FISCAL IMPACT REPORT

		LAST UPDATED	
SPONSOR	Chandler	**ORIGINAL DATE**	1/31/23
SHORT TITLE	Increase Certain Child Income Tax Credit	**BILL NUMBER**	House Bill 144
		ANALYST	Faubion

REVENUE*
(dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY23	**FY24**	**FY25**	**FY26**	**FY27**		
--	($102,600.0)	($102,600.0)	($106,900.0)	($109,200.0)	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
	$5.6	$5.6	$5.6	$16.8	Recurring	TRD/ITD
Total						

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)
Taxation and Revenue Department (TRD)

SUMMARY

Synopsis of House Bill 144

House Bill 144 (HB144) increases the child tax credit for the lowest three income levels from $175 to $600, $150 to $400, and $125 to $200. The bill also adds language to annually adjusts the credit amounts to account for inflation.

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.

FISCAL IMPLICATIONS

HB144 provides a much larger child tax credit for incomes up to $75 thousand than is currently outlined in statute. For people with incomes from $0 to $25 thousand, the credit is increased from $175 to $600. For people with incomes from $25 thousand to $50 thousand, the credit is increased from $150 to $400. For people with incomes from $50 thousand to $75 thousand, the credit is increased from $125 to $200. The remaining credit amounts for people with incomes from $75 thousand and up remain the same.

The impact of the new proposed child tax credit amounts for taxpayers with adjusted gross income under $75 thousand was estimated using tax return data for New Mexico taxpayers for tax years 2020 and 2021. Due to unavailability on the number of qualifying children each taxpayer has, the Taxation and Revenue Department (TRD) estimated the impact based on the number of exemptions each taxpayer claimed and their filing status. TRD's estimate of the increased fiscal impact by raising the credit amount for those under $75 thousand is based on the average impact for the last two tax years. 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 2025, impacting FY26, based on the application of the index under new proposed Section 7-2-18.34 (D) NMSA 1978. (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

Indexing the tax credit amount to inflation will ensure that the real value of the credit does not erode as prices rise. Especially given the recent high inflation, this ensures the credit maintains its intended value of the benefit regardless of what happens with inflation. TRD notes that by indexing the credit amount to the consumer price index, the proposed change maintains the 'real' buying power of the credit as inflation occurs year over year. A family with children will see the economic impact of the credit remain steady year-over-year as it applies that credit to the consumption of necessities such as food, childcare, gasoline, and housing. These areas of consumption in particular make up a larger proportion of income among the lower-income earners compared to higher-income earners.

The structure of the child tax credit creates "cliff effects" between each credit amount where taxpayers' credit amount is decreased dramatically as soon as they enter into a new income bracket. For example, someone making $24,999 will qualify for a $600 per child credit while someone making $25,001, effectively the same income, will only qualify for a $400 credit and have a higher tax liability than the other taxpayer. This creates issues with horizontal equity at those thresholds.

TRD notes the increase to the child tax credit will continue to erode horizontal equity in the state income taxes. By basing the credit on number of qualifying children, taxpayers with same level of income are no longer treated equally. Thus, two New Mexico residents who earn the same salary may have different tax liability given how many children they choose to have in their household. The credit will provide greater tax benefit to families with greater number of children. However, child tax credit is a tool to provide economic aid to families with children and is particularly helpful to lower income families. The increase to the credit amount is targeted at those with adjusted gross income below $75 thousand. This can be expected to result in a reduction in child poverty and hunger in the state.

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 credit and other information to determine whether the credit is meeting its purpose.

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).

TECHNICAL ISSUES

On page, lines 18 and 21 refers to the child income tax credit as a 'rebate.' TRD recommends striking the work 'rebate' and replacing it with 'child income tax credit' to be consistent with the section of law.

OTHER SUBSTANTIVE ISSUES

TRD notes the following:

> The new indexing language for the Child Income Tax Credit under proposed Section 7-2-18.34 (D) NMSA 1978, is parallel to the language in current law for the low-income comprehensive tax rebate (LICTR) under Section 7-14-3 (F) NMSA 1978. TRD in preparing to index LICTR 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 was 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 and other indexed legislation utilizing this language will simply lag by one year going forward.

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	?	While the current child tax credit was debated during the 2022 legislative session, this proposal has not been vetted in an interim 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 require annual reporting to interim legislative committees.
Accountable		
Public analysis	?	As there are no states annual targets or goals, there is nothing from which to determine progress, effectiveness, or efficiency.
Expiration date	✓	The tax exemptions expire at the end of tax year 2031.
Effective		
Fulfills stated purpose	?	As there are no stated 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