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

		ORIGINAL DATE	02/13/21		
SPONSOR	Sedillo Lopez	**LAST UPDATED**	03/08/21	**HB**	
SHORT TITLE	Paid Time Off Tax Credit			**SB**	300
				ANALYST	Graeser

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY21	**FY22**	**FY23**	**FY24**	**FY25**		
	($40,600.0)	($30,500.0)	($7,600.0)	Indeterminate but negative-	Likely Recurring	General Fund (PIT & CIT)

Parenthesis ( ) indicate revenue decreases

See FISCAL IMPLICATIONS for a discussion of whether the provisions of this bill should be considered recurring or nonrecurring and whether there is an expectation of impacts in FY25 and beyond.

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY21	**FY22**	**FY23**	**3 Year Total Cost**	**Recurring or Nonrecurring**	**Fund Affected**
		$36.2	--	$36.2	Nonrecurring	General Fund
Total		$104.0	$104.0	$208.0	Recurring	General Fund

Parenthesis ( ) indicate expenditure decreases

COMPANION TO: May be companions to HB37 – Sick Leave Act; HB38 – Paid Family & Medical Leave Act; and SB198 Sick Leave Act

SOURCES OF INFORMATION
LFC Files

Responses Received From
Taxation and Revenue Department (TRD)

Responses Not Received From
Workforce Solutions Department (WSD)

SUMMARY

Synopsis of Bill

Senate Bill 300 creates a paid time off tax credit for income tax and corporate income tax for a taxpayer who provides paid time off to employees of the taxpayer, provided the taxpayer employs 12 or fewer employees and the employee earned a wage of $16 or less per hour for the taxable year in which the credit is claimed. The paid time off tax credit shall be allowed for any employer for three consecutive years in an amount equal to the product of an employee's paid time off hours multiplied by the employee's hourly wage, and then further multiplied by 100 percent in the first year, 75 percent in the second year, and 25 percent in the third year. The credit can only be claimed for up to 56 hours of paid time off per year, per employee.

For corporate income tax purposes, the credit is limited to taxable years 2021 through 2023; no such limit applies to the personal income tax credit. The Taxation and Revenue Department (TRD) shall compile an annual report on the tax credit provided by this section that shall include the number of taxpayers approved to receive the tax credit, the aggregate amount of tax credits approved, and any other information necessary to evaluate the tax credit.

There is no effective date of this bill. It is assumed the effective date is 90 days after this session ends. There is no applicability date for bill's credit provisions for the personal income tax. For corporate income tax, the credit is limited to tax years 2021 through 2023.

FISCAL IMPLICATIONS

This bill creates a new 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.

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.

TRD describes the methodology for the estimate revenue impact:

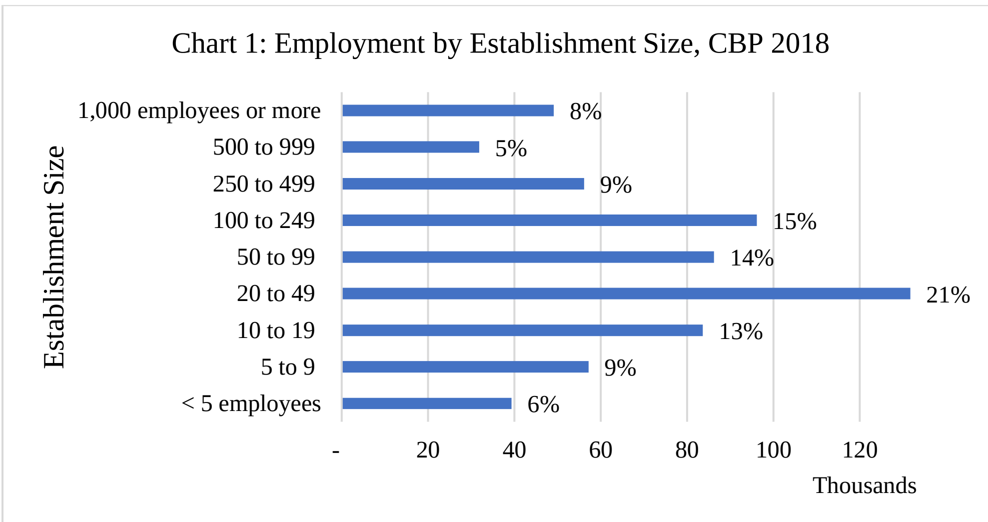
> The estimates presented here are based on data for the state of New Mexico from County Business Patterns (CBP), which is released annually by the United States Census Bureau[1]. CBP provides annual, industry-wide information on the number of establishments with

[1] https://www.census.gov/programs-surveys/cbp/data/tables.html

paid employees, employment during the week of March 12, and annual payroll of those establishments. The latest available CBP data are for the year 2018 and TRD uses these data for the estimation.

According to CBP, 29 percent of employees in New Mexico worked in establishments with fewer than 20 employees. Chart 1 below shows the distribution of employees by establishment size.

TRD used the information on annual payroll and number of employees from CBP to estimate the average hourly wage in New Mexico in each of the 21 industries using the North American Industry Classification System (NAICS), and by establishment size. This information was then used to determine the number of employees whose paid leaves the employers will be eligible to receive credit for.



