FISCAL IMPACT REPORT

		LAST UPDATED	2/6/23
SPONSOR	Chandler/Wirth	**ORIGINAL DATE**	2/1/23
SHORT TITLE	Index Modified Gross Income Amounts	**BILL NUMBER**	House Bill 81/aHCPAC
		ANALYST	Faubion

REVENUE*
(dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY23	FY24	FY25	FY26	FY27		
--	($18,400)	($18,800)	($19,200)	($19,600)	Recurring	General Fund

Parenthesis ( ) indicate revenue decreases
*Amounts reflect most recent version of this legislation.

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT*
(dollars in thousands)

	FY23	FY24	FY25	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
	$5.5	$5.5	$5.5	$16.5	Recurring	TRD/ITD
Total	**$5.5**	**$5.5**	**$5.5**	**$16.5**		

Parentheses ( ) indicate expenditure decreases.
*Amounts reflect most recent version of this legislation.

Sources of Information
LFC Files

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

SUMMARY

Synopsis of HCPAC Amendment

The House Consumer and Public Affairs amendment to Senate Bill 81 changes the consumer price index referenced for use for the 2024 taxable year from 2023 to 2022. This addresses a technical issue in the base year used in the inflation adjustment to correct a one-year lag beginning in FY25 (see *Other Substantive Issues*).

Synopsis of Original House Bill 81

House Bill 81 (HB81) mandates the income levels eligible to receive the low-income comprehensive tax rebate (LICTR) be adjusted to account for inflation each taxable year. HB81 also adjusts the 2023 tax year base table, expanding the income range and slightly increasing the rebate amount.

This bill does not contain an effective date, and as a result, would go into effect June 16, 2023, (90 days after the Legislature adjourns) if signed. The provisions of the bill apply to taxable years beginning on or after January 1, 2023.

FISCAL IMPLICATIONS

HB81 indexes both the LICTR payment amount and the eligible income levels to inflation, allowing both to grow with inflation. HB81 links the income thresholds to the consumer price index, increasing the income levels by the inflation rate, except in instances where the inflation rate would result in a downward revision.

The Taxation and Revenue Department (TRD) applied the proposed LICTR amounts by modified gross income (MGI) level and number of exemptions to historical data using tax year 2021. The average rebate amount for the current population claiming the rebate increases from approximately $142 to $164. The fiscal impact includes the expanded population of eligible taxpayers who can now qualify under the higher threshold of $39 thousand MGI, about 29 thousand additional taxpayers. Their average rebate amount is estimated at $32 per taxpayer. Additionally, the estimate includes a population of taxpayers who are currently eligible but have not claimed the rebate in the past. As the rebate amount increases, this may incentivize those currently eligible to claim the rebate, and TRD assumes that those taxpayers who currently have a modified gross income that meets the income levels would now claim the rebates. The annual growth in the estimate is based on IHS Markit's January 2023 forecast for the consumer price index. The growth is applied starting with tax year 2024, impacting FY25, based on the application of the index under current law Section 7-2-14 (F) NMSA 1978 and new proposed Section 7-2-14 (G) NMSA 1978 to index the MGI ranges (see *Other Substantive Issues* for detail on the application of the index).

This bill creates or expands a tax expenditure with a cost that is difficult to determine but likely significant. LFC has serious concerns about the significant risk to state revenues from tax expenditures and the increase in revenue volatility from erosion of the revenue base. The committee recommends the bill adhere to the LFC tax expenditure policy principles for vetting, targeting, and reporting or action be postponed until the implications can be more fully studied.

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

HB81 will index both the rebate amount and the eligible income levels to inflation, allowing both to grow as inflation pushes prices, and usually wages, higher. The rebate amount has been indexed to inflation since 2021, allowing the payment to keep up with inflation. This bill requires the income levels to also index to inflation, allowing incomes to naturally rise with inflation without "graduating" people off the rebate who may still need the support. Without adjusting the income eligibility for inflation, the rebate will "phase out" as people's incomes rise above the static eligibility income thresholds. This bill will eliminate the phase-out of LICTR as incomes rise.

