BILL ANALYSIS AND FISCAL IMPACT REPORT
Taxation and Revenue Department

February 6, 2024

Bill: HTRC Sub. for HB-252 **Sponsor:** Representative Derrick J. Lente

Short Title: Adjust Income Tax Brackets

Description: This *House Taxation and Revenue Committee* substitute is an omnibus tax bill including:

- **Sections 1-4 & 13:** Amends the Industrial Revenue Bond Act and the County Industrial Revenue Bond Act to allow some qualifying electric storage facilities to be eligible projects under those acts. The bill also amends Section 7-9-54.3 NMSA 1978 to allow a deduction from gross receipts, prior to July 1, 2034, for sales of energy storage equipment or related equipment to a government for the purpose of installing an energy storage facility.
- **Section 5:** Amends Section 7-2-7 NMSA 1978 to adjust the personal income tax (PIT) brackets for tax years beginning on or after January 1, 2025. It changes all of the tax rates for each filing status, increasing the income levels for certain backets and adjusting tax rates. It also adds additional income levels for each filing status.
- **Section 6:** Amends Section 7-2-18.17 NMSA 1978 to extend the date of a "qualified investment" which may be claimed for the Angel Investment Credit from December 31, 2025 to December 31, 2030.
- **Section 7:** Amends the Rural Health Care Practitioner Tax Credit under Section 7-2-18.22 NMSA 1978. The amendment lowers the number of hours of health care that practitioners must provide in rural areas to receive the credit from 2,080 to 1,584 for the full amount of the credit, and from 1,040 to 792 to receive the reduced credit. The bill adds certain categories of health care practitioners to the list of those eligible to receive the credit. The bill changes the definition of "rural" from being an area designated by the Department of Health (DOH) to one designated as such by the health resources and services administration of the U.S. Department of Health and Human Services. This credit adds a requirement for DOH to provide the certifications in a specified form and by an agreed upon manner and interval with the Taxation and Revenue Department (Tax & Rev). This bill also adds a requirement for Tax & Rev to report on this credit to the Revenue Stabilization and Tax Policy Committee and the Legislative Finance Committee with an analysis of the cost of the credit.
- **Section 8:** Amends Section 7-2-34 NMSA 1978, to increase the first of the "greater than" deduction options for net capital gains from $1,000 to $2,500, and then to limit the second of the greater than options of 40% of net capital gain income to 40% of $1 million of net capital gains income from the sale of a business allocated or apportioned to New Mexico. It also removes an outdated restriction related to a credit in the Venture Capital Investment Act that has been repealed.
- **Section 9:** 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 an amount equal to the expenditures, less any federal recovery, incurred by the taxpayer and may not exceed $50,000 per home. The credit is applied for through the Construction Industries Division of the Regulations and Licensing Department (RLD). The aggregate amount of credits that may be certified in a calendar year is $5 million. 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.
- **Sections 10-12 & 16:** Amends Section 7-2A-5 NMSA 1978 to set a flat corporate income tax (CIT) rate of 5.9%. Section 7-4-10 NMSA 1978 is amended to provide that the apportionment of business

income be done by multiplying the income by the sales factor only (rather than using the 3-factor sales, property, and payroll test), known as "single sales factor" apportionment. Section 7-4-19 NMSA 1978 is amended to remove references to additional apportionment factors. Also repeals Section 7-4-11 through 7-4-15 NMSA 1978, which provide the property factor and payroll factor for apportionment of income.

- **Section 14:** Provides that receipts of an eligible provider for environmental modification services reimbursed by the medical assistance division of Health Care Authority Department may be deducted from gross receipts, starting July 1, 2024, and prior to July 1, 2034. An eligible provider is one who meets requirements of the medical assistance division to provide environmental modifications pursuant to a waiver granted by the federal Department of Health and Human Services to provide home and community-based services to recipients. Definitions are provided for "environmental modifications" and include the purchasing and installing of equipment or making physical adaptations to a recipient's residence or enhance the recipient's ability to act independently.
- **Section 15:** Creates a new deduction from gross receipts for receipts from the sale of child care assistance services from a contract or grant with the Early Childhood Education and Care Department, and for receipts of for-profit pre-kindergarten providers for services that are provided pursuant to the Pre-Kindergarten Act. This deduction will be required to be separately reported and will require reporting to the Revenue Stabilization and Tax Policy Committee and the Legislative Finance Committee.

Effective Date: Section 1 through 4 and 13 through 15 are effective July 1, 2024, Sections 5, 8, and 10 through 12 are effective January 1, 2025. Sections 7 and 9 are applicable to taxable years beginning on or after January 1, 2024, and Sections 5, 8 and 10 through 12 are applicable to taxable years beginning on or after January 1, 2025.

