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

		ORIGINAL DATE	1/23/2021		
SPONSOR	Chandler	**LAST UPDATED**	2/01/2021	**HB**	42
SHORT TITLE	Low-Income Comprehensive Tax Rebate Changes			**SB**	
				ANALYST	Torres

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY20	FY21	FY22	FY23	FY24		
		Up to ($48,800.0)	Up to ($48,800.0)	Up to ($48,800.0)	Recurring	General Fund

Parenthesis ( ) indicate revenue decreases

SOURCES OF INFORMATION
LFC Files

Response Received
Taxation and Revenue Department (TRD)

SUMMARY

Synopsis of Bill

House Bill 42 (HB42) increases the amount and income eligibility of the low-income comprehensive tax rebate (LICTR) beginning in tax year 2021. Under current law, LICTR benefits filers with incomes up to $22 thousand who may claim the rebate at a maximum of $450 while the bill raises the maximum eligible income to $36 thousand with a rebate maximum of $730. The rebate increases with the number of claimed exemptions and decreases with income.

FISCAL IMPLICATIONS

Estimates from the Taxation and Revenue Department (TRD) use actual 2018 and 2019 tax payer information and projected 2020 tax payer filings. In 2019, 208 thousand filers claimed $16.2 million in low-income comprehensive tax rebates. HB42 is estimated to triple the cost of the credit, per year.

The fiscal impact includes the rebate amount increase for the current population claiming the credit, which is approximately 210 thousand taxpayers. The average rebate amount for the current population increases from $78 to $195. The fiscal impact includes the expanded population of eligible taxpayers who can now qualify under the higher threshold of $36 thousand MGI. Their average rebate amount is estimated at $68 per taxpayer. Additionally, the estimate includes a population of taxpayers who are currently eligible but have not claimed the rebate in the past.

The Covid-19 induced recession has impacted individuals working in the service industry where many jobs are low wage. Based on the website tracktherecovery.org, as of October 2020, New Mexico individuals with incomes less than $27 thousand have seen a 19 percent reduction in employment rates since January 2020. The $27 thousand income threshold is within the new proposed eligible threshold for LICTR. This analysis assumes this population is captured within the three sub-groups described above. Additionally, individuals with incomes between $27 thousand and $65 thousand have experienced approximately a 4 percent decrease in employment rates. A proportion of this income range may become eligible under the new proposed threshold for LICTR, but it is difficult to estimate.

The $48.8 million impact assumes that taxpayers will act to maximize their benefits of tax relief and tax rebates by quickly filing their state PIT returns in Spring 2022 rather than requesting extensions to file later, causing a full-year fiscal impact in FY22.

The amount of claimants and costs to the state has been declining over the last five years as economic conditions improved. As New Mexicans' income have been significantly impacted by the the pandemic, recession, and underlying economic shifts from 2019, the cost of the rebate could increase considerably as more people qualify due to lower incomes. The fiscal impact of HB 42 could be compounded by any newly eligible population, making the total cost difficult to predicct. Furthermore, tax payer behavior in filing for the rebate drives total costs. TRD outreach and education of the rebate could significantly impact the total cost of the bill.

