BILL ANALYSIS AND FISCAL IMPACT REPORT
Taxation and Revenue Department

January 22, 2024

Bill: HB-105 **Sponsor:** Representatives T. Ryan Lane, James G. Townsend, Harlan Vincent, Jared Hembree, and Candy Spence Ezzell

Short Title: Education Scholarship Tax Credit

Description: This bill authorizes the creation of school tuition organizations that can receive contributions for the purpose of granting education scholarships to certain students attending private schools. It creates new PIT and CIT credits for taxpayers who make a contribution to a tuition scholarship organization.

The Education Scholarship Income Tax Credit is equal to the amount contributed but to exceed $700 for single individuals and married individuals filing separately and $1,400 for head of household, surviving spouses and married individuals filing joint returns. The Education Scholarship Corporate Income Tax Credit is equal to the amount contributed but is not to exceed $1,400. Starting January 1, 2025, the credit amount is to be adjusted for inflation.

The taxpayer will apply for the credits with the Public Education Department (PED). Approved taxpayers will then claim the credit from the Taxation and Revenue Department (Tax & Rev) within 12 months following the calendar year in which the contribution is made.

This credit can only be used against a taxpayer's tax liability. Any unused credit can be carried forward for 3 years.

Effective Date: Not specified; 90 days following adjournment (May 15, 2024). Applicability – The provisions of Section 2 and 3 of this act apply to taxable years beginning on or after January 1, 2024.

Taxation and Revenue Department Analyst: Sara Grubbs

Estimated Revenue Impact*					R or NR**	Fund(s) Affected
FY2024	FY2025	FY2026	FY2027	FY2028		
--	($2,500)	($2,600)	($2,800)	($3,000)	R	General Fund

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

Methodology for Estimated Revenue Impact: Tax & Rev cannot anticipate how many taxpayers will contribute and how much they will contribute, since it depends on whether organizations can provide eligible educational scholarships and if the credit will incentivize contributions. Tax & Rev identified 10,923 organizations in New Mexico that have been granted an exemption from federal income tax as described in section 501(c)(3) of the Internal Revenue Code of 1986. However, it is unknown how many of these organizations will seek certification from the Public Education Department (PED) as a tuition scholarship organization, or how many new 501(c)(3) organizations may be created for that purpose.

Tax & Rev therefore estimated the impact using two sources of data on students at private schools, starting with the most recent data from the National Center for Education Statistics' Private School Universe Survey. This survey tabulates the annual number of private school students by state. In the 2021-2022 academic year, there were 16,909 private school students in New Mexico.

The nonprofit organization EdChoice[1] provides information on five tax programs that aid in reducing private school cost, including tax credit tuition scholarship programs. 12 states currently offer a low-income based tuition scholarship credit program. Using these states' education scholarship tuition credit activity from 2019 to 2022 as a proxy, Tax & Rev assumes an annual increase in the number of students served of 5.9%. Tax & Rev also used both sources to calculate a ratio between the number of low-income students attending private school receiving a tuition scholarship compared to the total number of private school students in the state to estimate the number of low-income private school students receiving scholarships in New Mexico. It is assumed these students and school tuition organizations are eligible and certified when applicable.

Tax & Rev assumes that the taxpayers claiming this credit will be higher income taxpayers or corporations that will contribute to a school tuition organization. Tax & Rev assumed the amount of donations needed and in turn credits to support a growth rate of 5.9% of low-income students attending private schools with a tuition scholarship. Tax & Rev assumed the maximum credit per taxpayer, ranging from $700 to $1,400 depending on filing status or applicable tax credit, will be used against the taxpayers' tax liability. The maximum credit is adjusted starting in tax year 2025 using the Congressional Budget Office's (CBO) May 2023 forecast of the consumer price index (CPI-U).

Policy Issues: Investing in education will positively impact communities and improve people's lives. The bill may foster educational opportunities for lower-income children and youth with the option of attending private school. Twenty-two states offer an education scholarship income tax credit, 12 with low-income limits. In most states, the number of low-income students served has steadily increased. Of particular interest is Rhode Island's program, which increases the amount of the tax incentive over sequential years of continued donation.

While the bill provides educational cost benefits to lower-income students, the tax benefits will likely accrue solely to higher-income taxpayers and corporations, as lower-income taxpayers are less likely have disposable income to contribute or to have income tax liability against which to offset the credit.

This bill subsidizes the demand for education instead of the supply of quality education services. An alternative to fostering education opportunities would be to finance the supply of education services by investing in improving access and quality of public education. The effect of this bill will be to reduce revenues from Personal Income Tax (PIT) and Corporate Income Tax (CIT), which fund public education, and instead divert those resources to private education. In addition, since the funds to cover the cost of tuition stem from private donations, low-income families that have chosen a private school might experience a sudden financial burden in the event the amounts of those donations decline significantly or once the program finishes.

