FISCAL IMPACT REPORT

SPONSOR HTRC **ORIGINAL DATE** 2/28/19 **LAST UPDATED** 9/13/19 **HB** CS/6/aHFl#1/aSCORC/aSFC/aCC

SHORT TITLE Tax Changes **SB**

ANALYST Clark

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY19	**FY20**	**FY21**	**FY22**	**FY23**		
NFI	$71,000.0 or More	$92,000.0 or More	$54,000.0 or More	$54,000.0 or More	Recurring	General Fund (direct bill impact)
NFI	**$37,000.0 or More**	**$58,000.0 or More**	**$33,000.0 or More**	**$33,000.0 or More**	Recurring	General Fund (minus contingent $34 million for Medicaid provider rate increases)*
NFI	$52,000.0	$53,000.0	$81,000.0	$83,000.0	Recurring	State & Local Road Funds (incl. DOT for District 2)
NFI	$35,000.0	$36,000.0	$124,000.0	$124,000.0	Recurring	Local Governments (not incl. local road funds)

Parenthesis ( ) indicate revenue decreases

*The General Appropriation Act (GAA) contains language providing an additional appropriation of $34 million for Medicaid provider rate increases for hospitals contingent on enactment of this bill. This language is not scored directly in the GAA, so the scoring for this bill includes the $34 million impact (and assumes the impact is recurring to continue to offset the tax effects on hospitals)

*Update 9/13/19: General fund and local government revenue reflects updated estimates for the repeal of the municipal equivalent distribution in FY22 and FY23 detailed on pages 4 and 7.

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY19	FY20	FY21	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
Total	Significant	Significant	Significant	Significant	Nonrecurring	TRD Operating Budget

Parenthesis ( ) indicate expenditure decreases

Relates to Appropriation in the General Appropriation Act

SOURCES OF INFORMATION

LFC Files

Responses Received From
Taxation and Revenue Department (TRD)
New Mexico Department of Transportation (DOT)
New Mexico Municipal League

SUMMARY

Synopsis of CC Amendment

The Conference Committee Amendment makes personal income tax rate and bracket changes, bringing the top rate to 5.9 percent from the current 4.9 percent. The top rate is imposed on single filers and estates with taxable incomes over $210 thousand, on married filing jointly and head-of-household filers with taxable incomes over $315 thousand, and on married individuals filing separately with taxable incomes over $157.5 thousand. These changes are contingent on FY20 general fund revenues exceeding FY19 revenues by less than 5 percent (in alignment with the current consensus forecast). The rates and brackets would take effect January 1, 2021.

The amendment also reduces the capital gains deduction from 50 percent to 40 percent, increases the working families tax credit to 17 percent from the 15 percent previously in the bill, and increases the motor vehicle excise tax rate to 4 percent from the 3.5 percent previously in the bill. This amendment keeps the SFC amendment for taxation of closed system cartridges for e-cigarettes at 50 cents per cartridge but changes the tax rate on e-liquids to 12.5 percent of the value of e-liquids.

The amendment makes changes to the distributions from motor vehicle excise tax revenues in addition to increasing the rate from the existing statutory rate of 3 percent to 4 percent in the following ways:

- For FY20 and FY21, the general fund will continue to receive the existing 3 percent, and the additional 1 percent will be sent to the Department of Transportation for expenditures needed to mitigate the emergency road conditions related to activity in the oil field in state transportation commission district 2; and
- For FY22 and subsequent fiscal years, the general fund will receive 2.5 percent (0.5 percent less than current statute), and the remaining 1.5 percent will be split equally between the state road fund and half to the local governments road fund.

It also makes technical corrections to section numbering and applicability dates.

Synopsis of SFC Amendment

The Senate Finance Committee Amendment makes changes to specific provisions of applying an excise tax to vaping "e-liquids" and "closed system cartridges", including making a technical correction. It also changes the distributions for 1 percent of motor vehicle excise tax revenues from the general fund to:

- In FY20 and FY21, to the Department of Transportation for expenditures needed to mitigate the emergency road conditions related to activity in the oil field in state transportation commission district 2; and
- In FY22 and subsequent fiscal years, half to the state road fund and half to the local governments road fund.

Finally, it makes technical corrections to section numbering and applicability dates.

