Fiscal impact reports (FIRs) are prepared by the Legislative Finance Committee (LFC) for standing finance committees of the NM Legislature. The LFC does not assume responsibility for the accuracy of these reports if they are used for other purposes.

Current and previously issued FIRs are available on the NM Legislative Website (www.nmlegis.gov).

FISCAL IMPACT REPORT

		ORIGINAL DATE	02/13/22		163/HTRCS/aHFl#1/a
SPONSOR	HTRC	**LAST UPDATED**	02/16/22	**HB**	SFC
SHORT TITLE	Tax Changes			**SB**	
				ANALYST	Torres/Faubion/Graeser

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY22	**FY23**	**FY24**	**FY25**	**FY26**		
--	($2,060.0)	($3,480.0)	($4,970.0)	($7,120.0)	Recurring	Sections 1 & 2 Adjust Food and Medical Hold Harmless Payments to certain municipalities
--	--	($74,000.0)	($74,700.0)	($75,400.0)	Recurring	Section 4 Child Credit -- General Fund PIT
	($7,400.0)	($13,500.0)	($17,800.0)	($18,600.0)	Recurring	Section 5 Military Pension Exemption -- General Fund – PIT
--	($84,100.0)	($89,400.0)	($94,400.0)	($99,500.0)	Recurring	Section 6 Social Security Exemption -- General Fund – PIT
--	($1,900.0)	($1,800.0)	($2,300.0)	($3,400.0)	Recurring	Section 7 New Solar Market Tax Credit General Fund PIT
--	($3,025.0)	($3,025.0)	($3,025.0)	($3,025.0)	Recurring	Section 8 Disclosed Agents General Fund – GRT
--	($94,050.0)	($194,100.0)	($199,900.0)	($206,200.0)	Recurring	Sections 9 – GRT Rate Cut General Fund GRT
--	($1,650.0)	($3,400.0)	($3,400.0)	($3,500.0)	Recurring	Section 10 Comp Tax Rate Cut General Fund – Comp
	($5,600.0)	($5,800.0)	($6,000.0)	($6.200.0)	Recurring	Section 11 B to B manufacturers-- General Fund GRT
--	($1,430.0)	($1,460.0)	($1,490.0)	($1,520.0)	Recurring	Section 12 Feminine Hygiene Products -- General Fund GRT
--	**($201,215.0)**	**($389,965.0)**	**($407,985.0)**	**($418,265.0)**	**Recurring Total**	**General Fund – RECURRING TOTAL**
	($337,600.0)				Nonrecurring	Section 3 PIT Rebate -- General Fund PIT
--	**($538,815.0)**	**($389,965.0)**	**($407,985.0)**	**($418,265.0)**	**TOTAL**	**General Fund – TOTAL**
--	($2,100.0)	($2,100.0)	($2,100.0)	($2,100.0)	Recurring	Section 8 Local Governments – Disclosed Agents
--	($670.0)	($670.0)	($670.0)	($690.0)	Recurring	Section 10 Small City Assistance Fund – Comp Tax
--	($440.0)	($450.0)	($450.0)	($460.0)	Recurring	Section 10 Small County Assistance Fund – Comp Tax
--	($3,800.0)	($3,900.0)	($4,000.0)	($4,100.0)	Recurring	Section 11 B to B -- Local Governments GRT
--	($950.0)	($970.0)	($990.0)	($1,100.0)	Recurring	Section 12 Feminine Hygiene Products -- Local Governments GRT
	$2,060.0	$3,480.0	$4,970.0	$7,120.0	Recurring	Section 2 Adjust Food and Medical Hold Harmless Payments to certain municipalities
--	**($5,900.00)**	**($4,610.00)**	**($3,240.00)**	**($1,330.00)**	**Recurring**	**Local Governments TOTAL**

Parenthesis ( ) indicate revenue decreases

* Note: the estimate of anti-pyramiding provisions in Section 11 are subject to uncertainty. (See FISCAL IMPLICATIONS for more detail). Reported here is the high estimate. All expenditures that carry through the forecast period are scored as recurring even if they have an end date beyond FY26.

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

Estimated Additional Operating Budget Impact*				Recurring or Nonrecurring	Fund(s) or Agency Affected
FY22	FY23	FY24	3 Year Total Cost		
$30.0	$70.0	$70.0	$170.0	Recurring	EMNRD General Fund Operating
$200.0	--	--	$200.0	NR	Sections 9 and 10 initial rate change: ITD - Contractual Resources
--	$8.0 (if rate change required)	$8.0 (if rate change required)	$8.0 (one-year cost)	NR	Sections 9 and 10 subsequent rate change if triggered: ITD - Contractual Resources
$5.2	--	--	--	NR	Section 2: ITD – Staff workload costs
--	$60.9	$60.9	$121.8	R	Section 3: RPD one FTE
$14.5	--	--	$14.5	NR	RPD—labor & mailing costs
$5.2	--	--	$5.2	NR	ASD – staff workload costs

This SFC Committee Substitute Bill can be considered as originating from HTRC CS/HB163 and modified by provisions of SB215 (Refundable PIT Rebate), SB26 (modifications of hold harmless payments for certain municipalities) and portions of SB137 (reporting GRT business and service locations).

See CONFLICTS, DUPLICATES, COMPANIONS.

SOURCES OF INFORMATION

Responses Received on Precursor Bills
Taxation and Revenue Department (TRD)
Energy, Minerals and Natural Resources (EMNRD) on SB44
New Mexico Attorney General (NMAG) on SB49, SB108, SB5
Aging and Long-Term Services Department (ALTSD) on SB49 and SB108
Department of Finance and Administration (DFA) on SB5

SUMMARY

Synopsis of Bill as amended

For clarity, the synopsis and fiscal impacts reflect HTRC substitute for HB163 as amended by SFC.

Sections 1 & 2 – amend Sections 7-1-6.46 and 7-1-6.47 of the Tax Administration Act to exempt certain municipalities and counties from the hold harmless distribution phase-out if they did not have a hold harmless gross receipts tax in effect on June 30, 2019. The amendment also allows

municipalities with a population of at least 10 thousand to retain a percentage of the hold harmless distribution based on their poverty level of the municipality or county, with the distribution decreasing as the poverty level decreases and decreasing each year for municipalities and counties with poverty levels two percentage points or more below the state poverty level. For other counties and municipalities, the hold harmless distributions would restart at 49 percent and decrease by 7 percent each year until being phased out entirely on July 1, 2029. In detail:

Criterion/Poverty Level:	Percentage of Applicable Maximum Distribution*
Municipality w/o hold harmless local option rate as of June 30, 2019 and under 10,000 population.	
No criteria as to poverty level	100%
Municipality w/o hold harmless local option rate as of June 30, 2019 and over 10,000 population.	
Poverty >2% above state poverty level (SPL)	80%
Poverty level two percentage points above to two percentage points below SPL	50%
Poverty level two percentage points below SPL	49% for FY23 and decreasing by 7% per fiscal year – 30% after FY25
Muni w hold harmless local option rate as of June 30, 2019 and over 10,000 population	
No criteria as to poverty level	49% for FY23 and decreasing by 7% per fiscal year – 0% after FY29
County w/o hold harmless local option rate as of June 30, 2019 and under 48,000 population.	
No criteria as to poverty level	100%
County w/ hold harmless local option rate as of June 30, 2019 and under 48,000 population and County over 48,000 population.	
No criteria as to poverty level	56% for FY22
	49% for FY23 and decreasing by 7% per fiscal year – 0% after FY29

* "Applicable maximum distribution" is also somewhat dependent on whether a county or municipality has previously enacted a local option hold harmless GRT. For those that did not have a hold harmless GRT in place as of June 30, 2019, the applicable maximum distribution is based on current total enactments. For those that had enacted the hold harmless GRT, the applicable maximum distribution is based on the rates in effect on January 1, 2007.

Section 3 – provides a one-year (nonrecurring) personal income tax (PIT) rebate to be paid to all taxpayers who filed PIT-1 returns for tax year 2021. The rebate amount will be $250 for single and married filing separate returns filers with adjusted gross income (AGI) less than $75 thousand and $500 for married filing joint returns and AGI less than $150 thousand. Implicitly, taxpayers who reside in the state for at least six months of calendar year 2021 will be eligible.

