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FISCAL IMPACT REPORT

ORIGINAL DATE 2/9/15

SPONSOR Candelaria, J **LAST UPDATED** 2/23/15 **HB** _____

SHORT TITLE NM Family Act For Family & Medical Leave **SB** 375

ANALYST Graeser

APPROPRIATION (dollars in thousands)

Appropriation					Recurring or Nonrecurring	Fund Affected
FY15	FY16	FY17	FY18	FY19		
	\$1,000.0	0	0	0	Nonrecurring	General Fund
		**	**	**	Recurring	Family and Medical Leave Compensation Fund

(Parenthesis () indicate expenditure decreases)

** First year funding would be general fund and devoted to rulemaking and administration, as well as to make compensation payments. However, the appropriation and the rulemaking authority are effective July 1, 2015, while the PIT and CIT supplemental taxes and the compensation fund payments are effective July 1, 2018. This will affect PIT liabilities beginning with the 2018 Tax Year filing in April, 2019 (FY2018) and CIT liabilities nominally due March 2019, but more realistically, September 2019 (FY 2020). Beginning on these dates, the proceeds of the supplemental income surtax will be deposited in the Family and Medical Leave Compensation Fund and appropriated to the Department of Workforce Solutions for expenditure. It is unknown whether the supplemental tax will be adequate to fund all of the demand for these funds.

REVENUE (dollars in thousands)

Estimated Revenue				Recurring or Nonrecurring	Fund Affected
FY15 – FY 18	FY19	FY 20	FY21		
0.0	(\$140.0)	(\$280.0)	(\$290.0)	Recurring	General Fund PIT
		(\$180.0)	(\$180.0)	Recurring	General Fund CIT
0.0	\$34,710	\$72,910	\$74,490.0	Recurring	Family and Medical Leave Compensation Fund – PIT
		\$6,260.0	\$6,260.0	Recurring	FMLC Fund -- CIT

(Parenthesis () indicate revenue decreases)

The estimates above do not include the positive revenue impact to the general fund from personal income tax imposed on the payments from the FMLC Fund to individuals. This would offset a relatively small portion of the taxes imposed. Note that the average PIT rate imposed on these payments would be less than 4.8 percent.

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY15	FY16	FY17	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
Total	0	**	**	**	Nonrecurring	DWS Operating

(Parenthesis () indicate expenditure decreases)

Note: the \$1 million appropriation does not revert. Also, DWS estimates the three-year cost would be \$25,200 with a subsequent, annual recurring cost of \$4,600.

SOURCES OF INFORMATION

LFC Files

Responses Received From

- State Treasurer’s Office (STO)
- Attorney General’s Office (AGO)
- Workforce Solutions Department (WSD)
- Taxation and Revenue Department (TRD)

SUMMARY

Synopsis of Bill

Senate Bill 375 proposes the New Mexico Family Act. This act piggybacks on the 1993 federal Family Medical Leave Act. It allows employees to request unpaid medical leave in order to take time away from work for their own serious health issues, to provide physical or mental health care for family members who cannot care for themselves or to provide care for and bond with a newborn or newly adopted minor child by providing the right to take unpaid family and medical leave. Once granted leave, the employee’s job is protected. The employee must be offered a position equal to or equivalent to the one the employee had before taking the leave.

An important feature of this bill is that it allows these workers taking leave to receive a reasonable level of compensation during unpaid time away from work. The level of this compensation would be similar to that of unemployment compensation.

This compensation is funded by a .2 percent income tax applicable to all taxable income under the Income Tax Act and all taxable corporate income under the Corporate Income Tax Act in the state. These tax levies are partially offset by a deduction from net income equal to fifty percent of the medical and family leave income tax liability. Net revenues from these taxes shall be distributed to the Family and Medical Leave Compensation Fund.

