TAXATION & REVENUE
NEW MEXICO

Tax and Fiscal Policy Solutions for New Mexico Children

Presented to the
Kids Count Conference

October 13, 2020

Stephanie Schardin Clarke, Secretary of Taxation and Revenue

Executive Leadership Team

Office of the Secretary

Cabinet Secretary: Stephanie Schardin Clarke

Deputy Cabinet Secretary: Emily Oster, CPA

Tax Policy Director: Vacant

Chief Legal Counsel: Tim Van Valen

General Counsel: Elizabeth Korsmo

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Taxpayer Advocate: Tiffany Smyth

Chief Economist: Lucinda Sydow

Local Government Liaison: David Montieth

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Deputy Director for Audit: Aaron Brown

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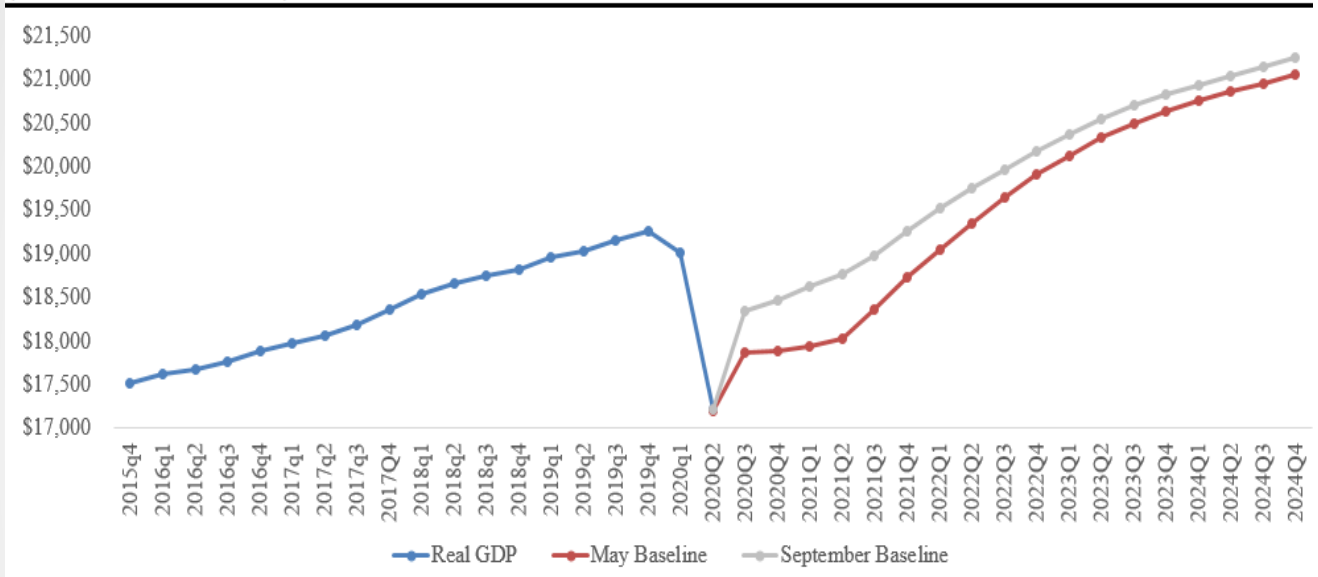
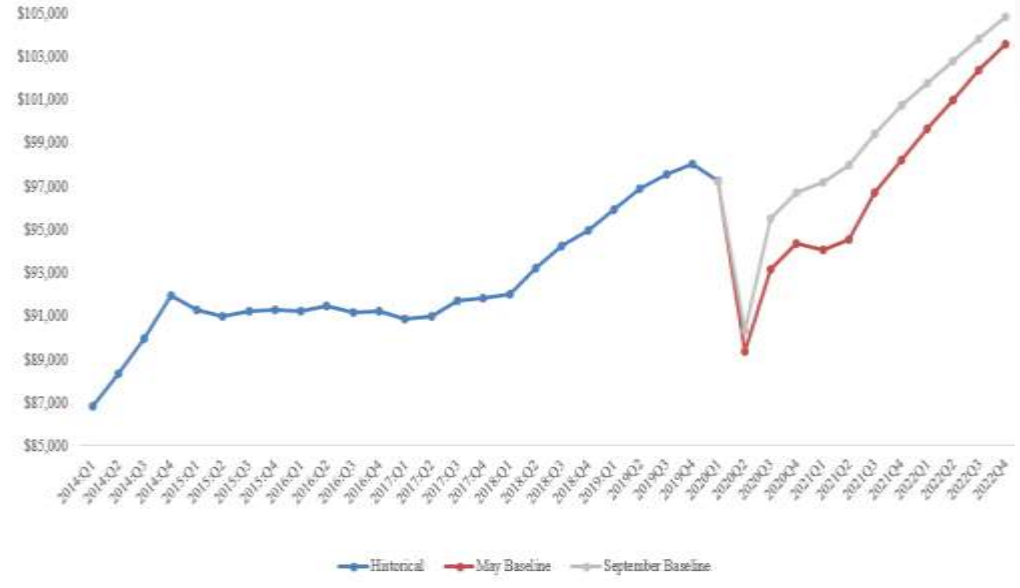
Macroeconomic Conditions: Gross Domestic Product

US Real Gross Domestic Product: 2015 Q4 to 2020 Q2, Forecast 2020Q3-2024Q4
(billions of chained 2012 dollars)



Source: GDP in billions of chained 2012 dollars, retrieved from bea.gov. Moody's September 2020 Baseline Scenario vs. May 2020 Baseline Scenario

New Mexico Real Gross Domestic Product (in 2012 chained millions of dollars)

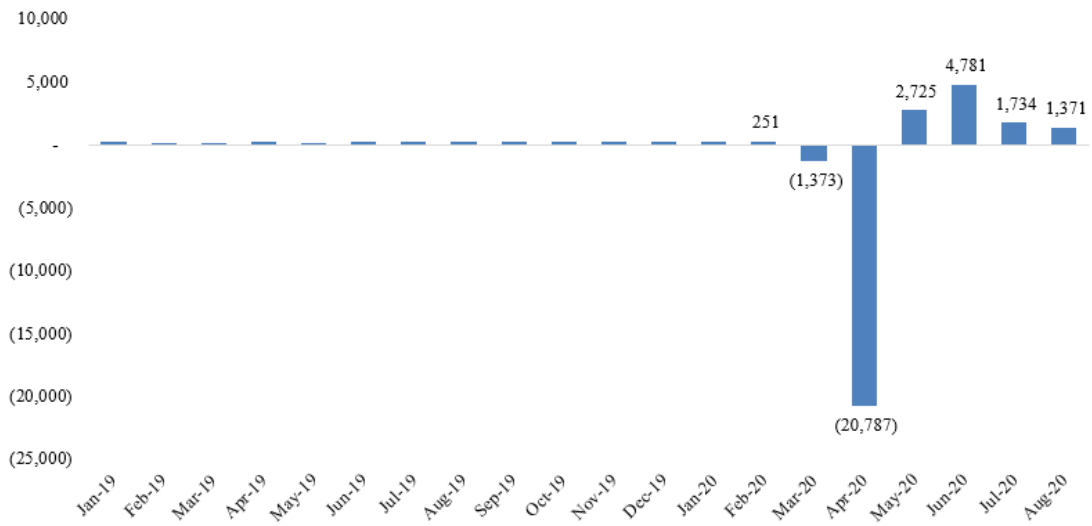


Source: bea.gov, Moody's September 2020 Baseline

- US GDP fell 31% in 2020Q2 and is not expected to rebound to pre-pandemic levels until 2022
- New Mexico GDP is expected to have fallen 25.5% in 2020Q2 and is not expected to rebound to pre-pandemic levels until 2021
- But economic forecasts now show a somewhat quicker recovery than was expected a few months ago