Synopsis of Bill & SCORC Amendment

The Senate Corporations and Transportation Committee (SCORC) Amendment makes the following key changes: removes any changes to personal income tax rates and brackets; removes any changes to the low-income comprehensive tax rebate; reduces the increase in the working families tax credit, with the credit value declining from 20 percent to 15 percent; removes the repeal of the capital gains deduction; reduces the increase in the motor vehicle excise tax rate, declining from 4.2 percent to 3.5 percent; changes cigarette and tobacco products taxation provisions; removes the increase and freeze of hold harmless distributions to mid-size municipalities; removes the increases in motor vehicle registration fees; removes a provision that would tax nonprofit organizations above a certain level of receipts; and makes various other changes, including changes related to required combined reporting for certain corporate entities.

Due to the complexity of and differences between the original bill as amended and this amendment, everything in the FIR shown below reflects the bill as amended by SCORC.

The bill makes multiple changes to the gross receipts tax (GRT), personal income tax (PIT), and other taxes and fees. Below are some key provisions of the bill that impact the general fund.

- **Hospital Tax Reform.** Enacts hospital tax reform similar to a reform measure in the last two sessions and increasing the existing 50 percent GRT deduction for hospitals to 60 percent, bringing nonprofit, for-profit, and governmental hospitals into more of an even playing field and removing local taxation (effective July 1, 2019);
- **Remote Sellers and Marketplace Facilitators.** Taxes remote (Internet) sales immediately and then applies local GRT increments and moves to destination-based sourcing (sourcing at the location of the buyer rather than the seller) with a two-year delay (effective July 1, 2019 and July 1, 2021, respectively);
  - The transition to destination-based sourcing is a significant change to the structure of the GRT and will require much preparation by the Taxation and Revenue Department and taxpayers
  - The bill distributes $24 million annually from the general fund to local governments in FY20-FY21 until the local increments are applied to remote sales
  - Once destination sourcing take effect, all sales will have an in-state location, so current GRT transactions coded as out of state would be shifted into counties and municipalities (if inside municipal boundaries)
- **PIT: Working Families Tax Credit.** Increases the PIT credit from 10 percent to 15 percent of the federal income tax credit (effective for tax years starting on or after January 1, 2019);
- **PIT: Dependents Deduction.** Creates a PIT deduction of $4,000 for every dependent beyond the first claimed by a taxpayer (effective for tax years starting on or after January 1, 2019);
- **Motor Vehicle Excise.** Increases the motor vehicle excise tax rate to 3.5 percent with all additional revenue to the general fund (effective July 1, 2019);
- **Tobacco Products.** Increases taxes on cigarettes, taxes e-cigarette/vaping products, and reduces taxes on cigars (effective July 1, 2019);
- **Repeals.** Repeals the hospital credit (and related distribution adjustment) effective July 1, 2019 and the municipal equivalent distribution when the local compensating tax increments become effective July 1, 2021; and

- **Combined Reporting.** Implements corporate income tax (CIT) combined reporting (effective beginning tax years starting on or after January 1, 2020).

In addition to these provisions impacting general fund revenues, the bill also performs the following key actions:

- **Compensating Tax.** Brings the state comp tax rates for services and tangible property into alignment and applies local government GRT increments to the compensating tax to equalize the rates (effective July 1, 2021); and
- **Market-Based Sourcing.** Implements CIT market-based sourcing (effective beginning tax years starting on or after January 1, 2020).

FISCAL IMPLICATIONS

CS/House Bill 6/aHFL#1/aSCORC/aSFC/aCC (millions $)					
	FY19	FY20	FY21	FY22	FY23
(general fund impacts only)					
Hospital tax reform - gross receipts w/60% deduction		$ 93	$ 96	$ 98	$ 100
Remote sales: direct state impact (at 5.125% - gains beyond existing revenues)		$ 43	$ 44	$ 45	$ 46
Remote sales: state loss from local sharing (static transfer, then loss of 1.225% on most of "e-commerce" base - existing and new)		$ (24)	$ (24)	$ (21)	$ (22)
Remote sales: state loss from destination sourcing of current GRT out-of-state revenue not from "e-commerce" base		$ -	$ -	$ (41)	$ (42)
Broaden PIT brackets and add new top rate of 5.9%		$ -	$ 20	$ 40	$ 41
Increase working families tax credit from 10% to 17%		$ (37)	$ (39)	$ (39)	$ (41)
Create dependent deduction ($4k for each dependent beyond the first)		$ (26)	$ (27)	$ (28)	$ (28)
Change PIT 50% deduction for capital gains to 40%		$ 10	$ 10	$ 10	$ 10
MVEX general fund distribution from 3% to 2.5% beginning FY22		$ -	$ -	$ (27)	$ (28)
Tax e-cigarettes/nicotine vaping & increase cig tax		$ 14	$ 14	$ 14	$ 14
Change 7-1-6.15 from annual to monthly average for adjustments to locals		$ (2)	$ (2)	$ (2)	$ (2)
Repeal municipal equivalent distribution		$ -	$ -	$ 5	$ 5
Combined Reporting for Corporate Income Taxes		Likely Revenue Positive			
HB6 General Fund Impact		**$ 71**	**$ 92**	**$ 54**	**$ 54**
HB2 set-aside for Medicaid provider rate increases for hospitals		$ (34)	$ (34)	$ (34)	$ (34)
Total General Fund Impact of HB6 & Contingent Approp. For Medicaid		**$ 37**	**$ 58**	**$ 20**	**$ 20**
Road Funds:1% of MVEX FY20-21, 1.5% FY22+ (total MVEX from 3% to 4%)		**$ 52**	**$ 53**	**$ 81**	**$ 83**

