TAXATION & REVENUE

NEW MEXICO

New Mexico 2019 and 2020 Tax Expenditure Report

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What is a Tax Expenditure Report?

- Tax expenditure reports (TER) describe areas where the tax code provides for preferential tax treatment of a certain activity
- The TER includes an estimate of revenue foregone because of the preferential tax treatment due to:
  - Credits
  - Deductions
  - Exemptions
  - Preferential tax rates
- Every dollar of revenue foregone is a dollar that cannot be appropriated or added to reserves
- State appropriations are rigorously evaluated and reprioritized annually; tax expenditures should be similarly revisited
- TER are important transparency tools that allow State policymakers, advocacy groups, and the public an opportunity to regularly evaluate the State's tax code

New Mexico's Tax Expenditure Report

- Annual TER has been produced by TRD since 2012
- This year's report compiles information for two new years: 2019 and 2020
- Follows format that has evolved over time
  - Separately identifies each "deviation" from the tax base
  - Categorizes each deviation as a tax expenditure, non tax expenditure, or "arguable"
  - Provides a description of each expenditure, the statutory reference, purpose, amendment history, estimated cost, evaluation, and recommendations
  - TRD constantly looking to improve cost estimates. Example: for report to be released in December 2020, new federal CMS data is being used to estimate cost of oxygen and oxygen equipment GRT and GGRT deduction
  - Categorizes each expenditure as existing for citizen benefit, economic development, environment, highly-specialized industries, or health care
- Past reports can be found at www.tax.newmexico.gov, then under Forms & Publications, Publications, Tax Expenditure Reports

What’s the Difference? Exclusions

- **Exclusions** – amounts of gross receipts, gross income, or other amount that is removed <u>to define the tax base</u>
  - Taxpayers exclude certain amounts of their “base income” to derive “net income” on which tax is imposed. § 7-2-2(N)
  - The property tax excludes personal property and has a 3% limit on annual value growth on residential property

What's the Difference? Exemptions

- **Exemptions** – often eliminate a taxpayer's obligation to register, report, and/or pay
- TRD does not have visibility into income or receipts that are exempt because they are not reported on a tax return
- Exemptions can hinge on the nature or character of the taxpayer:
  - Insurance companies are exempt from CIT because they pay premium tax
  - Nonprofits and disabled street vendors are exempt from GRT
  - Active duty armed forces salaries and persons over 100 years of age are exempt from PIT
  - Certain disabled military veterans are exempt from motor vehicle excise tax
- Exemptions can hinge on the nature of the transaction:
  - Commercial vehicles operating within 10 miles of the Mexico border are exempt from weight distance tax and trip tax
  - Receipts from sale and use of boats on which motor vehicle excise tax is imposed are exempt from GRT and compensating tax
- Generally, if the exemption is full and applies to the nature of the taxpayer, or if a taxpayer solely engages in exempt transactions, there is no registration or filing obligation

What's the Difference? Deductions

- **Deductions** - reduce liability by eliminating certain transactions or income from amounts taxpayers are required to report on returns
- Deductions and Exemptions have the same effect on a taxpayer's tax liability, but differ in taxpayer reporting obligations
- Deductions lower the tax base before calculating tax due
  - For GRT, taxpayers report a gross amount of receipts, then also show the amount of the deduction to compute taxable gross receipts
  - Some deductions are combined on a return; others are separately reported
  - Many GRT deductions statutorily require the seller to be in possession of a Nontaxable Transaction Certificate (NTTC) or alternative evidence at the time the return is due for the receipts from the transactions or within sixty days of a TRD audit notice
- Examples
  - Back-to-School Tax-Free Weekend GRT receipts deduction
  - 40% capital gains deduction from PIT
  - Food for home consumption GRT deduction
  - Health care practitioner services GRT deduction
  - Sale of prosthetic devices GRT deduction

What’s the Difference? Credits

- **Credits** – are dollar for dollar credits against the taxpayer’s tax liability due
  - Many credits require an application for approval to either TRD or another certifying agency before the credit is allowed
  - Where deductions and exemptions apply to one tax program, credits can offset tax liabilities in several tax programs
  - Credits can be transferrable
  - Credits can be refundable if the amount of the credit exceeds the taxpayer’s tax liability
  - Examples:
    - Angel investment PIT credit
    - Child care to prevent indigency PIT credit
    - Film tax credit against CIT and PIT
    - High-wage jobs credit against modified combined tax
    - Investment credit against GRT, Comp Tax, Withholding
    - Rural health practitioner PIT credit

Baseline System of Taxation

- Any tax program or baseline system of taxation is the application of a “tax rate” multiplied by a “tax base”
  - Common tax bases for New Mexico tax programs:
    - “Gross receipts” from sales of property or services or the “purchase value” of property (GRT/Comp)
    - “Net income” (CIT/PIT)
    - “Taxable value” (Severance-related taxes)
    - A percentage of “fair market value” for locally assessed property taxes
  - “Tax rate” is simply a percentage applied to the tax base

Tax Expenditures Must be a Deviation from the Tax Base

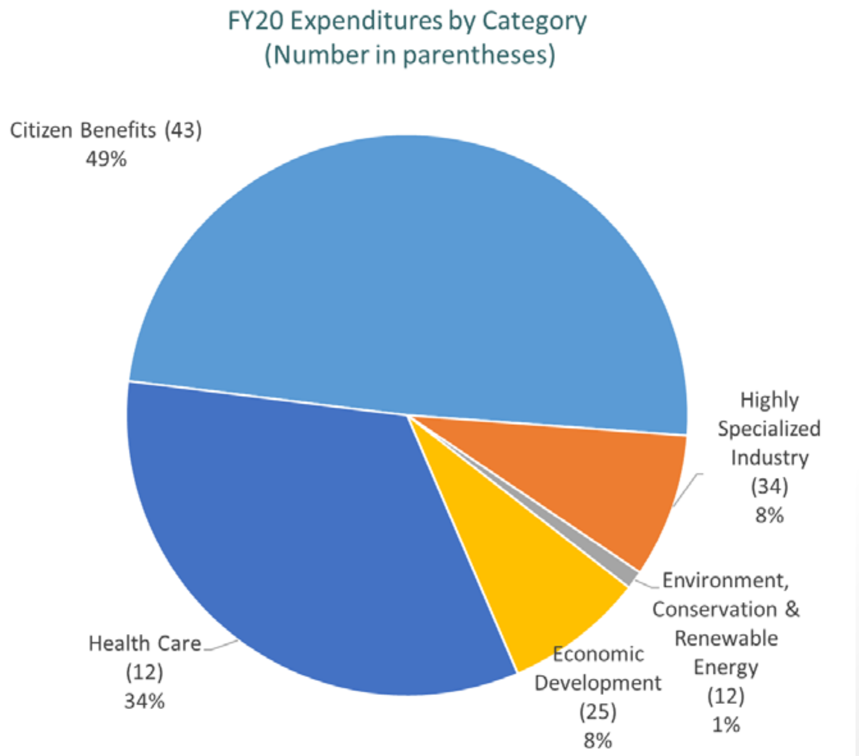
- Exclusions to derive the tax base are not considered deviations and are not considered tax expenditures
- Deviations can occur for many reasons:
  - “In lieu of” taxation
  - US constitutional prohibition or federal pre-emption
  - Government-to-government comity
  - To “true” a tax base – anti-pyramiding, bad debts
  - To provide special or preferential treatment to achieve a policy objective