Section 4 – Child income tax credit (CS/HB213): this credit may be claimed only for tax years 2023 through 2027 against a taxpayer's personal income tax liability, and any amount exceeding that liability may be refunded to the taxpayer. The amount of the credit is $25 to $175 per qualifying child, based on the adjusted gross income of the taxpayer. TRD is required to compile a report on utilization and cost. See TECHNICAL ISSUES for a discussion of "qualifying child".

Section 5 – Provides a "temporary" phased exemption for military retirement pension payments This exemption is scheduled as follows:

Taxable Year	Exemption Amount*
2022	$10,000
2023	$20,000

2024	$30,000
2025	$30,000
2026	$30,000

* Note: the exemption may only be applied against the amount of military retirement pay includable in net income.

Section 6 – Exempting social security income from income tax for certain individuals: allows an exemption for all social security benefits included in adjusted gross income. These exemptions would be equal to the amount included in adjusted gross income pursuant to the Federal Internal Revenue Code but only if the adjusted gross income includable but for this exemption of a maximum $75 thousand for married filing separate, $100 thousand for single filers, and $150 thousand for married filing jointly, heads of household, and surviving spouses.

Section 7 – Extending and amending the new solar market development income tax credit: extends the sunset on the new solar market development income tax credit by eight years from December 31, 2027 to December 31, 2035. The cap on the credit is increased from $8 million to $12 million. The credit is made refundable and transferable rather than eligible for carry forward for five years. Refund ability and transferability begins with solar systems installed on or after January 1, 2022.

Section 8 – Defines "disclosed agency" in the gross receipts and compensating tax act: provides a definition of “disclosed agency” for purposes of determining the gross receipts and compensating tax as an agent receiving money on behalf of a principal if the agent, or the agent's principal, disclosed the agency relationship to a third party from which the agent receives money, or if the third party otherwise has actual knowledge that the agent receives money on behalf of the principal.

Sections 9 & 10 – Reducing the rates of the gross receipts tax and the compensating tax; providing for an increase in the gross receipts tax and the compensating tax if gross receipts tax revenues decrease: reduces the state gross receipts and compensating tax rate from five and one-eighth percent (5.125 percent) to four and seven-eighths percent (4.875 percent) and provides for restoration of the 5.125 percent state gross receipts tax and the companion compensating tax if, in the next five years, the general fund transfer of revenues in any year is less than 95 percent of the amount transferred in the previous fiscal year. A determination would be made in February of the year following the end of a fiscal year and the restoration would be effective as of July 1 of the year of determination. However, any determination would be delayed until after FY25.

Section 11 – Providing gross receipts tax and governmental gross receipts tax deductions for the sale of services to a manufacturer: provides GRT deductions on accounting services, engineering services, financial management services, information technology services, human resources services, legal services, and temporary services, provided these sales are business-to-business transactions to a manufacturer.

Section 12 – Providing gross receipts tax and governmental gross receipts tax deductions for feminine hygiene products.

The effective date of gross receipts tax provisions in all sections except 6 and 7 is July 1, 2022. The nonrecurring, refundable PIT credit in Section 3 is effective July 1, 2022 and the credit expires effective June 30, 2023 (note: the non-recurring PIT rebate of Section 3 will be automatically mailed out after the effective date of the provision of July 1, 2022. Because of this effective date, virtually all rebates will be mailed out and not used to defray 2021 liabilities unless those liabilities

remain as of the date of mailing the checks.) The child tax credit is applicable for tax years 2023 through 2032. The social security exemption is permanent in this bill and applicable for tax years beginning January 1, 2022. The solar market development credit and refundability provisions are applicable for systems installed after January 1, 2022.

FISCAL IMPLICATIONS

Sections 1 & 2 – adjusts the hold harmless distribution phase-out for certain municipalities and counties based on poverty levels within the jurisdiction. In general, the distribution for municipalities is more complex and the distribution for counties is somewhat simplified. TRD has provided this analysis in SB26.

"An estimated 10 municipalities would be impacted by this legislation, with three frozen at 80 percent and three at 50 percent of their applicable maximum distribution. The remaining four municipalities continue the phase-out until FY26 at which point their distribution is frozen at 30 percent. "

Table 1 - Revenue Impact by Municipality ($ thousands of dollars)

Municipality	Hold-Harmless Increment	% - per Poverty Level	FY2023	FY2024	FY2025	FY2026
Santa Fe	N	30%	$0	$0	$0	$365.0
Roswell	N	50%	$58.6	$482.6	$932.1	$1,408.1
Hobbs	N	50%	$30.1	$248.0	$479.0	$723.5
Carlsbad	N	30%	$0	$0	$0	$75.9
Alamogordo	N	50%	$36.6	$301.6	$582.6	$880.1
Gallup	N	80%	$1,156.0	$1,459.6	$1,780.3	$2,118.9
Los Alamos[1]	N	30%	$0	$0	$0	$66.7
Los Lunas	N	30%	$0	$0	$0	$55.7
Las Vegas	N	80%	$475.9	$600.9	$732.9	$872.3
Portales	N	80%	$303.6	$383.3	$467.5	$556.5

Note: The difference between the current phase-out schedule for these municipalities is compared to the proposed phase-out schedules to determine the fiscal impact. FY2021 hold harmless distribution data was used in the estimate.

The changes to the hold harmless distributions would increase future distributions above current projected levels for the 10 municipalities that have not imposed a hold harmless gross receipts tax. This increase in distributions provides fiscal relief and may allow local governments to increase services, reduce taxes in other areas, or both. The increase in distributions, however comes at a loss to the general fund and may result in a future reduction in state government services, an increase in taxes, or both.

County GRT hold harmless distributions remain unimpacted by the proposed legislation.

Section 3 – provides a one-year (non-recurring) PIT rebate to be paid to all taxpayers who filed PIT-1 returns for tax year 2021. Using 2020 TRD PIT tax return data, LFC economists estimated the number of taxpayers eligible for the rebate based on their filing status and AGI. Economists assumed the number of taxpayers eligible in 2021 is similar to those in 2020.

Section 4 – Child income tax credit (TRD analysis):

> The impact of the refundable credit proposed in this legislation was estimated using tax return data for New Mexico taxpayers for tax years 2018 – 2020. Due to unavailability of information on the number of qualifying children each taxpayer has, the Taxation and

[1] Los Alamos is both a municipality and a class-H county and is classified as a municipality for tax statutes

Revenue Department (TRD) estimated the impact based on the number of exemptions each taxpayer claimed and their filing status. TRD's estimate is based on the average impact of the credit for the last three tax years. The annual growth in the estimate is based on the average growth in returns for the last three tax years. The tax credit is available for tax years 2022 through 2026 and is, therefore, considered to be recurring.

Section 5 – Exemption -- Armed Forces Retirement Pay (adapted from HB76).

Although this exemption may be considered temporary pursuant to the amended title of the bill, conventional budgeting rules classify this exemption as recurring. In order to be considered nonrecurring, these conventional rules imply that a one-year or two-year fiscal impact would be considered non-recurring but a five-year fiscal impact would be considered recurring.

TRD describes the methodology for this estimate: "Two sources of data were analyzed to arrive at an estimated revenue impact. The first data source is the Department of Defense (DOD) annual *Statistical Report on the Military Retirement System* for the federal fiscal year that ended September 30, 2020. The second data source was a sample of New Mexico military retiree state income tax returns for tax year 2018. The analysis takes into account the new 5.9 percent marginal tax rate effective for Tax Year 2021 and beyond."

"The *Statistical Report on the Military Retirement System* provides an aggregate number of retirees and survivor beneficiaries by state, and an aggregate amount of benefits distributed. This analysis assumes all retirees were qualified by years of service or disability to receive lifetime benefits. The sample of military retiree returns was used to establish an average personal income tax (PIT) decrease per retiree based on the phased in exemption of $10,000 for tax year 2022, $20,000 for tax year 2023, and $30,000 for tax years 2024 through 2026 of military retirement pay. Retiree annuities were increased by a cost of living adjustment, which for most retirees per the DOD report is based on the Urban Wage Earner and Clerical Worker Consumer Price Index (CPI-W). All other taxable income reported on the returns was kept flat. Subtracting the exemption amount, a new taxable income was calculated, and the PIT rates applied to determine the new PIT due. An average PIT decrease per year was calculated with the sample of 15,000 returns."

