BILL ANALYSIS AND FISCAL IMPACT REPORT
Taxation and Revenue Department

February 9, 2024

Bill: HB-10 **Sponsor:** Representatives Cynthia Borrego, Javier Martinez, and Kristina Ortez

Short Title: Home Fire Recovery Tax Credit

Description: This bill creates a tax credit in the Income Tax Act called the "Home Fire Recovery Income Tax Credit". This credit is effective for taxable year 2024 through December 31, 2029. This credit is for a taxpayer that incurs qualified site-build home expenditures for a home in New Mexico to replace a prior home of that taxpayer that was destroyed in a wildfire in calendar years 2021 through 2023. The credit is applied for through the Construction Industries Division of the Regulations and Licensing Department (RLD). The credit must be applied for within 1 year of the rebuilt home being completed. This credit is non-refundable and may be carried forward for 3 consecutive tax years.

Effective Date: Not specified; 90 days following adjournment (May 15, 2024). Applicability – The provisions of this act apply to taxable years beginning on or after January 1, 2024.

Taxation and Revenue Department Analyst: Pedro Clavijo

Estimated Revenue Impact*					R or NR**	Fund(s) Affected
FY2024	FY2025	FY2026	FY2027	FY2028		
--	($500 - $990)	($490 - $980)	($500 - $1,000)	($520 - $1,030)	R	General Fund

* In thousands of dollars. Parentheses ( ) indicate a revenue loss. ** Recurring (R) or Non-Recurring (NR).

Methodology for Estimated Revenue Impact: The bill's fiscal impact is uncertain and cannot be fully quantified. The lack of information such as (1) the number of site-built homes destroyed by wildfires between 2021 to 2023, (2) which taxpayers would seek compensation pursuant to the federal Hermit's Peak/Calf Canyon Fire Assistance Act (the Federal Act), (3) the dollar amount approved by the Federal Emergency Management Agency (FEMA) in qualified disaster relief payments for the home loss under the Federal Act, (4) the dollar amount of home expenditures incurred by the taxpayer, and (5) the taxpayer's tax liability after applying allowances or other credits to which they are entitled, prevent the Taxation and Revenue Department (Tax & Rev) from being able to provide an estimation of the revenue loss with precision. Notwithstanding that, Tax & Rev anticipates the revenue loss to the General Fund might be moderate based on some assumptions.

Considering the major wildfires between 2021 and 2023 affected mainly residents of Lincoln, Mora, and San Miguel counties, Tax & Rev used the median household income in these counties[1] and the overall statewide effective income tax rate for residents to compute the average income tax liability against which taxpayers might claim the proposed tax credit. Tax & Rev disregarded any other allowances or credits taxpayers might claim. Tax & Rev also assumes that per Internal Revenue Code (IRC) Section 139, any qualified disaster relief payments associated with the fires received by taxpayers are non-taxable and

[1] https://www.census.gov/quickfacts/fact/table/lincolncountynewmexico,moracountynewmexico,sanmiguelcountynewmexico/PST045223

therefore do not increase the state taxable income for those taxpayers receiving such payments.[2] Tax & Rev also used an average price for building a new home of $300,000. The new home's size, location, and design will impact the overall cost of the building. Per information released by FEMA on the amount of payments to claimants, Tax & Rev determined that $175,373 has been paid on average in compensation as of January 11, 2024, to 990 individuals or households under the Federal Act. These payments might include either loss of property (homes or cars), financial loss, or compensation for mental health treatment. After deducting these payments from the average home price for residents in Mora and San Miguel Counties, Tax & Rev determined that the average tax credit taxpayers might claim in Mora and San Miguel Counties, under current assumptions, is $124,627. For those in Lincoln County, the credit could be $300,000. Given the assumption of tax liability per individual and given the credit is non-refundable, only a fraction of these average credit amounts may be claimed against state Personal Income Tax (PIT) liability.

The range of values for the fiscal impact is based on the uncertainty regarding the number of homes destroyed by the wildfires. No official records exist, and the number ranges from 160[3] to 600[4] for the Hermit's Peak/Calf Canyon Fires and over 200 for the McBride Fire, depending on the source. The proportion of site-built homes is uncertain as well. Also, many homeowners may choose to buy a mobile home to place on their properties which are not covered under the bill. In addition, taxpayers with additional business pass-through income may have more tax liability to offset with this non-refundable credit. Hence, the range captures many uncertainties of each individual taxpayer financial situation and decisions in future construction. The fiscal impact was grown using the December 2023 Consensus Revenue Estimating Group (CREG) forecast for PIT growth rate.