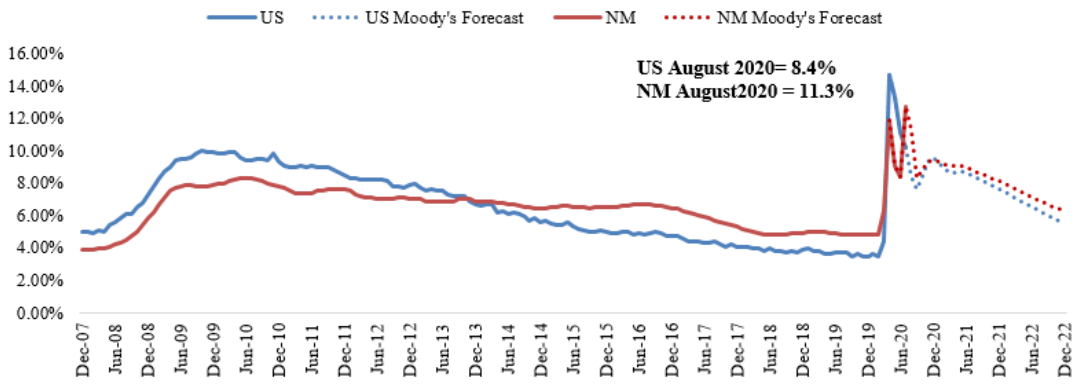
Macroeconomic Conditions: Labor and Unemployment

Monthly change in non-farm payroll employment (1,000s) in the US: Jan 2019 to Aug 2020



Source: bls.gov

US and NM Unemployment Rate (percent) : January 2008 to August 2020

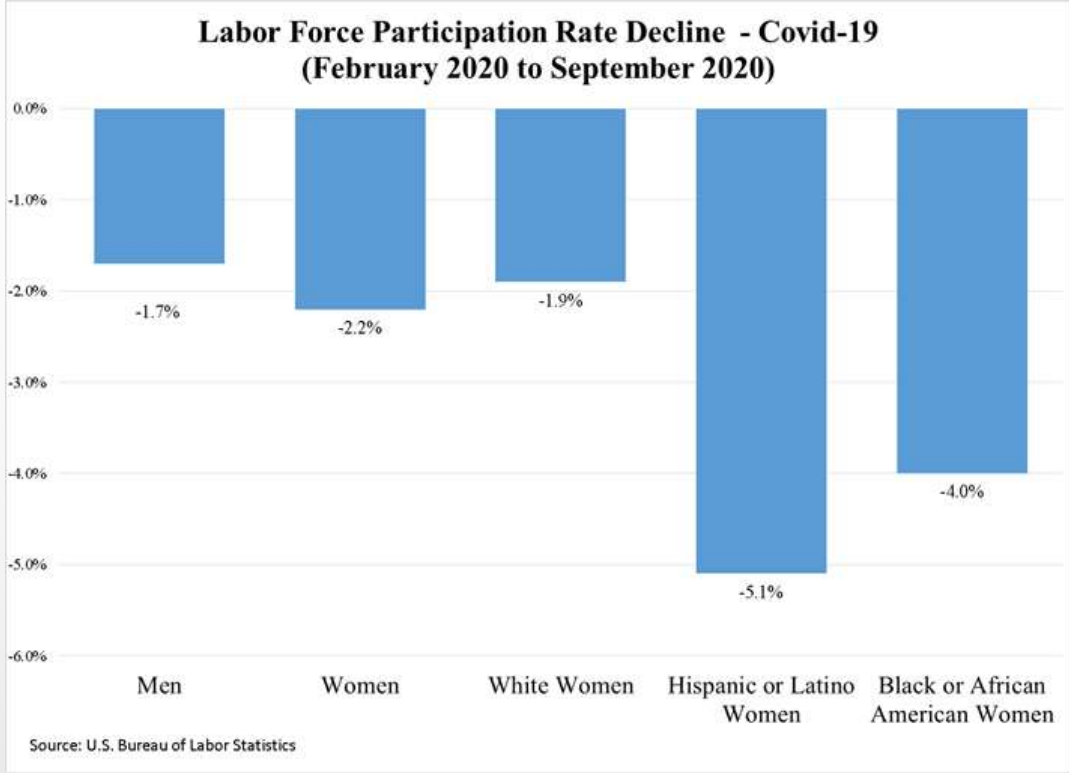


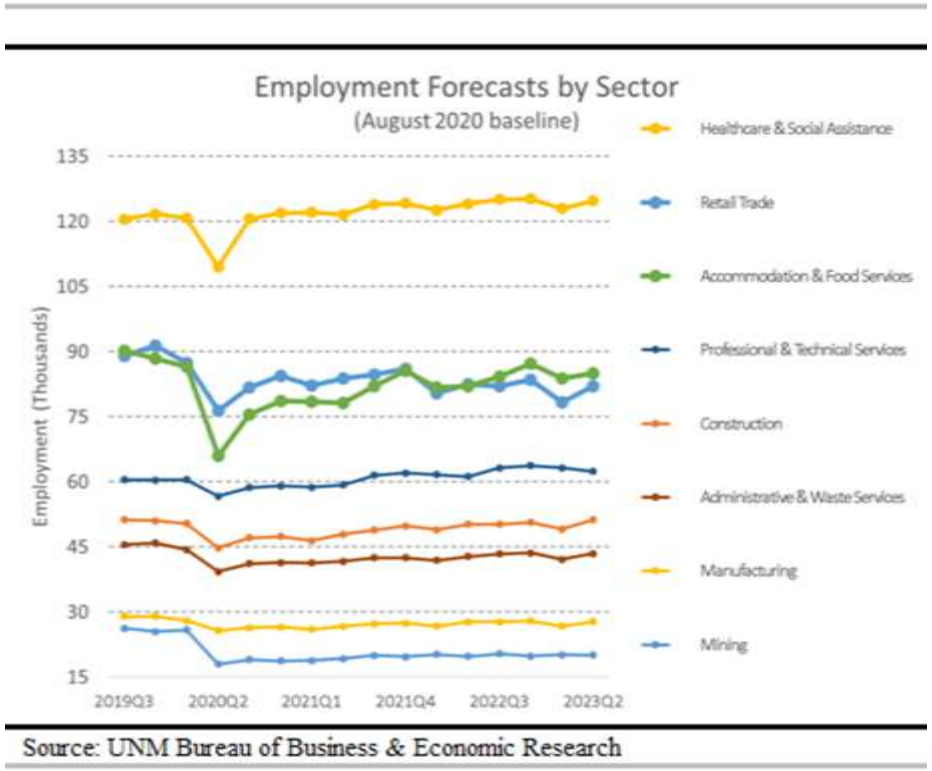
Source: bls.gov, seasonally adjusted

- The US economy lost 22 million jobs in March – April 2020. Over 10 million have been regained, but 12 million have not
- New Mexico lost 104,400 jobs from February 2020 to April 2020. By August 2020, 29,100 (27.9%) of them had been regained
  - Sectors with largest jobs regained are retail, manufacturing, trade, financial services, and education and health services
  - Most prolonged job losses are in mining, construction, wholesale trade
- The US unemployment rate was August 2020 was 8.4%, 7.9% in September. August was at 11.3% for New Mexico
- New Mexico had 70,500 fewer jobs in August 2020 than August 2019, with losses across most sectors
- New Mexico is not forecast to reach pre-pandemic job level until late 2025

