TAXATION & REVENUE
NEW MEXICO

Overview of TRD Tax Expenditure Report Process

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Stephanie Schardin Clarke, Cabinet Secretary

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
- TRD will be presenting a new TER covering 2019 and 2020 to RSTP on December 15, 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, conservation, economic development, highly-specialized industries, or health care
- 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

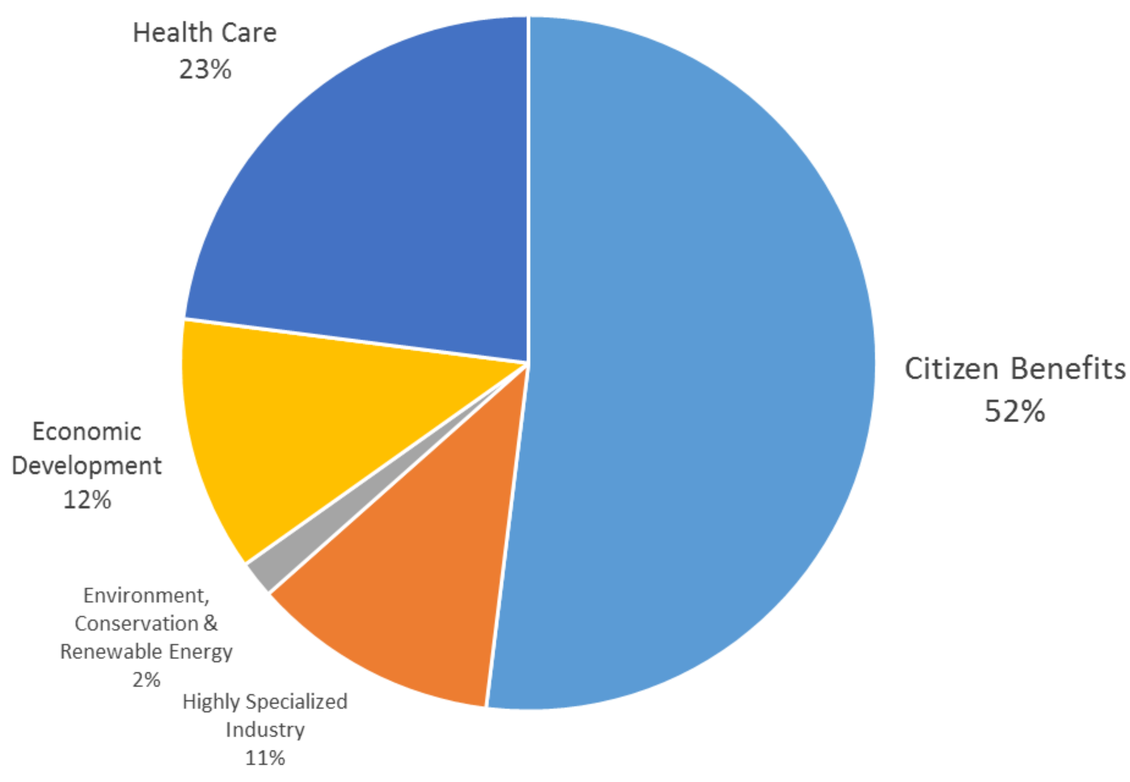
- Exclusions to derive the tax base are not considered deviations and are not considered tax expenditures
- Deviations can occur for many reasons:
  - “In lieu of” taxation
  - US constitutional prohibition or federal pre-emption
  - Government-to-government comity
  - To “true” a tax base – anti-pyramiding, 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 (2018)

- 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 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	67
2	Estimated from GenTax data	15
3	Estimated from national data	15
4	Least reliable. Estimated from limited data	11
Unknown	No data available	15

Top Ten Expenditures by Cost (2018)

Name	Amount ($000's)	reliability
Sale of Food at Retail Food Stores GRT Deduction and Hold Harmless Distribution	$250,465	1
Prescription Drugs and Oxygen GRT AND GGRT Deduction	170,000	3
Nonprofit Organizations Exemption from GRT	95,000	4
Health Care Practitioner Services GRT Deduction and Hold Harmless Distribution	54,224	1
Film and Television Credit Against PIT and CIT	49,965	1
Working Families Credit against PIT	49,549	1
Apportionment Election of CIT for Manufacturers	35,787	2
Capital Gain Deduction From PIT	29,264	1
Locomotive Engine Fuel GRT and Compensating Tax Deduction	22,292	2
Low-Income Comprehensive Tax Rebate and Property Tax Rebate against PIT	17,389	1

