anticipates this bill will require one existing FTE, and eight hours to perform testing of the system changes with a cost of $500.

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

The provisions of this bill relate to and conflict with SB277. SB277 also amends Section 7-2-18.16 NMSA 1978 and increases the special needs adopted child tax credit from $1,000 to $1,500. SB277 similarly changes "husband and wife" to "married individuals," and implements reporting requirements for the taxpayer and the department.

TECHNICAL ISSUES

TRD notes the following technical issues:

> Under subsection H., TRD suggests the following definition of "dependent" be added to clarify this credit, "As used in this section, "dependent" means" dependent" as defined in Section 152 of the Internal Revenue Code." On page 2, lines 14 and 15, then delete after dependent, 'for federal taxation purposes by the taxpayer.'
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> The definition of a "child" as under the age of eighteen while the definition of a "special needs adopted child" specially states they may be over eighteen years of age may cause confusion as "child" is used in both definitions and "child" is then used to refer to both types of adoptions under page 2, subsection C., line 13. Subsection C, states an adopted child tax credit may be claimed for each tax year the child may be claimed as a dependent. The definition of a "child" then contradicts that by the age limitation, as individuals over eighteen years of age may still be claimed as a dependent.
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> The definition of "child" under subsection H. states that the child must be a resident of New Mexico at the time of adoption. Nonetheless, the definition of "special needs adopted child" does not include that restriction, and therefore special needs adopted child tax credit can be claimed by non-residents who report nominal income to receive the credit. Hence, this rebate could be for children who do not reside in New Mexico. Adding language that requires the credit to be apportioned or available only for adopted special needs children who reside in New Mexico would prevent non-residents who do not have income in New Mexico from filing for the tax credit while not allocating or apportioning income to New Mexico.

The awarded amount for credits on or after January 1, 2023, allows a credit of $7,000 or $5,000. For adoptions before January 1, 2023, the tax credit amount is $1,000 or now $1,500 if the child is special needs. This will require separate tracking going forward, which may confuse taxpayers claiming the credit and add complexity to software development. Further, the credit will need to be verified and may result in more suspended returns or disallowed credits if the adoption type is unclear or adoption paperwork is not sent in with the return.

OTHER SUBSTANTIVE ISSUES

TRD notes the following:

It is not clear what the intent for excluding taxpayers who adopt their spouse's child for eligibility of the tax credit as implied by the proposed new statute language on page 2, lines 1 through 3. The Internal Revenue Service (IRS) allows deductions for adoption expenses on Form 8839 for federal income taxes. The eligibility states that qualified adoption expenses do not include expenses that a taxpayer pays to adopt the child of the taxpayer's spouse. If the bill intends to mirror the similar approach by the IRS, TRD suggests referring to federal language on the adoption tax credit.

The adoption date determines how much the taxpayer is eligible for, along with certification from CYFD or another adoption agency providing a special needs adoption certificate. While this can be verified with CYFD for children adopted in New Mexico, it is not as easy to get a certificate for a child adopted in another state or a foreign country.

POSSIBLE QUESTIONS

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	?	The special needs adoption provision has been in statute since 2007. The credit for all adoptions has not been discussed.
Targeted Clearly stated purpose Long-term goals Measurable targets	 ✗ ✗ ✗	The ultimate general fund cost is surprising and may be an example of "buying the base."
Transparent	✓	The credit will increase data concerning adoptions and those awaiting adoption.
Accountable Public analysis Expiration date	 ✗ ✗	With an expiration date, the legislature could determine if this mechanism is effective in increasing the numbers of adoptions.
Effective Fulfills stated purpose Passes "but for" test	 ✗ ✗	
Efficient	✗	
Key: ✓ Met ✗ Not Met ? Unclear		

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