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

ORIGINAL DATE 3/01/15
SPONSOR Roybal Caballero **LAST UPDATED** ______ **HB** 495

SHORT TITLE Corporate Tax for Preschool Programs **SB** ______

ANALYST van Moorsel

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY15	FY16	FY17	FY18	FY19		
$0.0	$2,600.0	$6,800.0	$7,500.0	$8,300.0	Recurring	Preschool Program Fund

(Parenthesis ( ) indicate revenue decreases

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

FY15	FY16	FY17	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
$0.0	Moderate	Moderate	Moderate	Recurring	CYFD
$0.0	$38.0	$0.0	$38.0	Nonrecurring	TRD

(Parenthesis ( ) Indicate Expenditure Decreases)

Duplicates SB 561 – Corporate Tax for Preschool Programs, Relates to HB 16 – Surtax on Certain Corporations; HB 279 – Reduce Corporate Income Tax Rate.

SOURCES OF INFORMATION
LFC Files

Responses Received From
Taxation and Revenue Department (TRD)
Children, Youth and Families Department (CYFD)
Public Education Department

SUMMARY

Synopsis of Bill

House Bill 495 creates the Preschool Program Act, imposes an additional corporate income tax on certain corporations and distributes the revenue to the preschool program fund to fund the Preschool Program Act. A section-by-section summary of the bill's provisions is at attachment 1:

The tax provisions of the bill apply to taxable years beginning on or after January 1, 2015. The effective date of the Preschool Program Act is January 1, 2016.

FISCAL IMPLICATIONS

This bill creates a new fund and provides for continuing appropriations. The LFC has concerns with including continuing appropriation language in the statutory provisions for newly created funds, as earmarking reduces the ability of the legislature to establish spending priorities.

To estimate the fiscal impact of the tax imposed by this bill, TRD used tax year 2012 data to establish the number of corporations that would meet the requirement as described in this bill. According to TRD, approximately 104 corporations operating in New Mexico have gross global income over $1 billion.

The 2015 federal poverty level threshold at 200 percent federal poverty level is $40,180. TRD assumes the employer's share of payroll tax is about $5,000. Subtracting $5,000 from $40,180 and dividing the outcome by 2080 hours yields a minimum hourly wage of $16.91 per hour.

TRD assumed each corporation employs, on average, 25 employees whose hourly wage is $16.91 or less. This estimate assumes that some of these corporations have very few employees that meet this wage level, while other corporations employ more than 25 employees that meet this wage level. To establish the base, TRD multiplied the number of companies by the average number of employees earning $16.91 per hour by 2080 hours (assuming these are full-time employees). To estimate the impact in out years TRD applied employment growth rates estimated by University of New Mexico Bureau of Business and Economic Research.

It is important to note that the estimate is only as accurate as the assumptions on which it is based. In the event more corporations meet the gross income level or employ more workers with wages below the required level, the additional revenue generated could be much higher.

TRD's estimate of the revenue generated by this bill represents a tax increase for certain corporations. The estimated impact of the bill represents approximately 1 percent of the FY16 CIT estimate, 3 percent of the FY17 estimate, 4 percent of the FY18 estimate, and nearly 5 percent of the FY19 estimate. The increasing percentages reflect the increasing revenue generated by the corporate low wage tax, driven by employment growth, and the decreasing consensus CIT estimate as the single-sales factor and CIT rate reductions are phased in.

SIGNIFICANT ISSUES

This bill may duplicate existing early child development and education programs administered by CYFD. The Childcare Assistance program and the Prekindergarten (PreK) program are targeted for at-risk children ranging in ages from 0 to 14 years old. This bill, however, seems to create a third program "preschool" targeted at the same or similar populations. In addition, it should be noted that in recent years CYFD has invested significant public resources in developing and implementing quality improvements focused on increasing school readiness. The preschool program created in this bill, however, does not adhere to the continued quality improvement initiative.