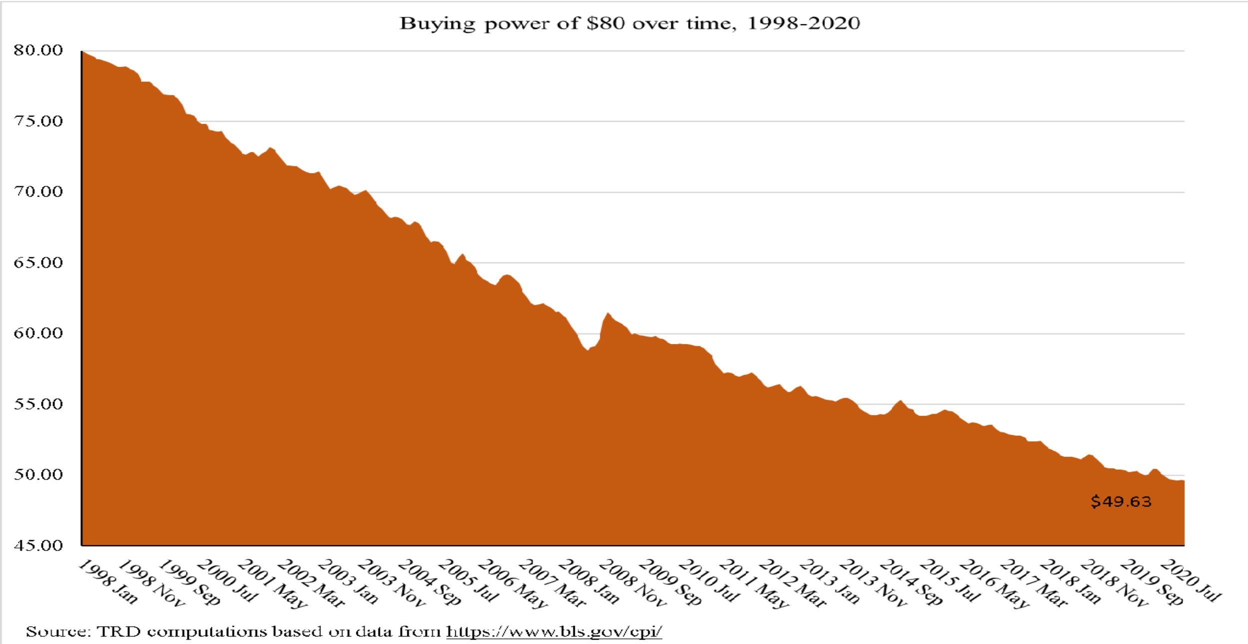
This bill may be counter to the LFC tax policy principle of adequacy, efficiency, and equity. Due to the increasing cost of tax expenditures, revenues may be insufficient to cover growing recurring appropriations.

SIGNIFICANT ISSUES

The LICTR income qualifications and rebate amounts were last revised in 1998. Due to inflation, LICTR rebates over time have diminished in purchasing power and as a percent of average incomes.

TRD provides the additional analysis:

> PIT represents a fairly consistent source of revenue for many states. While this revenue source is susceptible to economic downturns, it is also positively responsive to economic expansion. New Mexico is one of forty-two states along with the District of Columbia that imposes broad-based PIT. PIT is an important tax policy tool that has the potential to further both, horizontal equity by ensuring the same statutes apply to all taxpayers, and vertical equity by ensuring the tax burden is based on taxpayer's ability to pay.



The LICTR provides a rebate to most lower income New Mexico residents that file a PIT return. The LICTR has not been revised since 1998. Between 1998 and 2020, cumulative inflation based on the Bureau of Labor Statistics' Consumer Price Index for All Urban Consumers (CPI-U) has been 61 percent. Consequently, the buying power of the rebate has steadily diminished over the last 22 years. If the goal of the rebate is to reduce poverty and increase progressivity in the income tax structure, a lack of inflation adjustment has eroded these goals over time. Consider a family of four claiming four exemptions, with a modified gross income (MGI) at the 1998 Federal Poverty Guideline of $16,450; the amount of LICTR this family was eligible for in 1998 was $80. The chart below shows that buying power of this $80 rebate has eroded to $49.63 in real terms between 1998 and 2020. This reduction in the real value of rebate over time can be viewed as an "inflationary tax hike" on the low-income New Mexicans.