Economic Volatility Disproportionately Impacts Women and People of Color

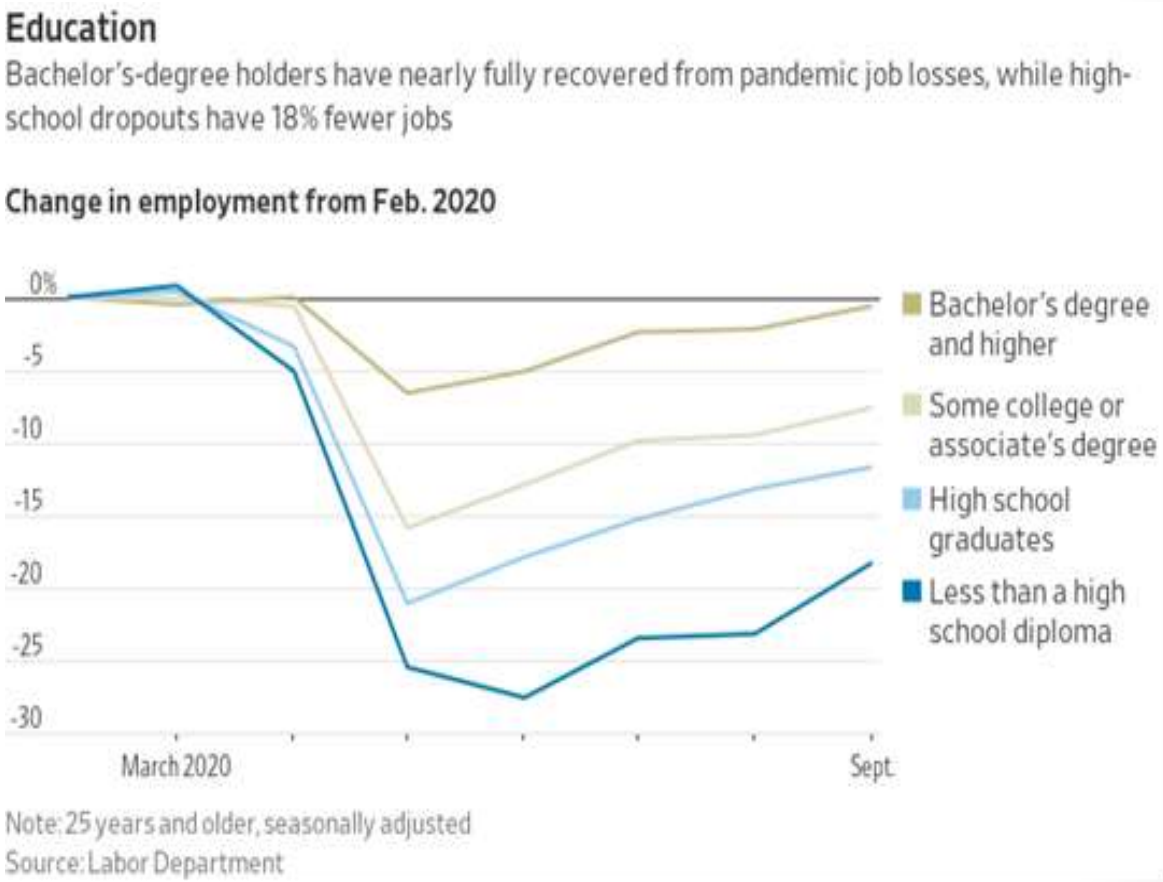
- National labor force participation has fallen for everyone, but participation by women of color has fallen the most
- Women and minorities are more representative in lower-wage service jobs hit hard by COVID-19 impacts
- In New Mexico, the 2nd and 3rd largest industries by employment - Retail and Accommodations & Food Services- are lower-wage jobs and are not forecasted to return to pre-recession levels in the next two fiscal years





Educational Attainment is Closely Tied to Economic Recovery

- Job losses since March 2020 have been most prolonged for workers with less educational attainment
- New Mexico's expected recovery is expected to be fastest in higher wage jobs requiring degrees - Healthcare, Professional & Technical Services



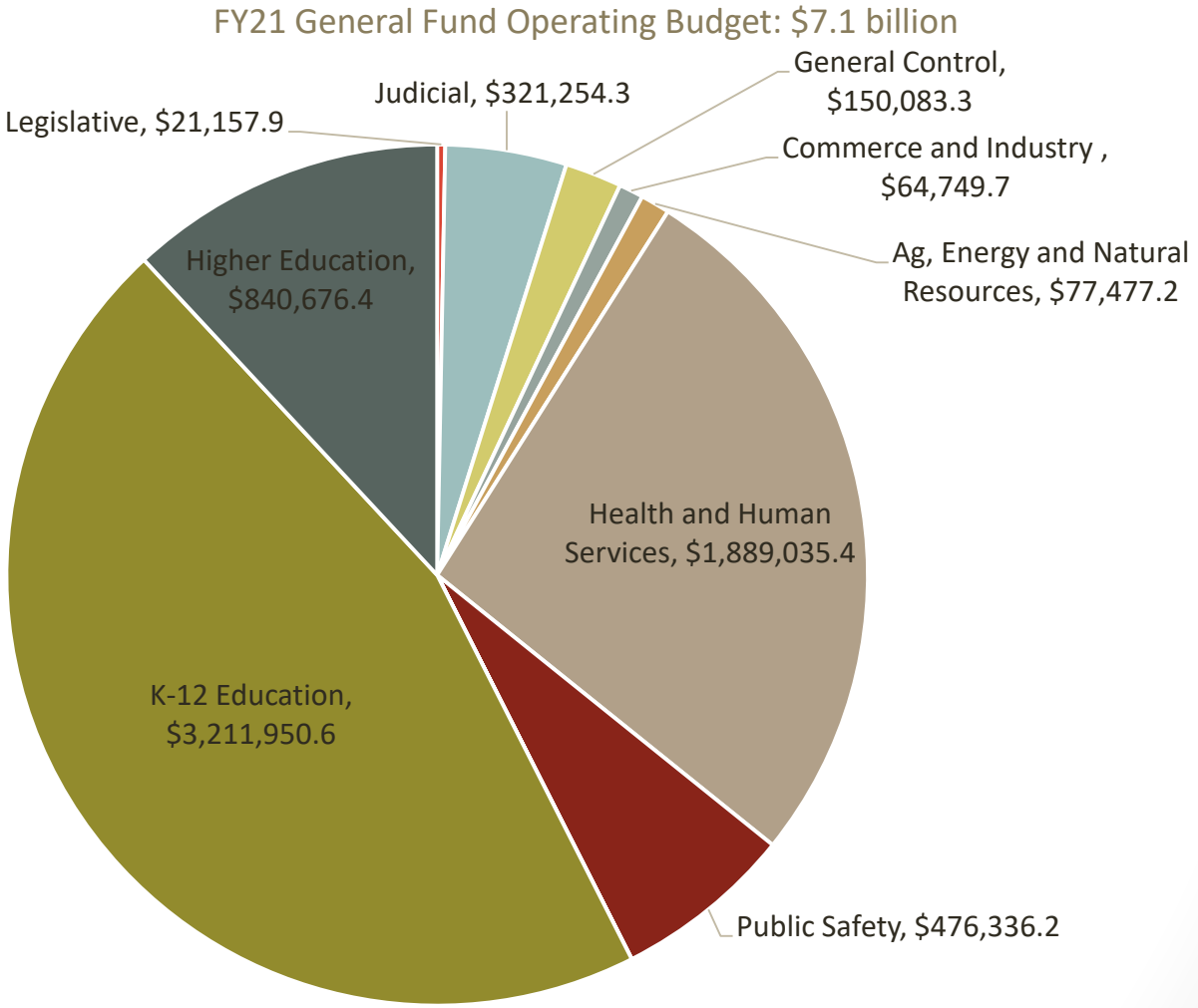
Credit: Wall Street Journal, Jeff Sparshott, 10/06/20

The Role of Affordable Child Care

- Affordable child care can be an added economic obstacle for individuals seeking to regain lost jobs
- Governor Lujan Grisham's administration has supported child care with some of the most comprehensive support in the nation:
  - Developed clear, detailed health and safety regulations
  - Subsidizing child care worker salaries
  - Waiving parent copays
  - Providing free child care to essential workers
  - Providing wage incentives to early childhood professionals
  - Awarding grants to licensed child care facilities
- New Mexico's Child Care Tax Credit lowers the cost of day care for lower-income families. About 1,400 families claim an average credit of $400 each year.

