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FISCAL IMPACT REPORT

LAST UPDATED 2/17/23
SPONSOR Cadena **ORIGINAL DATE** 2/4/23
SHORT TITLE GRT Deductions for Child Care Assistance **BILL NUMBER** House Bill 137

ANALYST Torres, I.

REVENUE* (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY23	FY24	FY25	FY26	FY27		
	($7,280.0)	($7,480.0)	($7,730.0)	($7,910.0)	Recurring	General Fund
	($8,230.0)	($8,450.0)	($8,730.0)	($8,930.0)	Recurring	Local Governments

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

Sources of Information

LFC Files

Responses Received From
New Mexico Attorney General (NMAG)
Taxation and Revenue Department (TRD)
Early Childhood Education and Care Department (ECECD)

SUMMARY

Synopsis of House Bill 137

House Bill 137 creates a new gross receipts tax (GRT) deduction for the sale of childcare assistance through either a licensed childcare assistance program or a for-profit prekindergarten provider.

For licensed childcare assistance services, the provider's receipts must be pursuant to a contract or grant with the Early Childhood Education and Care Department and through a licensed childcare assistance program.

For a for-profit prekindergarten provider, the services must be pursuant to the Prekindergarten Act.

Finally, HB137 creates a requirement for the Taxation and Revenue Department (TRD) to compile an annual report to be presented to the Revenue Stabilization and Tax Policy Committee and Legislative Finance Committee.

The effective date of this bill is July 1, 2023.

FISCAL IMPLICATIONS

The Early Childhood Education and Care Department (ECECD) used data from provider payments on file to determine the GRT deduction would cost at least $16.4 million from the deduction of GRT on ECECD contracts and grants alone. In attempting to determine additional revenue impacts, TRD used data from the most recent *PreK Annual Report, 2018-2019 School Year, February 2020* from the Public Education Department and Children, Youth and Families Department and *The State of Preschool 2021 – State Preschool Yearbook* about New Mexico from the National Institute for Early Education Research to estimate the receipts of prekindergarten providers eligible per the Prekindergarten Act.[1,2]

LFC staff estimated the cost using ECECD contract and grant totals, reported children served, and for-profit data. Estimates also use total births in the state by year from the Department of Health and childcare uptake data provided by the U.S. Census Bureau. Finally, estimates use the average weighted municipal gross receipts tax rate of 8.04 percent. The annual fiscal impacts used the GRT revenue growth from the December 2022 Consensus Revenue Estimating Group (CREG) forecast.

Using these sources, LFC staff estimates deducting for-profit prekindergarten exemptions from the gross receipts tax is likely to reduce total revenues by around $4 million a year. Similarly, deducting childcare contracts from the gross receipts tax is likely to reduce total collections by nearly $11.5 million a year. Because most childcare and prekindergarten services are in a municipality, the state share of the total cost is estimated to be 47 percent with the remainder representing costs to local governments.

This bill creates or expands a tax expenditure with a cost that is difficult to determine but likely significant. LFC has concerns about the 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 and targeting.

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 Early Childhood Education and Care Department notes:

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[1] https://webnew.ped.state.nm.us/wp-content/uploads/2020/08/PreK-2018-19-Annual-Report.pdf
[2]National Institute for Early Education Research, www.NIEER.org, https://nieer.org/wp-content/uploads/2022/04/New_Mexico_YB2021.pdf

> ECECD has received feedback in stakeholder roundtables that the collection of gross receipts taxes from for-profit childcare providers and PreK providers creates an unlevel playing field between for profit and non-profit and government entities. To be responsive to stakeholder concerns, ECECD included gross receipts taxes in its federally approved cost estimation model and approved alternative methodology that informed the new childcare reimbursement rates. If HB 137 were to pass, ECECD may need to reconsider its cost estimation model and rate setting for childcare payments and amend both administrative rule and its approved childcare development fund (CCDF) plan.
>
> Approved in accordance with its CCDF plan, the cost estimation model that replaced the market rate survey to reflect the true cost of care of childcare was the culmination of a year's worth of work and was an important step toward reimbursing and supporting our childcare industry for actual costs. As such, if HB137 were to pass, ECECD would need to revise its current rates (either through amending the current plan or in the next four-year cycle) to reflect the reduced costs paid by private childcare providers.

According to the Taxation and Revenue Department:

> The bill proposes a GRT tax deduction to support the provision of childcare assistance and prekindergarten services. It is, however, unclear what the purpose of this bill is. For instance, it is unclear whether the bill attempts to assist providers of these services so that they can hire more staff and increase the wages of their workers to improve the quality of these services or to aid in subsidizing childcare for low and middle income families. TRD suggests including a purpose statement in the bill to make the goal more transparent, which would help to evaluate the effectiveness of the deductions.
>
> While tax incentives may support particular industries or encourage specific social and economic behaviors, the proliferation of such incentives complicates the tax code. Adding more tax incentives: (1) creates special treatment and exceptions to the code, growing tax expenditures and/or narrowing the tax base, with a negative impact on the general fund; and, (2) increases the burden of compliance on both taxpayers and TRD. Adding complexity and exceptions to the tax code does not comport generally with the best tax policy.

This bill narrows the gross receipts tax (GRT) base. Many of the efforts over the last few years to reform New Mexico's taxes focused on broadening the GRT base and lowering the rates. Narrowing the base leads to continually rising GRT rates, increasing volatility in the state's largest general fund revenue source. Higher rates compound tax pyramiding issues and force consumers and businesses to pay higher taxes on all other purchases without an exemption, deduction, or credit.

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.

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/mg/hg/mg/al/ne