Currently, the Childcare Assistance program serves about 18 thousand children at a cost of $97 million annually and the PreK program serves almost 9 thousand children at a cost of $39.6 million annually. Using the average costs of these programs and the projected revenue generated by this bill, in FY16 the preschool program could serve about 500 children.

TRD reports the bill creates a punitive tax against corporations that pay their employees a wage, including benefits, less than 200 percent of the federal poverty level. TRD notes this tax may discourage companies from relocating or establishing business operations in New Mexico. TRD contends that although the purpose of the bill appears to encourage businesses to pay higher wages, it may make companies reduce hiring because it increases the cost of labor. TRD adds the bill does not consider part-time employment when calculating tax liability. TRD explains that to avoid a corporate low wage tax liability, part-time employees will have to be paid a higher wage than full-time employees because part-time employees are typically not entitled to benefits.

CYFD reports it is unclear if the licensing component of this bill is intended as an *additional* license that would apply to *only* the funding received under this bill, or if the license would be an operating license that would *replace* the existing operating license that is currently required by CYFD pursuant to the Public Health Act, NMSA 1978, §§ 24-1 sections 1 to 36. This act provides that health facilities shall not be operated without a license issued by the CYFD. The act defines health facilities to include child care centers, which often are also early childhood centers.

CYFD adds that, due to the unclear licensing provisions of the bill, the language reading "early childhood services providers and early childhood programs that are not seeking state funding are not required to be licensed" could exempt a large number of currently licensed early childhood service providers from licensure requirements, leaving New Mexico with a large number of unlicensed child care facilities. This provision is in conflict with the Public Health Act which requires child care facilities to be licensed by CYFD *regardless of whether or not they receive state funding*.

The bill requires CYFD to conduct criminal background checks on all staff of a preschool program that have access to children. CYFD points out the bill's requirements are less rigorous than those presently provided for by NMSA 1978, Section 32A-15-3 and the current CYFD licensing rules in NMAC 8.16.2, which call for a much more comprehensive criminal background check process.

ADMINISTRATIVE IMPLICATIONS

CYFD reports administration of this new funding and implementation of the licensure and application requirements of this bill would require a number of additional FTEs, stating the expanded duties cannot be absorbed by existing resources.

TRD reports the bill would require the department to change corporate income tax Gentax and Taxpayer Access Point documents, configuration for rates, and create new funds on the revenue side. TRD adds the new tax could be included with the income tax return. The program fund is not based on income, but rather wages paid to its employees. To determine whether a business qualifies, the department would have to gather information about the employer that it typically does not collect. To gather this data, the department would need to add reporting requirements to the existing state income tax return, increasing all taxpayers' reporting burden. As such, the bill would create the need for taxpayer and department personnel education. The changes to forms, instructions and publications will come at a higher cost because the extent of the information to be gathered would increase significantly. To audit and ensure compliance, additional FTE would be needed to manually review corporations.

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

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HB 495 Section Analysis

Section 1 amends the Tax Administration Act to distribute the corporate low wage tax to the preschool program fund.

Section 2 amends the Corporate Income and Franchise Tax Act to impose a "corporate low wage tax" on corporations with taxable income that have a global gross income over $1 billion. The tax imposed is $1 for every hour the corporation pays an employee a low wage in a taxable year, defined as an hourly wage that results in income less than 200 percent of the federal poverty level for a family of three. "Low wage" includes benefits but not the employer's share of payroll taxes. No tax credits that may be applied against CIT liability may be applied against corporate low wage tax liability.

Employers with a corporate low wage tax liability must disclosure that the employer is liable to pay the tax and include the number of employees to whom the employer paid a low wage in that taxable year and the number of hours worked on which the tax is calculated.

