TAXATION & REVENUE
NEW MEXICO

New Mexico 2021
Tax Expenditure Report

Presented to the
Revenue Stabilization and Tax Policy Committee

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What is a Tax Expenditure Report?

- Tax expenditure reports (TER) describe areas where the tax code provides for preferential tax treatment of a certain activity
- The TER includes an estimate of revenue foregone because of the preferential tax treatment due to:
  - Credits
  - Deductions
  - Exemptions
  - Preferential tax rates
- Every dollar of revenue foregone is a dollar that cannot be appropriated or added to reserves
- State appropriations are rigorously evaluated and reprioritized annually; tax expenditures should be similarly revisited
- TER are important transparency tools that allow State policymakers, advocacy groups, and the public an opportunity to regularly evaluate the State's tax code

New Mexico's Tax Expenditure Report

- Annual TER has been produced by Tax & Rev since 2012
- Follows format that has evolved over time
  - Separately identifies each "deviation" from the tax base
  - Categorizes each deviation as a tax expenditure, non tax expenditure, or "arguable"
  - Provides a description of each expenditure, the statutory reference, purpose, amendment history, estimated cost, evaluation, and recommendations
  - Tax & Rev constantly seeks to improve cost estimates
  - Categorizes each expenditure as existing for citizen benefit, economic development, environment, highly-specialized industries, or health care
- Past reports can be found at www.tax.newmexico.gov, then under Forms & Publications, Publications, Tax Expenditure Reports

What are the Differences? Exclusions

- **Exclusions** – amounts of gross receipts, gross income, or other amount that is removed <u>to define the tax base</u>
  - Taxpayers exclude certain amounts of their "base income" to derive "net income" on which tax is imposed. § 7-2-2(N)
  - The property tax excludes personal property and has a 3% limit on annual value growth on residential property

What are the Differences? Exemptions

- **Exemptions** – often eliminate a taxpayer's obligation to register, report, and/or pay
- Tax & Rev does not have visibility into income or receipts that are exempt because they are not reported on a tax return
- Exemptions can hinge on the nature or character of the taxpayer:
  - Insurance companies are exempt from CIT because they pay premium tax
  - Nonprofits and disabled street vendors are exempt from GRT
  - Active duty armed forces salaries and persons over 100 years of age are exempt from PIT
  - Certain disabled military veterans are exempt from motor vehicle excise tax
- Exemptions can hinge on the nature of the transaction:
  - Commercial vehicles operating within 10 miles of the Mexico border are exempt from weight distance tax and trip tax
  - Receipts from sale and use of vehicles on which motor vehicle excise tax is imposed are exempt from GRT and compensating tax
- Generally, if the exemption is full and applies to the nature of the taxpayer, or if a taxpayer solely engages in exempt transactions, there is no registration or filing obligation

What are the Differences? Deductions

- **Deductions** - reduce liability by making certain transactions or income reported on returns nontaxable
- Deductions and exemptions have the same effect on a taxpayer's tax liability, but differ in taxpayer reporting obligations
- Deductions lower the tax base before calculating tax due
  - For GRT, taxpayers report a gross amount of receipts, then subtract the amount of the receipts that are deductible to compute taxable gross receipts
  - Some deductions are combined on a return; others are separately reported
  - Many GRT deductions statutorily require the seller to be in possession of a Nontaxable Transaction Certificate (NTTC) or alternative evidence at the time the return is due for the receipts from the transactions or within sixty days of a Tax & Rev audit notice
- Examples
  - Back-to-School Tax-Free Weekend GRT receipts deduction
  - 40% capital gains deduction from PIT
  - Food for home consumption GRT deduction
  - Health care practitioner services GRT deduction
  - Sale of prosthetic devices GRT deduction

What are the Differences? Credits

- **Credits** – reduce a taxpayer's tax liability dollar for dollar
  - Many credits require an application for approval to either Tax & Rev or another certifying agency before the credit is allowed
  - Where deductions and exemptions apply to one tax program, credits can offset tax liabilities across several tax programs
  - Credits can be transferrable
  - Credits can be refundable or carried forward to future tax years if the amount of the credit exceeds the taxpayer's tax liability
  - Examples:
    - Working families tax credit for PIT
    - Angel investment PIT credit
    - Child care to prevent indigency PIT credit
    - Film tax credit against CIT and PIT
    - High-wage jobs credit against modified combined tax
    - Investment credit against GRT, Comp Tax, Withholding
    - Rural health practitioner PIT credit

Baseline System of Taxation

- Any tax program or baseline system of taxation is the application of a "tax rate" multiplied by a "tax base"
  - Common tax bases for New Mexico tax programs:
    - "Gross receipts" from sales of property or services or the "purchase value" of property (GRT/Comp)
    - "Net income" (CIT/PIT)
    - "Taxable value" (Severance-related taxes)
    - A percentage of "fair market value" for locally assessed property taxes
  - "Tax rate" is simply a percentage applied to the tax base

Tax Expenditures Must be a Deviation from the Tax Base

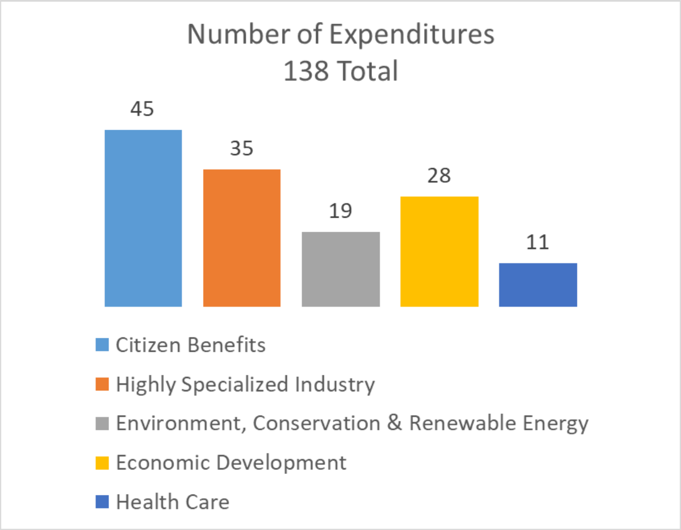
- Exclusions to derive the tax base are not considered deviations and are not considered tax expenditures
- Deviations can occur for many reasons:
  - “In lieu of” taxation
  - US constitutional prohibition or federal pre-emption
  - Government-to-government comity
  - To “true” a tax base – anti-pyramiding, bad debts
  - To provide special or preferential treatment to achieve a policy objective

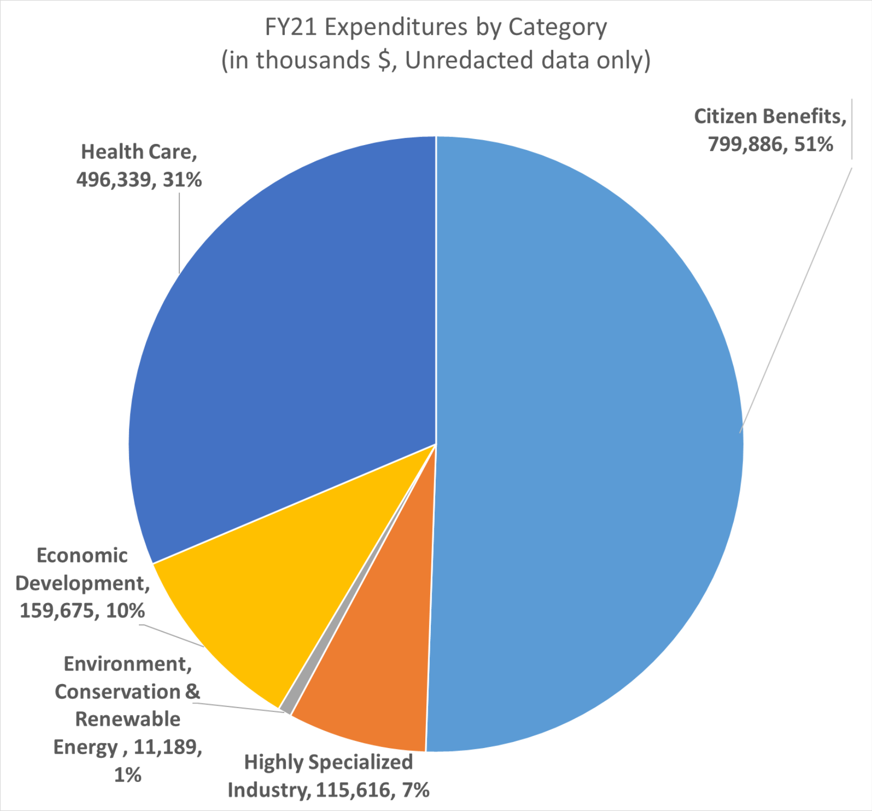
Tax Expenditures Must Convey Special Treatment