Tax Expenditures Must Convey Special Treatment

- Special treatment is typically evidenced by a policy choice regarding:
  - Benefitting a subset of the tax base
  - Benefitting a subset of the population or
  - Both
- Policy choices:
  - To benefit all, or a specific subset, of citizens
  - To induce economic development
  - To induce conservation
  - To aid specific industries

Tax Expenditures Categories

- Citizen Benefits: benefit all taxpayers or specific population (low-income, disabled, etc.), lessen the burden of taxation
- Economic Development: stimulate investment, job creation or job retention, attract industries
- Environment, Conservation, and Renewable Energy: support environmental health, promote conservation and renewable energy
- Health Care: increase access to or lower costs of health care
- Highly Specialized Industries: target specific or highly specialized industries



Expenditure Estimates – Data Reliability (2019-2020)

- The estimated revenue foregone should be evaluated in conjunction with reliability factor
- Reliability depends on data available to TRD
  - Exemptions that are not reported will have low reliability
  - Deductions that are separately reported (21) will have higher reliability than deductions that are reported together
  - Credits have high reliability

Reliability Factor	Description	No. of Expenditures
1	Most reliable. No estimation	68
2	Estimated from GenTax data	19
3	Estimated from national data	16
4	Least reliable. Estimated from limited data	9
Unknown	No data available	15

New Additions in the 2019-2020 Report

Expenditures	Legislative Session	Amount ($000's) (Local and State)
Foster Youth Employment credit against PIT and CIT	2018	$0
Small Business Saturday Thanksgiving Weekend deduction from GRT	2018	$2.1
Future Distribution to a Nonresident Beneficiary deduction from PIT	2019	$266
Durable medical supplies deduction from GRT	2014, 2020 –extended	$1,140

Not Tax Expenditures	Legislative Session
Exemptions from the Insurance Premium Tax	2018
Medical Insurance Pool Assessments credit against Insurance Premium Tax	2018
Dependent deduction from PIT for certain dependents (* fiscal impact reported)	2019
Large Health Care Facility exemption from Health Care Quality Surcharge	2019
Nonprofit Hospital exemption from local GRT	2019
Marketplace Seller deduction from GRT and GGRT	2019, 2020 – GGRT

Top Ten Expenditures by Cost: 2019 and 2020

Name	2019 ($000's)	2019 Rank	2020 ($000's)	2020 Rank	
Sale of Food at Retail Food Stores GRT Deduction and Hold Harmless Distribution	369,200	1	599,700	1	1
DOH-Licensed Hospitals Sixty Percent GRT Deduction	90,420	4	215,106	2	2
Prescription Drugs and Oxygen GRT and GGRT Deduction	175,600	2	173,600	3	3
Working Families Credit against PIT	49,904	7	83,408	4	1
Health Care Practitioner Services GRT Deduction and Hold Harmless Distribution	57,700	6	56,600	5	1
Film and Television Credit against PIT and CIT	148,200	3	55,596	6	1
Nonprofit Organizations Exemption from GRT	47,892	8	49,118	7	4
Capital Gain Deduction From PIT	75,303	5	41,226	8	1
Apportionment Election for CIT Manufacturers	29,371	9	34,643	9	2
Low- and Middle-Income Taxpayers Exemption from PIT	23,552	10	18,872	10	1

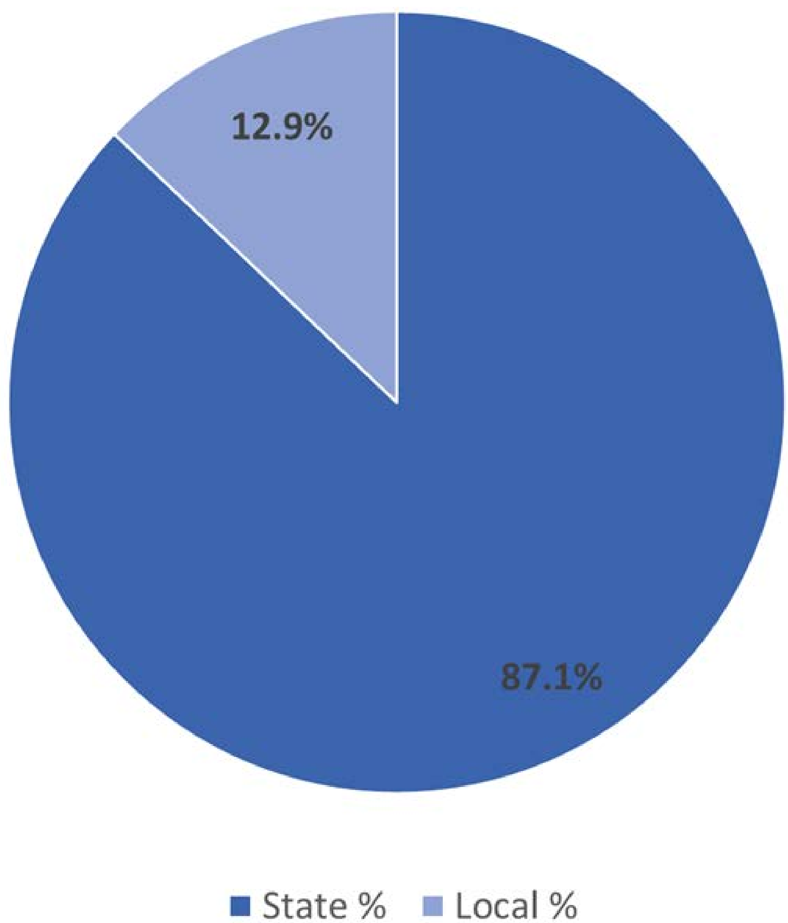
Redacted Expenditures in Most Recent Fiscal Year (fewer than 3 taxpayers) (2020)

Name
Aircraft Sales or Services GRT Deduction
Alternative Energy Product Manufacturers Credit Against Modified Combined Tax
Biodiesel Blending Facility Tax Thirty Percent Credit Against GRT and Compensating Tax
Military Transformational Acquisition Programs GRT Deduction
Uranium Hexafluoride and Uranium Enrichment GRT Deduction
Job Mentorship Credit against PIT and CIT (2018)