It is unusual to provide a credit for a charitable contribution; under the Internal Revenue Code (IRC), such contributions are usually deductible for federal tax purposes. Credits are more valuable, because they are a dollar-for-dollar reduction in a taxpayer's tax liability, whereas deductions only reduce taxable income, and therefore result in only a percentage of the contribution reducing overall tax liability. Under the IRC, taxpayers will already be able to deduct the amount of their contributions under this law from their federal taxable income, for taxpayers who itemize their federal deductions. Because New Mexico taxable income is based on federal taxable income, a taxpayer who itemizes their federal deductions, making a contribution under this act will receive *two* tax benefits: first, the deduction of the contribution amount from federal, and therefore New Mexico, taxable income, and then a credit against New Mexico income tax liability in an amount equal to 80% of the contribution. Tax & Rev recommends disallowing the

[1] www.edchoice.org

credit for any taxpayer claiming a deduction with respect to the same contribution to prevent double dipping.

This credit does not have a sunset date. Tax & Rev recommends a sunset date for policymakers to review the impact of tax expenditures before extending them.

Technical Issues: Section 1: The Secretary is given the authority to adjust the credit amount based on inflation. The bill should identify what inflation index is to be used to adjust the credit amount to avoid ambiguity. The following is suggested: "To determine the adjusted credit amount, the Secretary shall use the cost-of-living adjustment for the taxable year as determined by the secretary of the United States treasury for purposes of section 1(f) of the United States Internal Revenue Code of 1986, as amended." on page 8, line 20, after the period. Similarly, on Page 10, line 21, after the period insert: "To determine the adjusted credit amount, the Secretary shall use the cost-of-living adjustment for the taxable year as determined by the secretary of the United States treasury for purposes of section 1(f) of the United States Internal Revenue Code of 1986, as amended."

The state of New Mexico provides free lunches to all New Mexico public and charter school students regardless of income under Section 22-13C-4 NMSA 1978, universal school meals for children. This bill specifies that an eligible student is defined as a New Mexico resident whose household qualifies for a reduced-price lunch through the federal school lunch program established pursuant to 42 USCA Sections 1751 through 1769. For clarification, Tax & Rev recommends including "free or" before "reduced-price lunch" to ensure all low-income students are eligible in subsection I, page 6, line 22.

Sections 2 & 3: On Page 9, lines 4-11, and Page 11, lines 5-12: In Subsection D, the first sentence requires that the credit be claimed for the taxable year in which the contribution is made. But the following sentence allows the taxpayer to apply to the department for the credit within 12 months following the calendar year the contribution was made. Example: the taxpayer contributes in 2024, which can be claimed on the taxpayer's 2024 return filed in April 2025. Applying the second sentence, the taxpayer has 12 months, until December 2025, to apply for the 2024 credit. It is unknown if the taxpayer must file an amended 2024 return or can claim the credit on the 2025 return filed in 2026. To address this, Tax & Rev suggests the following adjustment: "A taxpayer may claim the tax credit allowed by this section for in the taxable year in which the taxpayer makes a contribution to a school tuition organization. To receive the tax credit, a taxpayer shall claim the credit on forms and in the manner prescribed by the department within twelve months following the calendar year in which the contribution is made. The application shall include a certification made pursuant to Subsection C of this section."

This bill does not prescribe the method of certification of the tax credit as done in other tax credit bills. It is recommended that language is added after Section C on page 9 line 3 and page 10 line 4 which prescribes the certification document requirements for PED. This language is standard on other tax credits certified by outside agencies. Tax & Rev recommends the following new section after C: "If the public education department determines that the applicant meets the requirements of this subsection for an Educational Scholarship Tax Credit, the public education department may issue a certificate of eligibility to the taxpayer. The certificate shall include the amount certified, an identification number, date of issuance and the first taxable year that the credit shall be claimed."

Tax & Rev is now required by Section 7-1-84 NMSA 1978 to compile and present a tax expenditure budget, which includes the number of taxpayers that claim and the amount of claims for a tax expenditure. Credits are seen as a tax expenditure and will be included on this report. For that reason, Tax & Rev recommends that on page 9, lines 20 through 25; page 10, lines 1 through 3; page 11, lines 21 through 25; and page 12, lines 1 through 4 are stricken in full.

Other Issues: None.

Administrative & Compliance Impact: Tax & Rev will make information system changes and update forms, instructions and publications. Staff will be trained to administer the credit.

Tax & Rev's Administrative Services Division (ASD) will perform systems testing. It is anticipated this work will take approximately 40 hours split between 2 Full-Time Equivalent (FTE) of a pay band 70 and a pay band 80 at a cost of approximately $2,900.

This bill will have an overall moderate impact on Tax & Rev's Information Technology Division (ITD), approximately 700 hours or about four and a half months and an estimated contractual cost of $154,000.

Tax & Rev's Revenue Processing Division (RPD) will review certifications to assure compliance of credits. Currently, all certifications must be entered manually, so increasing the number of claims would increase the administrative workload for Tax & Rev. Tax & Rev will need to enter into discussions with PED to share certification information. Tax & Rev assumes that electronic transfer of credit information will not occur before the effective date of the bill without required statutory language. RPD will need to add one FTE, an Accountant Auditor-A, to process the addition of another credit.

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
--	$154.0	--	$154.0	NR	Tax & Rev – ITD Contractual Cost
--	$83.0	$83.0	$166.0	R	Tax & Rev – RPD one FTE
--	$10.0	--	$10.0	NR	Tax & Rev – RPD one FTE one-time costs

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

Related Bills: Possible conflict with SB-48 (2024 legislative session); Similar bill, SB-113 (2023 Session)