"It is assumed that the sample of approximately 15,000 military retiree returns is representative of the approximately 21,000 average annual reported retirees. It is assumed that the net immigration and emigration of military retirees into the state per year is zero and that net new retirees and deceased retirees per year is zero. The historical retiree numbers in the last four years from the annual *Statistical Report on the Military Retirement System* indicate a slight annual decline of -0.5 percent. To the extent the legislation causes more military retirees to move to New Mexico and military retiree population growth is positive versus flat or negative, the fiscal impact will be larger. Finally, the analysis assumes 100% of qualifying retirees will claim the deduction in the first year of eligibility."

For more detail see FIR for HB76.

Section 6 – Exempting social security income from income tax for certain individuals:

TRD utilized data from the Individual Master File/Individual Return Transaction File (IMF/IRTF) extracts received from the Internal Revenue Service (IRS) for tax years 2018

and 2019. To scale the impact of this exemption to tax year 2022 and into the forecast horizon of this bill analysis, TRD utilized a combination of a) the growth in Social Security outlays forecasted by the Congressional Budget Office (CBO)[2], b) the growth rate of the population 65 years and older in New Mexico relative to the United States[3], and c) the cost-of-living-adjustment (COLA) to Social Security and Supplemental Security Income (SSI) benefits for calendar year 2022[4,5]. The estimate is based on the taxpayer population in IRS data who filed a New Mexico personal income tax (PIT) return. This population was further filtered to only include those with taxable social security benefits that were either R-filers or B-filers[6] and who were either residents, first-year residents or part-time residents in New Mexico. Non-resident B-filers do not allocate any of their pension/annuity/social security benefit income to New Mexico and hence were excluded. It was further assumed that taxpayers would select either this new exemption or the exemption pursuant to Section 7-2-5.2 NMSA 1978, depending on which decreased their tax liability the most. The fiscal impact also accounts for the higher top personal income tax (PIT) rate that is effective beginning tax year 2021.

Extensive additional explication and description are contained in the FIRs for HB48, HB49, HB158, SB49, SB108, SB121, and STBTC CS/HB5 et al. This latter reference is the only one of these related bills with the same $75 thousand, $100 thousand, and $150 thousand AGI ceilings as this bill.

Section 7 – Extending and amending the new solar market development income tax credit: EMNRD expects the provisions of this bill will stimulate an expansion of the market and a collateral expansion in the number of approved claims for refund. The potential fiscal revenue impact to the general fund could be an additional $4 million, if the solar installations continue to increase. Because the New Solar Market Development Tax Credit is quite new, there is only limited data available from EMNRD and TRD. See analysis included in HB34 for a discussion of a significant discrepancy between EMNRD approvals and TRD paid claims.

TRD estimates the fiscal impact of the increased cap amounts and refundability as follows: "The New Solar Market Development Tax Credit was enacted beginning Tax Year 2020, while a prior solar market development credit program was available from tax years 2006 through 2016. Based on data received from EMNRD, an average of 1,000 photovoltaic systems received the previous solar market development credit and approximately 350 solar thermal systems received it. Given the $3 million maximum aggregate cap amount on the credit for photovoltaic systems and a weighted average total system cost of $28,640, photovoltaic system credits were hitting the cap by the third year of the previous credit." TRD also highlights: "During the prior credit, the average cost per watt for an installed

---

[2] https://www.cbo.gov/publication/57342
[3] Population Projections, United States, 2004 - 2030, by state, age and sex, on CDC WONDER Online Database, Sept. 2005.
[4] https://www.ssa.gov/cola/
[5] 2022 COLA adjustment at 5.9% was significantly higher than the average in the last five years of 1.6%. An adjustment was, therefore made to CBO's projected outlays to account for this higher than expected adjustment as well as to account for the current high inflationary expectations in FY2022 and FY2023.
[6] 'R' filers file based on the rate tables. 'B' filers file a PIT-B for New Mexico allocation and apportionment of income.

residential photovoltaic system dropped from $9.01 per watt in 2009 to $4.50 per watt in 2016. Estimated national median installed prices in 2020 for residential installations were at $3.80 per watt[7]. The average residential installation price in New Mexico would be around $24,700, assuming national average per watt costs, a 14 percent decrease in system installation cost from the previous credit program. Further cost reductions are being sought by the U.S. Department of Energy's Solar Energy Technologies Office to maintain cost incentives over the lifetime of solar photovoltaic systems." The federal government continues a residential energy credit through tax year 2023 and a commercial credit beyond tax year 2022. The state solar energy systems gross receipts tax deduction, Section 7-9-112 NMSA 1978, also provides a deduction from the sale and installation of solar energy systems if used to generate power for on-site consumption."

"Lower installation prices and current solar market tax deductions and credits contribute to incentivizing continued growth in residential photovoltaic installations. U.S. Energy Information Administration data for solar photovoltaic net generation by sector indicates that between October 2015 and October 2021, New Mexico residential solar photovoltaic generation increased at an annual average rate of 31 percent and small-scale systems in the commercial sector increased at a rate of 9 percent[8]. In FY21, a total of 1,529 taxpayers claimed the New Solar Market Development Tax Credit from TRD. TRD assumes applications for this credit will continue to grow at an average annual rate of 20 percent to support the growth trend in solar photovoltaic generation seen between 2015 and 2021. However, with these assumptions while the state may reach the current cap of $8 million for aggregate credit in FY25, the state would not reach the proposed cap of $12 million in the forecasted timeframe."

LFC staff notes TRD analysis may not have included that the tax credit becomes refundable (and transferable) with 2022 tax returns filed by April 2023 because the applicability date of the changes affects the 2022 tax year. The current law carryover from prior years would persist but would not be repealed (See TECHNICAL ISSUES for discussion). Even with no expansion in installations and claims, the refundable tax credits will more closely approach the approvals. If there is an expansion in the number of claims, then this expansion will also increase the estimate. LFC staff found the current law is expected to lead to approximately $10.6 million in total credit approvals by TY26, while the proposed law would lead to $11.6 million in credit approvals and a decrease to the general fund of $4.1 million by TY26. The $12 million cap pursuant to this bill applies to refunds and rollovers from previous approvals. It is not expected that the transferability provision will materially affect the fiscal impact estimate.

The average of the LFC staff and TRD estimates are shown in the summary revenue impact table.

Section 8 – Defining "disclosed agency" in the gross receipts and compensating tax act: this definition of disclosed agent would make it easier for companies such as temporary staffing companies and other similar companies to claim the exemption from the GRT and compensating tax on the wages they collect from employers and pass on to the temporary employees. Data from the RP-80, a report generated by TRD reflecting sector-based GRT activity, was used to determine

---

[7] Galen Barbose, Naïm Darghouth Eric O'Shaughnessy, and Sydney Forrester, Lawrence Berkeley National Laboratory, "Tracking the Sun – Pricing and Design Trends for Distributed Photovoltaic Systems in the United States", 2021 Edition, September 2021.

[8] U.S. Energy Information Administration, "Electric Power Monthly" available at: https://www.eia.gov/electricity/monthly/

the fiscal impact. The amount of foregone revenue is adjusted to reflect a lower State GRT rate of 4.875 percent as provided in Section 8 of the bill.

Sections 9 & 10 – Reducing the rates of the gross receipts tax and the compensating tax; providing for an increase in the gross receipts tax and the compensating tax if gross receipts tax revenues decrease below 95 percent.

The general fund revenue impact of reducing the GRT and compensating tax rate is estimated according to the December 2021 Consensus Revenue Estimating Group's (CREG) estimate. Furthermore, effective tax rates are assumed in the cost estimate and range from 4.07823 percent to 4.34727 percent. The effective rate less than the stated rate of 4.875 percent is attributed to the 1.225 percent state share distributed to municipalities. For this purpose, analysts have used the higher percentage. Compensating tax cost estimates are similarly calculated with a set rate of 4.875 percent, since there is no state shared compensating tax revenue.

The decrease to small cities and small counties assistance funds results from reducing the state compensating tax rate; 25 percent of compensating tax is distributed to these funds (15 percent to small cities and 10 percent to small counties).