Allowing tax expenditures to phase out with inflation acts like a sunset and allows future legislatures to decide whether the rebate or credit should be continued and at what level. Indexing both the rebate level and the income thresholds creates permanence to this rebate, requiring statutory changes to eliminate or reduce the benefit.

TRD notes by indexing the MGI ranges along with the current law to index the rebate amount to the consumer price index, the proposed change provides consistent tax relief to low-income residents, often measured by the Federal Poverty Guideline, as that population's income increases with inflation. So, for example, for a family of four in 2003, the Federal Poverty Guideline was $18,400 of annual income. Twenty years later the Federal Poverty Guideline for a family of four in 2023 is $30 thousand annual income, a 63 percent increase or an average annual increase of 3.2 percent.[1] The new proposed indexing of the MGI ranges will thus maintain the rebate purchasing power to the population in New Mexico that is low-income. This will maintain progressivity in the income tax structure through LICTR, progressivity being where higher-earning taxpayers pay a larger share of their income in tax compared to lower-earning taxpayers.

Taxation and Revenue's 2021 Tax Expenditure Report states the following regarding LICTR:

> LICTR may be claimed by taxpayers with a modified gross income of less than $22 thousand. The rebate amount is dependent upon modified gross income as well as the number of personal exemptions claimed, defined as the sum of the taxpayer, spouse and dependents reported on the taxpayer's federal return, and varies between $15 and $730. LICTR provides a valuable offset to New Mexico's regressive GRT, which is relatively high compared to gross receipts and sales taxes in other states. LICTR phases out as income rises, ensuring a smooth tapering off of this support to low-income taxpayers. The 2021 amendment provides that LICTR will be adjusted for inflation in future years, ensuring that the support offered by LICTR is not diluted over time. In the last five fiscal years, on average 227 thousand taxpayers have benefitted from this rebate each year.

PERFORMANCE IMPLICATIONS

The LFC tax policy of accountability is <u>not</u> met since TRD is <u>not</u> 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

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[1] https://aspe.hhs.gov/topics/poverty-economic-mobility/poverty-guidelines

purpose. This rebate is included in TRD's annual tax expenditure report, including number of claims and total cost.

ADMINISTRATIVE IMPLICATIONS

TRD will need to make annual information system changes and update forms, instructions, and publications. These changes will be incorporated into annual tax year implementation starting with tax year 2023 and each subsequent tax year and represent $5,554 in workload costs for the TRD's Information Technology Division (ITD).

OTHER SUBSTANTIVE ISSUES

TRD, in preparing to index LICTR rebate amounts for tax year 2022, found that the way the statute is written for taxable year 2022, the numerator is the Consumer Price Index (CPI) on September 30 of the prior taxable year, or 2021 and the denominator is also the CPI on September 30, 2021. Therefore, the fraction for taxable year 2022 is 1, and there was no change to any rebate amount. TRD determined that this calculation will result in an inflation adjustment in taxable year 2023, and that adjustment will account for the high inflation rate during 2022. The adjustments for this bill to index both the rebate amount and the income ranges will simply lag by one year going forward starting in tax year 2025. **HCPAC amendment addresses this issue by amending the base year to 2022 instead of 2023.**

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	✘	This bill was not vetted through an interim legislative committee.
Targeted		
Clearly stated purpose	✘	No stated purpose.
Long-term goals	✘	No stated long-term goals.
Measurable targets	✘	No measurable targets.
Transparent	?	This bill does not require annual reporting to interim legislative committees. It is included in TRD's tax expenditure report.
Accountable		
Public analysis	?	As there are no stated annual targets or goals, there is nothing from which to determine progress, effectiveness, or efficiency.
Expiration date	✘	There is no expiration date.
Effective		
Fulfills stated purpose	?	As there are no states annual targets or goals, there is nothing from which to determine effectiveness or passing of the "but for" test.
Passes "but for" test	?	
Efficient	?	No stated desired results.
Key: ✓ Met ✘ Not Met ? Unclear		

JF/al/ne/rl