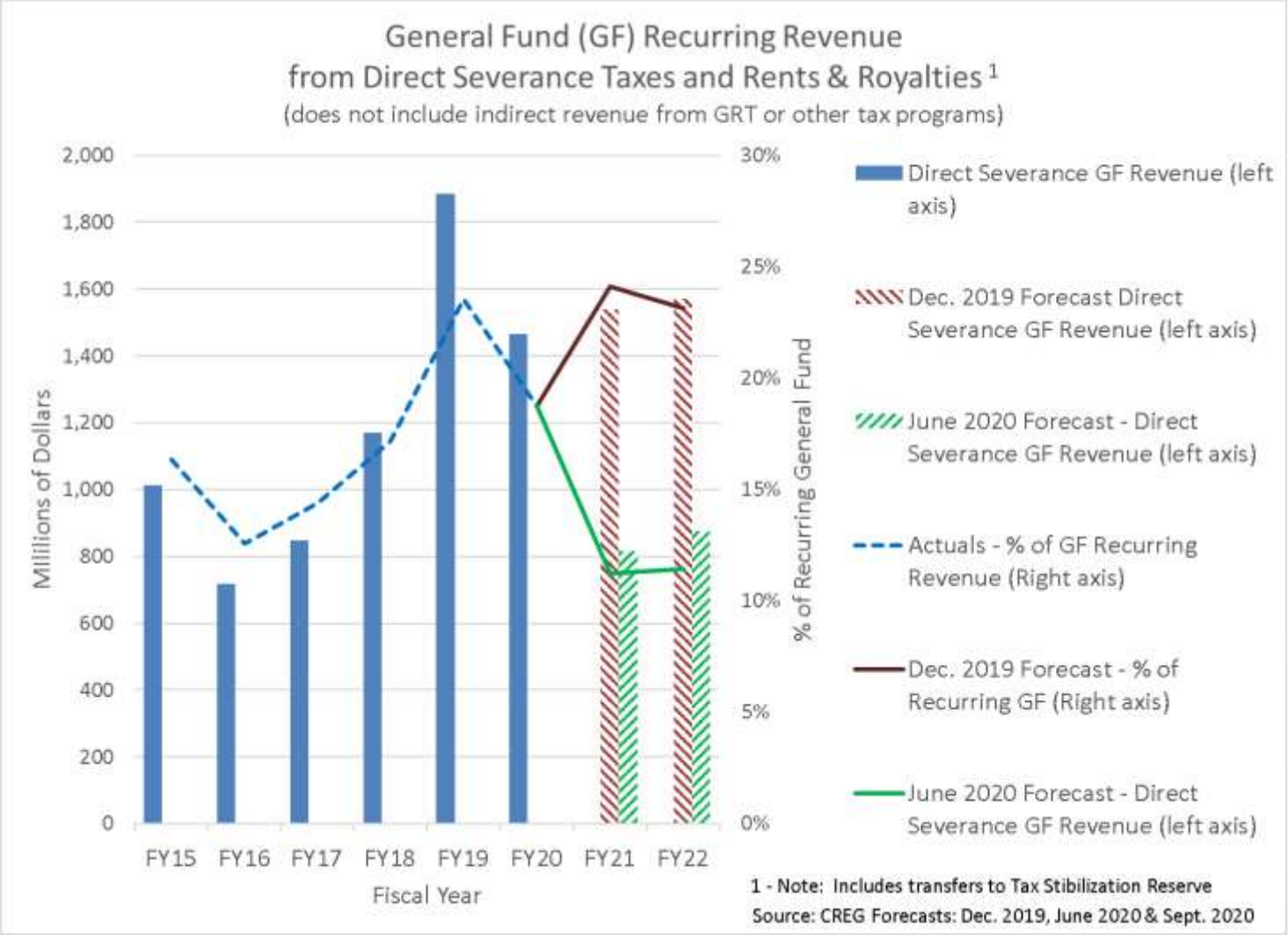
Revenue Volatility Threatens the Safety Net When New Mexicans Need it Most

- Unlike the federal government, New Mexico's Constitution requires a balanced budget
- When revenue falls significantly, New Mexico has only so many tools to balance the budget
  - Raising revenues
  - Reducing expenditures – New Mexico State agencies have only just begun to recover from austerity between 2010 – 2018
  - Expending reserves at a measured pace to ensure reserves last 2-3 years and bond ratings do not suffer
  - Injection of federal funding: CARES Act of 2020, ARRA of 2009



Energy Market Volatility in the State General Fund

- Energy markets are volatile, unpredictable, and largely out of New Mexico's control
  - State regulatory decisions do have some bearing
  - Oil markets are global and depend global supply and demand, geopolitical unrest, trading value of the US dollar, supply decisions of OPEC and other large producers, etc.
  - Natural gas markets are much more regional and depend on regional oil production, pipeline capacity, heating and cooling needs, hurricanes, etc.
- The good news? Some of New Mexico's volatile energy revenue has been diverted from the general fund…

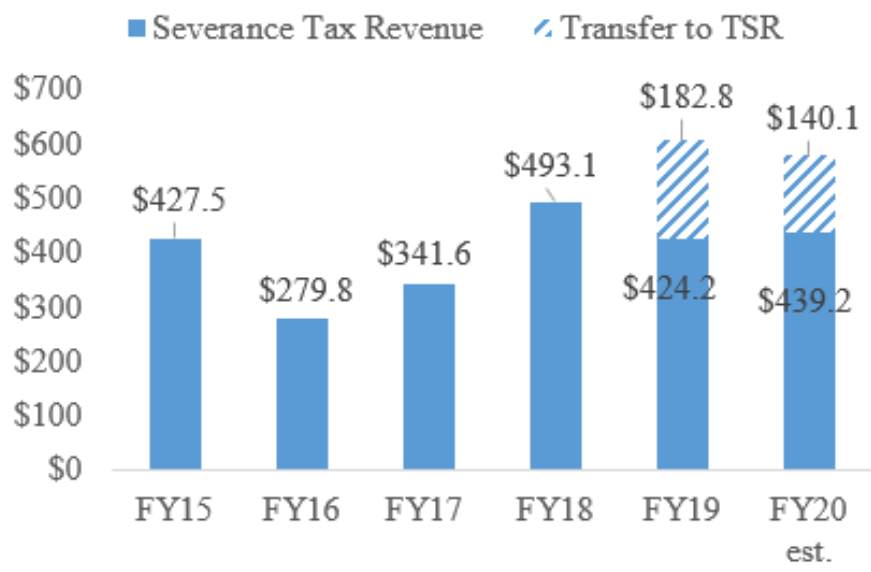


New Mexico's First Shield Against Volatility: Permanent Funds and Endowments

- New Mexico's permanent funds transformed volatile revenue into stable streams of interest earnings that provided 13% of General Fund recurring revenue in FY2020
- Stock market returns are volatile too, but the permanent funds distribute based on the average market value over several years
- Land Grant Permanent Fund – $19.5 billion as of August 2020. Receives revenue from energy royalties and leases. Distributes 5.0% of 5-year average market value to beneficiaries – General Fund is 86% beneficiary, receiving $674 million in FY2020
- Severance Tax Permanent Fund – $5.4 billion as of August 2020. Receives taxes on oil, natural gas and other resources severed from the earth that are not used for severance tax bonds. Distributes 4.7% of 5-year average market value to General Fund – distributed $225 million in FY2020
    - Early Childhood Education and Care Fund created in 2020 with an initial investment of $300 million. Will distribute $20 million per year to Early Childhood Education and Care Department at first, then the greater of $30 million or 5% 3-year average market value
    - Starting in FY2022, Early Childhood Education and Care Fund will receive excess Federal Mineral Lease revenue above a 5-year average