The GRT and Comp rate reductions are effective July 1, 2022 and remain in effect permanently as long as the contingency provisions are not met that cause the rates to rise. GRT revenues are forecasted to grow at a positive rate through FY26 so the trigger is not forecast to be invoked during the forecast period. (See, however, LFC staff technical note that the trigger calculation should begin with receipts for FY24, not FY23.)

Section 11 – Providing gross receipts tax and governmental gross receipts tax deductions for the sale of services to a manufacturer:

TRD utilized data from the RP-80 GRT report for fiscal years 2019, 2020, and 2021. TRD selected the services qualifying for the deduction based on the reported North American Industry Classification System (NAICS) codes. TRD took a 3-year average of the taxable gross receipts for these services. Based on an Ernst & Young LLP study[9], in New Mexico the estimated business share of state and local sales taxes is 60 percent. TRD assumed the 60 percent share in the analysis for business-to-business services. TRD then took the 3 percent average percentage of manufacturing in the tax base for fiscal years 2019, 2020, and 2021 to arrive at a final gross estimate. Finally, based on studies of tax-pyramiding, manufacturing has higher rates of tax-pyramiding due to the number of inputs into production. The share of services in the level of tax-pyramiding is unclear and in particular these services selected for the deduction. Due to this uncertainty, the fiscal impact is presented as a range. The low end of the range assumes manufacturing purchases these services at the same rate as other businesses. The high end of the range weights manufacturing 3 times that of other industries in the purchase of these services. Using a study from the state Washington[10], manufacturing has a degree[11] of pyramiding from

[9] Phillips, Andrew and Ibaid, Muath. Ernst & Young LLP, May 2019. "The Impact of imposing sales taxes on business inputs: Prepared for the State Tax Research Institute and the Council on State Taxation"

[10] Washington State Tax Structure Study Committee, chair William H. Gates Sr... Nov. 2002. "Tax Alternatives for Washington State; A Report to the Legislature"

[11] Pyramiding degree is measured by comparing effective Washington Business & Occupation (B&O) tax rates on a gross receipts base with effective B&O tax rates on a value added base. The ratio of the two tax rates is a measure the degree of pyramiding of the B&O tax.

approximately 2 to 7 depending on the type of manufacturing. Washington's tax structure is different than New Mexico's and it unclear what constitute services versus tangible inputs in the study so the analysis assigns a weighting of 3 to the degree manufacturing purchases at a higher rate than other industries. Caution is urged because NAICS codes are self-reported by taxpayers upon registration; to the extent taxpayers outside these NAICS codes legitimately claim the deduction, the fiscal impact could be impacted.

The December 2021 CREG base gross receipts forecast is used to forecast the change in the cost of the deduction over time. TRD adjusted the 5.7 percent FY23 growth rate over FY22 as the FY22 revenue estimate has non-economic impacts skewing the underlying economic growth rate. Historical splits between state and local GRT revenues are applied, and the effective state-wide GRT rate for FY21 is assumed for the estimate with an adjustment for the state rate share decrease per this bill.

Note the estimate of anti-pyramiding provisions in Section 11 are subject to substantial uncertainty. For the purpose of this estimate, the high numbers have been reported.

Section 12 – Providing gross receipts tax and governmental gross receipts tax deductions for feminine hygiene products (HB32):

> The United States market for feminine hygiene products is $4,310 million according to Statista, a provider of market and consumer data. The United States estimated female population in 2020 is 166.24 million. The female population in New Mexico is 1.052 million, or 0.63 percent of the total female population. Assuming the New Mexico market for feminine hygiene products is proportional to its share of the female population, the New Mexico market is estimated to be $27.15 million ($4,310 X .0063). The effective state gross receipts tax rate is 4.3 percent. Multiplying this rate by the $27.15 million base indicates that the revenue loss for the state would be approximately $1.183 million in 2022. The effective gross receipts tax rate for local governments is 3.1 percent. Multiplying this rate by the $27.15 million base implies that the revenue loss for local governments would be approximately $842 thousand in 2022. Statista projects the market for feminine hygiene products will grow by 4.6 percent per year from 2022 to 2026. This growth rate is used to project revenue losses after 2022.
>
> TRD uses somewhat different effective tax rates than LFC staff and reports slightly higher fiscal impacts. These slightly higher impacts are reported in the Revenue Impact table.

SIGNIFICANT ISSUES: ADJUST HOLD HARMLESS DISTRIBUTION PROVISIONS FOR CERTAIN MUNICIPALITIES (AND COUNTIES)

This section increases the complexity of Section 7-1-6.46 NMSA 1978 by basing the level of Food and Medical Hold Harmless on levels of poverty within the municipality compared to statewide levels of poverty. However, it somewhat simplifies Section 7-1-6.47 NMSA 1978 applicable to Counties.

This may be the first time this proposal has been discussed in bill form. Considering the list of municipalities that qualify for some increase in hold harmless distributions, it is clear that Gallup will be a major beneficiary of these provisions. It is equally evident that Los Alamos and Santa Fe do not require additional benefits compared to other similarly situated municipalities in the state.

SIGNIFICANT ISSUES: TEMPORARY REFUNDABLE PIT REBATE

TRD notes the following:

Income tax rebates are a countercyclical fiscal policy instrument used to mitigate the loss of employment-based income experienced because of a negative shock to the economic system. The COVID-19 induced recession has had the most severe and prolonged impact on low- and middle-income families. Job losses have also been concentrated among those in the bottom quintile of incomes. Based on the website tracktherecovery.org, as of August 2021, New Mexico individuals with incomes less than $27,000 have seen a 18% reduction in employment rates since January 2020[12]. By tying eligibility to the exemption for low-and middle-income taxpayers, these rebates will provide relief to taxpayers with federal adjusted gross income (AGI) of up to $55,000 (joint filers, head of household and surviving spouse), $36,667 (single filers) or $27,500 (married filing separately). For tax year 2020, the median AGI of New Mexico residents that claimed exemption for low-and middle-income taxpayers was $27,488 (joint filers), $13,934 (single filers) and $13,878 (married filing separately).

Economic theory suggests that a well-timed, temporary, and targeted fiscal stimulus can raise economic output and income in the short run, while minimizing long run costs[13]. Given that the proposed one-time rebate will be made available to households most likely to spend the rebate money[14], it is possible that the rebate will aid in the state's short run recovery from the pandemic by increasing consumption.

There are also multiplier effects of a rebate such as this on the economy. Fiscal multiplier of a policy is the change in economic output achieved because of each dollar spent for that policy. The magnitude of the fiscal multiplier is debatable and a consensus among economists doesn't exist[15]. Although the policy is targeted towards those most negatively impacted by the pandemic, empirical evidence shows that even the most liquidity constrained households will not use the rebate for current consumption but to pay off debt and improve their future liquidity position[16]. This behavior would reduce the magnitude of any economic boost the rebate was to have in the short run but make lower income New Mexicans more financially resilient.

Current statutory requirements for TRD to intercept tax refunds will offset the rebates to some taxpayers who have outstanding debts and obligations. Although taxpayers whose refunds/rebates are intercepted will not directly receive the financial benefit, their outstanding debt will be reduced. For the one-time rebates enacted in the 2021 legislation session (SB1), about 2.7% of the $101.4 million of tax relief was intercepted to pay taxpayer debts.

Rebates based on income thresholds can create cliff effects - sudden increases in tax liability

---

[12] Source: tracktherecovery.org

[13] Elmendorf, Douglas W. and Jason Furman. 2008. "If, When, How: A Primer on Fiscal Stimulus." Hamilton Project Strategy Paper. Washington, D.C. Brookings Institute

[14] Johnson, David S., Jonathan A. Parker, and Nicholas S. Souleles. 2006. "Household Expenditure and the Income Tax Rebates of 2001." American Economic Review 96(5): 1589–610.

[15] Whalen, Charles, and Felix Reichling. 2015. "The Fiscal Multiplier and Economic Policy Analysis in the United States." Working Paper 2015-2. Washington, DC: Congressional Budget Office.

[16] Matthew D. Shapiro & Joel Slemrod, 2009. "Did the 2008 Tax Rebates Stimulate Spending?," American Economic Review, American Economic Association, vol. 99(2), pages 374-79, May.