Tax Expenditure Incidence

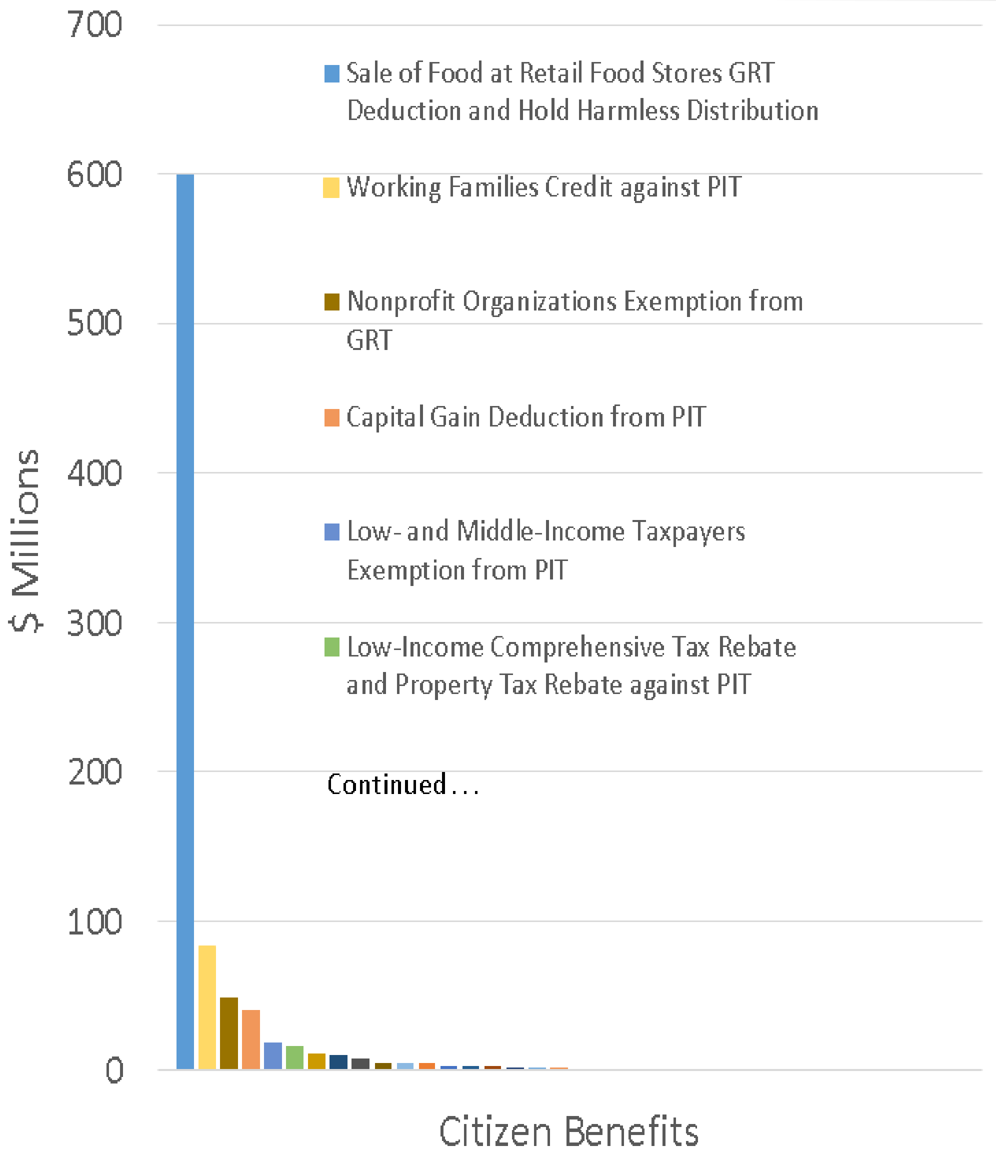
- GRT incidence for deductions and exemptions is shared between the State General Fund and local governments in most cases
- Tax expenditures for CIT, PIT, etc., generally impact only State General Fund directly