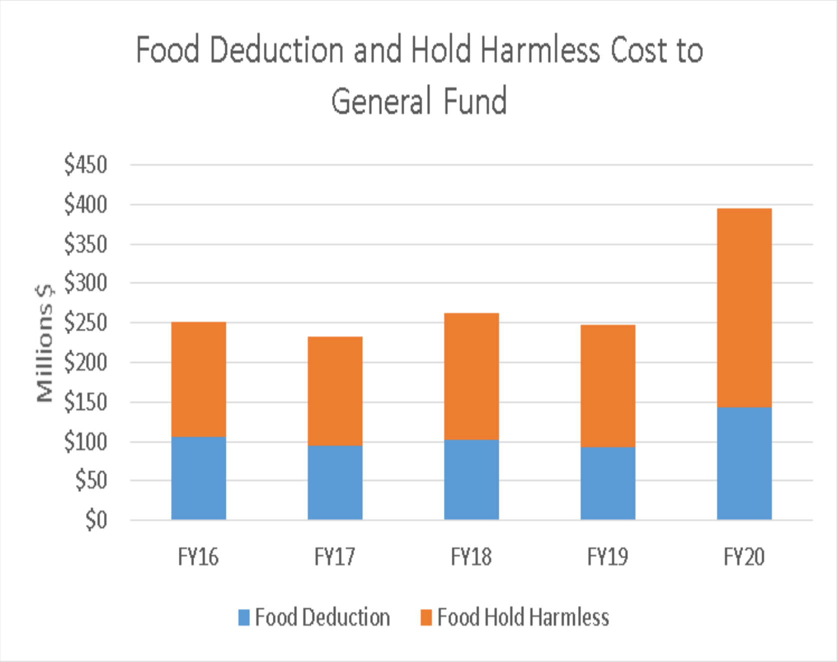
Redacted Expenditures in Most Recent Fiscal Year (fewer than 3 taxpayers) (2018)

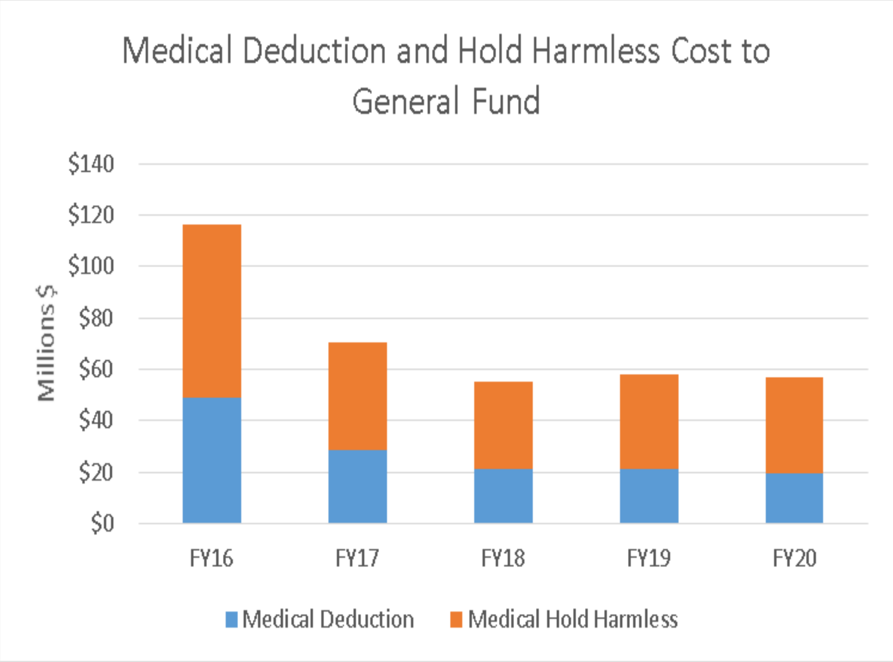
Advanced Energy Credit against GRT, Compensating Tax, Withholding Tax, PIT, or CIT
Agricultural Water Conservation Expenses Credit against PIT and CIT
Aircraft Sales or Services GRT Deduction
Alternative Energy Product Manufacturers Credit Against Modified Combined Tax
Coal Exemption from Severance Surtax
Electricity Exchange GRT Deduction
Job Mentorship Credit against PIT and CIT
Military Transformational Acquisition Programs GRT Deduction
Uranium Hexafluoride and Uranium Enrichment GRT Deduction
Veteran Employment Credit against PIT and CIT