> as income rises. As a result, two taxpayers under identical economic circumstances may face very different tax liability depending on which side of the income threshold they fall in. By basing this rebate on [AGI], the rebate will [have a] cliff-effect...

SIGNIFICANT ISSUES: CHILD INCOME TAX CREDIT

TRD notes the following: "The proposed child tax credit will erode horizontal equity in the state income taxes. By basing the credit on number of qualifying children, taxpayers with same level of income are no longer treated equally. Thus, two New Mexico residents who earn the same salary may have different tax liability given how many children they choose to have in their household. The credit will provide greater tax benefit to families with greater number of children. However, child tax credit is a tool to provide economic aid to families with children and is particularly helpful to lower income families. Recent changes to the federal child tax credit, for example, resulted in a drastic reduction in child poverty. While the proposed New Mexico credit may not have as dramatic an impact, the credit may be expected to have a significant impact in reducing child poverty and hunger in the state."

SIGNIFICANT ISSUES: ARMED FORCES RETIREMENT PAY EXEMPTION

TRD notes the following:

"…. New Mexico is one of 42 states, along with the District of Columbia, that impose a broad-based PIT. 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. Excluding types of retirement income from the taxable base is seen as eroding horizontal equity in state income taxes. By excluding income based on retirement status and profession, taxpayers in similar economic circumstances are no longer treated equally, with older taxpayers receiving a benefit not available to younger taxpayers at the same level of income."

"New Mexico, along with seven other states, has the third highest income level ($25,100) at which a couple's income may begin to be taxed. Conversely, Pennsylvania's income tax is applicable to most non-zero income. So, while New Mexico taxes retirement income, including for military retirees, the state does not begin to tax a couple's income until the $25,100 threshold. New Mexico also provides PIT exemptions to low-income individuals aged 65 years and older or blind."

"Excluding types of retirement income from the taxable base is seen as eroding horizontal equity in state income taxes. By excluding income based on retirement status and profession, taxpayers in similar economic circumstances are no longer treated equally, with older taxpayers receiving a benefit not available to younger taxpayers at the same level of income."

"There are many reasons why states may exempt some income for retirees, such as lessening the economic burdens for individuals on fixed incomes and trying to attract retirees to the state. Exempting retirement income is one of many factors that could help in achieving that goal, but will not necessarily have that result. For example, Texas does not tax any income, military retirement or otherwise, at all. Yet the state features as one of the least tax friendly states for retirees

in the country because of its high property and sales taxes[17]. Notably, New Mexico's property taxes are amongst the lowest in the nation. Looking at New Mexico's tax code holistically, the proposed exemption may not be necessary, at least not to achieve this policy goal, especially if the exemption is contrary to other, over-arching tax policy goals of simplicity and equity."

"Regarding attracting more retirees to the state, exempting retirement income is one of many factors that could help in achieving that goal. For example, Texas does not tax any income, military retirement or otherwise, at all. Yet the state features as one of the least tax friendly states for retirees in the country because of its high property and sales taxes[18]. Notably, New Mexico's property taxes are amongst the lowest in the nation. Looking at New Mexico's tax code holistically, the proposed exemption may not be necessary, at least not to achieve this policy goal, especially if the exemption is contrary to other, over-arching tax policy goals of simplicity and equity."

SIGNIFICANT ISSUES: SOCIAL SECURITY EXEMPTION

States that tax social security benefits broadly fall into four categories: (1) states that fully exempt social security benefits from their state income tax; (2) states that tax social security benefits the same way in which the federal government taxes them; (3) states that base benefit exemptions on certain factors such as age or income; and (4) states that do not tax income at all. Twelve states tax social security benefits to some extent. New Mexico is one of two states that follow the federal rules for including a portion of social security benefits as part of taxable income, and the state also provides a deduction for low- to middle-income persons over age 65 to help offset the tax on social security benefits.

At the federal level, if the taxpayer's adjusted gross income (AGI) including half of social security benefits totals less than $32 thousand for married couples filing jointly or $25 thousand for single filers, none of the benefit amount is included in gross income. Accordingly, none of it is subject to federal income tax or state income tax. For AGI including half of social security benefits that exceeds $44 thousand for married joint and $34 thousand for single, then 50 percent to 85 percent of social security income is taxable.

The Aging and Long-Term Services Department (ALTSD) points out that seniors with adjusted gross income levels less than two to three times the poverty standard, do not pay taxes and will see no impact from this bill. Three times the poverty standard for 2022 is $38,640 for one person, $52,260 for two. However, seniors and adults with disabilities who receive social security and have additional income sources, putting them into a taxable income bracket, will be affected by this bill.

See the *Other Significant Issues: Social Security Exemption* section of this FIR for additional discussion.

SIGNIFICANT ISSUES – NEW SOLAR MARKET DEVELOPMENT TAX CREDIT

According to EMNRD, the agency "has seen a measurable increase in applications submitted for

---

[17] https://www.kiplinger.com/kiplinger-tools/retirement/t055-s001-state-by-state-guide-to-taxes-on-retirees/index.php?state_id=44#

[18] https://www.kiplinger.com/kiplinger-tools/retirement/t055-s001-state-by-state-guide-to-taxes-on-retirees/index.php?state_id=44#

tax credit certificates under the New Solar Market Development Income Tax Credit. This has resulted in an increased workload at EMNRD. The amendments to increase the cap to $12 million and make the credit refundable will likely increase volumes and may encourage low- or middle-income homeowners and fixed income applicants to install solar systems, which would represent an expansion of the applicant pool."

"EMNRD's data indicates that the Solar Tax Credit became effective on March 1, 2020, and for that nine-month period over 2,364 solar installations were certified for a tax credit. The total amount of tax credit certificates for 2020 was $6,682,831. To date, the 2021 tax credit certificates are at 1,680 with a tax credit amount certified of $5,166,768. Applications for 2021 can be submitted until December 31, 2022. Based on the rate of applications received to date, it is likely that the current annual cap will be reached for 2022 applications."

TRD provides the following: "The bill extends the end date for the credit from 2028 to 2032. TRD supports sunset dates for legislators to review the impact of a credit before extending them, if a sufficient timeframe is allotted for tax incentives to be measured."

"The broader question of subsidizing solar energy has many economic factors to consider including job creation, impacts to established markets, and environmental concerns. A credit is a tax expenditure that gives preferential tax treatment to certain taxpayers. Some economists would argue that energy costs should include indirect impacts of energy use such as environmental impacts. Thus solar energy, which is often expensive to start-up, should be given tax incentives due to its low environmental impact and health and social benefits for the current and future populations. The long-term environmental, health and social benefits outweigh the short-term revenue cost. New job opportunities are associated with solar energy generation, such as solar photovoltaic installers, engineers, and managers. But job displacement also occurs with the shifting incentives for energy production away from traditional fossil fuels. Employees of both the San Juan Generating Station and associated coal mines face losing jobs with the closing of the station and care must be taken to ensure economic stability for those workers."

Given the uncertainty of the federal tax credit for residential solar continuing beyond tax year 2023, this state solar credit would provide a partial replacement for the federal credit. The proposed credit would support continued consumer demand and stability for the solar energy market. The credit aligns with Executive Order 2019-003, which aims to address climate change and energy waste prevention.

Making the credit both refundable and transferrable may allow lower and middle-income households to install solar because the benefit of the credit will be available sooner. Any transfer of the credit must be at full credit value, which will ensure that any taxpayer who sells their credit, perhaps to a solar installation firm, still receives the full value of the credit. (LFC note: not infrequently, the buyer of the credits will pay a fraction as low as 50 percent of the value of the credits. Economists calling this "extracting the rents".)

In previous personal income tax credits, including the former solar market development credit, the Legislature chose to implement a collateral corporate income tax credit. The current law does not allow a solar credit to be claimed on regular corporate income tax returns. However, the advent of virtually universal acceptance and use of pass-through entities (PTEs), including Sub-S corporations, Limited Liability Companies (LLCs), partnerships, limited liability partnerships, and others is critical. This credit can be claimed on personal income tax returns reporting income and

liability from PTEs.