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Estimated Revenue Impact*					**R or NR****	**Fund(s) Affected**
FY2024	**FY2025**	**FY2026**	**FY2027**	**FY2028**		
--	(Unknown, but likely minimal negative)				R	Sections 1- 4: State General Obligation Bonds
--	(Unknown, but likely minimal negative)				R	Sections 1- 4: Local Governments
--	($79,500)	($159,000)	($170,000)	($176,000)	R	Section 5: General Fund – PIT Tax Brackets
--	--	--	($1,100)	($1,100)	R	Section 6: General Fund – Angel Investment Credit
--	($11,630)	($11,630)	($11,630)	($11,630)	R	Section 7: General Fund - Rural Healthcare Practitioner Credit
--	--	$61,000	$63,000	$65,000	R	Section 8: General Fund – Capital Gains Deduction
--	(Unknown but up to $5,000)	(Unknown but up to $5,000)	(Unknown but up to $5,000)	(Unknown but up to $5,000)	R	Section 9: General Fund – Home Fire Recovery Credit
--	--	$11,710 - $18,100	$11,900 - $18,400	$12,300 - $19,100	R	Section 10: General Fund– Single CIT Tax Bracket
		Likely Positive, indeterminate			R	Sections 11 and 12:

						General Fund– CIT Single Sales Factor
--	($1,100)	($1,100)	($1,100)	($1,100)	R	Section 13: General Fund – Energy Systems Income Tax Credit
--	($700)	($700)	($700)	($700)	R	Section 13: Local Governments – Energy Systems Income Tax Credit
--	($280)	($290)	($300)	($320)	R	Section 14: General Fund – Medicaid Environmental Modifications GRT deduction
--	($190)	($190)	($200)	($210)	R	Section 14: Local Governments – Medicaid Environmental Modifications GRT deduction
--	($5,600)	($5,700)	($5,900)	($6,100)	R	Section 15: General Fund – Child Care GRT deduction
--	($6,700)	($6,800)	($7,000)	($7,300)	R	Section 15: Local Governments – Child Care GRT deduction
--	**($103,110)**	**($106,815)**	**($116,880)**	**($120,550)**	**R**	**Total General Fund**
--	**($7,590)**	**($7,690)**	**($7,900)**	**($8,210)**	**R**	**Total Local Governments**

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

Methodology for Estimated Revenue Impact:

[Sections 1-4]: The expansion of the Industrial Revenue Bond (IRB) program to include energy storage facilities will reduce property tax and GRT revenues for the state, local governments, and other taxing districts as property purchased pursuant to an issuance of IRBs is owned by the local government, and therefore is not subject to property taxes, and equipment is not subject to GRT, until the completion of the IRB lease and the property is turned over to the business or organization that owns the project.

[Section 5]: The impact of the proposed changes to the income tax brackets was estimated using tax years 2021-2022 tax return data for New Mexico taxpayers. Using the University of New Mexico's Bureau of Business and Economic Research (BBER) January 2024 forecast, the Taxation and Revenue Department (Tax & Rev) indexed the data to tax year 2025 and then grew the estimate annually by BBER's New Mexico's wage and salary growth.

[Section 6]: Tax & Rev reviewed the historical claims and credit amounts of the Angel Investment Credit. The average aggregate amount applied towards PIT liability in the last five fiscal year years is $900 thousand with a weighted average growth rate of 4.3%. Tax & Rev assumes that the Angel Investment Credit aggregate amount from FY2024 to FY2028 will be claimed at the same historical average rate.

[Section 7]: Tax & Rev first determined how many practitioners currently claiming the partial credit might be able to claim the full credit. Section 7(b)(1) reduces the number of hours required to be worked

in rural areas to qualify for the credit. Using a sample of taxpayers that have claimed the credit between 2016 and 2020, Tax & Rev calculated that the ratio of practitioners claiming the credit between full-time and part-time credits to be 60:40 and that part-time credit recipients represent about 850 taxpayers. Tax & Rev then assumes that 50% of the taxpayers receiving the part-time credit will increase their hours to obtain the full credit amount within their qualifying practitioner group. To increase their hours, they must work 9 months a year versus previously about 6 and ½ months a year for the partial credit.

Tax & Rev then estimated how many additional practitioners may now become eligible for the credit with the reduced hours or be incentivized to work additional hours in rural areas part of the year and receive a full-time or part-time credit. Tax & Rev used the information provided in the New Mexico Health Care Workforce Committee (HCWC) annual report for 2022[1] and 2023[2] to determine how many practitioners in rural areas may currently not be covered by the credit[3]. Tax & Rev analyzed providers in non-metropolitan areas of the state for each current eligible practitioner group based on the report's geographic distribution. In total, 189 healthcare practitioners are estimated to become newly eligible for the credit under the provisions of this bill. Tax & Rev assumed a 60:40 split for full-time versus part-time credit of the additional pool of practitioners. Some of the providers in metropolitan areas may qualify for part-time credits if they perform some of their practice in rural qualified areas; but such metropolitan providers are not assumed in this estimate.

Tax & Rev assumes no growth in the number of professionals eligible for the credit each year after the changes set out above. Given the presumed intent to improve access to health care, this credit could see growth as more professionals provide services in qualified rural areas.

Section 7(b)(1) amounts to $1.43 million of the total estimated revenue impact.