<u>Hospital Tax Reform</u>

The bill takes the existing 50 percent deduction applicable to for-profit hospitals, increases it to 60 percent, and applies it to nonprofit and governmental hospitals as well, subjecting the remaining gross receipts of for-profits and nonprofits to state-only GRT rates (and preventing the municipal 1.225 percent distribution from the state to municipalities of hospital receipts) and of governmental hospitals to the governmental GRT (GGRT) rate. The hospital credit is repealed. The estimates in the table represent the combination of direct revenue from the credit repeal and the additional gross receipts base. Part of the additional revenue could be used to increase Medicaid provider rates, offsetting the additional taxes levied on hospitals by leveraging federal funds, and this could be done in the General Appropriation Act.

<u>Remote Sellers and Marketplace Facilitators</u>

The estimated fiscal impact is particularly uncertain. These estimates use publicly available data to represent a projected amount of GRT revenue lost through untaxed internet sales (note the state currently receives tax revenues from some online sellers, such as sales made directly by

Amazon, otherwise the estimate would be higher). The estimate assumes nearly full compliance, and gaining revenues from the handful of largest marketplace facilitators and remote sellers would likely result in receipt of the vast majority of possible revenues.

For the first two years, the state would capture all the large online sellers, but local GRT increments would not yet apply due to the time needed to switch over to destination-based sourcing, which would provide for these sales to be deemed to take place at the buyer's location instead of the "out-of-state" GRT coding. In order to provide local governments with a portion of this revenue stream for those two years, $24 million would be sent annually from the general fund to local governments, apportioned on a population basis.

After these two years, GRT switches to destination-based sourcing, with all such sales deemed to take place at the buyer's location, and local increments would apply. Local governments should see a significant surge in revenues due to taxing the online sales the state currently taxes, taxing all the new online sales, and taxing other sales that are currently booked as out-of-state.

Corporate Income Tax: Combined Reporting

This bill requires combined reporting for certain corporate entities (see discussion in the *Significant Issues* section). This provision would simultaneously increase general fund revenues from certain changes and for certain taxpayers and decrease revenues from other changes and for other taxpayers. It is impossible to estimate the impact or determine with certainty whether the total effect would be positive or negative. However, the primary purpose of a state moving to combined reporting is to prevent income-shifting, which can cause state revenue losses, so the long-term impact is likely to be positive. There is no available data to estimate the impacts, so this portion of the bill cannot be scored.

Personal Income Tax Changes

The proposed PIT changes (working families tax credit and dependent deduction) take effect for tax year 2019, but by the time the bill becomes law, little if any impact would be seen in FY19. However, FY20 should see close to full-year impacts. The impacts grow gradually over time by the growth rates similar to those in the consensus revenue estimate.

The conference committee amendment adds a new top rate and bracket that becomes effective in FY21, contingent on FY20 general fund recurring revenues exceeding FY19 revenues by not more than 5 percent.

Motor Vehicle Fees and Excise Taxes

The bill increases the motor vehicle excise fee (MVEX) from 3 percent to 3.5 percent, and all additional revenue generated goes to the general fund. This is estimated to generate about $26 million for the general fund.

The conference committee amendment increases the MVEX from 3 percent to 4 percent, which is estimated to generate about $52 million. The additional revenue is directed to the Department of Transportation in FY20 and FY21 to improve road conditions in district 2 (Eddy and Lea counties). Beginning in FY22, the additional revenue is directed in an even split to the state road fund and the local governments road fund, with an additional $26 million from existing MVEX revenue also directed to these two funds.