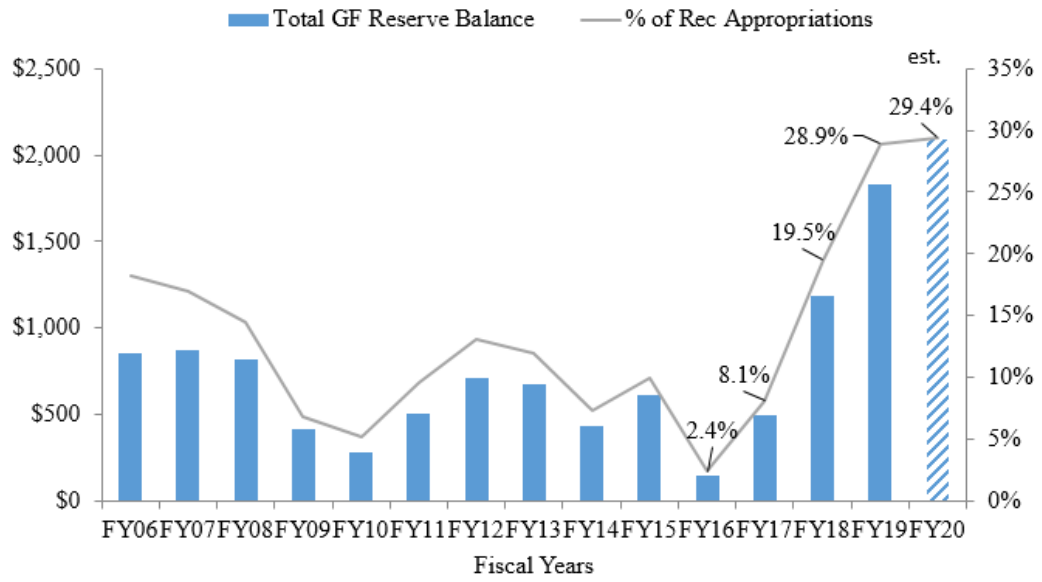
New Mexico's Second Shield Against Volatility: Tax Stabilization Reserve (TSR) and Other Reserves

Severance Taxes from FY15 to FY20 (in millions)



Source: DFA, CREG

General Fund Reserve Balances as a Percent of Recurring Appropriations



Source: DFA, FCD, CREG

- Due to extraordinary fiscal restraint, New Mexico's reserves are expected to end FY2020 at the highest level in state history, $2.1 billion or 29.4%
- Reserves give the State flexibility to deal with revenue downturn while protecting critical services
- Since FY2019, the TSR has received any Oil & Gas Emergency School Tax Revenue above the prior 5-year average

New Mexico's Third Shield Against Volatility: Severance Tax Bonding Program

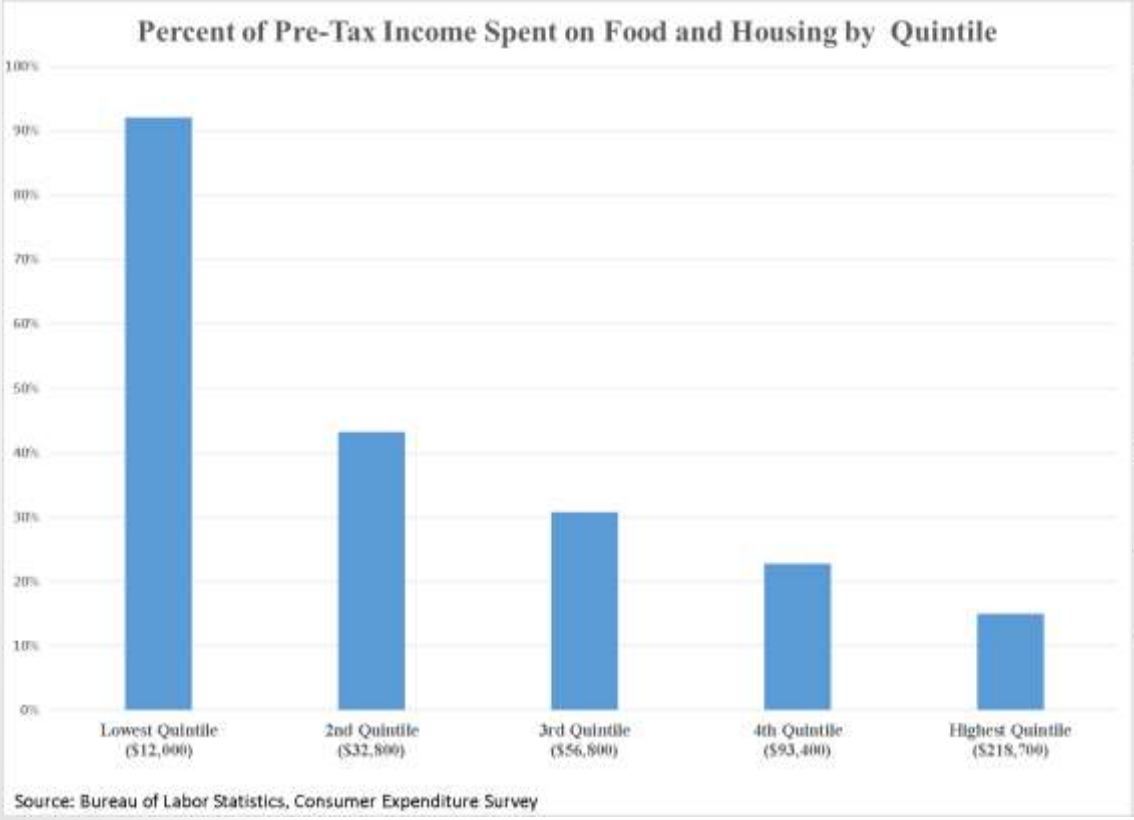
- While half of severance tax revenue goes to the State general fund, the other half goes into the severance tax bonding fund to be used to repay bonds or for transfer to the severance tax permanent fund
- The severance tax bonding program is wisely designed to allow New Mexico to issue highly-rated bonds to fund state and local capital projects backed by oil and natural gas revenues
- The severance tax bonding program prevents the need to raise other taxes (property tax, sales tax) to finance state and local infrastructure
- This steady stream of capital funding keeps New Mexicans employed throughout economic cycles
- A portion of the bonding program is reserved for New Mexico's public school buildings – over $3.4 billion has been allocated to public school buildings since FY2000, making the condition New Mexico's public school buildings amongst of the best in the nation