Preview of Select 2019 and 2020 Results

Food & Medical GRT Deductions

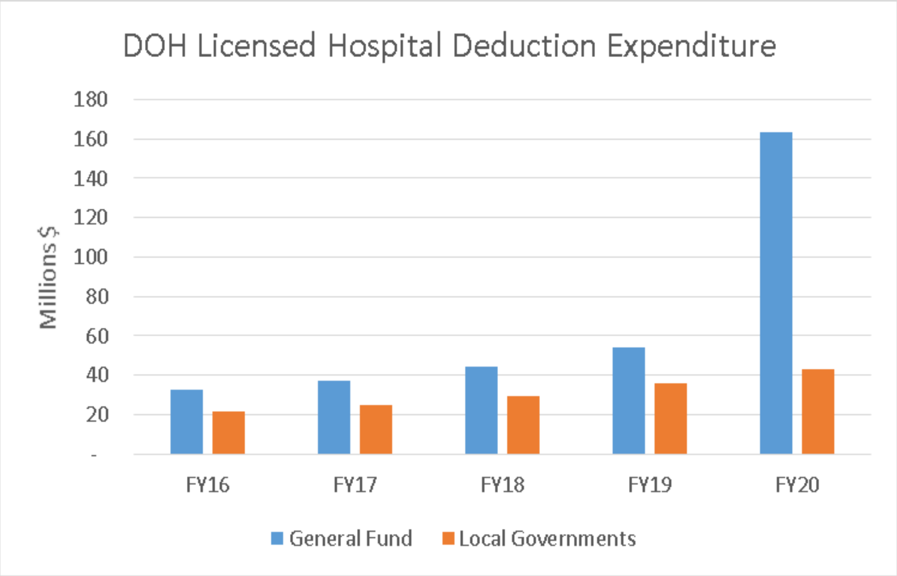
- GRT Deductions enacted in 2004 to reduce the cost of food and medical services
- Hold harmless provision included offsets foregone local tax revenue as a result of the deductions
- 2013 legislation began a phase-out of the hold harmless payments to certain local governments scheduled to end in 2030
- 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