The bill permits a person to bring a civil action to challenge an employer for underpayment of the tax and to allow TRD to recover the balance of the taxes owed, including interest, an additional amount equal to twice the taxes owed and any other appropriate legal or equitable relief. An employee who has suffered discrimination in any manner or had adverse action taken against that employee in retaliation for challenging a corporate employer pursuant to this section may bring a civil action and if successful, recover actual damages plus reinstatement in the case of discharge. If an employee was discharged in retaliation for challenging an employer, the period of violation extends from the day of discharge until the day of reinstatement, the day the employee waives reinstatement or, if not rehired, until the day legal judgment is final. A prevailing plaintiff is entitled to recover costs and expenses of suit and attorney fees.

Sections 3-8 of the bill create the Preschool Program Act:

Section 5 governs licensure and funding applications. CYFD is responsible for licensing and funding preschool programs that meet the requirements of the act. CYFD must distribute money for this purpose upon its approval of applications and proposals from eligible providers. Early childhood service providers and programs not seeking state funding need not be licensed.

The bill requires providers seeking state funding to apply to CYFD for a license which covers both the provider and the preschool program. Applications for licensure must include:

- qualifications of the provider and the provider's early childhood development staff;
- the way in which the program addresses the total developmental needs of the children served;
- the way in which the program meets other CYFD rules and standards;
- the number and ages of children to be served;
- site and floor plans and a description of the preschool facilities;
- revenue sources available for the program and the proposed budget for the ensuing year;
- the plan for communicating with and involving parents in the preschool program;
- the way in which the preschool program services meet the continuum of services to children;

- other relevant information requested by the department; and
- a statement the program won't include religious or sectarian purposes, instruction or material.

CYFD must require criminal background checks of staff with access to children; it may not pay the cost of obtaining the FBI record. Providers must report any known conviction of a felony or misdemeanor involving moral turpitude that results in any type of action against the employee.

CYFD must promulgate rules to govern license terms, renewal dates and requirements and may charge a $200 license fee and may charge different fees for different classes of preschool programs. Public schools and other governmental providers shall not be charged a license fee.

If possible, preschool programs must collaborate with existing head start programs and other early childhood programs in the community. Each preschool program must have strong parental involvement and staff development and a process to enable CYFD monitoring and evaluation.

Section 6 governs funding proposals, per-child reimbursement, and staff development.

CYFD must rank preschool funding applications and allocate funding based on availability and on a per-child calculation for approved and ranked applications, taking into account:

- priority funding for preschool programs in communities with public elementary schools that are designated as Title 1 public schools;
- each program's staff overhead, training, and professional development costs;
- the time the preschool program will operate in the upcoming fiscal year;
- funding derived from copayments, tuition, gifts, grants, donations and other sources; and
- awards for research-based quality initiatives to improve developmental outcomes.

Additional funding criteria include:

- the number of children to be served and the length of the program's year;
- the adequacy and capacity of preschool programs and facilities;
- language and literacy services in the community;
- the cultural, historic and linguistic responsiveness of the preschool program;
- parent education services available for parents in the community;
- qualifications of providers and staff of the applicant and in the community;
- staff professional development plans;
- capacity of local organizations and involved in preschool programs and other services for children and their commitment to ensuring children are prepared for school age 5; and
- the extent of local support for preschool programs in the community.

By each April 1 CYFD must determine the number of funding proposals for the next fiscal year; the number of children enrolled in each program requesting funding; available funding; and the per-child calculation. By July 1, CYFD must distribute ¼ of the per-child calculation to each provider. After two quarters, CYFD must recalculate the per-child distributions.

Section 7 creates the nonreverting Preschool Program Fund, administered by CYFD, to be used to foster preschool development by:

- increasing access to programs by increasing eligibility and outreach program funding;
- limiting copayments for preschool programs to 10 percent of family income for families of fewer than five earning below 200 percent of federal poverty level;
- funding quality initiatives supported by data to improve developmental outcomes; and
- sustaining New Mexico's preschool infrastructure by providing adequate per-child funding.

Section 8 governs contract provisions, monitoring, and audit requirements CYFD must:

- monitor programs to ensure state funds are not used for religious, sectarian or denominational purposes;
- require every provider to have an independent audit each year; and
- monitor and evaluate the effectiveness of every preschool program once every license period.