- Special treatment is typically evidenced by a policy choice regarding:
  - Benefitting a subset of the tax base
  - Benefitting a subset of the population or
  - Both
- Policy choices:
  - To benefit all, or a specific subset, of citizens
  - To induce economic development
  - To induce conservation
  - To aid specific industries

Tax Expenditures Categories

- Citizen Benefits: benefit all taxpayers or specific population (low-income, disabled, etc.), lessen the burden of taxation
- Economic Development: stimulate investment, job creation or job retention, attract industries
- Environment, Conservation, and Renewable Energy: support environmental health, promote conservation and renewable energy
- Health Care: increase access to or lower costs of health care
- Highly Specialized Industries: target specific or highly specialized industries





Expenditure Estimates – Data Reliability

- The estimated revenue foregone should be evaluated in conjunction with reliability factor
- Reliability depends on data available to Tax & Rev
  - Exemptions that are not reported will have low reliability
  - Deductions that are separately reported (21) will have higher reliability than deductions that are reported together
  - Credits have high reliability

Reliability Factor	Description	No. of Expenditures
1	Most reliable. No estimation	84
2	Estimated from GenTax data	15
3	Estimated from national data	16
4	Least reliable. Estimated from limited data	8
Unknown	No data available	15

Reporting by Tax Year & Fiscal Year

- Difference between
  - Tax Year (aka Calendar Year – Jan 1 to Dec 31) and
  - State Fiscal Year (July 1 to June 30)
- Income taxes are based on the tax year/calendar year
- But State budgeting is on a fiscal year basis
  - Assumption – revenues accompanying returns for a tax year go to the General Fund during the following fiscal year
  - Late filers and amended tax returns pose a challenge
- Issue most evident in the most recent tax year, when number of filers for that tax year may be smaller than usual, but revenue based on fiscal year maybe more or less stable due to filings for prior tax years trickling in.
- Example – Low Income Comprehensive Tax Rebate (LICTR) Tax Year vs Fiscal Year:

Tax Year (Calendar)	2016	2017	2018	2019	2020
Claims	241,664	228,278	219,520	216,591	207,947
Expenditure (thousands)	$19,176	$18,031	$17,203	$16,975	$16,777

Fiscal Year	2017	2018	2019	2020	2021
Claims	243,163	228,064	219,751	221,426	222,781
Expenditure (thousands)	$19,281	$18,025	$17,246	$17,395	$18,073

Beginning with this year's report, a portion of the PIT expenditures will be presented by both calendar year and fiscal year

New Additions in the 2021 Report – Recent Legislation

Expenditures	Legislative Session	2021 Amount ($000's) (Local and State)
Income Tax Rebate 2020 tax year filing (7-2-7.4 NMSA 1978)	2021	$98,766
New Solar Market Development Credit against PIT (7-9-18.31 NMSA 1978	2020	$3,360
Restaurant and Bar Temporary GRT Deduction (7-9-118 NMSA 1978)	2021	$51,065
Technology Readiness Credit against GRT (7-9-96.3 NMSA 1978)	2020	$0

New Additions in the 2021 Report - Reevaluations

Expenditures	FY21 Amount ($000's)
Molybdenum rate differential from Resource and Processors Tax (7-25-4A(3) & 7-25-5A(4) NMSA 1978)	$47
Potash rate differential from Resource and Processors Tax (7-25-4A(2) & 7-25-5A(3) NMSA 1978)	$1,258
Timber Rate Differential from Processors Tax (7-25-4A(2) NMSA 1978)	$0.6
Processing Natural Gas Deduction from Oil and Gas Emergency School Tax (7-31-6 NMSA 1978, Regulation 3.18.6.10)	$24,843
Reasonable Expense of Trucking Product to Market Deduction from Oil and Gas Emergency School Tax (7-31-5(C) NMSA 1978)	$2,038
Transportation Natural Gas Deduction from Oil and Gas Emergency School Tax (7-31-6 NMSA 1978,Regulation 3.18.6.9)	$32,055

Not Tax Expenditures
Royalties Paid or Due to the US, State of NM, or any Indian Tribe, Pueblo, or Ward of the US Deduction from Oil and Gas Severance Tax, Oil and Gas Conservation Tax, Oil and Gas Emergency School Tax, and Oil and Gas Ad Valorem Production Tax (7-29-4.1A, 7-29-4.1B, 7-30-5A(1), 7-30-5A(2), 7-31-5A, 7-31-5B, 7-32-5A(1) and 7-32-5A(2) NMSA 1978)
Reasonable Expense of Trucking Product to Market Deduction from Oil and Gas Severance Tax, Oil and Gas Conservation Tax, and Oil and Gas Ad Valorem Production Tax (7-29-4.1C , 7-30-5A(3), and 7-32-A(3) NMSA 1978)

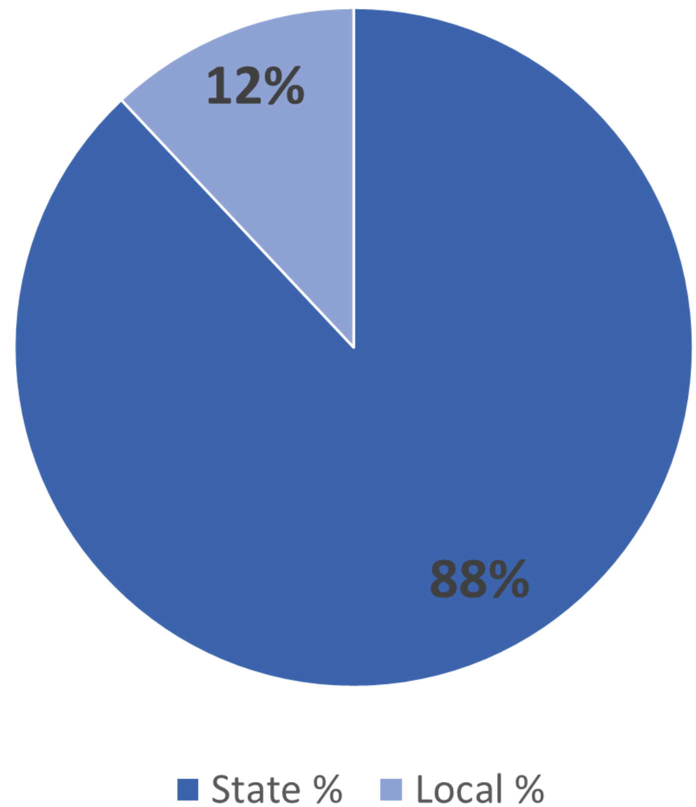
Top Ten Expenditures by Cost: 2021 compared to 2020

Name	2020 ($000's State & Local)	2020 Rank	2021 ($000's State & Local)	2021 Rank	
Sale of Food at Retail Food Stores GRT Deduction and Hold Harmless Distribution	599,700	1	442,464	1	Green
DOH-Licensed Hospitals 60 Percent GRT Deduction	219,789	2	227,147	2	Yellow
Prescription Drugs and Oxygen GRT and GGRT Deduction	173,600	3	183,000	3	Red
Income Tax Rebate 2020 tax year filing	NA	NA	98,766	4	Green
Working Families Credit against PIT	83,408	5	75,863	5	Green
Health Care Practitioner Services GRT Deduction and Hold Harmless Distribution	84,500	4	71,662	6	Green
Restaurant and Bar Temporary GRT Deduction	NA	NA	51,065	7	Green
Nonprofit Organizations Exemption from GRT	49,118	7	50,600	8	Red
Apportionment Election for CIT Manufacturers	34,643	9	42,876	9	Yellow
Film and Television Credit against PIT and CIT	55,596	6	39,824	10	Green
Capital Gain Deduction From PIT	41,226	8	31,587	12	Green
Low- and Middle-Income Taxpayers Exemption from PIT	18,872	10	20,170	14	Green