To compute the revenue impact of the proposed legislation, TRD made the following assumptions:

1) To calculate the total number of employees in establishments with 12 or fewer employees, TRD used 100 percent of the employees reported in the CBP under the “less than 5 employees” and “between 5-9 employees” categories, and 50 percent of the employees under the “10 – 19 employees” category.
2) Employers claim credit for paid leaves were granted to 60 percent of the employees in the low wage industries (that is, industries with average wage of $16 or less) and 40 percent of the employees in all other industries.
3) Average wage of employees for whose paid leaves the employers claim credit for is $11/hour.
4) Employers claim credit for 56 hours (or 7 days) of annual paid vacation hours per employee.
5) The change in state minimum wages, per Section 50-4-22 NMSA 1978, will have no effect on relative employment in low and high wage industries or in average wages across industries.
6) The first year of all claims falls in fiscal year 2022.

LFC staff note the tax credit reimburses the employer 100 percent of the cost of paid time off in the first year, 50 percent in the second year, and 25 percent in the third year. If the mandatory paid sick leave bills do not pass, many employers may take advantage of the first-year credit, then eliminate paid time off in subsequent years. Other employers eligible for the personal income tax credit, including LLCs, Sub-S corporations and partnerships, might delay offering paid time off for a year or two. These possibilities add to the uncertainty of the estimate.

LFC also staff note that apparently this bill is designed to provide employer assistance to ameliorate some of the financial hardships of the Covid-19-related closures and recession. In addition, the lack of an applicability date may encourage some employers who have offered their low-wage employees paid time off in 2020 to apply for this tax credit on tax returns filed for the 2020 tax year, although this bill would not become effective until June 18, 2021. That might require an amended return or the filing of an extension of time to file. The corporate income tax credit clearly establishes that the credit is applicable for the 2021, 2022 and 2023 tax years, so Corporate Income taxpayers could not claim credit for any 2020 paid time off. If one of the paid sick leave bills passes and is implemented, this credit would assist small schedule C-corporations. However, very few firms that employ 12 or fewer workers would find it useful to incorporate as a regular corporation.

The CIT credit sunsets after the 2023 tax year; however, no such sunset is provided for personal income taxpayers. There are a large number of small business pass-through entities (PTEs) that could qualify for this paid time-off credit. These include partnerships, limited liability partnerships (LLPs), Limited liability corporations (LLCs) and subchapter S corporations. Again, depending on if any of the paid sick leave bills passes and the provisions implemented, this tax credit would ease the transition. On the other hand, many sole proprietorships, as well as PTEs, would not have claims the first year of the mandate. The three-year clock apparently would start ticking in the first-year of the claim. Although it is quite impossible to estimate this possibility, it is shown in the table on page 1 as "indeterminate but negative" and probably classified as recurring revenue loss.

The fiscal impact of SB300 would also include costs for TRD to set up data systems and processes. These nonrecurring tasks are estimated to result in $36.2 thousand in one-time costs; however, the recurring impacts could require additional staff, estimated at 2 FTE for a cost of $104 thousand a year. (See "Administrative Implications" below.)

SIGNIFICANT ISSUES

TRD notes the following significant features of this bill:

> Small businesses generally have fewer resources than larger employers in offering employee benefits. The credit provided for in this bill subsidizes the cost to small employers for the provision of paid time off. This may result in more small businesses offering paid time off benefits to employees.
>
> Paid time off may result in better financial as well as health and wellness outcomes for employees and their families. Those without paid time off benefits may be at a higher risk of financial insecurity that results from time taken off of work and may be at a higher risk of a loss of employment as their work schedule is less flexible than those with paid time off.

Benefit packages may impact the job choice of potential employees. If small businesses are able to offer benefits such as paid time off, they may be more competitive in the employment market.

The definition of "wages" in the statute appears to exclude tip income. Employers in the food service industry who employ tipped staff may receive less benefit from this bill than other industries, as tipped workers are paid a regular wage substantially below the regular minimum wage.

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

TRD notes a significant administrative impact of the provisions of this bill and would need to have additional resources provided.

The Information and Technology Division (ITD) of TRD estimates that implementation of the legislation will cost approximately $15.5 thousand in staff workload.

The Revenue and Processing Division (RPD) of TRD will require 2 additional full-time employees (FTE) to administer the program, and $20.7 thousand in staff workload costs for implementation. The FTE costs are based on a Tax Examiner O and a Tax Examiner B.

Estimated Additional Operating Budget Impact*				**Recurring or Nonrecurring****	**Fund(s) or Agency Affected**
FY2021	**FY2022**	**FY2023**	**3 Year Total Cost**		
--	$15.5	--	$15.5	Nonrecurring	TRD – ITD Staff Workload
--	$20.7	--	$20.7	Nonrecurring	TRD – RPD Staff Workload
--	$104	$104	$208	Recurring	TRD – RPD 2 FTE

* In thousands of dollars. Parentheses ( ) indicate a cost saving. ** Recurring (R) or Non-Recurring (NR).

TECHNICAL ISSUES

TRD notes the following technical issues which may require amendment of the bill:

TRD recommends new tax credit statutes indicate how the credit is applied for, certified and how the credit may be claimed. This clarity aids TRD in administering the credit and the taxpayer in knowing what information is needed to submit to support eligibility.

An effective date for this credit is not specified. The effective date is important to designate the beginning certification date for eligible periods.

Section 2 for the corporate income tax credit specifies the taxable years but Section 1 for the income tax credit does not identify taxable years.

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

LG/sb/al