FISCAL YEAR 2020 EXPENDITURES BY STATE AND LOCAL TAX INCIDENCE



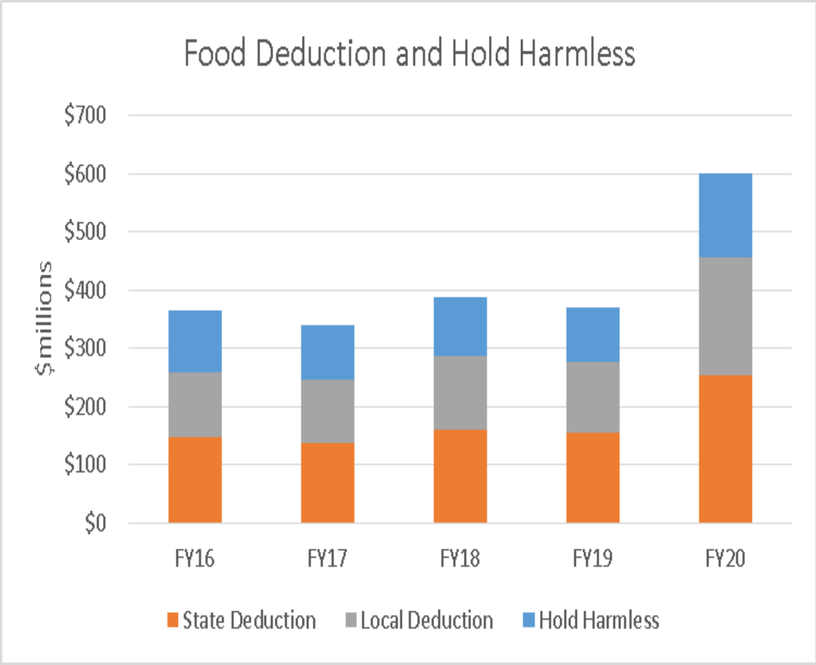
Citizen Benefits

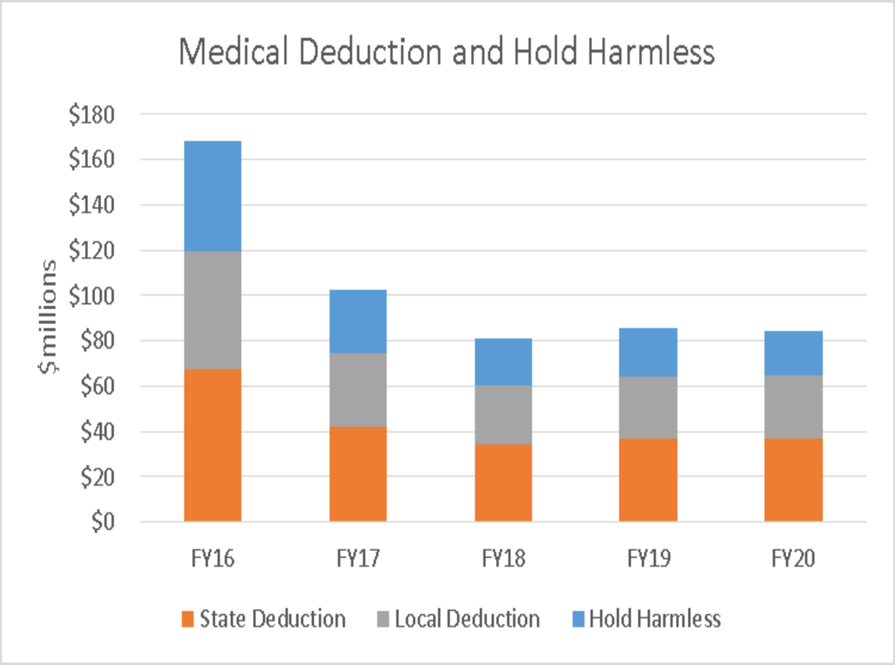
- Represent the largest share of tax expenditures in FY20 - 49%
- The largest reported contributor is the Food Deduction and Hold Harmless Distribution
  - Broadest citizen benefit as well
- Working Families Tax Credit increased to second with increase from 10% to 17% of federal EITC
- 43 Expenditures in this category
  - 4 with $0 fiscal impact
  - 6 with unknown costs
  - 1 with redacted reporting



Citizen Benefits : Food & Medical GRT Deductions

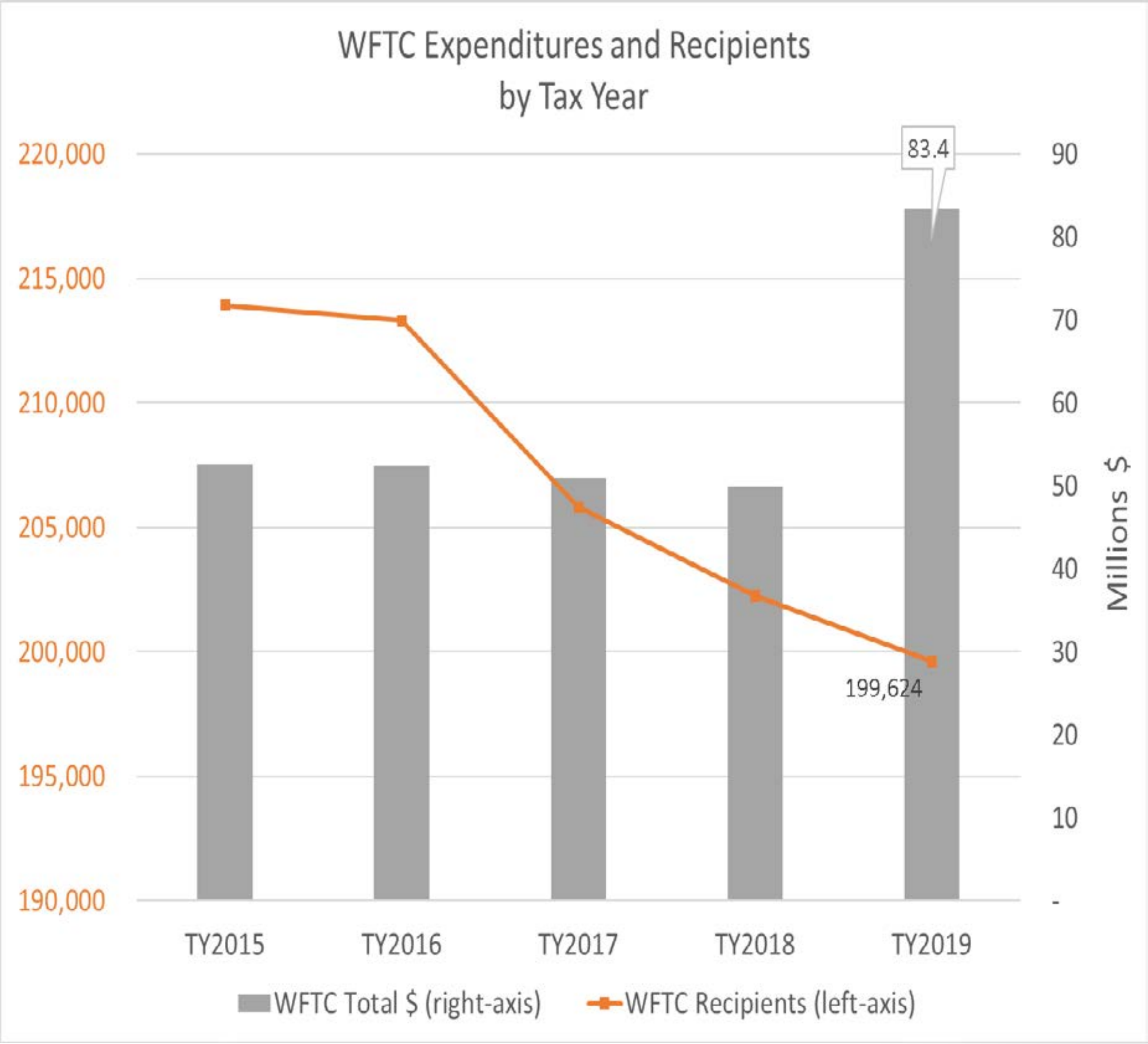
- GRT Deductions enacted in 2004 to reduce the cost of food and medical services
- Hold harmless provisions offset foregone local tax revenue as a result of the deductions
- 2013 legislation began a phase-out of the hold harmless payments to certain local governments scheduled to end in 2030
- Large food deduction in FY20 result from a taxpayer submitting 3 years of amended returns
- Large medical deduction in FY16 relates to HealthSouth decision; statute was subsequently amended





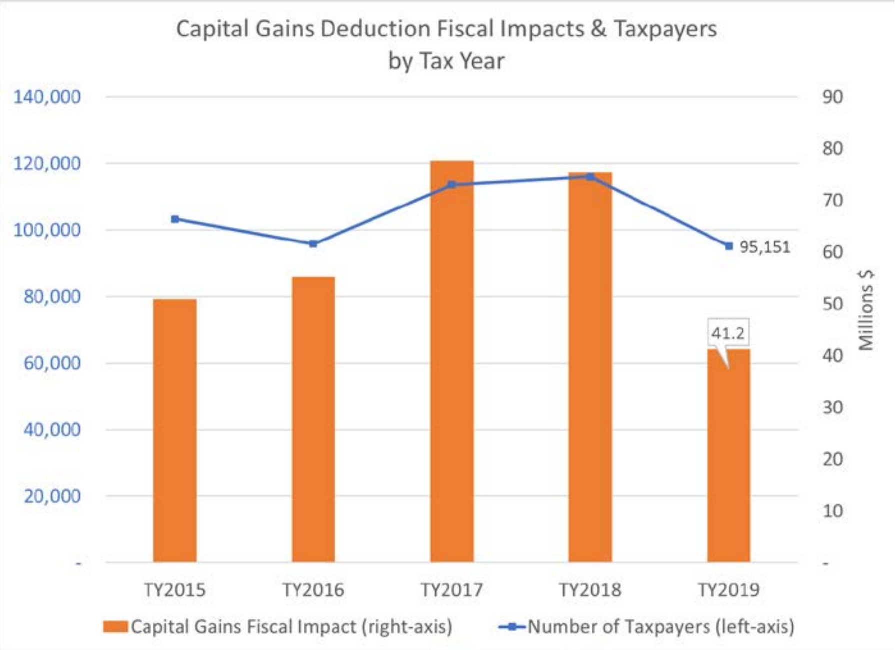
Citizen Benefits: Working Families Tax Credit in PIT