Section 7(b)(2): Section 1(b)(2) expands the list of persons eligible to receive the credit. To compute the fiscal impact, Tax & Rev used the information provided in the New Mexico Health Care Workforce Committee (HCWC) annual report for 2023. The largest fiscal impact is from the inclusion of registered nurses (RNs) among the health care professionals eligible for the credit. Per the 2023 HCWC report's Table 5.6, there were 16,181 practicing RNs and Certified Nurse Specialists (CNS) in New Mexico. CNSs are advanced practice RNs that are already eligible for the credit. The Department assumed that 90% of the 16,181 were RNs. Of these, 20% are practicing in nonmetropolitan areas, given the report's geographic distribution, and are assumed to become eligible for this credit. Based on these calculations, approximately 2,914 RNs would be newly eligible for the credit.

The next largest component of the fiscal impact is from the inclusion of various types of behavioral healthcare providers to the list of eligible health care practitioners. Due to a lack of available data on some health care providers for the 2023 HCWC report, Tax & Rev uses the 2022 report. According to the 2022 HCWC report, there were approximately 8,434 classified behavioral health care providers. Of these, based on Table 6.2, which details the workforce by provider type in the 2022 HCWC report, 87% of providers are assumed to be classified as one of the newly added categories of eligible behavioral healthcare providers in this bill (clinical social workers, independent social workers, professional mental health counselors, professional clinical mental health counselors, marriage and family therapists, professional art therapists, alcohol and drug abuse counselors). Tax & Rev assumes approximately 25% of these providers are practicing in nonmetropolitan areas. Based on these calculations, approximately 1,677 health care professionals would be newly eligible for the credit.

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[1] New Mexico Health Care Workforce Committee. 2022 Annual Report. Albuquerque NM: University of New Mexico Health Sciences Center, 2022

[2] New Mexico Health Care Workforce Committee. 2023 Annual Report. Albuquerque NM: University of New Mexico Health Sciences Center, 2023

[3] New Mexico Regulation and Licensing Department (RLD) experienced a data breach in October 2022 and anticipates the absence of comprehensive data for the next two to three years.

The remaining components of the fiscal impact come from the addition of pharmacists and physical therapists (PTs) to the list of eligible health care practitioners. Based on the 2022 HCWC report, there were approximately 1,890 pharmacists and 1,536 PTs working in the state of New Mexico. Of these, 24% of pharmacists and 25% of PTs are practicing in non-metropolitan areas, given the report's geographic distribution, and are assumed eligible for this credit. Based on these calculations, approximately 460 pharmacists and 380 PTs would become eligible for the credit.

In total, 5,372 healthcare practitioners are estimated to become newly eligible for the credit under the provisions of this bill. Some of the providers in the newly eligible categories in metropolitan areas may qualify for part-time credits if they perform some of their practice in rural qualified areas; but such metropolitan providers are not assumed in this estimate.

Tax & Rev assumed the distribution of the new population of practitioners claiming the credit between full-time and part-time credits to be 60:40. Tax & Rev also assumed a percentage share of the credit that these newly eligible taxpayers may apply to their annual tax year liability, given the associated average salaries for the new categories of practitioners eligible for the $3,000 maximum credit. The average salary for each respective practitioner category was taken from the Department of Workforce Solutions'[4] occupation and wage data. For pharmacists and PTs, the tax liability based on their average salary is assumed to reach the $3,000 credit amount. But for the other categories of newly eligible practitioners, it was assumed that, based on their average salaries, 75% of the credit amount will be claimed.

Section 7(b)2 amounts to $10.2 million of the total estimated revenue impact.

In total, based on the foregoing figures and assumptions, the reduction of eligible hours and expansions outlined in this bill are estimated to reduce PIT revenue by $11.63 million per year. Tax & Rev assumes no growth in the number of professionals eligible for the credit each year. Given the presumed intent to improve access to health care, this credit could see growth as more professionals provide services in qualified rural areas.

[Section 8]: Tax & Rev does not know whether the source of net capital gain income is from the sale of a business allocated or apportioned to New Mexico, but used tax return data for taxpayers claiming the capital gain deduction from tax year 2020 to tax year 2022 to estimate the fiscal impact of this bill.

Tax & Rev assumes for all eligible taxpayers with any source of net capital gain income, any taxpayer whose capital gain deduction currently equals exactly $1,000 would be eligible for the $2,500 deduction. This marginally decreases tax liability and tax revenue.

The estimate is inflated using Standard & Poor's 500 index's November 2023 forecast. Tax & Rev assumes no change in the number of taxpayers eligible for the deduction each year.

Additional analysis of Section 7-2-34 NMSA 1978 can be found in the 2023 New Mexico Tax Expenditure Report.[5]

[Section 9]: Ths sections fiscal impact is uncertain and cannot be fully quantified. The lack of information such as (1) the number of site-built homes destroyed by the wildfire, (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 compensations for the home loss under the Federal Act, (4) the dollar amount of home expenditures

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[4] https://www.dws.state.nm.us/en-us/Researchers/Data/Occupations-Wages

[5] See https://www.tax.newmexico.gov/forms-publications/

incurred by the taxpayer, and (5) the taxpayer's tax liability after applying allowances or other credits to which they are entitled, prevent the Tax & Rev from being able to provide an estimation of the revenue loss with precision. Per the bill, the maximum amount of the credits would not exceed $5 million for credits claimed under PIT.