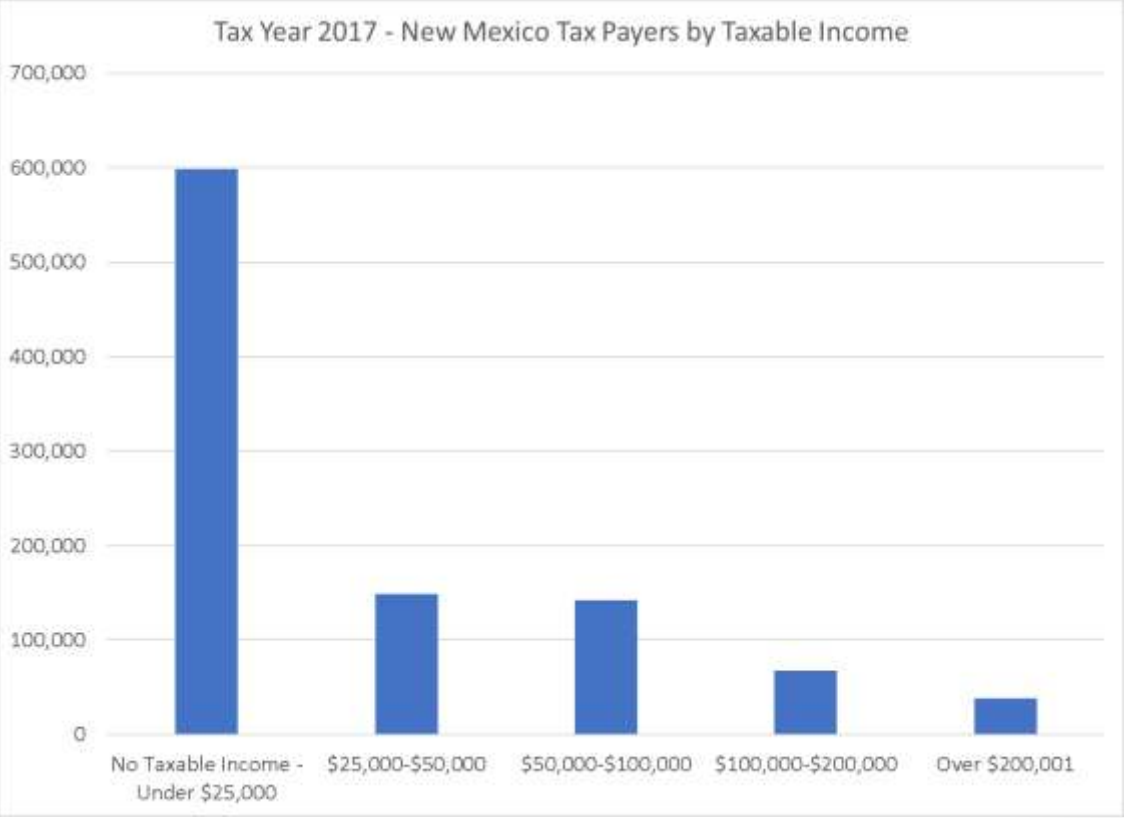
How can We Further Stabilize New Mexico's Revenue Rollercoaster?

- Use reserves strategically and at a measured pace over two to three years with a plan to replenish them
- Ensure New Mexico's tax revenues are adequate to meet the critical needs of New Mexicans
- Diversify the economy outside of oil and natural gas and federal sector. Target industries include:
  - Advanced Manufacturing
  - Biosciences
  - Digital Media and Film & Television
  - Outdoor Recreation & Tourism
  - Sustainable & Value-Added Agriculture
  - Aerospace
  - Cybersecurity
  - Global and Interstate Trade
  - Sustainable & Green Energy
- Business growth and recruitment isn't just about tax policy. Businesses grow and relocate based on many factors:
  - Access to a skilled workforce
  - Safe communities
  - Recreational amenities
  - High quality schools
  - Affordable cost of living

A Progressive Tax Code Strengthens New Mexico's Economic Recovery

- The lower an individual's income, the greater share of income is spent on food and housing
- 60% of New Mexico's PIT filers had taxable income between $0-$25,000 in 2017
- Protecting lower income taxpayers at this time will prevent spiking demand for critical government services





Working Families Tax Credit Increased

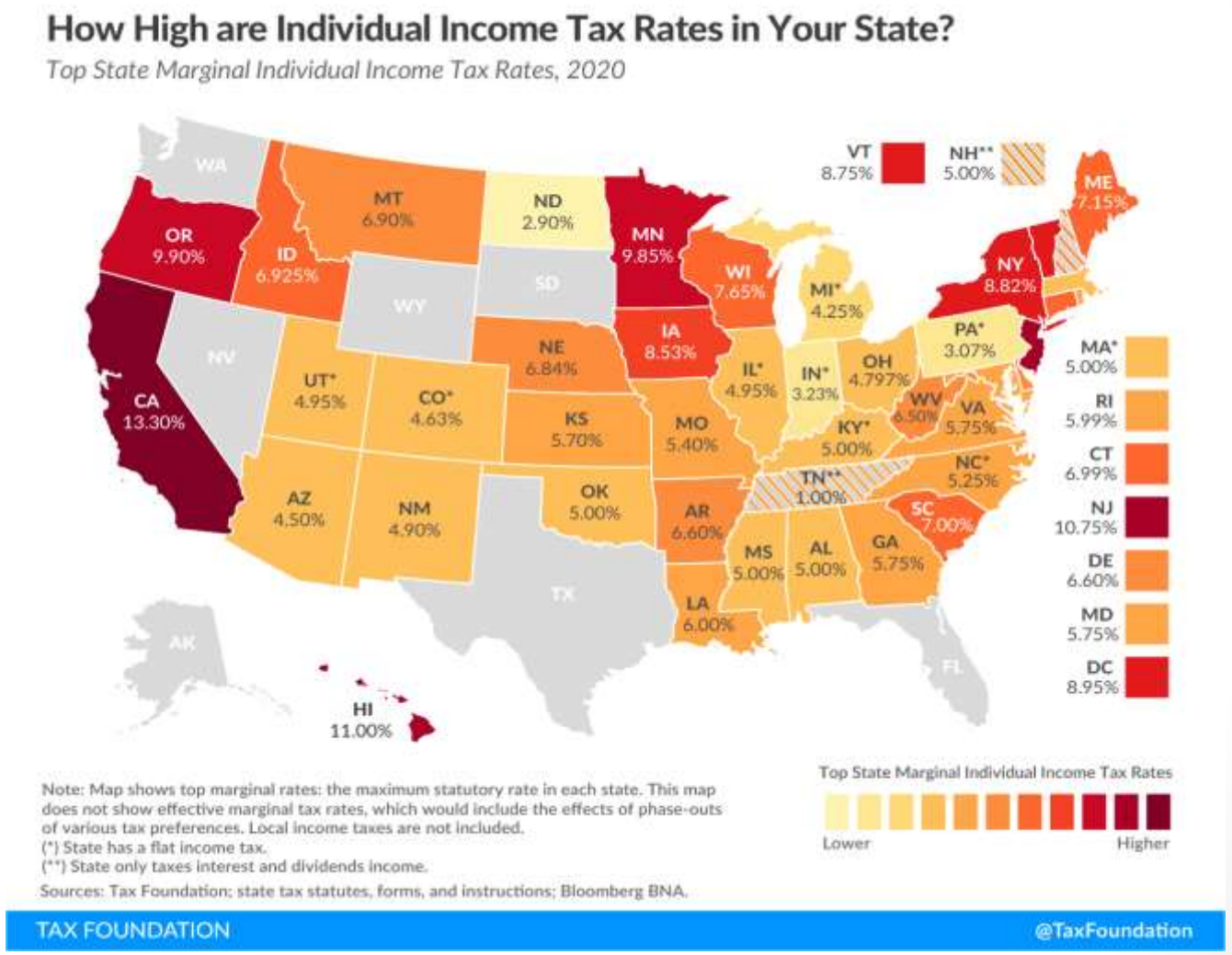
- The WFTC is a refundable PIT credit for about 208,000 New Mexico families each year, 20% of New Mexico filers
- WFTC is sized as a percentage of the federal Earned Income Tax Credit (EITC)
- In 2019, HB6 increased the size of the WFTC from 10% to 17% of the federal EITC
- Tax relief from the WFTC will rise from about $52 million per year to $92 million per year
- In 2019, the average family's refundable WFTC increased from $245 to $420 per year
- Nationally, 97% of EITC benefit goes to families with children
- WFTC effectively targets low-income populations with children; size of credit is larger for larger families
- Incentivizes work since it can only be claimed by taxpayers who have earned income
- Phases out gradually as income rises, avoiding "cliff effects" in taxation
- For first time ever, in 2019 NM Taxation and Revenue Department identified taxpayers who may be eligible but did not claim the credit and sent them a friendly notice
  - As of September 2020, 642 taxpayers who we notified had claimed a combined $120,000 in State WFTC, and we estimate another $1,200,000 in federal EITC
  - Of those same 642 taxpayers, 496 have claimed $180,000 in WFTC for tax year 2019, with an estimated $1,050,000 in federal credits claimed