The bill provides for a state Unpaid Family and Medical Leave Program to be administered by the WSD. For the first year, the bill appropriates \$1 million for expenditure in FY2016 and sub-

sequent years to implement the act's provisions – particularly rulemaking and designing the administrative procedures. After the effective dates, the supplemental tax is assumed to be adequate to fund all of the requested family leave amounts.

The effective date of the most of the provisions of this bill is July 1, 2018, with the supplemental tax imposed for half of tax year 2018. (TRD is authorized under the Income Tax Withholding Act to publish withholding tables that can be adjusted to include this supplemental tax. However, there is no comparable mechanism to accelerate the first year corporate income tax payments to include this supplemental tax. There is no explicit provision for a withholding tax.) There is no sunset date. The LFC recommends adding a sunset date.

FISCAL IMPLICATIONS

The supplemental income tax is imposed on all individuals, partnerships, Sub-S corporations in section 12. The tax is imposed on business income of non-resident individuals, so the tax base is identical to that of the regular income tax.

The supplemental corporate income tax is imposed on the net income of all corporations. The regular UDITPA allocation and apportionment rules would apply.

TRD may have some difficulty designing a form to be used for taxpayers who qualify for an income tax deduction of 50 percent of the FMLA supplemental tax. Section 13 A has the following instruction:

“A. A taxpayer that is a business and that has a family and medical income tax liability may claim a deduction from net income in an amount equal to fifty percent of what that liability would be if not for the deduction pursuant to this section [creating the deduction].

Consider the following example for an individual that is a business:

Assume taxable income pre FMLA supplemental tax = \$150,000

Regular personal income tax = \$6,942

.2 percent of TI surtax = \$300

Which creates a deduction from taxable income of \$150.

The post FMLA taxable income = \$149,850

And the recalculated regular tax = \$6,934.65

Thus, the total liability is $\$300 + \$6,934.65 = \$7,234.65$

The negative General Fund impact would be $-\$7.35$

And the positive impact for the FMLA fund would be \$300

The problem may be that there is no way of determining from the state income tax return – PIT-1 – whether a taxpayer is a business, eligible for the deduction, or not a business and therefore not eligible for a deduction. The error rate will be quite high. Fortunately, the value of the deduction will be quite small.

The intent of sections 12 and 13 for the income tax act and sections 14 and 15 for corporate income tax are clear, however, there may be a technical defect in the business deduction. However, since the intent is clear, TRD may choose to promulgate regulations to forestall any abuse of this deduction.

This bill may be counter to the LFC tax policy principles of adequacy, efficiency, accountability and equity. Due to the increasing cost of tax expenditures revenues may be insufficient to cover growing recurring appropriations. However, the deduction creates a very small negative general fund impact. Unless there is widespread abuse, the general fund impact can almost be ignored.

Estimating the cost of tax expenditures is difficult. Confidentiality requirements surrounding certain taxpayer information create uncertainty, and analysts must frequently interpret third-party data 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. A combination of HIPPA and other federal privacy laws along with the Federal Transmitted Information Act will also inhibit full disclosure of the costs of this program.

WSD is quite concerned about the administrative costs of administering this program and has submitted a calculation to sustain the following estimate:

SB 375 entails a significant fiscal impact to the general fund which will far exceed the \$1 million appropriation set forth in the bill. Initial costs for construct, test, and launch of a system capable of administering the Act's complex and new compensation program are estimated at \$11.4 million. In addition to the initial cost, the system will require yearly system maintenance and system enhancement at an estimated cost of \$1.4 million.

Administration of the program would necessitate additional staffing at an estimated annual cost of \$3.2 million. This amount includes additional salaries, benefits, and facilities. NMDWS' current state owned facility would not accommodate the necessary staffing which would require new lease space.

The total estimated three-year cost is \$25.2 million with a subsequent, annually recurring cost of \$4.6 million.