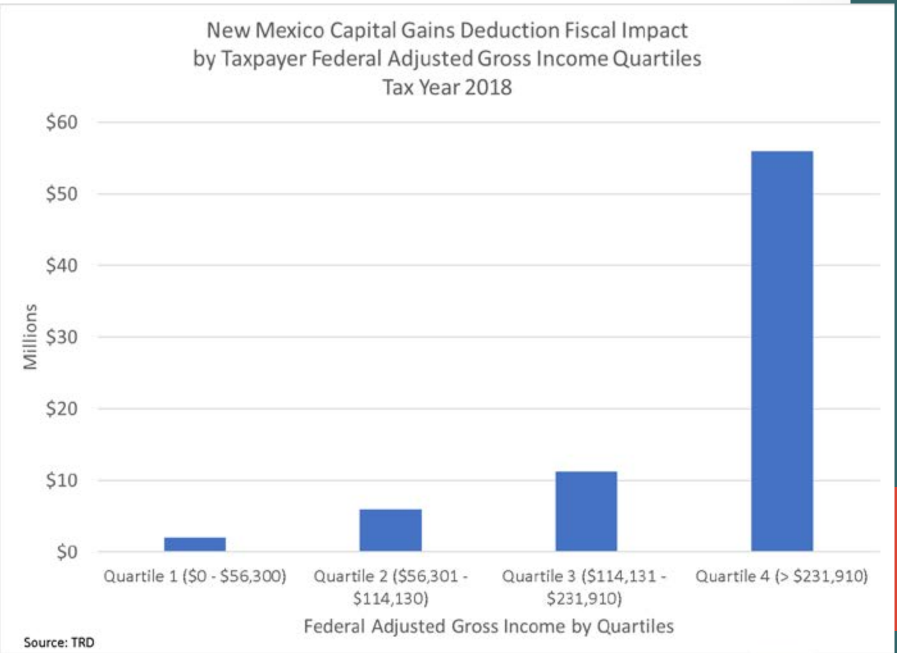
- Refundable PIT credit for about 200,000 New Mexico families each year
- In 2019, HB6 increased the size of the WFTC from 10% to 17% of the federal EITC
- In 2019, the average family's refundable WFTC increased from $245 to $420 per year



Citizen Benefits: Capital Gains Deduction

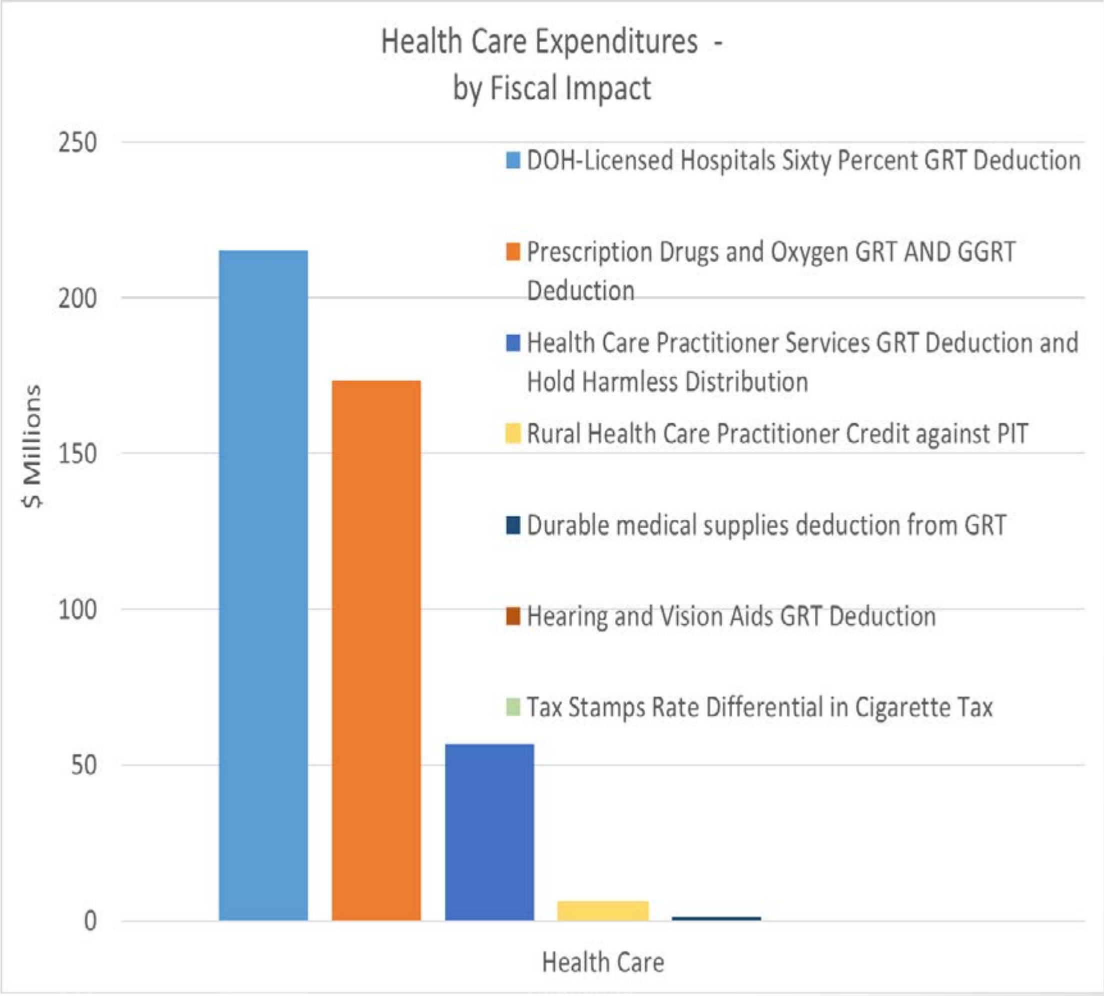
- Capital gains deduction previously allowed taxpayers to deduct the greater of $1,000 or 50% of the taxpayer's net capital gain income for the taxable year
- Effective tax year 2019, threshold reduced from 50% to 40%
- Claimed by about 105,000 tax filers per year
- In tax year 2018, about $56 million of the $75 million claimed went to top 25% earning taxpayers