Tax Expenditure Incidence

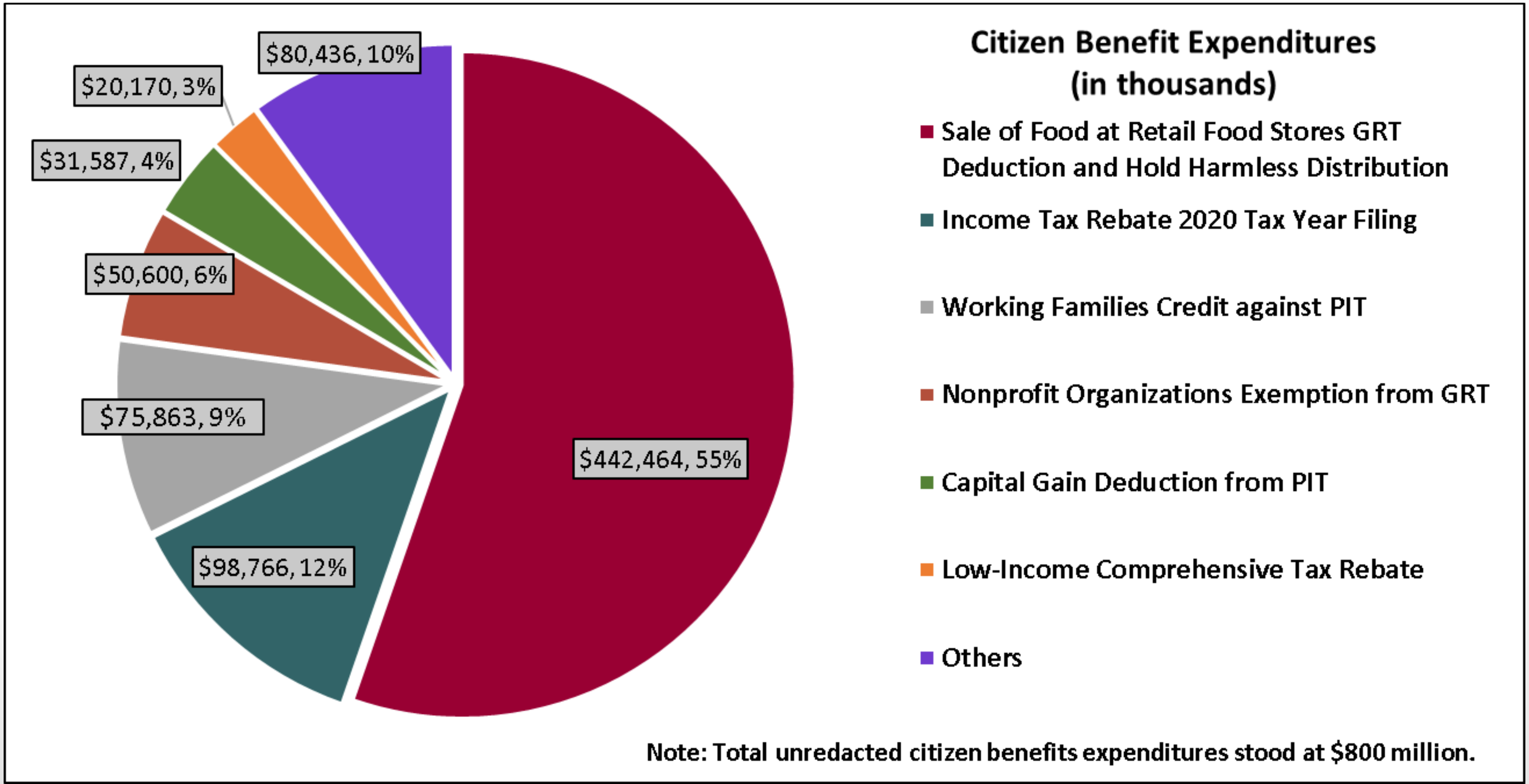
- GRT incidence for deductions and exemptions is shared between the State General Fund and local governments in most cases
- Tax expenditures for CIT, PIT, etc., generally impact only State General Fund directly

FISCAL YEAR 2021 EXPENDITURES BY STATE AND LOCAL TAX INCIDENCE



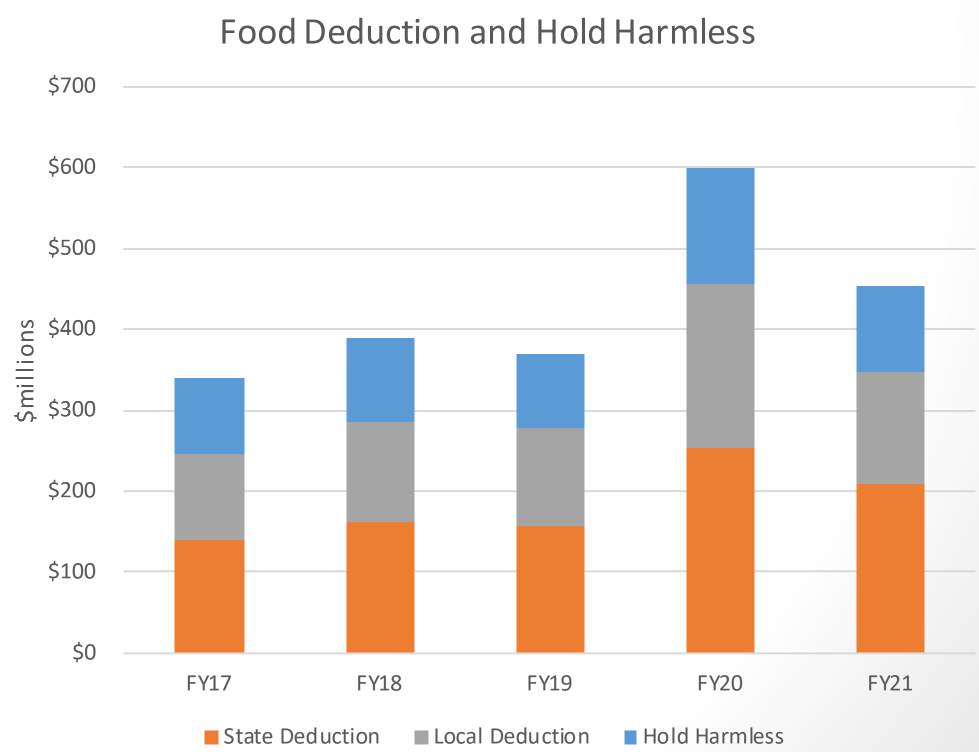
Citizen Benefits

- Represent the largest share of tax expenditures in 2021 - $800 million or 51%
- The largest reported contributor is the Food Deduction and Hold Harmless Distribution
  - Broadest citizen benefit as well
- $600 one-time income tax rebate for TY 2020 was the second largest contributor
- 45 Expenditures in this category
  - 8 with $0 fiscal impact
  - 5 with unknown costs