SIGNIFICANT ISSUES

WSD has provided the following analysis of significant issues involved in implementing the provisions of this bill:

“Although SB 375 borrows terminology from the Family Medical Leave Act (FMLA), it leaves significant issues to NMDWS rulemaking. The bill, however, does not offer guidance on important questions that would impact rulemaking and administration of the program. For example, unlike FMLA, SB 375 does not have any accrual provisions. By its terms, a worker appears to be entitled to twelve weeks of leave per twelve month period, but need not to have worked any minimum amount of time with the employer before being eligible for the leave. SB 375 does not give NMDWS discretion to impose an accrual or time requirement for the leave provisions. Such requirements, however, are important in the context of government mandated leave programs because they help offset the instability that can be caused when employees take large amounts of leave within a short time period. For similar reasons, FMLA applies only to larger employers (those with fifty or more employees within a certain geographic zone) who can more easily absorb the leave-taking activity. SB 375, on the other hand, purports to govern all employers in New Mexico, including those who have only one employee. Because it applies to even the smallest of employers and does not address issues such as accrual, SB 375 may possibly

impact business operations for some of New Mexico’s smallest employers. SB 375 does not exclude public sector employers, including the State of New Mexico, from the mandatory requirements of the Act. SB 375 does not expressly create a private cause of action against employers who violate the Act, but it might be read to imply one.”

“Likewise, there may be concerns from employers regarding the provisions allowing them to recover health care premiums paid on behalf of individuals who do not return to work. Recovery of these premium amounts may prove to be difficult in some cases.”

“Notably absent from SB 375 are provisions related to fund solvency. NMDWS has expertise in administering a fund designed to pay benefits. Specifically, NMDWS administers the unemployment compensation fund, which is used to pay unemployment benefits. NMDWS uses actuarial principles to assure adequacy of funds to pay the benefits required under federal and state law.”

“SB 375 offers no guidance on the effect of fund insolvency. It does not allow for the suspension of benefits in the absence of adequate funds, and it does not provide an alternative means of meeting benefit obligations when funds run out. At the same time, the law appears to create a vested entitlement to receive compensation for individuals who meet eligibility requirements. The lack of solvency safeguards is compounded because the Act requires the comingling of administrative and benefit funds. The bill does not limit the percentage of the funds available for administration. This comingling will hamper the Department’s ability to apply sound actuarial principles to manage the fund.”

“SB 375 does not address the procedures applicants should follow in the event that they are denied benefits. Because the law sets forth eligibility and certification requirements, negative determinations will occur. No structure is suggested for administrative appeal and review of negative determinations. In addition to negative determinations, areas of dispute may include the correct calculation of the benefit amount. Benefit calculations maybe complex, and SB 375 lacks important guidance on situations such as where applicants have multiple employers within the preceding month, or have no wage history in the preceding month but are otherwise eligible. The bill contains other ambiguities and inconsistencies that could make it difficult during the rule-making proceedings to determine legislative intent regarding benefit amounts. There is no monetary eligibility component to the benefit compensation, and NMDWS cannot impose one in regulation.”

“SB 375 does not state whether compensation received pursuant to this Act is subject to withholding or other tax obligations. If such withholdings apply, NMDWS would have to facilitate those payroll deductions when issuing compensation payments. NMDWS will also be obligated to issue the appropriate tax documents to cover the receipt of compensation under the Act. NMDWS would not have the authority under rule-making to assert tax provisions for compensation received under this Act that the statute does not explicitly authorize.”

“Because of reporting and other provisions in the bill, NMDWS will have to work to assure full compliance with federal privacy laws and with the Federal Transmitted Information Act.”

PERFORMANCE IMPLICATIONS

The LFC tax policy of accountability is probably not met, although TRD is required in the bill to report annually to an interim legislative committee regarding the data compiled from the reports from taxpayers taking the deduction. However, the deduction is a small portion of the overall impact of this legislation. DWS should also be directed to report annually on the number of individuals filing claims for FMLA support and other information to determine whether the tax imposed on personal and corporate income taxpayers is meeting its purpose.