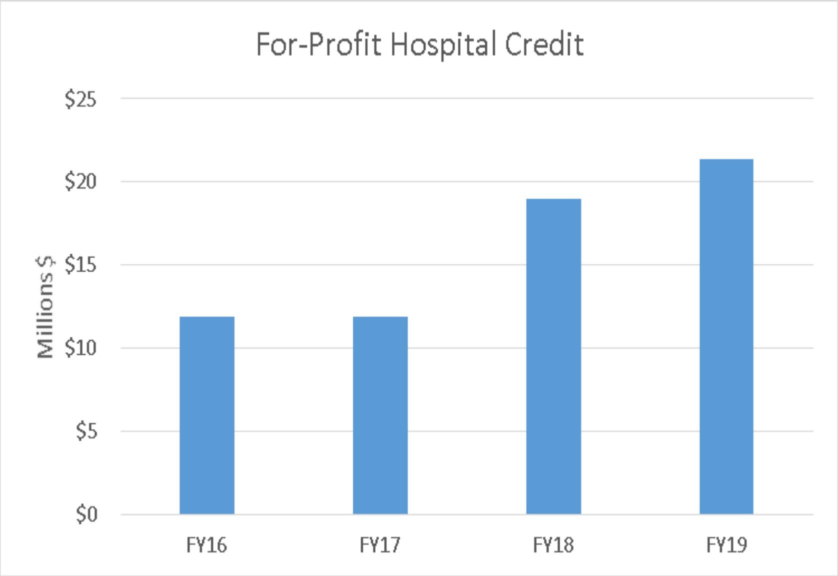




Hospital GRT Deductions & Credits

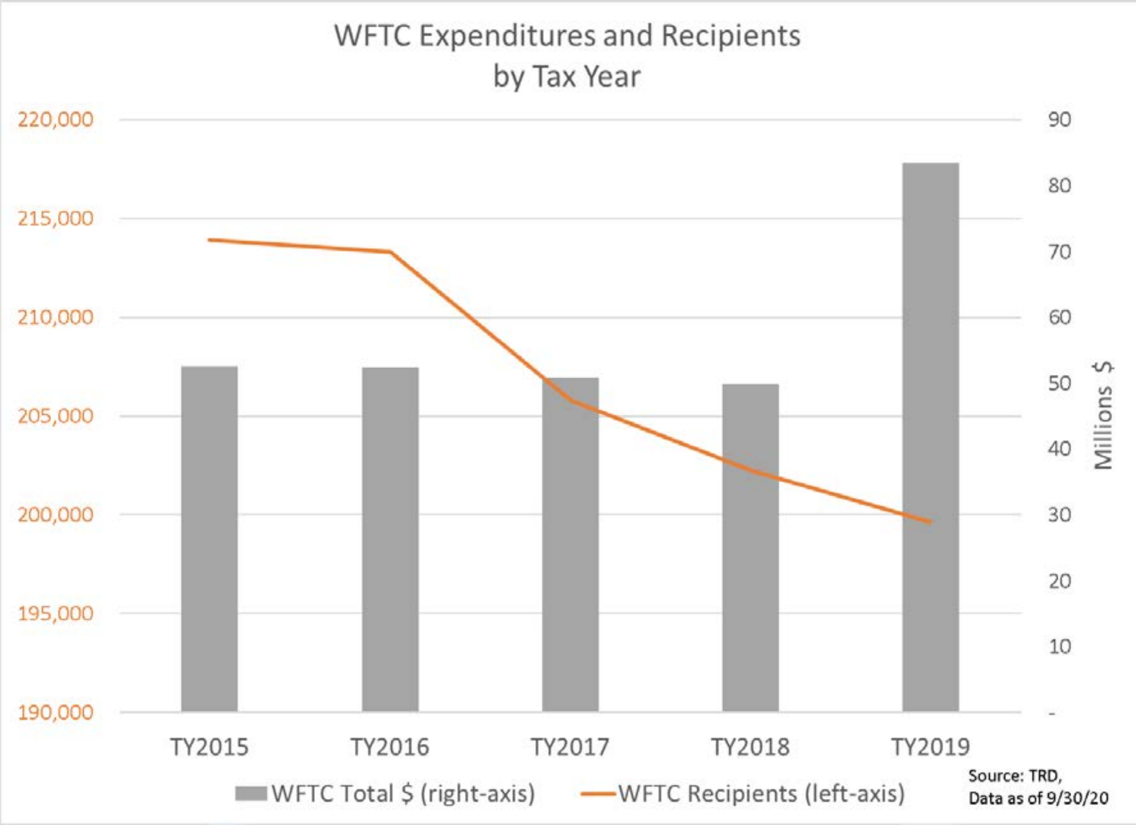
- HB6 increased GRT deduction for private hospitals for medical services from 50% to 60%
- But it also added non-profit and governmental hospitals into the tax base, allowing them the deduction
  - Non-profit and governmental hospitals not subject to local government gross receipts taxes, so only the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





Working Families Tax Credit in PIT

- WFTC is a 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
- Tax Year 2019 is not quite complete

