FISCAL IMPACT REPORT

SPONSOR Pirtle **ORIGINAL DATE** 02/15/21
LAST UPDATED **HB**

SHORT TITLE Small Business Pandemic Takings Reparations **SB** 79

ANALYST Torres

APPROPRIATION (dollars in thousands)

Appropriation		Recurring or Nonrecurring	Fund Affected
FY21	**FY22**		
	$55,000.0	Nonrecurring	General Fund

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY20	**FY21**	**FY22**	**FY23**	**FY24**		
	(Negative, likely in the tens of millions)				Recurring	General Fund

Parenthesis ( ) indicate revenue decreases

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

FY21	FY22	FY23	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
$25.8	$434.5	$434.5	$894.8	Recurring	General Fund- TRD

Parenthesis ( ) indicate expenditure decreases

SOURCES OF INFORMATION
LFC Files

Responses Received From
New Mexico Attorney General (NMAG)
Taxation and Revenue Department (TRD)
Economic Development Department (EDD)

SUMMARY

Synopsis of Bill

Senate Bill 79 (SB79) appropriates $55 million from the general fund to the pandemic reparations fund for the purpose of administering the newly created "Small Business Pandemic Reparations Tax Credit." The bill also accomplishes the following:

- **Section 1:** This section adds the denial or failure to allow an application of eligibility for a small business pandemic reparations tax credit to the list of actions that a taxpayer can file a protest for. The protest must be filed within 90 days of the denial or claim.
- **Section 2, 3, 4:** These sections create the Small Business Pandemic Taking Reparations Act to allow New Mexico to provide compensation for private property taken or damaged for public use.
- **Section 4:** This section outlines the small business reparations tax credit. This credit can be applied against personal income tax or corporate income tax liability. The credit is the amount of compensation determined to be owed to the small business (defined as a business with fewer than 150 full- or part-time employees) pursuant to the Act. If the amount of the credit is more than the amount of tax due for the year it is claimed, then the excess credit shall be refunded if there is enough money in the Pandemic Reparations Fund (Section 7). If there is no money in the fund the credit can be carried forward for 20 consecutive taxable years.
- **Section 6:** This section outlines the responsibilities of the pandemic reparations division of TRD, created by the bill. This bill specifies that once a certificate of eligibility is applied for, TRD must respond with an approval or denial within 180 days. This section also specifies the new division is responsible for determining the amount of the business reparations tax credit. This credit amount includes expenses incurred directly as a result of complying with the public health order, minus any state and federal government assistance received by the small business; however, the bill is silent on exactly what expenses would qualify and places no cap on the amount of credit that can be claimed. TRD will then issue a certificate of eligibility. This section also requires TRD to enact regulations that govern the evaluation of an acceptance of the small business pandemic reparations tax credit. TRD will provide a report to the Legislature on the use of this credit by September of every year.
- **Section 7:** Creates the Pandemic Reparations fund that will be funded initially as outlined in Section 9 of this bill. There is no provision for ongoing yearly appropriations, although the formation of the fund creates an expectation for future legislatures to appropriate revenues to the fund for the purpose of the credit.
- **Section 9:** Appropriates $55 million from the general fund to the pandemic reparations fund for expenditure in FY2022 and subsequent fiscal years. Any unexpended or unencumbered balance remaining at the end of a fiscal year shall not revert to the general fund.

There is no effective date of this bill. It is assumed that the effective date is 90 days following adjournment of the Legislature.

FISCAL IMPLICATIONS

SB79 creates a tax credit that reduces income tax liability based on expenses and damages incurred during the pandemic in a manner determined by TRD. If the amount of the credit exceeds the taxpayer's liability, they are eligible to receive a refund equal to that amount. Refunds will be paid for by the $55 million appropriation provided by SB79 to the newly created pandemic reparations fund.

Although this bill appropriates $55 million from the general fund to pay out the refundable portions of the pandemic reparations credits, the cost of the bill is not limited to $55 million. Because the bill reduces taxpayer liability and provides no limit in the amount of damages that can be claimed, the credit will result in general fund revenue losses from the reduced liability even if a refund is not claimed. This cost will likely be in the tens of millions. Because the bill requires TRD to establish rules for the amount of the credit and is ambiguous on the amount of damages that can be claimed, the total amount of reduced tax payer liability is unknown. Additionally, since the bill defines small businesses as those with less than 150 employees (which is estimated to be over 46 thousand businesses, or 98 percent of all businesses in New Mexico) and many of those businesses incurred additional costs and lost revenues due to the pandemic and business closures, it is assumed that a significant number of businesses would be eligible for this credit.

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.

Estimating the cost of tax expenditures is difficult. Confidentiality requirements surrounding certain taxpayer information create uncertainty, and analysts must frequently interpret third-party data sources. The statutory criteria for a tax expenditure may be ambiguous, further complicating the initial cost estimate of the expenditure's fiscal impact. Once a tax expenditure has been approved, information constraints continue to create challenges in tracking the real costs (and benefits) of tax expenditures.

SIGNIFICANT ISSUES

The New Mexico Attorney General notes the following:

> SB79's implementation hinges on a significant Constitutional issue: whether the State's emergency health orders, brought on by the Covid-19 pandemic, constitutes a taking. The New Mexico Supreme Court recently heard oral arguments on this question and the court's decision is pending.