[Section 10]: The fiscal impact is based on reviewing CIT tax return data from fiscal years 2021 through 2023. The revenue increase was modeled applying the single tax rate of 5.9% to the portion of taxable income less than $500 thousand. CIT is an extremely challenging revenue to forecast in times of relative stability. Given the variable economic conditions that may impact CIT taxpayers, the estimate has been presented as a positive range to emphasize the uncertainty of the magnitude of the impact. Using the December 2023 Consensus Revenue Estimating Group (CREG) forecast, the average range impact is grown by the current growth rate for gross CIT.

[Sections 11 - 12]: The directional positive impact is based on reviewing CIT tax return data from tax years 2019 through 2023. The taxpayer liability was modeled applying the single-sales. On an individual basis, the impact is diverse among taxpayers, but in aggregate the impact is a revenue increase to the state. The increase is due to the fact that New Mexico imports and consumes more than it produces and exports; New Mexico is a "market" state. Therefore, eliminating the two other factors of property and payroll increases the amount of income apportioned to New Mexico, overall.

[Section 13]: Tax & Rev cannot anticipate whether a government will purchase energy storage equipment to estimate a precise fiscal impact of the gross receipts tax (GRT) deduction. However, estimates from the New Mexico Public Regulation Commission suggest that the cost of 1,000 megawatts of new energy storage capacity would be $2.3 billion.[6] Tax & Rev used these estimates and the experience of the Atrisco Heritage Academy High School project to calculate the potential revenue loss from this bill's deduction.[7] However, the revenue loss would depend on the magnitude of the project and the price of the storage unit purchased. The analysis assumed a constant cost during the periods of revenue impact and used the statewide effective GRT rate.

While the energy storage market is still considered underdeveloped, notable New Mexico private projects have emerged. One significant project is the Buena Vista Energy Center, developed by NextEra Energy Resources. This facility, completed in early 2023 with a capacity of 50 megawatts (MW), is one of the largest battery storage projects in the United States. The U.S. Energy Information Administration (EIA) provides data and reports on battery storage in the United States, including New Mexico. Their reports, such as the "Battery Storage in the United States: An Update on Market Trends[8]," highlighted New Mexico as a developing market.

[Section 14]: Using data from the Human Services Department (HSD), Tax & Rev estimated that in 2021 approximately 1,341 Medicaid recipients had benefited from environmental modifications at the aggregate cost of $5,788,099. Tax & Rev used S&P's growth rate for the health care chained price index to assume inflationary cost increases for the services provided. The impact to the General Fund is from the direct impact of the GRT deduction only and is not adjusted for changes to Medicaid state and federal matching funds. Tax & Rev defers to HSD's impact to the General Fund as relates to General Fund appropriations and federal revenue impacts.

[Section 15]: Tax & Rev employed data from the Early Childhood Education and Care Department on for-profit contractual services and pre-kindergarten funding to estimate the revenue loss. The fiscal

[6] https://nmlegis.gov/Sessions/23%20Regular/firs/SB0456.PDF
[7] https://energy.sandia.gov/news/atrisco-heritage-academy-high-school-solar-storage-project/
[8] https://www.eia.gov/analysis/studies/electricity/batterystorage/

impacts used the GRT revenue growth from the December 2023 Consensus Revenue Estimating Group (CREG) forecast and the statewide effective GRT rate.

The fiscal impact is based on the statewide effective GRT rate within municipalities as the majority of childcare will be located in municipalities. The state and municipalities portions are adjusted for the 1.225% distributions under Section 7-1-6.4 NMSA 1978.

Policy Issues:

[Sections 1-4]: The legislation may be viewed as a modernization of the existing statute. Electric storage capacity at an industrial location is a relatively new development in the renewable energy industry.

The expansion of the IRB Acts to include energy storage facilities is consistent with the existing electric generation and transmission facilities allowed for under IRBs. This, however, comes at the cost of foregone property taxes on the project for the period of the ownership of the property by the local government, and its concurrent lease of that property by the local government to the owner of the project.

[Sections 5 - 9]: PIT represents a consistent source of revenue for many states. For New Mexico, PIT is approximately 25% of the state's recurring general fund revenue. While this revenue source is susceptible to economic downturns, it is also positively responsive to economic expansions. New Mexico is one of 41 states, along with the District of Columbia, that impose a broad-based PIT (New Hampshire and Washington do not tax wage and salary income). Like several states, New Mexico computes its income tax based on the federal definition of taxable income and ties to other statues in the federal tax code. This is referred to as "conformity" to the federal tax code. The PIT is an important tax policy tool that has the potential to further both horizontal equity, by ensuring the same statutes apply to all taxpayers, and vertical equity, by ensuring the tax burden is based on taxpayers' ability to pay.