SIGNIFICANT ISSUES – GROSS RECEIPTS AND COMPENSATING TAX RATE DECREASE

If FY24 through FY28 gross receipts tax revenue transfers to the general fund are less than 95 percent of the previous year's corresponding transfers, then the state gross receipts tax rate would be restored back to the 5.125 percent level. In February 2025, the DFA Secretary would compare FY24 general fund gross receipts tax receipts (including year-end audit adjustments) to final FY23 comparable general fund receipts. If the FY24 amounts were less than FY23, the 5.125 percent rate would be restored for FY25, which would begin July 1, 2025. Similar calculations, determinations and restoration would occur for the next four fiscal years.

By lowering the state GRT rate, New Mexico could increase its business tax climate competitiveness nationally and with surrounding states. Arizona, Colorado, and Texas have average combined state and local tax rates of 8.4 percent, 7.72 percent, and 8.19 percent, respectively. By lowering the state GRT rate by a quarter percent, New Mexico could have the lowest average combined state and local tax rate of 7.58 percent. It should be noted, however, that the Gross Receipts tax is imposed on most services, including construction, as well as the more conventional sales tax base that includes most tangible personal property and building materials but not construction services.

According to the Tax Foundation's *2021 State Business Tax Index*, New Mexico ranks 41st in the nation for its gross receipts tax when compared with other state tax rates. For all taxes, New Mexico is in the middle of the pack, ranking 23rd, due to better rankings for personal income taxes, a top 10 ranking in corporate and unemployment insurance taxes, and best in the nation for property taxes.

The increase in GRT rates over the years has exacerbated the effect of tax pyramiding, still an issue in many industries despite multiple exemptions and deductions attempting to mitigate the impact. Lowering GRT rates would not change the mechanism of pyramiding, but it would provide some relief for the impact of pyramiding and reduce the effective rate more than the rate reduced in the bill.

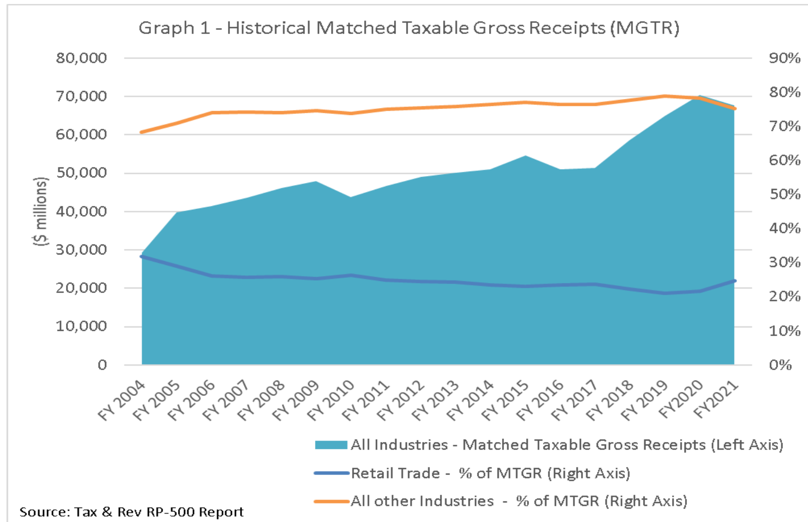
The Department of Finance and Administration Reports:

> To maintain revenues in the wake of the Great Recession, the statewide GRT rate increased by 1/8 percent (or 0.125 percent to 5.125 percent in 2010. According to the Taxation and Revenue Department, New Mexico has not decreased its statewide gross receipts tax rate since 1981. This tax decrease of 2/8 percent (or 0.25 percent) is more than double the increase in 2010.
>
> Since the GRT effectively functions as New Mexico's sales tax as well, consumers and businesses may see a decrease in the net costs of taxable goods and services if this bill is enacted and other variables remain constant.

The Taxation and Revenue Department reports:

> Good tax policy begins with taxing a broad base and imposing a low rate. Since 2019, New Mexico's GRT base has been broadened to include internet sales and a broader type of

hospital receipts. Graph 1 below demonstrates this recent expansion of the GRT base (Matched Taxable Gross Receipts). Since the Great Recession, although the total GRT base had increased steadily, retail trade had been declining as a share of the base. Some of this decline reflected consumers choosing non-taxable internet sales. With taxation of internet sales beginning July 1, 2019, retail trade's share of the tax base increased significantly. With the broader base, a lower rate is justified benefiting all New Mexicans. Although reducing the GRT and compensating tax rates reduces General Fund revenues, this comes after significant increases in revenue from the expansion of the tax base over the last few years.



A lower tax rate supports all industries in the economy, providing relief to local businesses and consumers, and makes New Mexico more competitive with other states. The reduction in the GRT and compensating tax rates reduces the impact of pyramiding, where the same final good or service is taxed multiple times in the production process and can result in effective tax rates significantly higher than the current 5.125 percent state GRT rate. This increases the cost of New Mexico exports, providing a significant obstacle to the manufacturing sector.

Consumers will receive the benefit especially among lower-income families because the GRT is a regressive tax; the lower a person's income, the higher percent of their income is spent on GRT. The tax relief provided to New Mexico families may be used to increase savings, pay off debt, and improve quality of life. Lower income New Mexicans will circulate these tax savings back into the economy.

SIGNIFICANT ISSUES – DISCLOSED AGENCY

This bill creates a definition of "disclosed agency" in the Gross Receipts and Compensating Tax Act. Disclosed agency has been a frequent source of tax litigation in New Mexico since the 1990s, and this definition will provide clarity to prevent disputes. Tax protests and litigation are costly both for taxpayers and TRD, and this bill will create savings on both sides of tax disputes. This definition will also prevent tax pyramiding on receipts an agent receives on behalf of the agent's principal.

The definition of disclosed agent would make it easier for companies such as temporary staffing companies and other similar companies to claim the exemption from the GRT and Compensating tax on the wages they collect from employers and pass on to the temporary employees. Data from the RP-80, a report generated by the Taxation and Revenue Department reflecting sector-based GRT activity was used to determine the fiscal impact.

SIGNIFICANT ISSUES – BUSINESS-TO-BUSINESS SERVICES FOR MANUFACTURING GRT DEDUCTION

TRD notes:

The deduction for qualified business services sold to manufacturers may reduce operational costs for manufacturers that use these services. These lower costs may be viewed as a reduction in tax pyramiding, as well as a leveling of the playing field for small businesses that are likely to be more reliant upon external business services. However, while larger businesses are more likely to have in-house accounting, legal, etc. departments, they also have tax liabilities associated with these in-house services in place of the GRT currently paid by businesses that use outside services, such as unemployment tax and social security withholding on employee pay, as well as overhead costs such as office space, health insurance premiums if applicable, and other employee costs. The bill may unintentionally encourage larger companies to shed in-house professional staff in favor of using independent contractors to provide professional services, by economically advantaging the use of outside professional service providers, who bear those costs themselves. The deduction also singles out certain service providers for favorable treatment, violating principles of tax equity.

TRD is concerned that this section is not a true anti-pyramiding provision, but rather represents a wholesale reduction in taxes on services, when those services are supplied to a manufacturer. For example, if a manufacturer is involved in litigation regarding one its products, then those receipts will be deductible; the bill states that professional services need only "be related" to a manufactured product to be deductible, and litigation, e.g. product liability litigation, regarding a product "relates to" that product. But the cost of litigation is not a real manufacturing input, and therefore allowing a deduction for litigation services is not an anti-pyramiding provision, but just a diminishment of the tax base. Either the deduction should be limited to receipts from true manufacturing inputs, or the definition of when a service relates to a manufactured product should be significantly tightened. Similarly, whether a service "relates to" a particular product may be unclear, and will likely lead to taxpayer disputes as to whether the deduction is applicable to a particular service or set of receipts. The loose definition also invites abuse of the deduction.

Tax incentives may be used to promote economic development, but over time they narrow the tax base, and require that the lost revenue be made up elsewhere, to maintain the same level of government services. Narrowing the tax base therefore often requires raising rates on the remaining taxpayers. Sound tax policy calls for a broader tax base, with lower tax rates. The deduction does not comport with these tax policies.

Finally, making a specific deduction for manufacturers violates good tax policy, and horizontal equity, by treating similarly placed businesses differently, depending on the type of business they are engaged in. Allowing special treatment for manufacturers will invite claims by other types of business to be allowed the same deduction when services are provided to them, further narrowing the tax base at considerable cost to the General Fund.