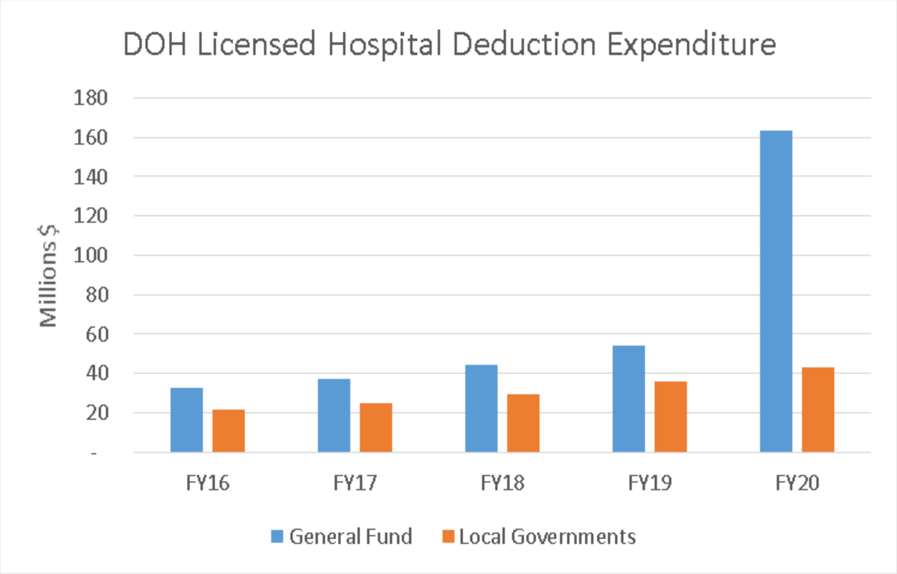
Health Care

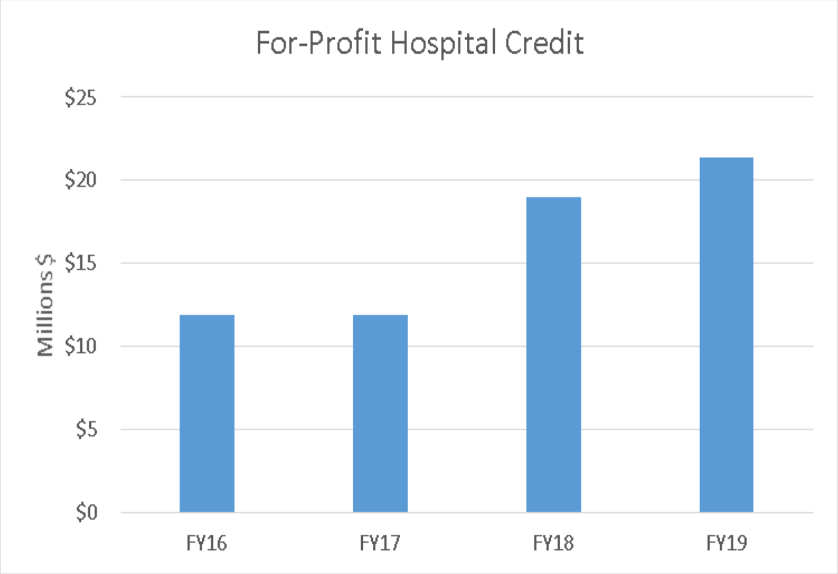
- Represents the second largest share of the fiscal impact in FY20 - 34%
- The largest contributor is the DOH-Licensed Hospitals 60 % GRT Deduction from GRT at $215 million
- Of the 12 expenditures, 7 have a current FY20 fiscal impact (shown in graph)
  - 5 have $0 fiscal impact
  - 0 with unknown costs
  - 0 with redacted reporting



Health Care: Hospital GRT Deductions & Credits

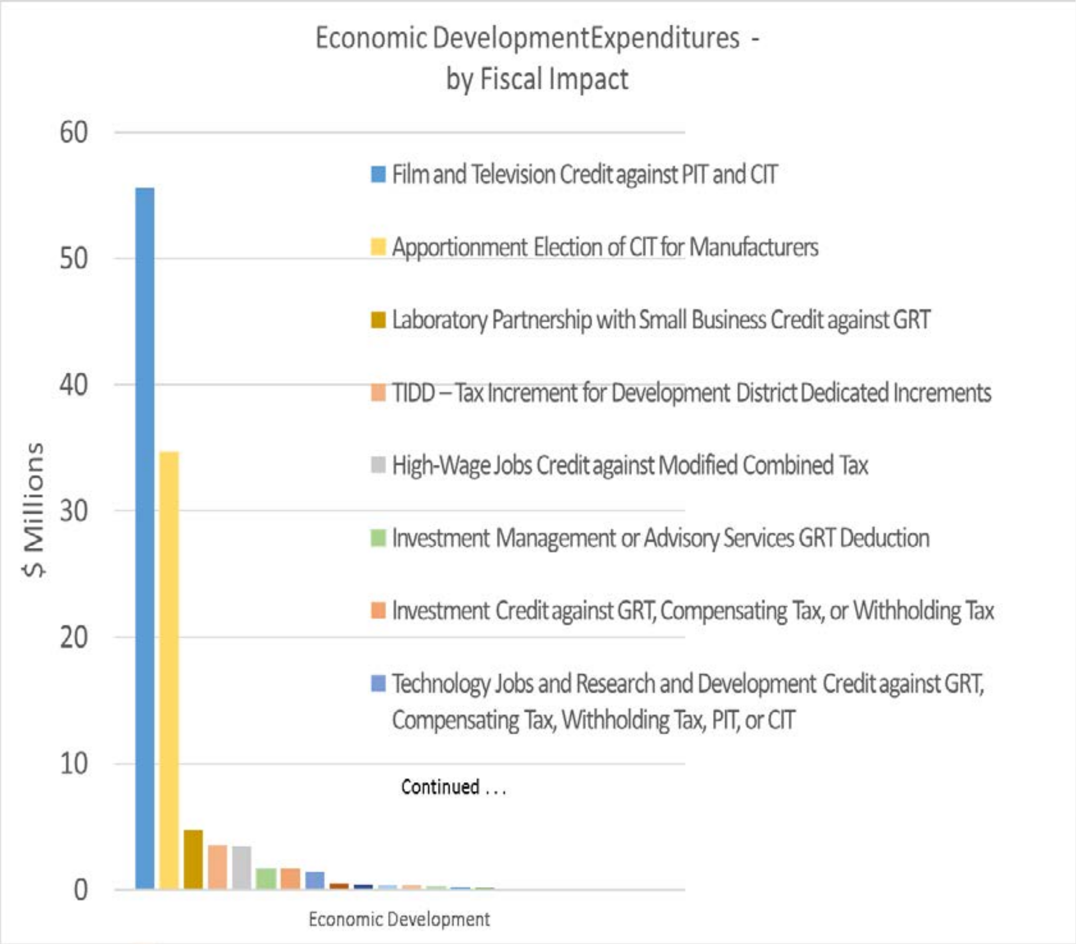
- HB6 increased GRT deduction for private hospitals for medical services from 50% to 60%
- But it also added non-profit and governmental hospitals into the tax base, allowing them the deduction
  - Non-profit and governmental hospitals not subject to local government gross receipts taxes, so only the State General Fund deduction increased
- Repealed a 5% credit to for-profit hospitals against their post-deduction gross receipts