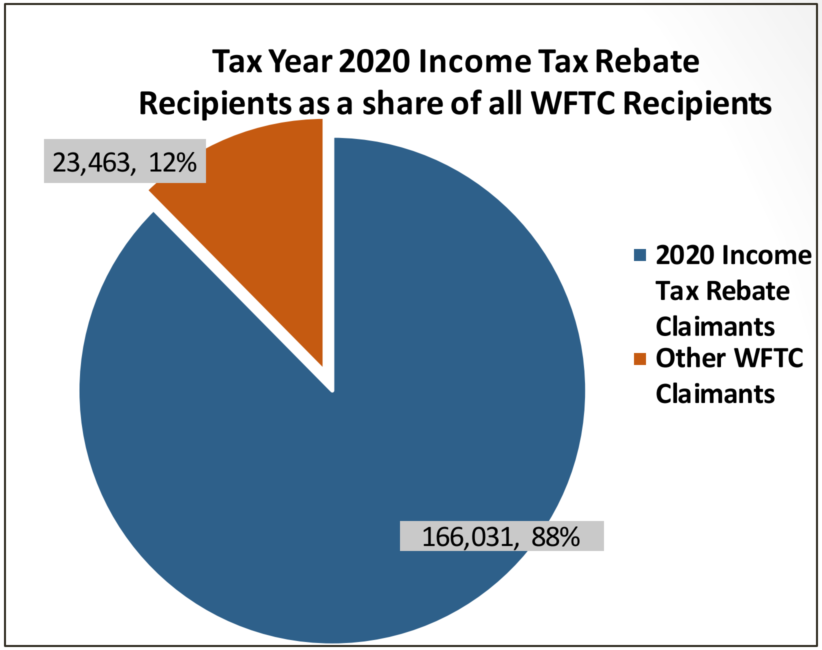
Citizen Benefits : Food GRT Deduction

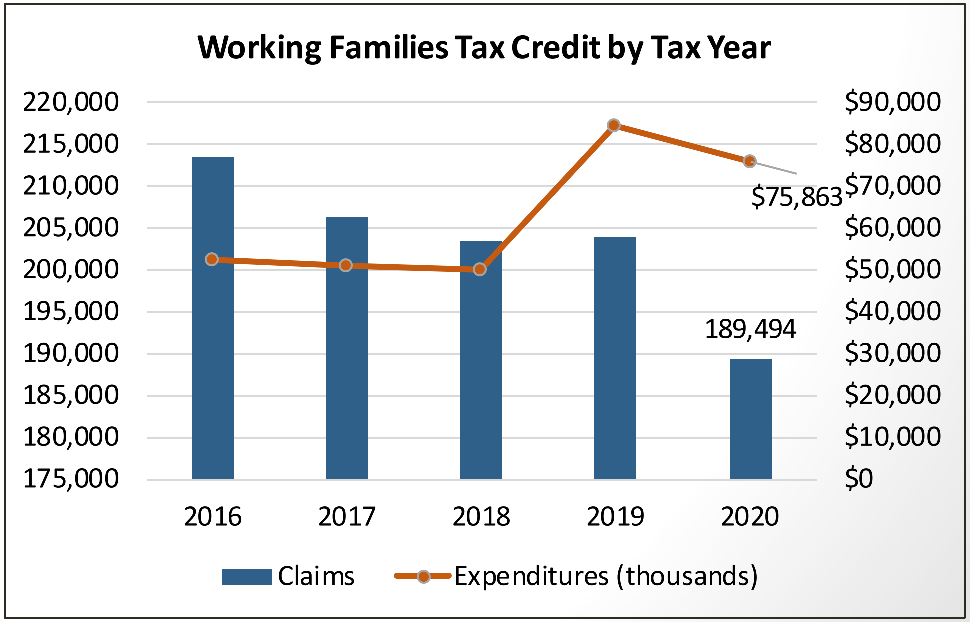
- GRT deductions enacted in 2004 to reduce the cost of food and medical services
- Hold harmless provisions partially offset foregone local tax revenue as a result of the deductions
- 2013 legislation began a phase-out of the hold harmless payments to larger local governments scheduled to end in 2030
- COVID-19 has had striking impacts on the Food GRT Deductions
  - The FY2020 and FY2021 amounts for food deduction increased as food consumption shifted away from restaurants and towards food purchased at grocery stores
- In discussion of this large fiscal impact, policymakers may also consider reducing the deduction to an amount less than 100% of eligible receipts
- Any future decision to tax any portion of food for home consumption may be coupled with consideration of the appropriate size of other tax benefits targeted only to lower-income New Mexicans, such as LICTR, in recognition of the regressive nature of the GRT



Citizen Benefits: 2020 $600 Income Tax Rebate & Working Families Tax Credit

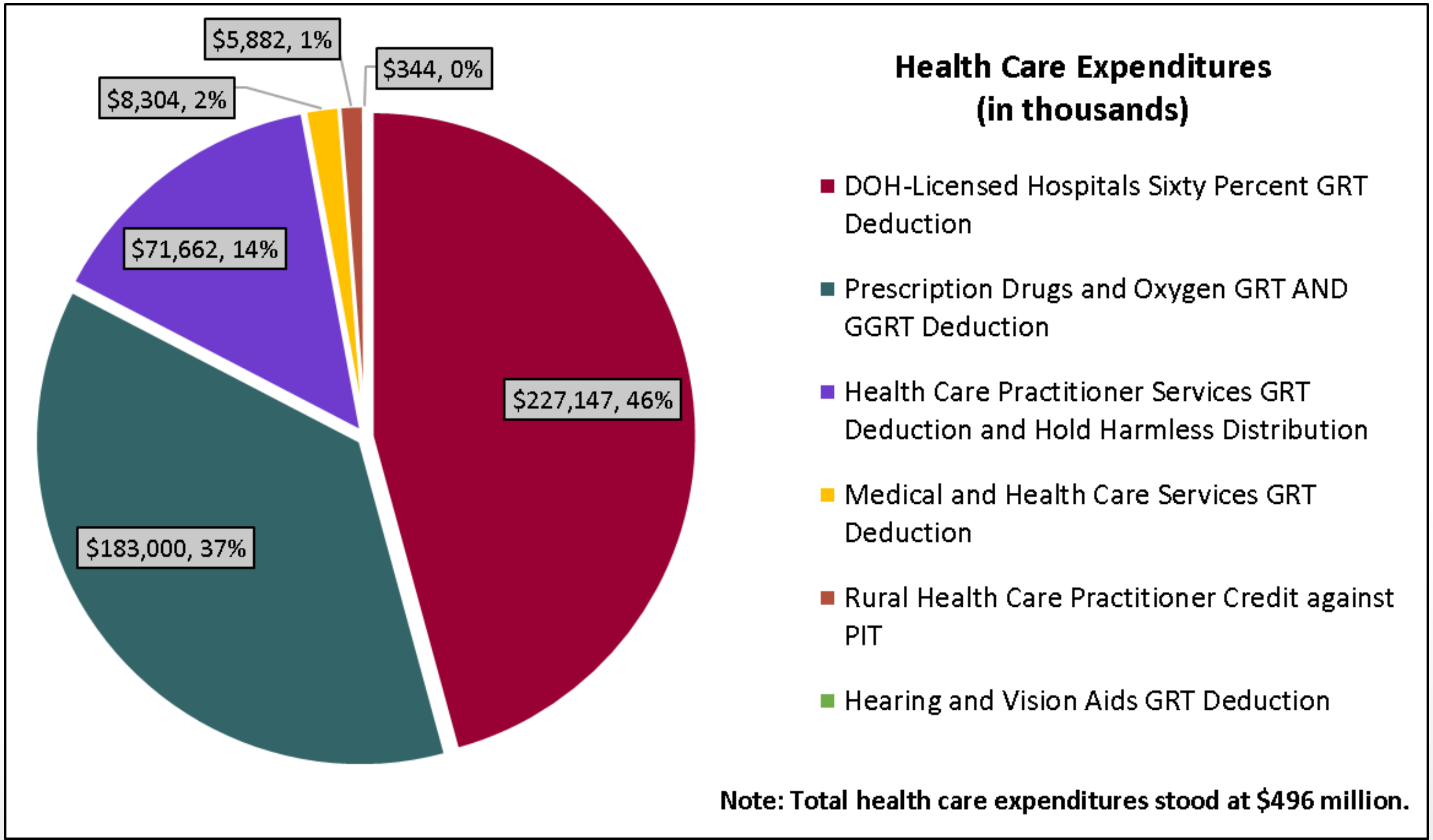
- WFTC is a refundable PIT credit for about 190,000 New Mexico families each year
- In 2020, some recipients of WFTC were also eligible for a one-time $600 rebate based on their adjusted gross income (AGI)
  - Single filers with AGI not exceeding $31,200 and heads of household, surviving spouses and married individuals filing joint returns with AGI not exceeding $39,000 are eligible
  - 88% of WFTC recipients in 2020 also received the 2020 $600 Income Tax Rebate for a total expenditure of $99 millions in rebates alone.