If the rebate were to have kept pace with inflation, the $80 would have had to be increased to $128.95 by end of 2020. In contrast, this bill increases the rebate amount for this reference family to $235. This increase outweighs the impact of inflation, making the tax structure more progressive than it was in 1998. Progressivity in income taxes is commonly sought to reduce the tax burden of those with a lower ability to pay and shift the burden increasingly to those with a higher ability to pay. Further, a progressive income tax is also seen as a tool to make the overall tax structure, which includes more regressive taxes such as the gross receipts tax, property tax and the gasoline tax, fairer. Consumption of necessities such as food, child care, gasoline, and housing makes up a larger proportion of income among the lower-income earners compared to higher-income earners. Any tax applied on such consumption will take up a larger share of income for lower and middle-income earners, compared to the higher income earners making it regressive.

Because increases in progressivity of tax structure leads to changes in individual behavior, economic literature remains divided on whether such a tax structure reduces inequality. Under the optimal tax theory, there is some theoretical evidence that very high earners should be subject to high and rising marginal tax rates on earnings. Also, that the earnings of low-income families should be subsidized to incentivize work, and those subsidies should then be phased out with high implicit marginal tax rates. But the optimal tax rate on high income earners is negatively related to the opportunities for tax avoidance and evasion available to them. These opportunities can be reduced through base broadening and tax enforcement .

There is also, however, some evidence that increased progressivity may lead to lower human capital investments, output and productivity (via capital and labor mobility towards regions with less progressive or even flat tax structures). See, for example, Caucutt et al. (2003) , Li and Sarte (2004) , Erosa and Korkeshova (2007) , and Heathcote et al. (2010) .

To avoid the erosion in the buying power of this rebate because of inflation, TRD suggests adding a provision to make an inflation adjustment to the income thresholds and the rebate amounts each year using the Consumer Price Index for All Urban Consumers (CPI-U) as published by the United States Department of Labor, Bureau of Labor Statistics. This could be done by multiplying the income thresholds and the rebate amounts by a fraction, the numerator of which is the CPI-U ending during the prior tax year and the denominator of which is the CPI-U ending in 2021. If, however, the result of this multiplication leads to lower income thresholds and rebates than were in place in the preceding year, no adjustments are to be made.

PERFORMANCE IMPLICATIONS

The LFC tax policy of accountability is not met since TRD is not required in the bill to report annually to an interim legislative committee regarding the data compiled from the reports from taxpayers taking the rebate and other information to determine whether the rebate is meeting its purpose. Although, general data is provided in TRD’s tax expenditure report.

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

Does the bill meet the Legislative Finance Committee tax expenditure policy principles?
1. **Vetted**: The proposed new or expanded tax expenditure was vetted through interim legislative committees, such as LFC and the Revenue Stabilization and Tax Policy Committee, to review fiscal, legal, and general policy parameters. 2. **Targeted**: The tax expenditure has a clearly stated purpose, long-term goals, and measurable annual targets designed to mark progress toward the goals. 3. **Transparent**: The tax expenditure requires at least annual reporting by the recipients, the Taxation and Revenue Department, and other relevant agencies. 4. **Accountable**: The required reporting allows for analysis by members of the public to determine progress toward annual targets and determination of effectiveness and efficiency. The tax expenditure is set to expire unless legislative action is taken to review the tax expenditure and extend the expiration date. 5. **Effective**: The tax expenditure fulfills the stated purpose. If the tax expenditure is designed to alter behavior – for example, economic development incentives intended to increase economic growth – there are indicators the recipients would not have performed the desired actions "but for" the existence of the tax expenditure. 6. **Efficient:** The tax expenditure is the most cost-effective way to achieve the desired results.

LFC Tax Expenditure Policy Principle	**Met?**	**Comments**
Vetted	✗	Was not vetted by interim legislative committees
Targeted		
Clearly stated purpose	✗	
Long-term goals	✗	
Measurable targets	✗	
Transparent	✓	
Accountable		
Public analysis	✗	
Expiration date	✗	
Effective		
Fulfills stated purpose	?	There is no purpose statement
Passes "but for" test	?	
Efficient	✗	
Key: ✓ Met ✗ Not Met ? Unclear		

IT/rl