SIGNIFICANT ISSUES: FEMININE HYGIENE PRODUCTS GROSS RECEIPTS

TRD notes, "..feminine hygiene products as defined in the bill may be considered to be healthcare products, and the bill would provide financial relief to families that struggle to afford such

products. Deductions however reduce the tax base, and may result in a reduction in government services, an increase in taxes in other areas, or both.”

PERFORMANCE IMPLICATIONS

Pertaining to the New Solar Market Development Tax Credit, the LFC tax policy of accountability is met with the bill’s requirement to report annually to an interim legislative committee regarding data compiled from reports from taxpayers taking the deduction and other information to determine whether the deduction is meeting its purpose. The actual report from TRD to the Legislature is likely to be in the form of the annual update of the TRD Tax Expenditure Report. However, note refundability makes this tax credit different from the 2020 enactment. TRD might be able to separately detail the amount of carryover.

TRD recommends all tax incentive legislation include specific standardizations to facilitate operational efficiency. This includes: (1) Tax credits programs should be limited to five year periods. This term facilitates a market-facing analysis, whereby market changes can be acted upon by legislators; (2) Credits should not be refundable, but they should incorporate a standardized carryforward period of three years. This limits the evaluation period of any tax credit incentive to a total of eight years, and limits the fiscal obligation to a period of three years after expiration; and (3) Legislation should require tax filers to apply for any credit within 12 months of the calendar year the filer qualified for the credit. This incentivizes the filer to use the credit program timely, or risk losing eligibility due solely to their nonfeasance.

The Social Security exemption will probably be reported in TRD’s annual Tax Expenditure Report. The Gross Receipts and Compensating tax reductions will not be reported by TRD in the annual Tax Expenditure Report, but it is expected that TRD and LFC will separately calculate the reduction in the quarterly updates of the revenue estimates conducted by the Consensus Revenue Estimating Group (CREG).

ADMINISTRATIVE IMPLICATIONS -- EMNRD

EMNRD states ongoing staff resources are required to manage, redesign electronic application processes, provide system reviews, certify systems for tax credit eligibility, collect data, and maintain a database. Based on feedback from past applicants, many struggled with electronic submissions. In anticipation of increased volumes, EMNRD will need to revise the electronic platform to ensure continued struggles do not increase paper applications which further slowdown processing and significantly increase administrative workloads.

ADMINISTRATIVE IMPLICATIONS -- TRD

All sections of the bill will require TRD to make information system changes and update forms and publications. Personal Income Tax and Corporate Income Tax respective credit changes will be implemented with annual tax year changes. The following details specific section impacts to divisions within TRD:
This bill implementation will have an overall high impact on TRD’s Information Technology Division (ITD), approximately 1,300 hours or about 6 months and $245,164, $240 thousand of contractual resources through FY28 and $5,164 of staff workload costs.

Social Security Exemption: ITD will required approximately 100 hours or about 1 month and $5,164 of staff workload costs. This includes implementing a new exemption in GenTax and the Taxpayer Access Point. These updates will be implemented with annual tax year changes.

GRT and Compensating Tax Rates: Lowering the imposition of gross receipts tax and compensating tax state rates to 4.875 percent, from 5.125 percent, will take approximately 1000 hours or approximately $200 thousand for the initial rate change and 40 hours for a subsequent rate change if enacted, for a cost of $8,000 in contractual resources.

GRT filer's kits will have already been mailed with older rates to paper filers before the effective date of the bill. RPD estimates mailing costs of $14,479 to send a letter to all taxpayers that receive filer's kits explaining the rate change per the proposed legislation.

The Administrative Services Division (ASD) will work with ITD to implement the new rates and test distributions. ASD will have $5,200 in associated staff workload costs.

Due to the effective date of July 1, 2022 for several sections of this bill and other proposed bills, any changes to rates, deductions and distributions adds to the complexity and risk TRD faces to ensure complete readiness and testing of all processes.

Solar Tax Credit: Currently, all certifications must be entered manually, so if increasing the cap and making the credit refundable leads to an increase in the number of claims received, the administrative workload for TRD will increase.

RPD assumes that electronic transfer of credit information will not occur before the effective date of the bill and thus an additional FTE will be required to process additional credit claims. The recurring budget estimate for Tax Rev is based on a Tax Examiner-A.

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

Transferability provisions of Section 1 conflict with HB34.
Gross Receipts and Compensating Tax Rate Reduction – sections 9 & 10 relate to and affect:
HB14 Bonds and GRT Deduction for Electric Storage;
HB15 Tribal Gross Receipts Tax Rates;
HB32 Feminine Hygiene Gross Receipts;
HB39 GRT Deduction for Nonathletic Special Events;
HB47 Exclude Home Health Care from DSB Sourcing;
HB67 Tech Readiness Gross Receipts Tax Credit;
HB72 Space Ticket Gross Receipts;
HB82 Dialysis Facility Gross Receipts;
SB30 Regional Transit GRT Distributions; and
SB60 Film Company Security Gross Receipts.

TECHNICAL ISSUES

Child Tax Credit

TRD notes, "..presumably, the bill intends that the determination of a qualifying child continue to be controlled by IRC Sec. 152(c) and any IRS regulations or guidelines (even though the federal

exemption will not be permitted). The bill, however, further expands who is considered a "qualifying child" to include a "child or step-child of the taxpayer who would be a qualifying child for federal income tax purposes if the public assistance contributing to the support of the child or stepchild was considered to have been contributed by the taxpayer." This appears to address IRC Sec. 152(c)(1)(D) which might be interpreted to exclude a "qualifying child" who receives more than one-half of that child's support from public assistance."

"Similarly, the bill limits the credit to "residents." This could cause it to be challenged under the Equal Protection and Privileges and Immunities Clauses of the federal constitution. It is uncertain whether such a challenge could prevail. The standard for treating residents and non-residents differently is higher under the Privileges and Immunities Clause, but it is not generally considered an exacting standard. The standard requires that lawmakers determine that there is a valid purpose to the different treatment and that the distinction made between residents and nonresidents bears substantial relationship to that purpose. New Mexico currently allows some credits to be claimed by both residents and nonresidents. Credits granted to nonresidents can be limited according to their presence in the state or other factors with little risk of any constitutional challenge. In the instant case, the credit is likely to survive a challenge, as it is directly tied to the health and welfare of children in this state."

Armed Forces Retirement Pay Exemption

TRD has concerns about two technical issues:

(1) "The term armed forces might need further clarification to determine who qualifies as a military retiree. According to U.S. Code, Title 10, Chapter 1 – definitions, there is a distinction between armed forces and uniformed services. Armed forces mean the Army, Navy, Air Force, Marine Corps, Space Force, and Coast Guard. It does not include the commissioned corps of the National Oceanic and Atmospheric Administration or the commissioned corps of the Public Health Service, both of which are part of the uniformed services; and

(2) "This bill does not outline how TRD would verify the information to determine eligibility for the exemption. TRD may have to draft regulations to outline what information will need to be submitted with the return to verify this exemption. This exemption would most likely be added to the PIT-ADJ form, schedule of additions, deductions and exemptions."

Solar Tax Credit: The bill indicates that systems installed after March 1, 2020 qualify under this section. Carryforward language is stricken on page 5, line 10 and makes this credit refundable. Taxpayers who have already been issued the credit and have applied their credit against tax may have carryforward available. It is unclear if the proposed legislation permits taxpayers with existing credit and certifications to claim their remaining credit on their tax year 2022 return and claim the remainder as a refund if applicable.

TRD suggests the carry forward information is not removed but that the refundable portion of the credit is clarified as follows on page 4 starting on line 1. "That portion of a new solar market development income tax credit that exceeds a taxpayer's liability in the taxable year in which the credit is claimed may be carried forward for a maximum of five consecutive taxable years. Starting for those credits issued with the first claimable tax year starting January 1, 2022, any credit that exceeds a taxpayer's liability in the taxable year in which the credit is claimed shall be refunded to the taxpayer." This will prevent confusion as to which time period's credits are refundable and

individuals who have carry forward credit available to them prior to this bill's changes will not be able to get the amount refunded based on current law. This will also make this change easier to administer and easier to estimate the amount of credit that will need to be refunded from this credit. Without this change, it is possible that individuals who have received this credit in the past will file amended returns for prior years and request refunds of any unused credit.