Economic Development

- Along with Highly Specialized Industries, Economic Development represents 8% of the fiscal impact in FY20
- The largest reported contributor is the Film and Television Credit against PIT and CIT at $56.6 million
- 25 expenditures in this category
  - 3 having $0 fiscal impact
  - 3 with unknown costs
  - 2 with redacted reporting

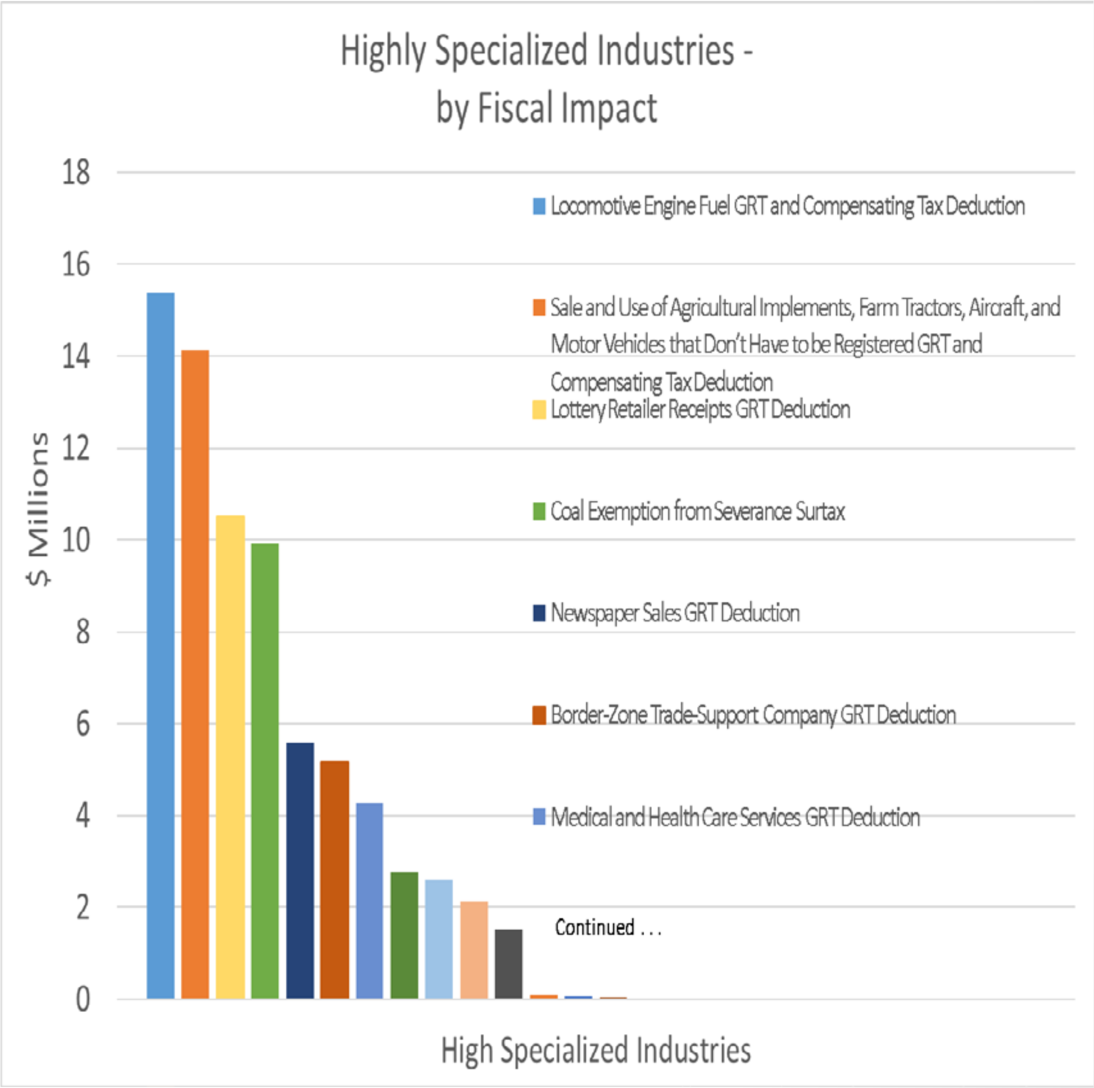


Economic Development: Film Tax Credit

- 2019 Legislation
  - Increased film credit cap from $50 million to $110 million
  - Created new category of film partners that are not subject to the cap
  - NBC Universal and Netflix are the current two film partners
- Backlog
  - $127 million in film credit backlog accrued under the previous $50 million cap was repaid in FY19 and FY20
- FY20
  - $55.6 million in film credits paid
- FY21
  - Potential for $130 million in film credits, $110 million cap and additional $20 million roll-over
  - Unlikely to be met as film projects delayed as a result of Covid-19