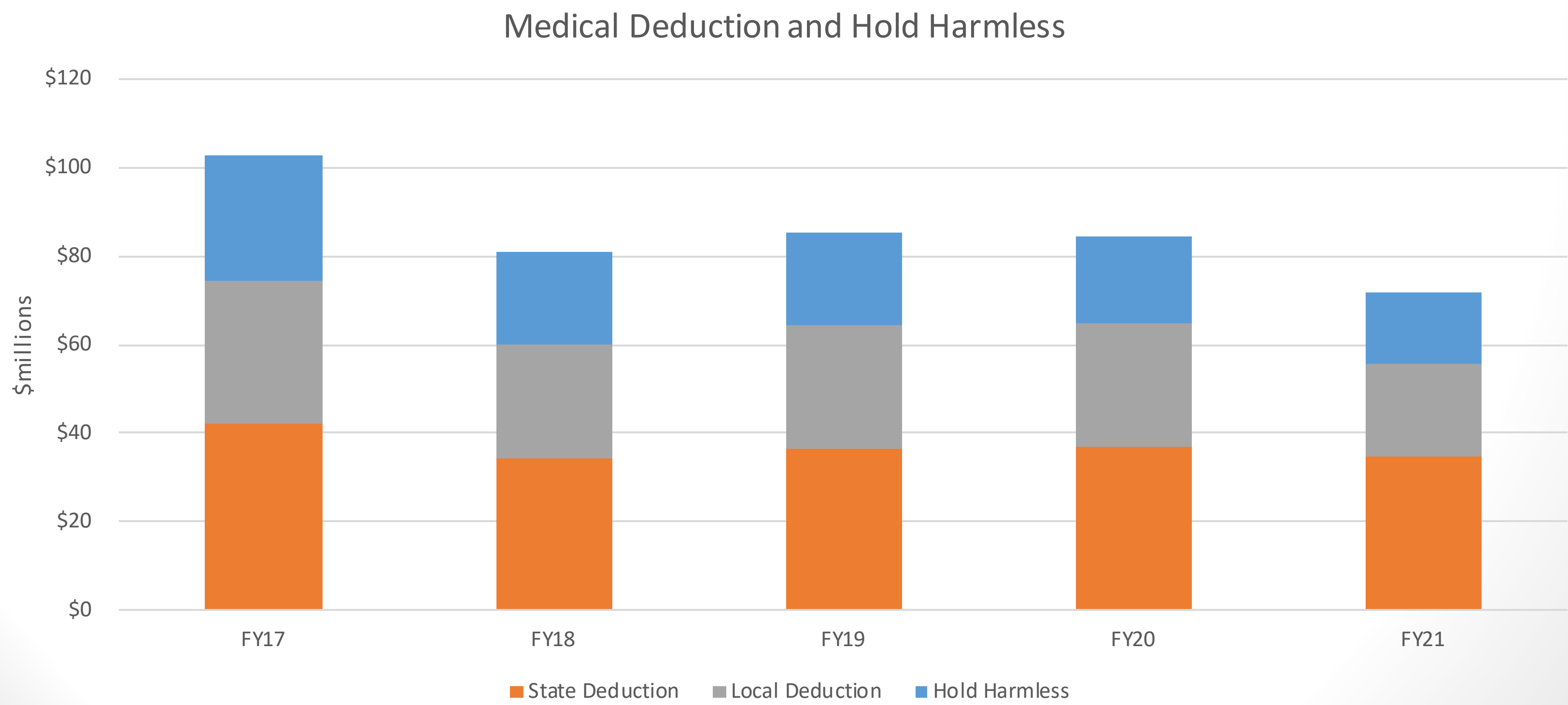
Health Care

- Represents the second largest share of tax expenditures in FY21 - $496 million or 31%
- The largest reported contributor is the DOH-Licensed Hospitals 60 Percent GRT Deduction at $227 million.
- 11 Expenditures in this category
  - 5 with $0 fiscal impact
  - 0 with unknown costs
  - 0 with redacted reporting



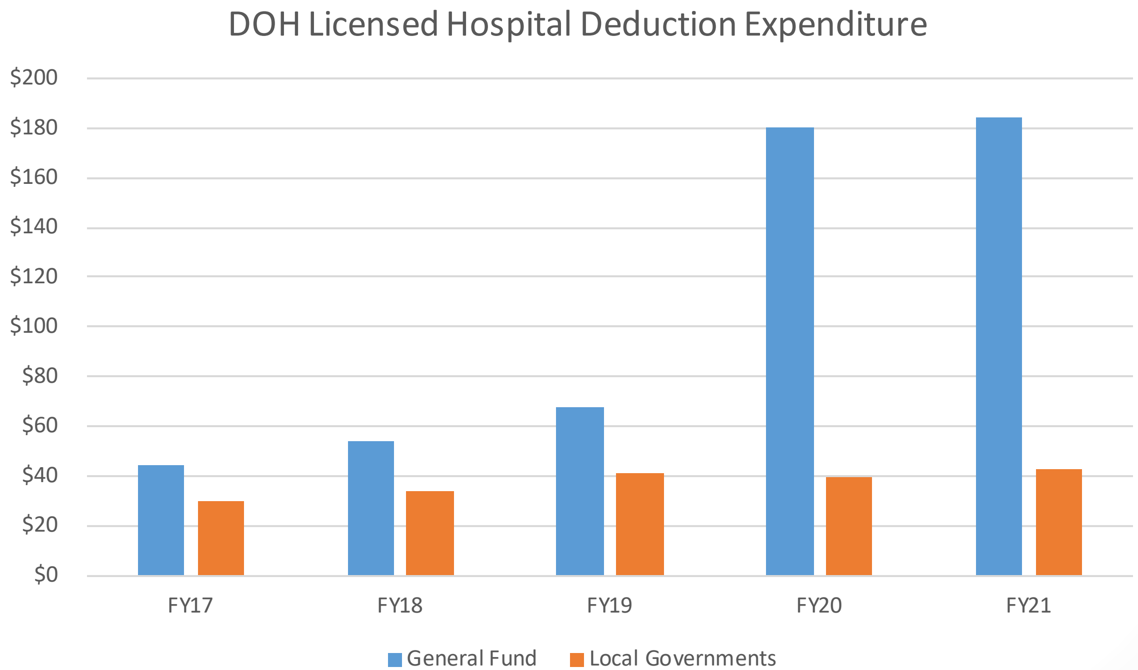
Health Care: Medical GRT Deductions

- GRT deductions enacted in 2004 to reduce the cost of food and medical services
- Hold harmless provisions partially offset foregone local tax revenue as a result of the deductions
- 2013 legislation began a phase-out of the hold harmless payments to larger local governments scheduled to end in 2030
- COVID-19 has had striking impacts on Medical Deductions
  - The FY2020 and FY2021 amounts for medical have decreased as individuals delay medical care



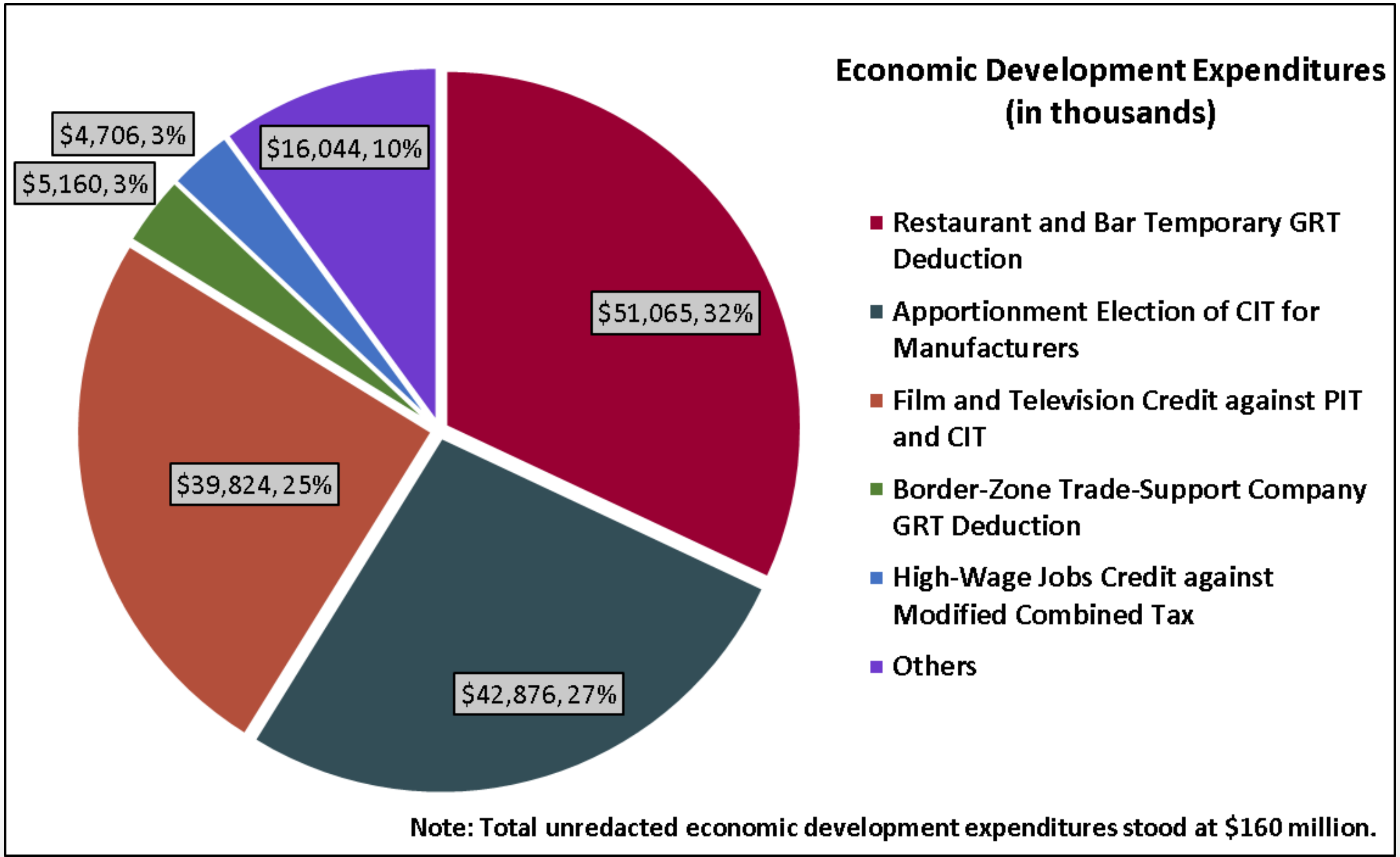
Health Care: Hospital GRT Deductions & Credits