The Taxation and Revenue Department highlights:

> This bill is loosely couched in terms of compensation to businesses for an unconstitutional "taking" of private property for public use. Under analogous federal constitutional law, "the Takings Clause is designed to bar Government from forcing some people alone to bear public burdens which, in all fairness and justice, should be borne by the public as a whole." *Arkansas Fish and Game Comm'n v. U.S*, .568 U.S. 23 (2012). This area of law is not well defined. Protecting the public in general is a recognized exception to the "Takings Clause".
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> The term "reparations" may be best replaced with "Compensation". This bill does not address reparations for unlawful acts by the New Mexico government. The bill appears to be an effort to compensate small businesses for losses resulting from Covid-19 public

health orders, which result from the Covid-19 pandemic. The federal government has taken similar action on a variety of fronts in Covid-19 relief legislation.

The bill only requires that a taxpayer "allege" that a business closure was due to a public health order, which invites fraud. While the newly created pandemic reparations division will determine whether such allegations are true under the bill, the department anticipates that there will be extensive litigation and appeals from claimants whose claims are denied in whole or in part, at potentially great cost to the department in time and money.

PERFORMANCE IMPLICATIONS

The New Mexico Attorney General may be called upon to challenge the actions of a small business in the event its application for tax credits is denied, and may incur additional costs in litigation and attorney hours that may have been spent on other issues.

ADMINISTRATIVE IMPLICATIONS

TRD does not believe that it is necessary to create a new division to administer the credit. Infrastructure is already in place to administer several business credits across various tax programs. TRD estimates that two full-time employees would be needed to administer the credit. The recurring budget estimate for TRD is based on 2 Tax Examiner-A, 2 Tax Auditor III, 1 Paralegal-A, and 2 Attorney 4 positions.

TRD Information Technology Division (ITD) will require approximately 500 hours of effort or approximately 3 months for an estimated $25,820 of staff workload costs. This estimate is for implementing the new small business reparations tax credit. The effective date of June 18, 2021 will be challenging to meet considering the effort required. A more feasible date would be October 1, 2021. These estimates assume legal interpretation of the final bill and complete technical requirements are completed timely to configure the GenTax system.

TECHNICAL ISSUES

TRD identified the following technical issues:

[Section 3] The public health order, for the benefit of all, does not constitute a "taking" without just compensation as contemplated by the New Mexico or U.S. Constitutions. There is deprivation of use of property (business facilities), but all New Mexicans are affected by the public health orders. The bill implies that the restrictions benefit the State exclusively and therefore the State is solely responsible for compensation. The department also questions whether all business defined as "small" by the statute, being those with fewer than 150 full- or part-time employees, are small, and suggests that use of a gross revenue threshold or similar measure may better capture small businesses. The bill also fails to define "employee", and therefore a business that uses 150 or more contractors, rather than employees, may qualify for the credit, which does not appear to be the intent of the bill.

[Section 5] In sub-part A, TRD suggests clarifying what taxable year the credit can be claimed and how many times per year taxpayers can apply. The "closure" of a business will need to be defined to clarify whether that means total cessation of business, temporary closure or both.

[Section 6] Under subsection A(3)(a), the pandemic reparations division is required to determine whether a small business was closed "as a result of a public health order." Such determinations of causation are not within the department's expertise. The department is authorized to employ personnel and consultants to carry out the provisions of the bill; nevertheless, determinations of causation are difficult, if not impossible, to make in such situations. For example, a business may close for multiple reasons, of which response to a public health order may be just one. The bill does not provide for apportionment of fault among multiple causes. Finally, customer behavior was also affected by public health orders; even if retailers, e.g., were allowed to operate at partial capacity under a public health order, such retailers may have lost business, and suffered closure, due to the reluctance of consumers to patronize in-person establishments, and not due directly to a public health order. For these reasons, the department will have difficulty determining that a business was closed due to a public health order. Additionally, these factors mean that the department's determinations are likely to be challenged by disappointed taxpayer applicants for the credit, greatly increasing the administrative burden on the department and the administrative hearings office.

Under sub-section A(3)(d) of Section 6, TRD is directed to determine the amount of losses incurred by a business to determine the credit amount. The bill language lacks clarity on how these losses are to be determined. As part of defining losses, "state and federal government assistance" listed in the sub-section will also need to be defined. This clarity is needed for both TRD and the taxpayer to properly assess losses and determine eligibility for the credit.

It is not clear that a public health order, for the benefit of all, constitutes a "taking" without just compensation as contemplated by the New Mexico or U.S. Constitutions. There is deprivation of use of property (business facilities), but all New Mexicans have been affected by the public health orders and the State was not the sole beneficiary of the health orders.

[Section 5] In sub-part B, lines 2 through 5 on page 7, the bill stipulates that the credit may be carried forward for a period of 20 years. This is administratively difficult and TRD recommends the credit expire after three consecutive tax years.

[Section 5] Per sub-part C, a taxpayer must file their application for the credit by the end of the year when the closure occurred. This would place any closures or "takings" occurring in 2020 out of the scope of the credit as that year has ended.

This bill does not contain a delayed repeal date. LFC recommends adding a delayed repeal date.

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	✘	
Targeted		
Clearly stated purpose	✓	
Long-term goals	✘	
Measurable targets	✘	
Transparent	✓	
Accountable		
Public analysis	✓	
Expiration date	✓	
Effective		
Fulfills stated purpose	?	
Passes "but for" test	?	
Efficient	?	
Key: ✓ Met ✘ Not Met ? Unclear		

IT/al/sb