Cigarettes and Tobacco Products Taxes

The total estimated general fund impact for changing the cigarette tax to 10 cents per cigarette, reducing the tax on cigars to $0.50 per cigar (instead of the current 45 percent of wholesale value), and bringing e-cigarettes and e-liquids into the tobacco products tax base is about $9 million annually. The tax reduction on cigars is estimated to outweigh the benefit of taxing e-cigarettes and e-liquids, resulting a net loss of $3.2 million in tobacco products tax revenue, while the cigarette tax increase is estimated to generate about $12.5 million. The bill adjusts cigarette tax revenue distributions to send new money to the general fund and hold harmless the five other cigarette tax beneficiaries.

The conference committee amendment taxes e-liquids at 12.5 percent and adds a 50 cent tax to closed system cartridges, which is expected to generate an additional $4.8 million in FY20, offsetting the revenue losses from the tax reduction on cigars. The table below illustrates the various components of the changes.

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY19	**FY20**	**FY21**	**FY22**	**FY23**		
$0.0	$12,560.0	$12,160.0	$11,610.0	$11,010.0	Recurring	General Fund (Cig)
$0.0	$1,603.2	$1,951.2	$2,307.5	$2,667.7	Recurring	General Fund (TPT)
$0.0	$5.0	$5.0	$5.0	$5.0	Recurring	Credit Enhancement Account
$0.0	$10.0	$10.0	$10.0	$10.0	Recurring	UNM Cancer Center
$0.0	$10.0	$10.0	$10.0	$10.0	Recurring	NM Finance Auth./UNM Health Sciences
$0.0	$5.0	$5.0	$5.0	$5.0	Recurring	Rural County Cancer Treatment
$0.0	$10.0	$10.0	$10.0	$10.0	Recurring	Department of Health Facilities
$0.0	$14,163.2	$14,111.2	$13,917.5	$13,677.7	Recurring	Subtotal (General Fund)
$0.0	$14,203.2	$14,151.2	$13,957.5	$13,717.7	**Recurring**	**TOTAL**

Local Government Impacts

Local governments initially benefit through the distribution of $24 million annually in FY20 and FY21 to municipalities and counties as an indirect way of sharing remote sales revenues. Beginning in FY22, additional provisions take effect that provide significant local government benefits, including applying local GRT increments to remote sales and local compensating tax increments. Also starting in FY22, municipal governments will no longer receive the municipal equivalent distribution (estimated at a revenue shift from local governments to the general fund of $5 million).

Local governments benefit from changing the way TRD can reduce distributions based on taxpayer amendments, altering the methodology from an annual average calculation to a monthly average. This cost is difficult to estimate, but a preliminary range of a loss for the state and gain for local governments of $2 million to $4 million appears to be a reasonable estimate, although the costs could be less or significantly greater.

CS/House Bill 6/aHFL#1/aSCORC Local Government Fiscal Impacts (millions $)					
	FY19	FY20	FY21	FY22	FY23
Local hospital impacts (50% to 60% deduction, repeal of hospital credit)		$ 9	$ 10	$ 10	$ 10
Local direct distributions as way of sharing remote sales revenue		$ 24	$ 24	$ -	$ -
Local remote sales & destination sourcing gains		$ -	$ -	$ 75	$ 75
Local comp tax increments		$ -	$ -	$ 42	$ 42
Change 7-1-6.15 from annual to monthly average for adjustments to locals		$ 2	$ 2	$ 2	$ 2
Repeal municipal equivalent distribution		$ -	$ -	$ (5)	$ (5)
Total Local Government Impacts		**$ 35**	**$ 36**	**$ 124**	**$ 124**

SIGNIFICANT ISSUES

Hospital Tax Reform

The healthcare landscape changed significantly in the last decade. Over the last five years, the industry was one of few bright spots in New Mexico for job growth, yet it remains largely untaxed. Hospitals are virtually untaxed at the state level despite more than $5 billion in annual gross receipts. The uneven tax playing field for hospitals interferes with the market, creating economic inefficiencies with strong incentives for hospitals to adopt preferential corporate structures.

This bill mostly corrects this decades-old inequity, subjecting 40 percent of gross receipts of for-profit, nonprofit, and government hospitals to the state portion of the GRT and GGRT, leaving a 60 percent deduction (currently in statute as a 50 percent deduction for for-profit hospitals). Taxing nonprofit and government facilities along with for-profits at nearly identical rates would be a key step to apply the tax in a more equitable manner. However, in order to achieve these nearly identical rates, the bill removes the for-profit hospitals from local taxation. In current statute, local GRT increments apply to for-profit hospitals after the 50 percent deduction is applied, and municipalities also receive the related 1.225 percent distribution from the state.