New Mexico Created the Dependent Deduction that the Federal Government Removed

- Starting in 2019, the federal Tax Cuts & Jobs Act of 2017 (TCJA) removed the ability for taxpayers to claim personal exemptions for dependents on their federal tax return in lieu of a larger standard deduction
- Despite the higher standard deduction, for a segment of taxpayers, this increased the amount of taxable income subject to New Mexico's Personal Income Tax
- Starting in tax year 2019, HB6 created the dependent deduction for New Mexico families
- Deduction is $4,000 per dependent beyond the first dependent claimed
- Expected to allow families with children to continue to deduct about $25 million per year, avoiding a tax increase that would have been caused by TCJA
- Approximately 120,000 with taxable income to offset claimed the deduction for 2019
- The deduction decreased the tax liability for 120,000 families by an average of $210 per family

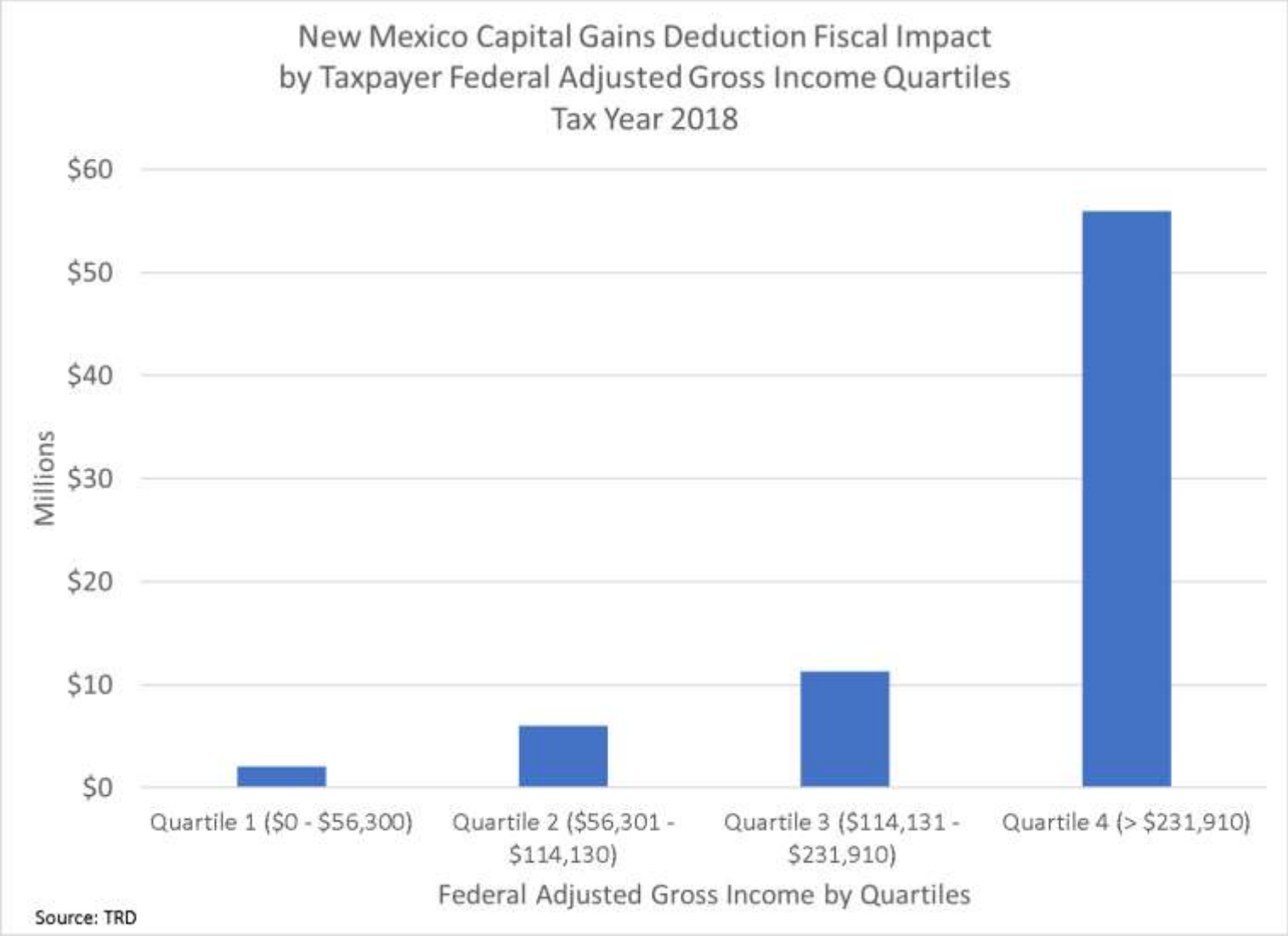
Added Progressivity to Personal Income Tax: New 5.9% Top Marginal Rate

- Marginal tax rate expected to impact only the top 3% of taxpayers
  - Single Filers – Minimum Gross Income > $222,000 on taxable income over $210,000
  - Head of Household/Married filing Jointly – Min. Gross Income > $333,000 on taxable over $315,000
- Expected to generate about $40 million per year additional PIT revenue
- Top rate of 5.9% still far lower than 8.2% top rate prior to 2003 rate reductions
- At 5.9%, New Mexico's top marginal PIT rate will remain in line amongst the 50 states



Added Progressivity to Personal Income Tax: Reduced Capital Gains Deduction

- The capital gains deduction previously allowed taxpayers to deduct the greater of $1,000 or 50% of the taxpayer's net capital gain income for the taxable year
- Effective tax year 2019, the 50% threshold was reduced to 40%
- Reducing the size of the deduction is expected to increase PIT revenue by about $10 million per year
- The deduction is claimed by about 105,000 tax filers per year, about 10% of filers