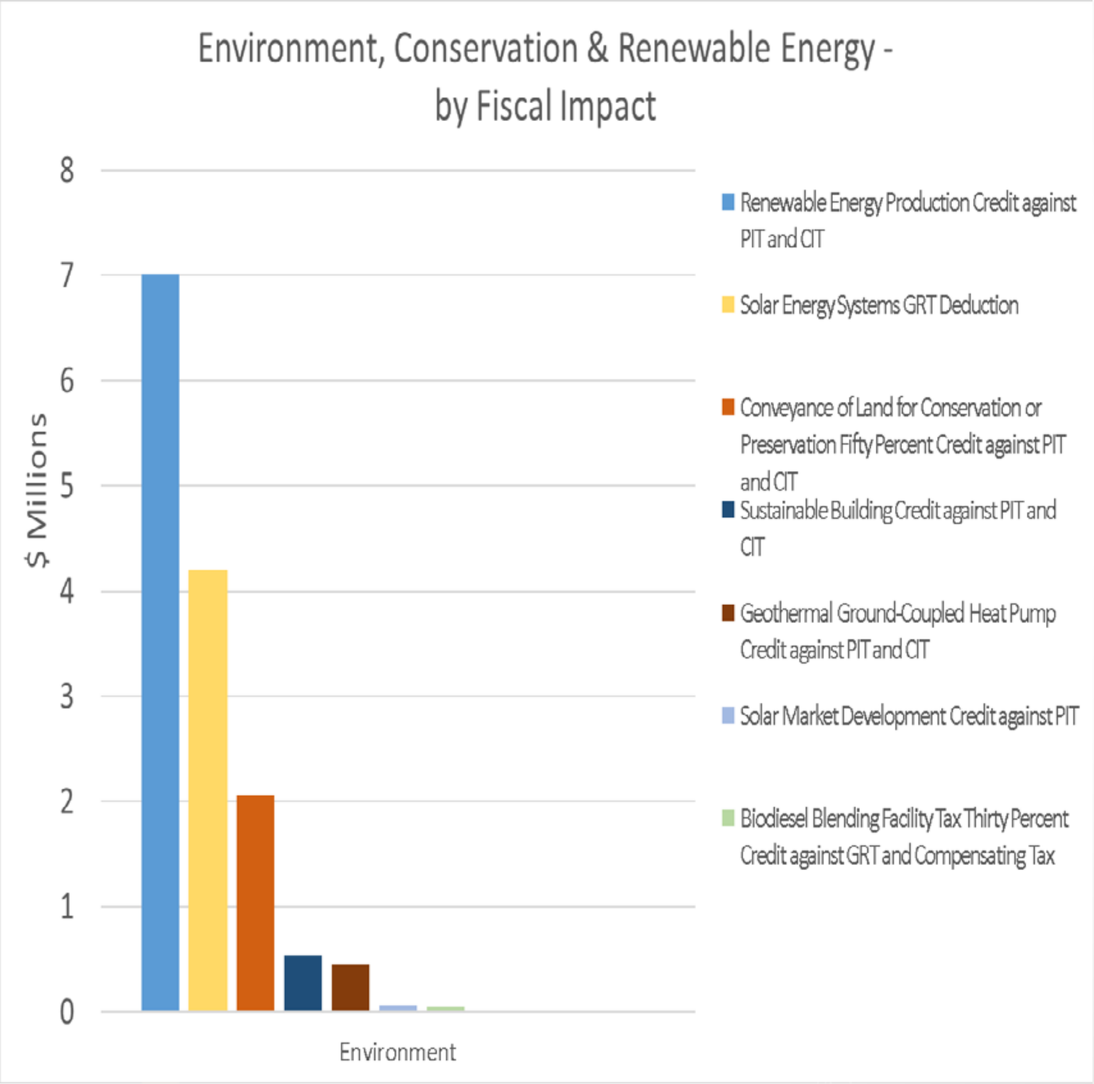
Highly Specialized Industries

- Represents 8% of the fiscal impact in FY20
- The largest reported contributor is the Locomotive Engine Fuel GRT and Comp Tax Deduction at $15.4 million
- 34 expenditures in this category
  - 10 with $0 fiscal impact
  - 5 with unknown costs
  - 2 with redacted reporting



Environment, Conservation & Renewable Energy

- Represents 1% of the fiscal impact in FY20
- The largest reported contributor is the Renewable Energy Production Credit against PIT and CIT at $7 million
- 13 expenditures in this category
  - 4 with $0 fiscal impact
  - 1 with unknown costs
  - 0 with redacted reporting



Recommendations for Repeal

Name	Rationale for repeal	2020 ($000's)
Advanced Energy GRT and Compensating Tax Deduction *Note: This deduction works in tandem with the advanced energy credit, and neither are widely used*	No claims to date	$0
Advanced Energy Credit Against GRT, Compensating Tax, Withholding Tax, PIT, or CIT	No claims to date	$0
Blended Biodiesel Fuel Credit against PIT and CIT	Credit has expired and carry-forward period ended in tax year 2017	$0
Business Facility Rehabilitation Credit against PIT and CIT	No claims to date, there are no enterprise zones to establish eligibility	$0
Electronic ID Reader Credit against PIT and CIT	No claims to date	$0
Nonprofit Elderly Care Facility Exemption from GRT *Note: The fiscal estimate would also be included in the non-profit exemption, leading to double counting of this tax expenditure in aggregate*	Non-profit entities already qualify for GRT exemption based on non-profit status	$10,800
Penalty Pursuant to Section 7-1-71.2 NMSA 1978 Credit Against GRT, Compensating Tax and Withholding Tax	Credit has not been available since July 1, 2010	$0

Recommendation for Repeal (continued)

Name	Rationale for repeal	2020 ($000's)
Physician Participating in Cancer Treatment Clinical Trials Credit against PIT	Credit applied to tax years 2014-2016. The time period this credit could have been claimed has expired	$0
Research and Development Small Business Credit Against GRT or 50% Credit against Withholding Tax	Credit expired in 2015	$0
Sales to Qualified Film Production Company GRT and GGRT Deduction	This deduction cannot be claimed by a film production company if they claim the film production tax credit. Based on relative value to taxpayer, the possibility of claiming this deduction over the film credit is very small	Unknown, but likely small
Vehicles Titled Before July 1, 1991 Exemption from Leased Vehicle GRT	At this point, this exemption applies to very few, if any, vehicles	Unknown, but likely small
Venture Capital Investment Credit against PIT	No claims to date. It appears to mirror the net capital gain income deduction	$0
Veteran Employment Credit against PIT and CIT	Credit applied to tax years 2012-2016 with carry forward of three years. Credit can no longer be claimed	$0
Welfare-to-Work Credit against PIT and CIT	Tied to a federal program that no longer exists	$0

Not a Tax Expenditure: New Dependent Deduction in PIT

- Starting in 2019, the federal Tax Cuts & Jobs Act of 2017 (TCJA) removed the ability for taxpayers to claim personal exemptions for dependents on their federal tax return in lieu of a larger standard deduction
- Despite the higher standard deduction, for a segment of taxpayers, this increased the amount of taxable income subject to New Mexico's Personal Income Tax
- Starting in tax year 2019, HB6 (2019 session) created the dependent deduction for New Mexico families, $4,000 per dependent beyond the first dependent claimed
  - This is not classified as a tax expenditure and is reverts back to the tax base prior to the passage of the TCJA.
  - Expenditure amounts is reported per statute- $24.9 million with approximately 169,000 taxpayers claiming the deduction
- The deduction decreased the tax liability for 120,000 families by an average of $210 per family

Concluding Thoughts

- Legislative Thoughts
  - Purpose not always defined – difficulty to then evaluate
  - Sunset clause – forces evaluation of the expenditure where that is appropriate
  - Reporting requirements – electronic reporting: ease in working with other departments when cross-collaboration of expenditures; allows transparency; ability to evaluate expenditure cost
  - Reassessment of expenditures: have expired but remain in statute, $ 0 fiscal impact as no claimants, or cannot be claimed due to statute language
- Other Resources
  - National Conference of State Legislatures has a State Tax Incentive Evaluations Database (worked with Pew Charitable Trusts)
    - http://www.ncsl.org/research/fiscal-policy/state-tax-incentive-evaluations-database.aspx
  - Can compare different incentives across states, years, analysis, incentive type

Thank you!

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http://www.tax.newmexico.gov/