- HB6 (2019) reformed hospital taxation to level the playing field between public, private and non-profit hospitals
  - Increased GRT deduction for private hospitals for medical services from 50% to 60%
  - Added non-profit and governmental hospitals into the tax base, allowing them the deduction
  - Non-profit and governmental hospitals are not subject to local government gross receipts taxes, so only the State General Fund deduction increased
- Repealed a 5% credit to for-profit hospitals against their post-deduction gross receipts
- Deduction reflects hospital receipts, which have risen due to COVID-19 hospitalizations



Economic Development

- Represents 10% of tax expenditures in FY21 - $160 million
- The largest reported contributor is the Restaurant and Bar Temporary GRT Deduction at $51 million (2021 SB1)
- 28 Expenditures in this category
  - 5 with $0 fiscal impact
  - 2 with unknown costs
  - 2 with redacted reporting

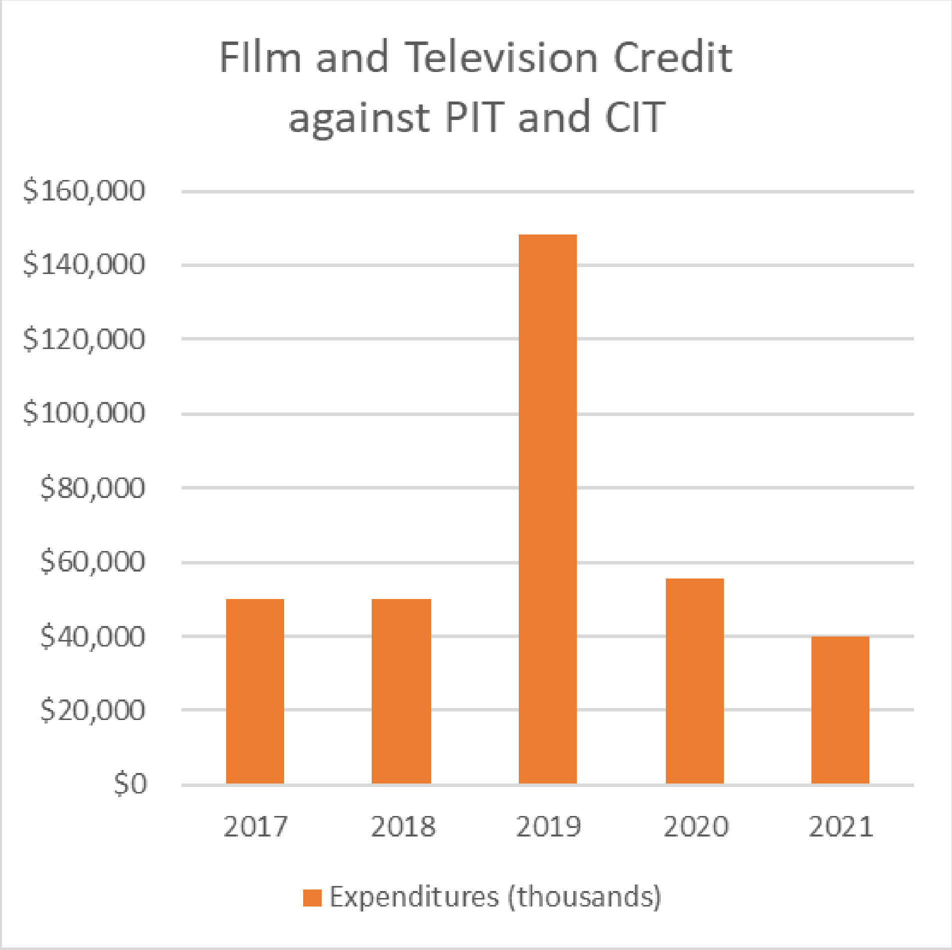


Economic Development: Restaurant and Bar Temporary GRT Deduction (2021 SB1)

- SB 1 of the 2021 regular session allowed for a deduction against the receipts of prepared food and beverages at restaurants
  - The deduction was available from March 1st, 2021 through July 1st, 2021
  - Enacted to provide temporary relief to restaurants and bars that were impacted by public health orders and lower customer traffic as a result of the COVID-19 pandemic
  - Excluded fast food and package liquor, included food trucks
- The expenditure includes a hold harmless to local governments, with the General Fund absorbing the entire cost of the deduction
- $51.1 million total impact to the General Fund
  - $34.1 million from the deduction portion
  - $16.9 million in hold harmless payments to local governments
- Original estimated impact was $90.3 million
- Restaurants may amend past GRT returns to claim deduction

Economic Development: Film Tax Credit

- 2019 Legislation
  - Increased film credit cap from $50 million to $110 million
  - Created new category of film partners that are not subject to the cap
- FY19
  - $127 million in film credit backlog accrued under the previous $50 million cap was repaid in FY19 and FY20
- FY20
  - $55.6 million in film credits paid
- FY21
  - $39.8 million in credits claimed
  - Film projects delayed as a result of COVID-19 likely reduced cost of credit