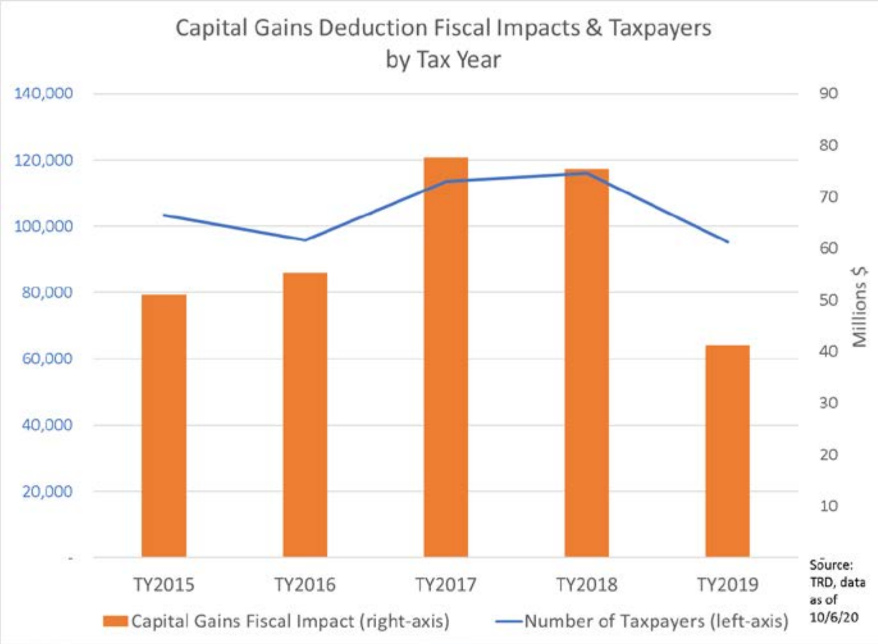


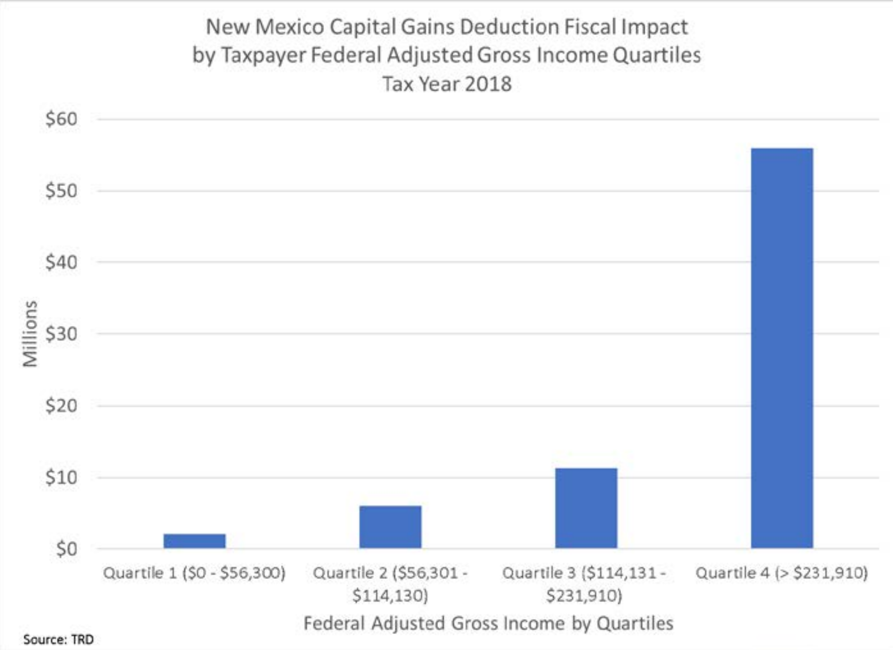
New Dependent Deduction in PIT

- 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 created the dependent deduction for New Mexico families
- Deduction is $4,000 per dependent beyond the first dependent claimed
- Expected to allow families with children to continue to deduct about $25 million per year, avoiding a tax increase that would have been caused by TCJA
- Approximately 120,000 with taxable income to offset claimed the deduction for 2019
- The deduction decreased the tax liability for 120,000 families by an average of $210 per family

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%
- Expected to increase PIT revenue by about $10 million per year
- 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





Concluding Thoughts

- Legislative Thoughts
  - Purpose not always defined – difficulty to then evaluate
  - Sunset clause – forces evaluation of the expenditure
  - Reporting requirements – electronic reporting: ease in working with other departments when cross-collaboration of expenditures; allows transparency; ability to evaluate expenditure cost
- 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!

Stephanie Schardin Clarke

StephanieS.Clarke@state.nm.us

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