This bill contains an implicit delayed repeal date for installation, but may allow rollovers to continue for some time. The bill does not require taxpayers to file the claim for refund in the year of the installation. In addition, in the case of the previous Solar Credit that was limited by the cap, EMNRD apparently rolled over applications for certification in excess of the cap – in effect allowing these applications in excess of the cap to be first in the queue for the following year. If the total amount of approved credits should exceed the $16 million cap, there may well be rollover. LFC usually recommends adding a delayed repeal date. In this case, however, the credit should not be repealed until the expiration of the rollover period.

To better serve taxpayers and to create department efficiencies, the smooth flow of certification data between EMNRD and TRD is necessary. TRD recommends adding language that requires electronic information sharing for certificates awarded by EMNRD. Receiving electronic files of awarded certificate data improves return processing efficiency and accuracy and supports annual reporting by allowing for process automation and avoiding time delays associated with manual processing.

OTHER TECHNICAL ISSUES

There is a mechanism whereby the benefit of the tax reductions of the social security exemption would be exported to residents of other states. PIT 1, Schedule B apportions income for other state residents who have income in New Mexico and in at least one other state. Many of these taxpayers have OGAS interests in New Mexico. For these taxpayers, the exemption for social security income included in federal AGI would be reported on the proforma New Mexico PIT 1 form. The apportionment calculation for New Mexico source income would be unaltered by the social security deduction. Out-of-state taxpayers' liability is the product of the decreased PIT 1 proforma liability based on everywhere income less the social security deduction times the apportionment schedule. Thus, out-of-state taxpayers will share in the benefit of this social security exemption. This is a technical note only. There is no mechanism within the interstate commerce clause of the U.S. Constitution to avoid this result. The fiscal estimate does not include the subtle point. Other investigations over the years imply that as much as 25 percent of our total personal income tax is paid on Schedule B and a similar percentage of the benefits of this exemption could be exported.

OTHER SUBSTANTIVE ISSUES – NEW SOLAR MARKET DEVELOPMENT TAX CREDIT

1. Any tax expenditure reduces revenue. In this case, a personal income tax credit only reduces general fund revenue, whereas gross receipts tax expenditures tend to reduce both state level taxes and local taxes.
2. Economic efficiency is also suspect, since this tax expenditure serves to subsidize a particular form of economic activity.

3. Overall, the purchase of a 5 or 6 Kilowatt solar array for around $28 thousand puts this option out of the price range of about 80 percent of New Mexicans. It is, perhaps, still a luxury good, which may raise equity issues.
4. Because of the desirable feature of this tax expenditure that minimizes abuse but requires at least three state agencies to be involved (Construction Industries Division of RLD, TRD and EMNRD) and an Investor-Owned Utility (in case of grid-tied systems and the potential of REC), soft costs and approval delays add between $3,200 and $4,700 to the costs of a typical 5 Kw system.
5. Accountability is preserved with this credit because of the required TRD reporting to the Legislature.

TRD notes implementation of the New Solar Market Tax Credit has been somewhat difficult. At least some of the discrepancy noted between EMNRD approvals and TRD's payment of tax credit claims can be explained by this difficulty. Tax year 2020 is the first year TRD received tax credit claims for the New Solar Market Credit. Many returns were not able to be processed at time of receipt due to incomplete information. Some issues were attributed to backlogs at EMNRD. This added to TRD's Revenue Processing Division inventories of returns suspended and this suspension caused taxpayer frustration. To better serve the taxpayers and to create department efficiencies, the smooth flow of certification data to TRD is necessary. TRD recommends adding language requiring electronic information sharing for EMNRD certificates awarded. Receiving electronic files of awarded certificate data improves return processing efficiency and accuracy and supports annual reporting by allowing for process automation and avoiding time delays associated with manual processing.

OTHER SIGNIFICANT ISSUES: SOCIAL SECURITY EXEMPTION

PIT represents a consistent source of revenue for many states. While this revenue source is susceptible to economic downturns, it is also positively responsive to economic expansions. New Mexico is one of 42 states along with the District of Columbia that impose a broad-based PIT. 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 taxpayer's ability to pay.

New Mexico statutes for state personal income tax are linked to the federal tax code. This is also termed "conformity." As the federal tax code changes, such as under the 2017 Tax Cuts and Jobs Act (TCJA), states see impacts on their revenue collection from PIT, depending on their level of conformity. New Mexico's level of conformity is currently high, given that PIT starts with federal adjusted gross income (AGI), applies federal standard deductions, and uses Internal Revenue Service (IRS) definitions such as the definition for "dependents". With that conformity, New Mexico's treatment of social security benefits follows the federal application.

Since 1984, a portion of Social Security benefits have been subject to federal income taxes. The taxable portion is dependent on the level of the taxpayer's combined income, which includes 50 percent of the Social Security benefits, plus income from other sources, including interest on tax exempt bonds. Because the combined income thresholds for taxation of benefits have remained unchanged since they were introduced in 1984 and 1993, but wages have increased over the years, the proportion of beneficiaries paying tax on their benefits has risen over time.

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.

Relative to the New Solar Market Development Tax Credit

LFC Tax Expenditure Policy Principle	Met?	Comments
Vetted	✓	This is an expansion of an existing credit.
Targeted		
Clearly stated purpose	✓	The solar industry in New Mexico can hardly be considered new. Zomeworks began business in New Mexico in 1969 and is still in business. The purpose is clearly to incentivize the expansion of the industry
Long-term goals	✗	None stated.
Measurable targets	✗	None stated
Transparent	✓	
Accountable		
Public analysis	✓	
Expiration date	✓	
Effective		
Fulfills stated purpose	✗	No purpose stated
Passes "but for" test	✗	The industry has been continuously growing, but may be in a saturation phase.
Efficient	✗	Credit serves to subsidize a particular but socially beneficial industry. This may be a way of internalizing positive externalities because of the non-polluting nature of solar-generated electricity.
Key: ✓ Met ✗ Not Met ? Unclear		

Relative to the Military Retirement Pay Exemption

LFC Tax Expenditure Policy Principle	Met?	Comments
Vetted	✓	This bill has previously been introduced and extensively debated.
Targeted		
Clearly stated purpose	✗	The purpose of this bill is to encourage highly skilled officers and senior enlisted personnel to retire to New Mexico and aid in economic development of the state. However, this goal is not accompanied by any measureable target.
Long-term goals	✓	
Measurable targets	✗	
Transparent	?	
Accountable		
Public analysis	✗	
Expiration date	✓	The provision is temporary for five years.

Effective Fulfills stated purpose Passes "but for" test	 ✘ ?	No purpose or goals are established in the bill.
Efficient	✘	
Key: ✓ Met ✘ Not Met ? Unclear		

Relative to the Social Security Exemption

LFC Tax Expenditure Policy Principle	Met?	Comments
Vetted	?	It is unknown if the issue has been discussed at an interim committee recently. The issue was discussed in 2019 at the Revenue Stabilization and Tax Policy Committee prior to the 2020 Legislative Session, but without endorsement.
Targeted Clearly stated purpose Long-term goals Measurable targets	 ✘ ✘ ✘	No purpose, targets, or goals established.
Transparent	?	TRD will likely publish a cost estimate in its annual Tax Expenditure Report; however, no specific reporting on this exemption to interim committees is required.
Accountable Public analysis Expiration date	 ✘ ✘	The bill contains no provisions for reporting. The bill does not include an expiration date.
Effective Fulfills stated purpose Passes "but for" test	 ? ?	Without a purpose statement or required reporting, it is not possible to determine if the exemption fulfills intended outcomes.
Efficient	✘	Without a purpose statement or required reporting, it is not possible to determine if the exemption is the most efficient means of achieving desired outcomes. However, current data and recent studies indicate this exemption would be inefficient in providing tax relief to low-income households receiving social security benefits and may not be a meaningful recruitment tool for retirees to the state.
Key: ✓ Met ✘ Not Met ? Unclear		

IT/JF/LG/al/rl/acv/rl