[Section 5]: The last substantial amendment to the PIT brackets was passed in 2005, though the changes made by that amendment were not fully implemented until tax year 2008. In 2019, HB6 added an additional 5.9% top income bracket to each filing status, effective from tax year 2021. As New Mexico PIT brackets are not indexed to inflation, taxpayers have gradually moved into higher tax brackets, a phenomenon described as "bracket creep", despite the fact that their "real income", or the purchasing power of their income, has not changed. Over time, the effective PIT rate, which is the average tax rate paid by a taxpayer on their total gross income, has therefore increased. The federal personal income tax indexes both the standard deduction and tax brackets. The revisions proposed in this bill will adjust New Mexico's PIT brackets for inflation since 2008. Further, the bill expands the 5 current brackets into 6 brackets. In addition, as bracket 1's income range has not been adjusted for inflation, taxpayers at the lowest income are most susceptible to bracket creep, reducing vertical equity, although their rate would decrease from 1.7% to 1.5%.

Table 1

Current Tax Bracket	Taxable Income Range	Rate	Proposed Tax Bracket	Taxable Income Range	Rate
Married Filing Separate					
1	Not over $4,000	1.7%	1	Not over $4,000	1.5%
2	$4,000 -- not over $8,000	3.2%	2	$4,000 -- not over $12,500	3.2%
3	$8,000 -- not over $12,000	4.7%	3	$12,500 -- not over $25,000	4.3%
4	$12,000 -- not over $157,500	4.9%	4	$25,000 -- not over $50,000	4.7%
5	Over $157,500	5.9%	5	$50,000 -- not over $157,500	4.9%
			6	Over $157,500	5.9%

Married Filing Joint, Heads of Household					
1	Not over $8,000	1.7%	1	Not over $8,000	1.5%
2	$8,000 -- not over $16,000	3.2%	2	$8,000 -- not over $25,000	3.2%
3	$16,000 -- not over $24,000	4.7%	3	$25,000 -- not over $50,000	4.1%
4	$24,000 -- not over $315,000	4.9%	4	$50,000 -- not over $100,000	4.3%
5	Over $315,000	5.9%	5	$100,000 -- not over $315,000	4.7%
			6	Over $315,000	5.9%
Single					
1	Not over $5,500	1.7%	1	Not over $5,500	1.5%
2	$5,500 -- not over $11,000	3.2%	2	$5,500 -- not over $16,500	3.2%
3	$11,000 -- not over $16,000	4.7%	3	$16,500 -- not over $33,500	4.3%
4	$16,000 -- not over $210,000	4.9%	4	$33,500 -- not over $66,500	4.7%
5	Over $210,000	5.9%	5	$66,500 -- not over $210,000	4.9%
			6	Over $210,000	5.9%

All taxpayers will see a decrease in their tax liability with most of the savings from this bill occurring for middle-income taxpayers as demonstrated in Table 2 below. This is achieved by both increasing the income ranges for the brackets but also applying a lower marginal rate for the proposed brackets 3 and 4. The lower marginal rate for brackets 1 through 4 reduces these taxpayers' share of their tax liability in proportion to their income. This supports the concept of vertical equity mentioned above.

Table 2				
Current Tax Bracket	**Proposed Tax Bracket**	**Estimated No. of Taxpayers**	**Estimated Fiscal Impact for FY2026 ($ thousand)**	**Average Tax Relief Per Taxpayer**
1	1	431,000	($480)	($1.11)
2	2	67,000	($830)	($12.39)
3	2	58,000	($3,270)	($56.38)
4	2	6,000	($680)	($113.33)
4	3	162,000	($29,900)	($184.57)
4	4	183,000	($59,880)	($327.21)
4	5	149,000	($57,200)	($383.89)
5	6	42,000	($7,230)	($172.14)

The proposed bracket changes maintain the so-called "marriage penalty". As defined by the Tax Foundation, a marriage penalty exists when a state's income brackets for married taxpayers filing jointly are less than double the bracket widths for single filers. As of tax year 2023, New Mexico is one of 15 states with a "marriage penalty" built into its income tax brackets[9].

The proposed tax brackets 1 through 4 are still quite "compressed", meaning that only small amounts of income are sufficient to enter the next bracket.

Although the table above provides that the lowest income taxpayers will experience smaller nominal savings, their savings are largest in percentage terms. For example, a married couple with an income of $8,000 currently pays 1.7%, for a tax liability of $136 annually. This proposal would reduce tax due to $120, representing savings of $16 or 12%. Conversely, a wealthier couple with an income of $400,000

[9] https://taxfoundation.org/state-marriage-penalty-2022/

would currently owe $20,042, versus $19,489 under this proposal. The higher-income couple saves $553, representing savings of 2.8%.

[Section 6]: The Angel Investment credit is meant to encourage taxpayers to invest in the state with an assumed benefit to the economy of the state. While any taxpayer may apply for this credit, most of the financial benefit of this credit will be realized by high earning individuals. The broader economic benefit to the state of these investments, which may include additional jobs, wages, and economic development, is hard to measure though and it is unclear if it exceeds the loss of PIT revenue. The bill extends the sunset date to December 31, 2030, applicable to the date by which the investment must be made. Tax & Rev supports sunset dates for policymakers to review the impact of a credit before extending it. Additional analysis of Section 7-2-18.17 NMSA 1978 can be found in the 2023 New Mexico Tax Expenditure Report[10].