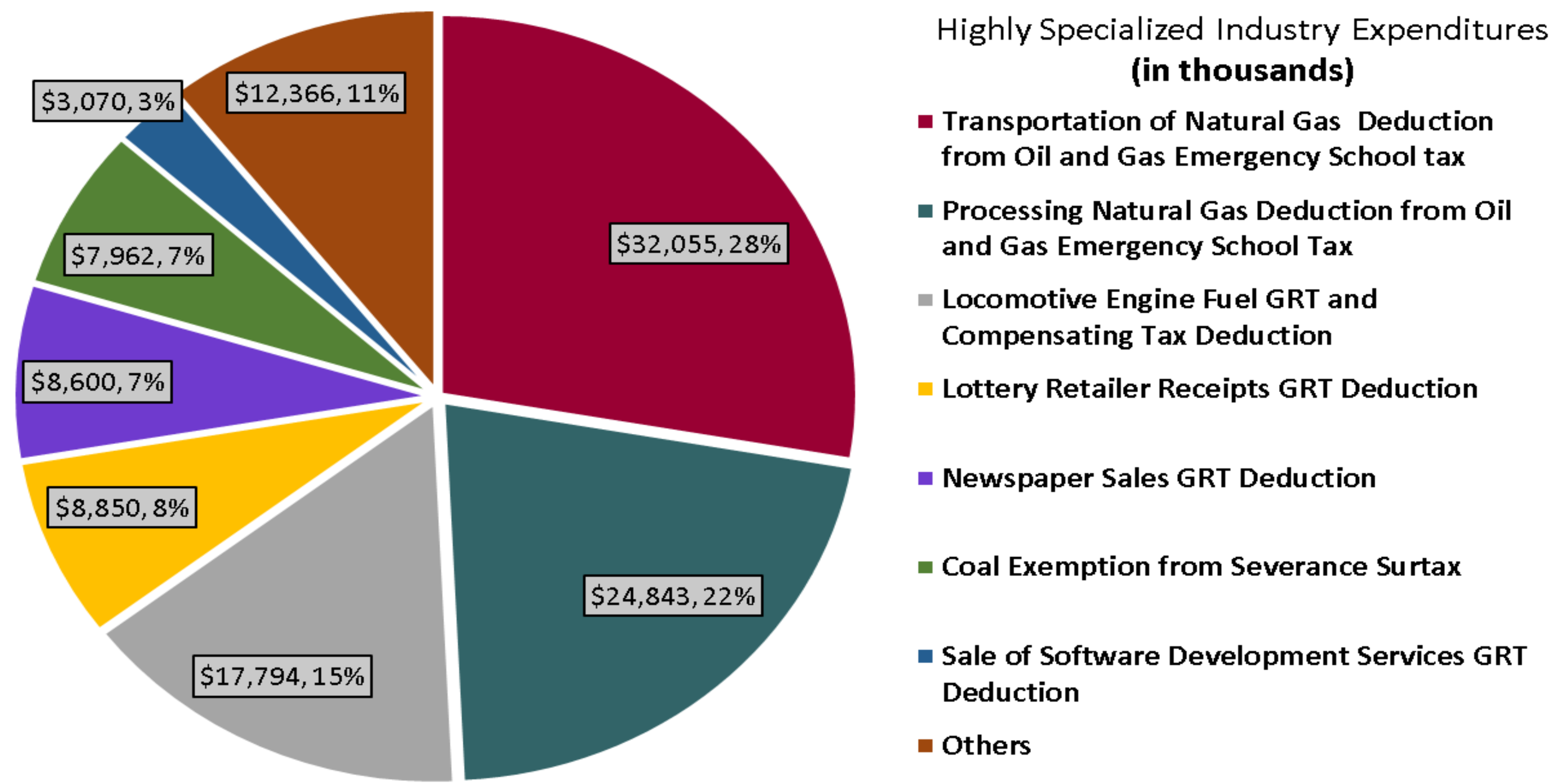


Economic Development: Technology Readiness Credit Against GRT

- HB 255 of the 2020 Regular Legislative Session enacted the Technology Readiness GRT Credit and created the Technology Readiness GRT Credit Fund
  - The credit is paid from the new fund rather than the General Fund
  - No credits were claimed in FY21
  - As of October 2021, $2 million has been distributed to the fund
    - $125,000 monthly distribution
    - Fund amounts are carried forward across fiscal years
- Credit is available July 1, 2020 through July 1, 2023
  - Repealed effective July 1, 2024

Highly Specialized Industry

- Represent 7% of tax expenditures in FY21 or $115 million
- The largest reported contributor is the Transportation of Natural Gas Deduction from Oil and Gas Emergency School tax at $32 million
- 35 Expenditures in this category
  - 8 with $0 fiscal impact
  - 6 with unknown costs
  - 2 with redacted reporting



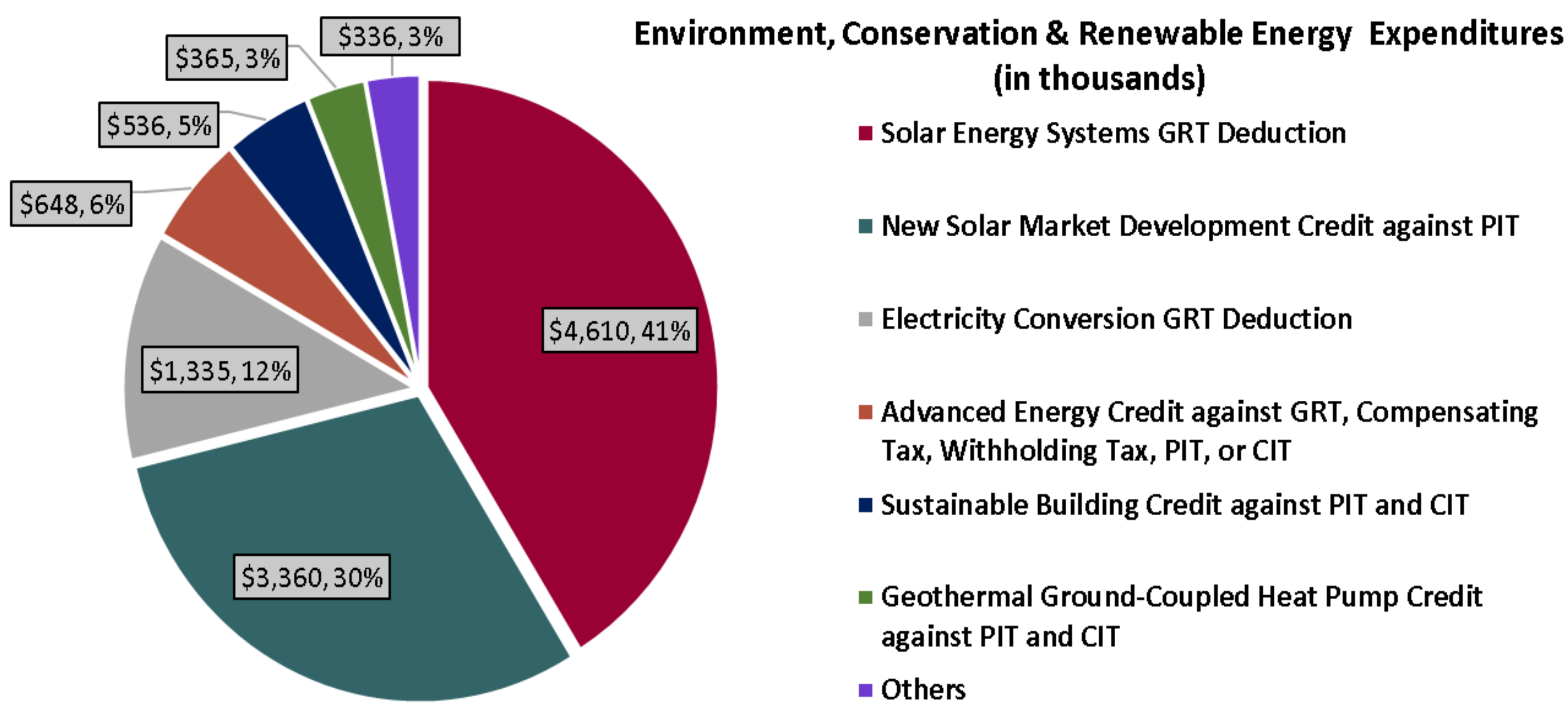
Note: Total unredacted highly specialized industry expenditures stood at $115 million.

Highly Specialized Industry: Reevaluations & Reinstatements

- This year's publication includes reinstatements of expenditures and non-expenditures that either had not been included in prior years or are being reinstated
- The current set of statutes fall within the severance tax programs and thus are classified under Highly Specialized Industry
- The goal to reevaluating all statutes is to provide as much transparency to policymakers
  - Debate can focus around whether they are expenditures or non-expenditures but deviations from the tax base should appear in the TER

Environment, Conservation & Renewable Energy

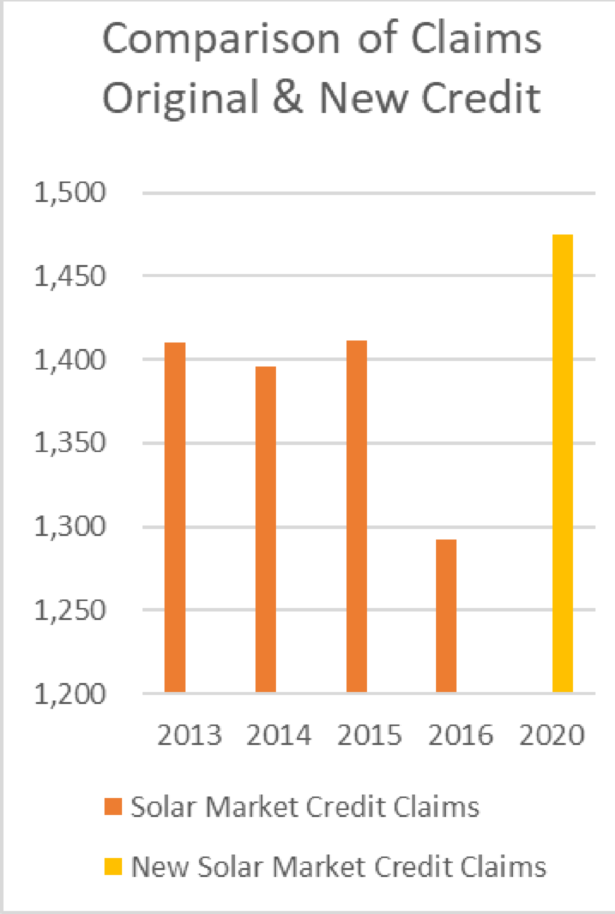
- Represent 1% of tax expenditures in FY21 or $11 million
- The largest reported contributor is the Solar Energy Systems GRT Deduction at $4.6 million
- 19 Expenditures in this category
  - 7 with $0 fiscal impact
  - 1 with unknown costs
  - 4 with redacted reporting