Policy Issues: Considering that some taxpayers might not comply with FEMA's requirements to get qualified disaster relief payments under the Act, the bill seeks to aid claimants responsible for replacing their homes. This credit, though, erodes horizontal equity in income taxes as it treats some taxpayers as unique from other taxpayers who have suffered the same type of loss from wildfires or other natural disasters. In particular, owners of manufactured or mobile homes are excluded from the proposed tax credit, while owners of this type of home are typically lower-income New Mexicans. In addition, those with a higher income who may choose to build a home with a higher value may have a higher tax liability to offset with a proportionally higher tax credit. Finally, business owners may have more applicable tax liability to apply against the credit than wage earners with associated withholding.

This section allows a credit for home rebuilding costs, even if some or all of those costs are covered by a homeowner's insurance policy. Tax & Rev recommends including language at page 35, line 4, under the definition of "qualified site-built home expenditures" to exclude not only federal payments but also payments received from any insurance policy. The language of Section 139 makes federal and state payments non-taxable "but only to the extent any expense compensated by such payment is not otherwise compensated for by insurance or otherwise." Tax & Rev recommends the inclusion of this specific language. Otherwise, homeowners will be compensated with a credit for expenditures that are made by a third party.

This bill augments the tax code complexity and poses higher risks to tax collections by giving taxpayers more choices. This occurs because taxpayers are given additional credits or incentives, allowing them to choose which credits to claim. For example, since the proposed tax credit is not refundable and may be carried forward for up to three taxable years, some taxpayers may choose to intentionally increase their tax liability to get a credit as high as possible while available. Furthermore, if this credit is approved,

2 26 USC 139: Disaster relief payments, Title 26 of the United States Code (26 USC), https://uscode.house.gov/

[3] https://storymaps.arcgis.com/stories/d48e2171175f4aa4b5613c2d11875653

[4] https://www.singletonschreiber.com/practices/california-fire-damage-attorneys/hermits-peak-fire-lawyer

taxpayers may opt to disregard the federal help, increasing the burden for the State. Additionally, the credit might be incentivizing predatory behaviors as there are no limits regarding the costs taxpayer may incur in rebuilding their home, and therefore, they might incur disproportionate costs and pass them on to the State via this credit. These scenarios would imply a higher revenue loss for the General Fund than the one considered here.

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 or narrowing the tax base, with a negative impact on the general fund; and (2) increases the burden of compliance on both taxpayers and Tax & Rev. Adding complexity and exceptions to the tax code does not comport generally with the best tax policy.

Technical Issues: Section H page 4, line 6- 14 adds an element that permits a member of a pass-through entity (PTE) to claim a portion of the tax credit proportionate to their ownership in an entity. This language is helpful when the tax credit is available through the Corporate Income Tax Act to allow an LLC or Partnership to certify for the tax credit. In this case, the tax credit is not available for the Corporate Income Tax Act and this section is not necessary. A corporation does not have the opportunity to receive this credit.

Other Issues: In its current form, the proposed tax credit does not have an aggregate cap. Tax & Rev recommends adding a credit cap to be administered by the Regulation and Licensing Department.

Administrative & Compliance Impact: Tax & Rev will update forms, instructions, and publications and make information system changes. This bill will have an impact on Tax & Rev's Information Technology Division (ITD) of approximately 640 hours or about four months for an estimated staff workload cost of $35,520. Tax & Rev's Administrative Services Division (ASD) will require approximately 40 hours, split between two existing full-time employees. Tax & Rev's Revenue Processing Division (RPD) will require a new Account Auditor-A on a recurring basis and workload from an existing full-time employee (FTE).

Estimated Additional Operating Budget Impact*				**R or NR****	**Fund(s) or Agency Affected**
FY2024	**FY2025**	**FY2026**	**3 Year Total Cost**		
--	$2.9	--	$2.9	NR	Tax & Rev – ASD – staff workload
--	$35.5	--	$35.5	NR	Tax & Rev – ITD – staff workload
--	$83	$83	$166	R	Tax & Rev – RPD - FTE
--	$10	--	$10	NR	Tax & Rev – RPD - staff workload

* In thousands of dollars. Parentheses ( ) indicate a cost saving. ** Recurring (R) or Non-Recurring (NR).