[Section 7]: The proposed changes of the rural health care practitioner tax credit will erode horizontal equity in state income taxes. By basing the credit on profession and location of work, taxpayers in similar economic circumstances are no longer treated equally. Thus, two dentists who earn the same salary may have different tax liability given where they work. The proposed changes to lower the required number of qualified hours further erodes that horizonal equity by potentially increasing the pool of qualified taxpayers. However, the broader public good of subsidizing medical professional employment in rural areas for the betterment of New Mexico residents' quality of life in those areas. There are health, social, and environmental benefits gained by serving residents in their home communities versus those residents incurring travel costs, time commitment, and other burdens to travel long distances, or not receive care at all.

Reducing the qualified hours may have unintended consequences. The current level of the full credit represents working full-time annually in a rural clinic. By dropping the hours down to 1,584, this represents working approximately 9 months of the year in a rural clinic. The population of taxpayers receiving the credit with higher hours may lower their hours working in rural areas and work for three months in a metropolitan area to receive a higher income for a fourth of the year. That said, requiring a practitioner to work 2,080 hours per year equates to that individual taking no time off in a year, whether for vacation or illness; this is likely not feasible.

The demand for health-care workers in the current market could facilitate an arrangement such as this. Thus, current practitioners receiving the higher credit amount working full-time in rural clinics may decrease the time seeing patients in rural areas. This could potentially impact patients who have established care with certain healthcare practitioners. If the changes proposed in the bill do not incentivize more practitioners to serve rural areas or increase their service hours in rural areas that could put further strain on the healthcare infrastructure in rural areas.

The New Mexico Health Care Workforce Committee has routinely recommended the expansion of the rural health practitioner tax credit, including listing it as Recommendation 7 from the New Mexico Health Care Workforce Committee, 2023 Annual Report. The annual report notes that pharmacists, physical therapists, social workers, and counselors who are included in the expansion of this credit are particularly needed in many areas of the state. By expanding the population of eligible practitioners, this credit could further incentivize the recruitment and retention of professionals to work in rural areas of the state, where residents are currently medically underserved.

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[10] See https://www.tax.newmexico.gov/forms-publications/

The current credit does not include a sunset date. Tax & Rev supports sunset dates for policymakers to review the impact of a credit before extending it if a sufficient timeframe is allotted for tax incentives to be measured. Given the expansion of this credit and the additional cost to the state, a sunset date would force an examination of the benefit of this credit versus the cost.

[Section 8]: Current statute recognizes any taxpayer's capital gain during a tax year, regardless of income level. The increase in the deduction from any source of net capital gains decreases taxable income for taxpayers with lower levels of capital gains. However, higher earning individuals tend to also have higher levels of capital gains, so they receive a larger proportion of benefit from this deduction. Limiting the type of net capital gain to the sale of a qualified business and capping that income to $1 million reduces the proportion of benefit to high earning taxpayers. Out of all taxpayers that claim this capital gain deduction, approximately 3.8% of taxpayers claim a deduction over $1 million. The cap would not unduly harm lower-income beneficiaries with smaller capital gains. However, taxing capital gains or limiting a deduction affects savings and investment decisions over the long term. The $1 million cap could affect capital flight and cause decline in entrepreneurship in New Mexico.

[Section 9]: The bill seeks to aid claimants responsible for replacing their homes following the major fire disasters in Northern New Mexico. 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 the wildfires. In particular, owners of manufactured or mobile homes are excluded from the proposed tax credit, considering that people who resort to this type of homes are typically low-income.
Under federal law, FEMA payments are not taxable, unless the loss is also compensated from another source, such as insurance. If a loss is compensated by insurance, then FEMA payments likely become taxable for federal purposes. While this bill only allows a credit with respect to rebuilding costs that are not compensated by FEMA, the federal government may nevertheless regard the state payments as rendering some or all of any FEMA payment taxable. Furthermore, 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. Otherwise, homeowners will be compensated with a credit for expenditures that are made by a third party.

[Section 10-12]: Corporations and the economy like certainty and that applies to the tax code. Changing the tax code and in this case the tax rates would be the sixth change to the CIT brackets in 10 years as detailed in the table below. This uncertainty is seen by corporations as creating a less favorable business environment: on the other hand, the majority of states with CIT are moving to a single tax rate.

<table>
<tr><th colspan="7">Table 3 – Historical and Current New Mexico CIT rates</th></tr>
<tr><th>Taxable Income</th><th>1987-2013</th><th>2014</th><th>2015</th><th>2016</th><th>2017</th><th>2018-present</th></tr>
<tr><td>Up to $500,000</td><td>4.8%</td><td>4.8%</td><td>4.8%</td><td>4.8%</td><td>4.8%</td><td>4.8%</td></tr>
<tr><td>$500,000.01 to $1,000,000</td><td>6.4%</td><td>6.4%</td><td>6.4%</td><td>6.4%</td><td rowspan="2">6.2%</td><td rowspan="2">5.9%</td></tr>
<tr><td>Over $1,000,000</td><td>7.6%</td><td>7.3%</td><td>6.9%</td><td>6.6%</td></tr>
</table>

One tax rate though reduces the complexity of the CIT code. The reduction of the CIT rates to one rate moves the majority of taxpayers who have tax liability to the higher tax rate. In Tax Year 2020, of those that had tax liability, the majority, approximately 94%, incurred that liability with taxable income less than $500,000 placing them at the 4.8% current tax rate. This now places smaller income companies on par with larger corporations. But while for personal income time (PIT) there is progressivity tied to the 'ability to pay" and fairness with vertical equity, that association of ability to pay is not readily applied to corporate income tax policy. The Tax Foundation quotes Jeffrey Kwall, a professor of law at Loyola University Chicago School of Law that "Graduated corporate income rates are inequitable – that is, the

size of a corporation bears no necessary relation to the income levels of the owners."[11] An argument that the Tax Foundation puts forth for a single-rate is that it minimizes the effort by corporations to avoid the tax liability at the higher marginal tax rates. New Mexico would join 29 other states who have a CIT and the District of Columbia in enacting a single-rate corporate income tax.

