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

ORIGINAL DATE 02/06/16
SPONSOR Kernan **LAST UPDATED** 02/09/16 **HB**

SHORT TITLE Livable Home Tax Credit **SB** 225

ANALYST Keyes

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY16	**FY17**	**FY18**	**FY19**	**FY20**		
$0	(Significant)	(Significant)	(Significant)	(Significant)	Recurring	General Fund

Parenthesis ( ) indicate revenue decreases

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY16	FY17	FY18	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
Total	$51.6	$16.6	$16.6	$87.8	Recurring	Taxation and Revenue Department

Parenthesis ( ) indicate expenditure decreases

SOURCES OF INFORMATION

LFC Files

Responses Received From
Taxation and Revenue Department (TRD)

SUMMARY

Senate Bill 225 enacts a new section to the Income Tax Act which provides the livable home income tax credit. The credit is applicable to taxable years beginning on or after January 1, 2016 and ending on or before December 31, 2023, and may be claimed against personal income tax in the amount of fifty percent of qualifying costs from retrofitting or renovating an existing residence to improve physical accessibility, but only up to five thousand dollars.

FISCAL IMPLICATIONS

The Taxation and Revenue Department (TRD) evaluated direct taxpayer data to estimate the potential fiscal impact. The North America Industry Classification System (NAICS) classifies establishments for the purpose of collecting, analyzing, and publishing statistical data. NAICS 236118 is the classification for Residential Remodelers. This estimate is based on an analysis of direct taxpayer data who self-reported in this NAICS. A detailed discussion is provided below.

TRD analyzed direct taxpayer data from firms who self-reported in NAICS 236118 Residential Remodelers. This is a subset of the larger construction market (NAICS 23), and excludes both non-residential revenues and new housing starts revenues. Additionally, TRD reviewed "Emerging Trends in the Remodeling Market," a 2015 paper published by the Joint Center for Housing Studies (JCHS) of Harvard University. For the 11 month period February through December 2014, the statewide gross receipts for Residential Remodelers is approximately $4.8 million. For the 11 month period January through November 2015, the statewide gross receipts for this NAICS is approximately $9.3 million.

Construction-related economic data experiences seasonality: a characteristic of a time series in which the data experiences regular and predictable changes which recur each calendar year. Furthermore, residential remodeling demand is directly related to the pace of the housing market as well as the broader economy. These influences account for the disparity across the 2014 and 2015 gross receipts figures.

Existing federal and state stimulus programs encourage homeowners and rental property owners to invest in energy efficient upgrades and other renovations that they might otherwise have deferred.

According to the JCHS report the 2013 inflation-adjusted average outlay for home improvement was $2,500. However, major bath remodels and major kitchen remodels average $8,829 and $18,097 per expenditure, respectively. These are the two most expensive renovations allowed in the bill.

Whether the work is completed by a professional or a do-it-yourself individual (DIY) it has a significant fiscal impact. The average expenditure for a professional is over two times the expenditure for a DIY. This introduces the potential for fraud; either a DIY might overstate the expense, or a contractor might overstate the expense. In either case, the State would incur a higher expenditure, essentially reimbursing 100% of the taxpayer's cost.

SIGNIFICANT ISSUES

TRD states that IRS Publication 530 provides guidance to homeowners regarding federally allowable deductions and credits. Renovation of a home is not generally an expense that can be deducted from your federal taxes. However, there are improvements that can be deducted as medical expenses if they are medically necessary. The cost of installing entrance or exit ramps, modifying bathrooms, lowering cabinets, widening doors and hallways and adding handrails, among others, are home improvements that can be deducted as medical expenses. However, the deduction amounts must be reasonable, given their medical purpose, and expenses incurred for aesthetic or architectural reasons cannot be deducted.

This bill does not include language that specifies improvements be medically necessary. However, the enumerated improvements align to the federal standard for an allowable medical expense. To address enumerated concerns regarding the probability of fraud and abuse, adding language that limits the credit to medically necessary improvements is recommended.

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 has noted that implementation will have a moderate impact:

- Changes to documents, instructions, and forms are necessary.
- Upgrades and configuration to IT systems and software is required.
- These costs are one-time expenses incurred after bill passage.
- Future changes will be handled as part of year-to-year transition.

The administrative and compliance impact will be minimal for TRD. The bill does not impact the financial distribution process, but the credit may be subject to the financial disclosure requirements per Governmental Accounting Standards Board (GASB) Statement No.77. GASB 77 disclosure statements are effective for financial statements for periods beginning after December 15, 2015. An assessment of the credit against the tax abatement criteria specified in GASB 77 will need to be performed by TRD. If the credit meets the criteria, then the disclosure is required in TRD's financial statements. A 0.25 FTE is required to review and approve credits.

TECHNICAL ISSUES

As written, a taxpayer may receive this credit for: property not in New Mexico; property not owned by the taxpayer; or investment property, whether owned or not owned by the taxpayer.

It is not clear if the intent of the bill is to incentivize residential upgrades in accordance with the Americans with Disabilities Act (ADA); to allow a credit for medically necessary improvements; or a broader incentive for repair, maintenance, and renovation of any property. Regardless of the intent, the language creates opportunity for waste, fraud, and abuse. Disreputable or dishonest taxpayers, individually or in collaboration with dishonest construction-remodeling firms, might inflate the actual cost of improvements such that the credit awarded is equal to 100 percent of the real cost incurred. Succinctly, the bill can be misused so that the State of New Mexico funds 100 percent of all renovation costs.

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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