This reform measure would bring nonprofit hospitals into the state GRT base and governmental hospitals into the GGRT base. It repeals the for-profit hospital tax credit of Section 7-9-96.1 NMSA 1978, helping to better level the playing field for hospitals at the state tax level.

Hospital Tax Reform – State Taxation						
	Current Law			**Proposed Changes**		
	For-Profit	Nonprofit	Government	For-Profit	Nonprofit	Government
State Tax Rate	5.125% GRT	n/a	n/a	5.125% GRT	5.125% GRT	5.0% GGRT
Credits	3.75% to 5%	n/a	n/a	n/a	n/a	n/a
Deductions	50% GRT	n/a	n/a	60% GRT	60% GRT	60% GGRT

Remote Sellers and Marketplace Facilitators

Untaxed Internet sales are eroding New Mexico's retail sales tax base and reducing general fund revenues by tens of millions of dollars annually. Taxing local retailers but not large, online retail operations creates significant disparities and makes it very difficult for local shops to compete with remote sellers. Amazon is now paying tax on direct sales but not on sales by other parties that use Amazon as a sales platform. Recent reporting in *The Wall Street Journal* noted third-party sales represent 70 percent of all sales through Amazon, indicating New Mexico continues to lose tax revenue on the majority of Amazon sales. Further, Amazon is only paying the state portion of the GRT, not the local government portion, which creates a disparity in the total rate that favors out-of-state sellers over local businesses and means local governments are not receiving any tax revenue.

This bill levels the playing field for local businesses by requiring all remote sellers that sell more than $100 thousand within New Mexico to collect and pay GRT on all sales, including third-party platform sales. Under this bill, sales will be determined to take place at the location to which the product is delivered, and after revenue sharing with local governments through direct distributions in FY20 and FY21, local GRT rates will apply to these sales beginning in FY22. It is important to note that while generally, and for tangible personal property specifically, the sale location is determined by delivery location, professional services are an exception and are to be reported from the location at which the services are performed.

<u>Personal Income Tax Changes</u>

The provision creating a PIT dependent deduction for each dependent after the first appears to be designed to reduce the unintended increase in overall state PIT revenue attributed to the federal Tax Cuts and Jobs Act (TCJA) that is expected to increase PIT collections by roughly $55 million in fiscal year 2019. This increase is due to the repeal of the personal exemption in favor of a substantial increase in the standard deduction. New Mexico "piggy-backs" on these two changes. It does not, however, piggyback on the federal child credit that serves to balance the impact of the federal changes on taxpayers when they calculate their federal liabilities. This bill would create a state dependent deduction for heads of household and married filers (but not singles) that would serve a similar function and offset much of the negative state-level TCJA impacts on families.

The bill also increases the working families tax credit from 10 percent to 15 percent, which could also act as a way to reduce the TCJA impacts and could likely create overall positive impacts for heads of household and married filers when combined with the dependent deduction.

<u>Motor Vehicle Excise Taxes</u>

Motor vehicle excise taxes in New Mexico are less than half the rates in many locations in Arizona, Colorado, and Texas. New Mexico's rate is 3 percent, while rates in surrounding areas can be as high as about 8 percent after adding in local rate increments. The Arizona and Texas statewide rates alone are nearly double those in New Mexico. The motor vehicle excise tax rate is less than half the effective GRT rate across most of New Mexico, creating a disparity in rates for consumer goods.

The taxable base for motor vehicles is much more stable than the base for the GRT, which has become more volatile over time; the higher tax rate applied to the more volatile revenue source and the lower rate applied to the more stable source amplify the volatility. Each additional percent added to New Mexico's excise rate generates about $50 million for the general fund.

<u>Tobacco Products Tax – Incorporating E-Cigarettes</u>

Electronic nicotine delivery systems, also known as electronic cigarettes or e-cigarettes, are a relatively new product in the U.S. market. Data regarding health effects and tax revenues are currently limited. Some consumers use e-cigarettes as a means to reduce use of or to quit smoking combustible cigarettes. Many experts contend that e-cigarette vapor is less harmful than cigarette smoke since it does not contain most of the cancer causing byproducts; however, research is extremely limited on the long-term effects of the chemicals in e-liquids.