A single-sales factor and one tax rate reduces the complexity of the CIT code even further. This change would support the tax policy principle of simplicity. Taxpayers incur compliance burdens as they prepare, submit, and keep records about tax returns. Likewise, Tax & Rev incurs administrative costs to collect taxes, review the accuracy of tax returns and tax payments, and bring taxpayers into compliance. The reduction of apportionment from three factors to one simplifies the tax code for both taxpayers and Tax & Rev.

Some policymakers have argued that using a single sales factor method of apportionment incentivizes corporations to increase payroll in a state. However, the data regarding increase in local employment from adopting the single sales factor are inconclusive. Furthermore, the large majority of states have now adopted the method, diluting any potential positive impact on employment substantially.

Changing to a single sales factor will place New Mexico as a more competitive environment compared to other states with a similar application of a single sales factor or no corporate income tax at all. Most states have moved to a single sales factor for purposes of income apportionment. As of January 2022, of states with CIT, only four states including New Mexico used the three-factor formula, while 30 states and the District of Columbia used only sales in their apportionment formula[12]. The remaining states with a corporate income tax used a formula that gave greater weight to sales. "By using the portion of a corporation's sales rather than employment or property to determine tax liability, states hope to encourage companies to relocate or to expand their production operations within the states they operate in."[13] By shifting the burden of taxation to out-of-state companies, the single sale factor apportionment method encourages companies to set up their physical plant and locate employees in states that do not apportion based on these two factors. In an environment where most other states have adopted single-sales factor, New Mexico's continuing use of the three-factor apportionment test places it at a disadvantage for companies to form or relocate here. However, it is also true that corporations look to more than just the tax code when considering operations. These include among other things, the work force skill-level and education, infrastructure, and education systems.

The change from a property-payroll-sales formula to a sales-only formula substantially reduces the corporate tax burden of businesses that arguably are benefiting the most from public services in a state and unfairly shifts the tax burden to out-of-state businesses that benefit from state services to a lesser extent.[14] The shifting of the tax burden to out-of-state companies counters a fundamental principal of tax equity and to an extent adequacy of tax revenues, as in-state corporations benefit from the expenditures of state government revenue: roads, health care, K-12 education and higher education State revenues also help support local government expenditures for public safety.

The three factors were meant to represent the profits attributable to labor (employment), capital (physical plant), and market (sales). In an economy increasingly service-oriented and based on the internet, investment in physical plant no longer has the importance in generating profit for companies that it once did. Profits are less attributable to the location of physical plant in one state, and therefore assume less

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[11] https://taxfoundation.org/publications/state-corporate-income-tax-rates-and-brackets/
[12] Federation of Tax Administrators, January 2022
[13] https://www.urban.org/policy-centers/cross-center-initiatives/state-and-local-finance-initiative/projects/state-and-local-backgrounders/corporate-income-taxes
[14] Mazerov, Michael (2005), 'The "Single Sales Factor" Formula for State Corporate Taxes: A Boon to Economic Development or a Costly Giveaway?' Center on Budget and Policy Priorities, Washington, D.C.

importance in deciding how to apportion income to each state. Increases in productivity also mean that businesses can do more with a smaller payroll, decreasing the importance of the payroll factor. Remote work also may have some impact on the payroll factor.

But, overall, to the extent that New Mexico remains more weighted to consumption than the presence of corporate operations, then the single-sale factors will remain revenue positive to the state.

[Section 13]: Energy storage is vital to building a modernized electric grid in New Mexico and is critical for the state's energy transition toward clean sources as renewables continue to grow. Thus, this deduction aligns with the goals of using energy efficiently, modernizing the energy supply, and replacing extant nonrenewable energy sources.

The expansion of the IRB Acts to include energy storage facilities is consistent with the existing electric generation and transmission facilities allowed for under IRBs. This, however, comes at the cost of foregone property taxes on the project for the period of the ownership of the property by the local government, and its concurrent lease of that property by the local government to the owner of the project.

[Section 14]: The bill seeks to aid in reducing the cost of making environmental modifications to Medicaid recipients' homes. Tax & Rev assumes this tax reduction would be passed on to New Mexico Medicaid program's outlay for these services whereby the state and federal match would be reduced, saving additional general fund dollars. The impact though is not offset for local governments. The Medicaid recipients themselves would continue to have these modifications covered through Medicaid and thus not be impacted by the reduction of the tax due.