ADMINISTRATIVE IMPLICATIONS

Substantial impact on TRD in order to administer the deduction provisions. This is a new concept that will require substantial reworking of the PIT-1 and all the supporting information systems. The \$1 million appropriation in the bill is directed to WSD. No portion of the additional costs imposed on TRD will be met by the appropriation.

The provisions of the bill will require major administrative support at WSD to administer the applications for FMLA financing – see other portions of this review for a discussion.

TECHNICAL ISSUES

1. The PIT deduction is largely un-administrable. There is no easy means for TRD to determine if a particular taxpayer is a business from the PIT-1 return and therefore eligible for the deduction. The error rate for non-business taxpayers erroneously claiming the deduction will be high.
2. The majority of businesses in the state filing the PIT-1 do not have employees. Presumably, the reason for the deduction is to compensate employers who are somewhat disadvantaged by allowing their employees to take unpaid leave, but who are required to take the employee back at the end of the leave period. However, the non-employer businesses who are not disadvantaged by the FMLA will also benefit from the deduction.
3. Considering the value of the deduction, this provision may be seen as largely a nuisance rather than a benefit.
4. Funds from the surtax should be invested by the state treasurer in like manner to the Local Government Investment Pool or other short-term investment pools, rather than in like manner to the permanent fund. The claims against this fund are likely to exceed the income.
5. WSD points out a number of issues involving solvency of the fund. These should be addressed.
6. WSD points out a number of issues involving protest procedures in the case of denial of benefits. These should be addressed.

This bill does not contain a sunset date. The LFC recommends adding a sunset date.

OTHER SUBSTANTIVE ISSUES

WSD provides the following extended description of the features of this bill.

SB 375 proposes to enact the “New Mexico Family Act.” Under SB 375, employees in New Mexico would be entitled to up to twelve weeks of unpaid leave within a twelve

month period for the birth of a child, the placement of a minor child with the employee for adoption or foster care and the provision of care for the child, the provision of care for a spouse, child, parent, or domestic partner who has a serious health condition, or for a serious health condition that makes the employee unable perform the functions of the employee's position. SB 375 provides certain protections for individuals who take leave pursuant to the Act, including entitlement to be restored to an equivalent position with equivalent pay and benefits after returning from leave. Employers must continue to pay health insurance premiums for workers on leave, but may recover premiums paid for individuals who end up not returning.

SB 375 provides for the creation of a Family Medical Leave Program, which WSD will administer. The program will allow for employees taking leave pursuant to SB 375 to apply for Family Medical Leave Compensation, a daily benefit of an amount determined by WSD. SB 375 requires WSD to calculate the benefit as nine percent of the employee's average weekly wages for the month immediately preceding the first day of unpaid leave. The maximum benefit for a twelve month period is forty-two times the daily benefit. WSD is tasked with making eligibility determinations and with retaining certain records related to administration of the program.

In addition to the leave and benefit provision, SB 375 includes new supplemental personal and corporate income taxes to fund the benefit provision. The personal income tax is imposed at a rate of two-tenths percent on the taxable income of every resident individual and on the taxable income of every non-resident individual employed or engaged in the transaction of business in, into or from this state, or deriving any income from any property or employment within the state. The corporate income tax is similarly assessed at two tenths percent on the net income of every domestic corporation and on every foreign corporation transacting business in New Mexico. Taxpayers that have family medical leave income tax liability may claim a deduction from net income in an amount equal to fifty percent of what liability would be if not for the deduction. Taxpayers are required to report the deduction to WSD. In turn, WSD is required to compile an annual report on the deduction.

The income taxes that SB 375 imposes are directed to the Family and Medical Leave Fund, which the Act also creates. The fund is a non-reverting fund in the state treasury and would be administered by WSD. It would consist of the net revenue attributable to SB 375's income taxes, and any money appropriated or donated. SB 375 appropriates money in the fund to WSD to pay family and medical leave compensation benefits and to administer SB 375. SB 375 appropriates \$1 million to the fund for FY 2016 and for each subsequent fiscal year.