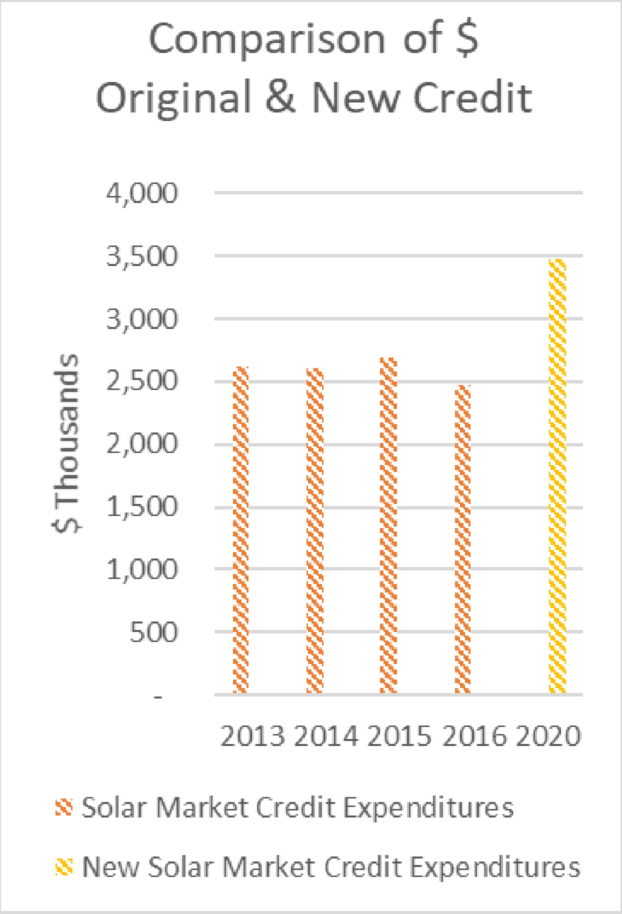


Note: Total unredacted Environment, Conservation & Renewable Energy expenditures stood at $11 million.

Environment, Conservation & Renewable Energy: New Solar Market Development Credit

- Taxpayers who purchase and install a solar thermal system or photovoltaic system may apply for a $6,000 credit against PIT
- New Solar Credit claims demonstrate immediate taxpayer reception
- New Credit has higher aggregate cap of $8 million versus original cap of $5 million
- New credit can apply for full cost of purchase and installation versus 10% in original credit





Recommendation for Repeal

Name	Rationale for repeal	2021 ($000's)
Advanced Energy GRT and Compensating Tax Deduction	No claims to date. Construction of facility required prior to Dec. 31, 2015.	$0
Advanced Energy Credit Against GRT, Compensating Tax, Withholding Tax, PIT, or CIT	Fewer than 3 taxpayers. Construction of facility required prior to Dec. 31, 2015.	Redacted
Blended Biodiesel Fuel Credit against PIT and CIT	Credit has expired and carry-forward period ended in tax year 2017.	$0
Business Facility Rehabilitation Credit against PIT and CIT	No claims to date, there are no enterprise zones to establish eligibility.	$0
Electronic ID Reader Credit against PIT and CIT	Credit has never been claimed.	$0
Hybrid Vehicle Exemption from MVX	Exemption was effective until June 2009.	$0
Military Construction Services GRT Deduction	No claims to date.	$0
Nonprofit Elderly Care Facility Exemption from GRT	Non-profit entities already qualify for GRT exemption based on status.	$11,960

Recommendation for Repeal (continued)

Name	Rationale for repeal	2021 ($000's)
Penalty Pursuant to Section 7-1-71.2 NMSA 1978 Credit Against GRT, Compensating Tax and Withholding Tax	Credit has not been available since July 1, 2010.	$0
Physician Participating in Cancer Treatment Clinical Trials Credit against PIT	Credit applied to tax years 2014-2016. The time period this credit could have been claimed has expired.	$0
Research and Development Small Business Credit Against GRT or Fifty Percent Credit against Withholding Tax	Credit expired in 2015.	$0
Sales to Qualified Film Production Company GRT and GGRT Deduction	This deduction cannot be claimed by a film production company if they claim the film production tax credit.	Unknown
Vehicles Titled Before July 1, 1991 Exemption from Leased Vehicle GRT	At this point, this exemption applies to very few, if any, vehicles.	Unknown, but likely small
Venture Capital Investment Credit against PIT	No taxpayers have claimed this credit. It appears to compete with the net capital gain income deduction.	$0
Veteran Employment Credit against PIT and CIT	Credit applied to tax years 2012-2016 with carry forward of three years. Credit can no longer be claimed.	$0
Welfare-to-Work Credit against PIT and CIT	Tied to a federal program that no longer exists.	$0

Expenditures recently expired

Name	Detail	Sunset Date	2021 ($000's)
Renewable Energy Production Credit against PIT and CIT (7-2A-19 & 7-2-18.18 NMSA 1978)	Only projects that produced energy prior to January 1, 2018 are eligible for the credit with eligibility extending for 10 consecutive years. CIT credit enacted in 2002 and the PIT credit in 2007.		36,268
Geothermal Ground-Coupled Heat Pump Credit against PIT and CIT (7-2A-24 & 7-2-18.24 NMSA 1978	Purchase and installation must occur before Dec. 31, 2020. Credit carry-forward of 10 years.	Dec. 31, 2020	365
Border-Zone Trade-Support Company GRT Deduction (7-9-56.3 NMSA 1978)	Trade-support company must locate in border-zone before Jan. 1, 2021	Jan. 1, 2021	Redacted

Look Ahead – Expenditures with Sunsets next 5 years

Name	Note	Sunset Date	2021 ($000's)
Nonathletic Special Event at New Mexico State University GRT Deduction (7-9-104 NMSA 1978)	Enacted 2007. Previously extended twice.	June 30, 2022	$0
Military Construction Services GRT Deduction (7-9-106 NMSA 1978)	Enacted 2007. Previously extended once.	July 1, 2022	$0
Technology Readiness Credit against GRT (7-9-96.3 NMSA 1978)	Recently enacted 2020 regular legislative session	July 1, 2024	$0
Unreimbursed or Uncompensated Medical Care Expenses Deduction From PIT (7-2-37 NMSA 1978)	Enacted 2015. Similar Credit and Exemption for Unreimbursed or Uncompensated Medical Care Expenses do not have sunsets	Jan. 1, 2025	$4,558
Military Transformation Acquisition Program GRT Deduction (7-9-94 NMSA 1978)	Enacted 2005. Previously extended twice.	June 30, 2025	$76
Future Distribution to a Nonresident Beneficiary Deduction from PIT (7-2-38 NMSA 1978)	Recently enacted 2019 regular legislative session	Jan. 1, 2025	$124
Small Business Saturday Thanksgiving Weekend GRT Deduction (7-9-116 NMSA 1978)	Enacted 2018. Previously extended once.	July 1, 2025	$9.7
High-Wage Jobs Credit against modified combined tax (7-9G-1 NMSA 1978)	Sunset is tied to definition of 'new high-wage' which must be created before July 1, 2026	July 1, 2026	$4,706

Concluding Thoughts

- Legislative Thoughts
  - Purpose not always defined – difficulty to then evaluate
  - Sunset clause – forces evaluation of the expenditure where that is appropriate
  - Reporting requirements – electronic reporting: ease in working with other departments when cross-collaboration of expenditures; allows transparency; ability to evaluate expenditure cost
  - Reassessment of expenditures: have expired but remain in statute, $ 0 fiscal impact as no claimants, or cannot be claimed due to statutory language
- Other Resources
  - National Conference of State Legislatures has a State Tax Incentive Evaluations Database (worked with Pew Charitable Trusts)
    - http://www.ncsl.org/research/fiscal-policy/state-tax-incentive-evaluations-database.aspx
  - Can compare different incentives across states, years, analysis, incentive type
  - U.S. Department of the Treasury, Federal Expenditure Reports
    - https://home.treasury.gov/policy-issues/tax-policy/tax-expenditures

Thank you!

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http://www.tax.newmexico.gov/