[Section 15]: The bill proposes a GRT deduction to level the playing field between for-profit and non-profit childcare assistance and pre-kindergarten service providers, serving the public interest in providing quality child care and pre-kindergarten education to New Mexico children. For for-profit child care assistance programs, GRT may currently be passed on to families who live at or below the federal poverty line, often times resulting in a burdensome monthly payment for families who already struggle to afford child care. This deduction will establish an equitable cost between for-profit child care providers and pre-kindergarten providers and non-profit and governmental entities who are generally exempt from GRT.

Technical Issues:
[Section 7]: The bill adds language to require the practitioner taxpayer identification number on the certificate. Clarifying that this should be the social security number of the taxpayer and not the business tax ID number for those that are private practitioners would be beneficial to credit processing at Tax & Rev and improve the customer experience by requiring fewer supplemental items to be submitted.

[Section 12]: Section 7-2A-2(BB) NMSA 1978 defines the water's edge group. A company is excluded from the water's edge group if it has less than 20% of its property and payroll sourced to locations within or without the United States, following the sourcing rules of Uniformed Division for Income Tax Purposes Act (UDITPA). This section repeals the property and payroll factors, which would be applicable to the water's edge group definition, and there would be no basis for determining whether a company meets the 80/20 rule.

The fix would be to amend Section 7-2A-2(BB) NMSA 1978 to include the definitions of property and payroll or make the repeal of property and payroll inapplicable to Section 7-2A-2(BB) NMSA 1978.

In addition, Tax & Rev suggests that Sections 12(B) and (C) should not be deleted. These sections provide the opportunity for Tax & Rev to require certain types of income (known to Tax & Rev through review of records or its own research) to be properly reported by the taxpayer using the factors for

allocation or apportionment.

Removing these sections leave Tax & Rev only able to require the taxpayer to provide an "accounting" or "other method" of presenting its "business activity" to Tax & Rev limiting Tax & Rev from requiring that factors known to Tax & Rev to simply be included or improper assertions pursuant to the relevant factors to be excluded.

The first phrase of the Section requires the request from Tax & Rev to be "reasonable" so a taxpayer may object to Tax & Rev use of Subsections (B) and/or (C) on the basis of not meeting that standard. But Tax & Rev should have the option.

[Section 14]: Considering the definition of "eligible provider" in the bill, it is unclear if this deduction should be extended to governmental gross receipts tax as well. The bill provides a deduction for the provision of "environmental modification services". But "environmental modifications" are defined to include "the *purchasing* and installing of equipment…" In order to ensure that the deduction covers all aspects of environmental modification, Tax and Rev suggests changing the words "environmental modification services" to just "environmental modifications".

Other Issues:
[Section 12]: Making changes to apportionment under Section 7-4-19 NMSA 1978 does not only impact CIT. These changes impact all income tax programs when calculating net taxable income, including Personal Income Tax, fiduciary filers, S-CORP filers and non-income pass-through entity.

New Mexico is a member state of the Multistate Tax Commission (MTC). MTC is an intergovernmental state tax agency whose mission is to promote uniform and consistent tax policy and administration among the states, assist taxpayers in achieving compliance with existing tax laws, and advocate for state and local sovereignty in the development of tax policy.

New Mexico is a member of the "Multistate Tax Compact" as enacted into law and entered into with all jurisdictions legally joining therein, in the form substantially as follows: Ch. 7, art. 5 NMSA 1978. This compact requires the adoption of uniform language. It is not clear if this proposed changes to UDIPTA conflict with agreements for uniformity.

Administrative & Compliance Impact: All sections of the bill will require Tax & Rev to make information system changes and update forms, instructions and publications. PIT and CIT respective changes will be implemented with annual tax year changes. The following details specific section impacts to divisions within Tax & Rev:

This bill implementation will have an overall high impact on Tax & Rev's Information Technology Division (ITD), approximately 3,060 hours or about 19 months for total implementation of all sections and $170,000 of staff workload costs.

Tax & Rev's Administrative Services Division (ASD) will test credit sourcing and perform other systems testing. It is anticipated this work will take approximately 120 hours split between 2 Full-Time Equivalent (FTE) of a pay band 70 and a pay band 80 at a cost of approximately $8,900.

[Section 7]: Tax & Rev recommends an interface to allow the Department of Health (DOH) to send the certification information regularly and securely. The added requirement for DOH to provide the certifications in a specified form and by an agreed upon manner and interval with Tax & Rev will increase processing efficiency for the Revenue Processing Department (RPD) and reduce risks for certification data being shared from the source versus at the time of filing with the taxpayer. Tax and Rev may have

some non-recurring costs to facilitate the data exchange with DOH but will have recurring savings which will aid in other reported impacts if several bills with new tax credits become law.

[Section 9]: 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**		
$73	$97	--	$170	NR	All Sections: ITD – Staff workload costs
--	$9	--	$9	NR	All Sections: ASD – Staff workload costs
--	$83	$83	$166	R	Section 9: RPD one FTE
--	$10	--	$10	NR	Section 9: RPD – staff workload

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

Related Bills: Related to various bills, including HB-10, HB-37, HB-83, HB-93, HB-143, HB-163, HB-166, HB-216, HB-252