The difficulty when it comes to e-cigarette taxation is establishing the most effective tax rate. The major problem with analyzing e-cigarette tax rates is that there is not a clean conversion between traditional cigarettes and e-liquid. This makes it challenging to evaluate the price point at which traditional tobacco cigarettes become the more cost effective option for nicotine consumers, potentially causing many e-cigarette users to switch or revert to traditional tobacco cigarettes. Ideally, the tax on e-cigarette products would be high enough to limit overall usage, especially for younger users that as a group are largely very sensitive to price, but not high enough to make e-cigarettes cost prohibitive. Given that e-cigarettes may be less harmful and help some cigarette users quit smoking, an e-cigarette tax rate that is too high could be counterproductive to public health objectives.

States have only recently begun taxing e-cigarette products. The tax has been applied as either a percentage of the wholesale price or as a fixed tax per milliliter of nicotine product (cent/ml of e-liquid). A wholesale tax strategy has been adopted by California, Minnesota, and Pennsylvania. A fixed tax per milliliter (cent/ml) has been adopted by Delaware, Kansas, Louisiana, New Jersey, North Carolina, and West Virginia.

<u>Corporate Income Tax Changes: Combined Reporting</u>

This bill requires combined reporting for corporate entities. More than half the states that impose a corporate income tax require combined reporting, and the Multistate Tax Commission recently testified before an interim committee that this is one of the most important steps New Mexico can take to update and reform our tax code.

One of the principal purposes for enacting combined reporting is to protect state revenues against income-shifting. There are generally two ways to prevent income-shifting: (1) required combined reporting, which eliminates the intercompany transactions that permit the shift; or (2) "addback" statutes, which require separate entity filers to "add back" to their income certain intercompany payments.

Some tax experts estimate that corporate income-shifting structures, which largely result from a separate entity filing regime, can cost states billions of dollars in lost revenues. Historical examples have included the establishment of a trademark holding company in a tax haven state to increase the business expense deduction of the in-state separate entity filer, and thereby reduce taxable income. Income-shifting structures can be complex, but most derive from the inability of separate entity filing regimes to treat the unitary group of related companies as a single taxpayer.

As more than half the states that impose corporate income tax already require combined reporting, most multistate taxpayers are familiar with unitary rules, principles, and reporting mechanics. However, combined reporting can result in increased tax burdens to certain taxpayers depending on facts and circumstances.

<u>Corporate Income Tax: Market Based Sourcing</u>

Market-based sourcing provides an additional measure of CIT reform by amending the Uniform Division of Income for Tax Purposes Act (UDITPA) to determine the sourcing of certain sales and services; it updates the tax code to assess the tax based on sourcing services and intangibles to New Mexico if delivered to a customer in the state or used in the state. The current assessment method using "cost of performance" does not allow New Mexico to tax companies that incur the majority of costs of providing the service or intangible outside the state but which sell to customers inside the state.

ADMINISTRATIVE IMPLICATIONS

TRD will likely report there will be significant, nonrecurring impacts to make changes to GenTax and reporting forms until all changes are made by the end of FY21.

TECHNICAL ISSUES

There is a technical issue with the language for taxation of vaping liquids in the SCORC amendment. It imposes a tax "per milligram of nicotine by volume in the e-liquid" but does not specify any volume level. A policy decision needs to be made whether to impose the tax on the milligrams of nicotine, taxing the total amount of the nicotine, or on the number of milligrams of nicotine per milliliter of the e-liquid, taxing higher concentrations at a higher rate regardless of the total nicotine content in volume of liquid sold. The first method taxes the nicotine consumed at equal rates but gives no preferential treatment for less concentrated liquids. The second method taxes the concentration of nicotine at proportionally higher rates and gives preferential tax treatment to lower concentrations. If vaping liquids are viewed as a smoking cessation tool and the policy decision is to encourage lower concentrations, this preferential tax policy would align with that decision. Regardless of the tax policy choice, either "by volume" should be removed, or a set volume level, such as milliliter, needs to be used instead.

TRD noted the following technical issue.

> In adding a deduction from income for certain dependents, TRD recommends adding a sunset date for after the 2025 tax year. This will then parallel the personal exemptions and standard deductions amount sunset on December 31, 2025 at the federal level for the TCJA (federal tax reform). The language tying this deduction to the internal revenue code (IRC), as long as the federal exemption means zero could be sufficient; however, this is specific to the IRC. If the IRC changes, New Mexico law will then have to change. The sunset date forces a reassessment of the deduction as federal changes are reassessed.

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.

JC/gb/al