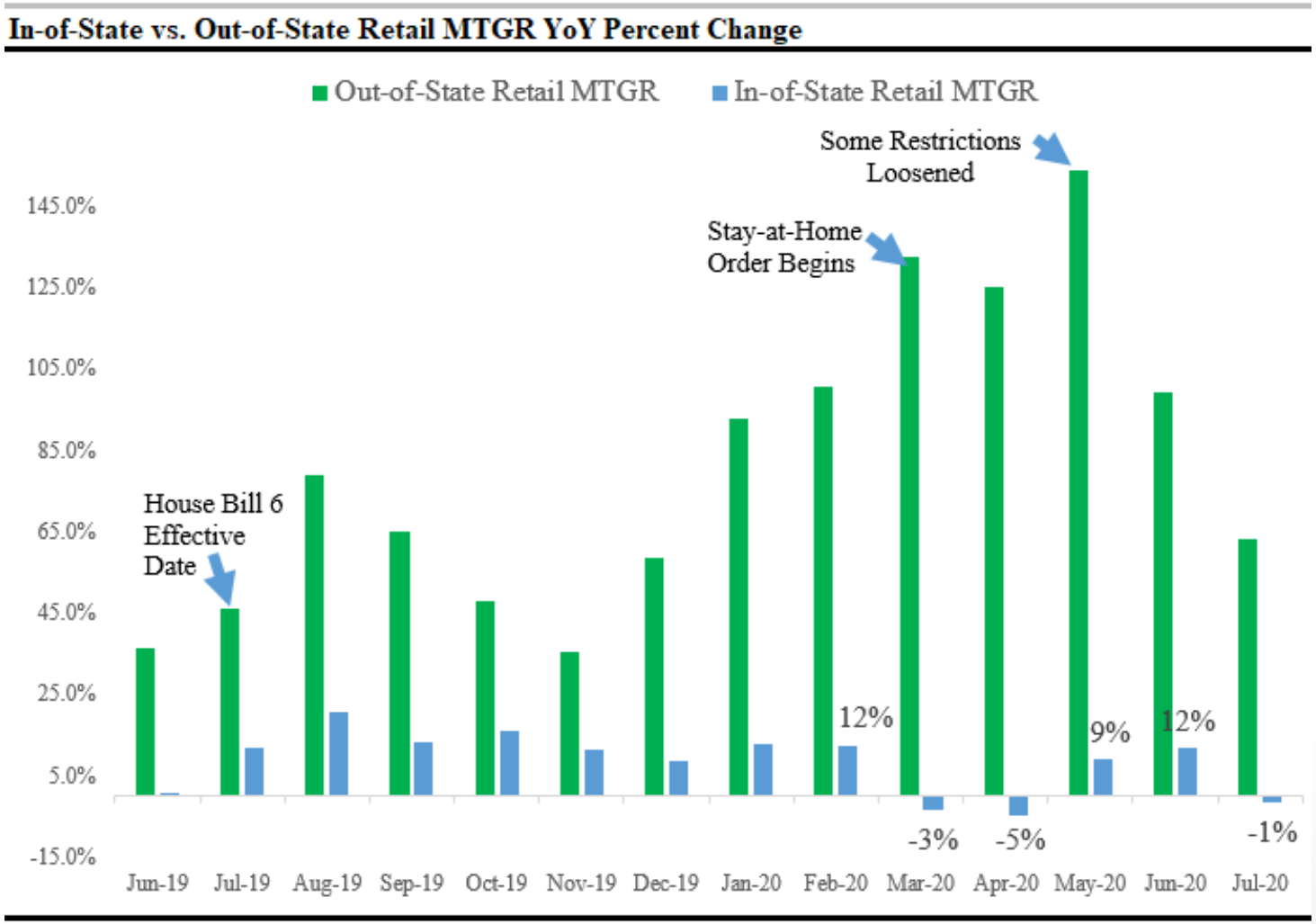


Preserved New Mexico's Corporate Income Tax in 2020 Special Session

- The federal CARES Act of 2020 changed treatment of corporate operating losses
- The idea is that corporations can use one year's losses to offset positive income in another tax year by deducting the losses
- Prior to the CARES Act, New Mexico and federal CIT allowed corporations to deduct losses only in future tax years, and only to offset up to 80% of future year income with past year losses
- The CARES Act let corporations offset past year losses and took off the 80% cap
- Without a legislative change, New Mexico would have made the same change to its treatment of corporate losses
- This was expected to decrease New Mexico CIT revenue by $20 – 40 million per year
- In the 2020 Special Legislative Session, New Mexico decoupled from the CARES Act change to preserve CIT revenue at the status quo that New Mexico had always intended

Internet Sales GRT Adds to Adequacy and Levels the Playing Field for New Mexico Businesses

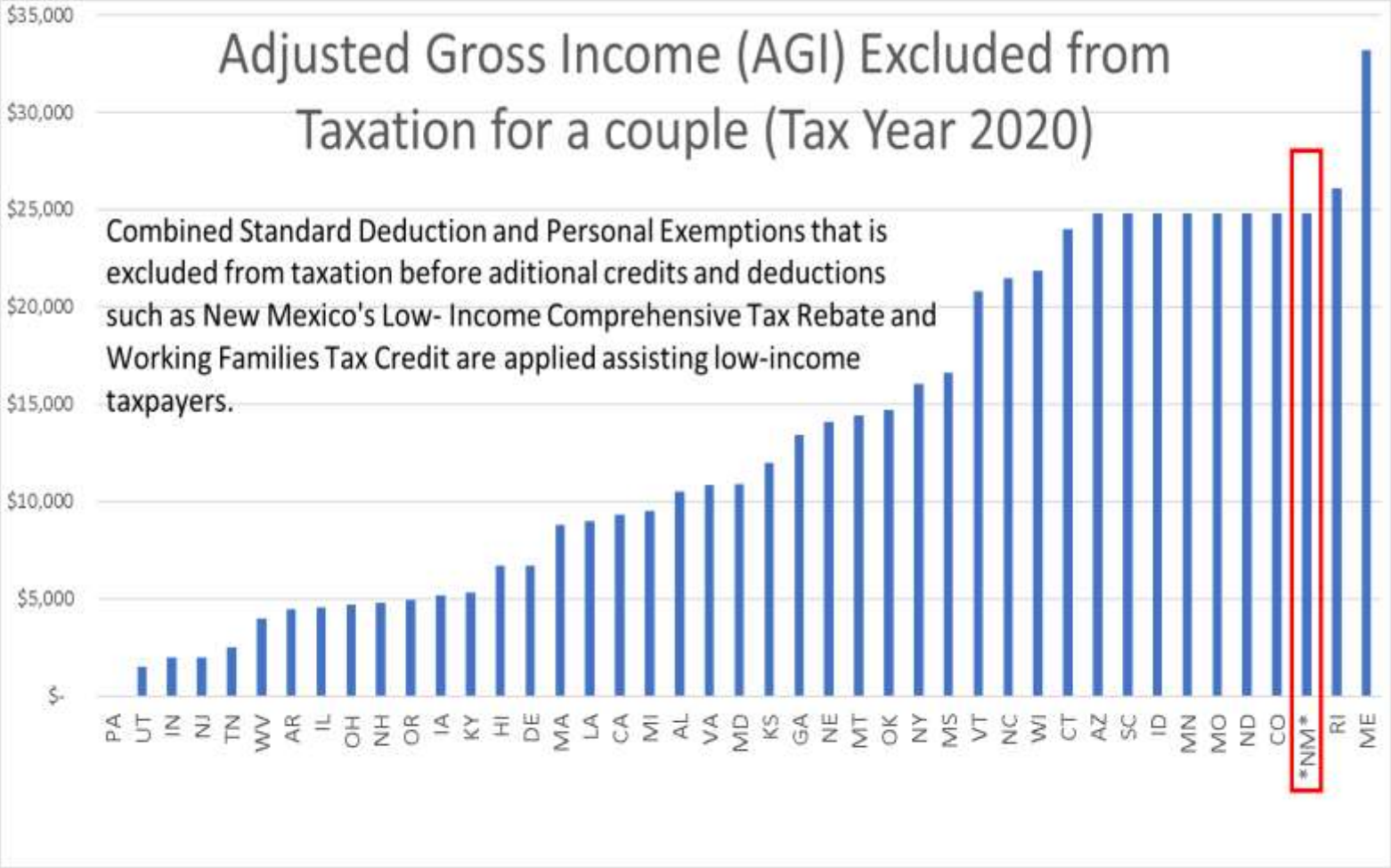
- Retail sales today are 3 times the 1992 level
- Remote sales are 20 times the 1992 level – even more than that since the onset of COVID-19
- Internet sales have skyrocketed during pandemic
- Local option GRT on internet sales will take effect on July 1, 2021



Source: DFA, TRD, RP-500

More Good News: New Mexico Automatically Excludes More Income from PIT than Almost Any State

- Between New Mexico's standard deduction and personal exemptions, New Mexico excludes the first $24,000 of any taxpayer's income from PIT
- Combined with other credits, deductions and rebates for lower-income families, this provides lower tax burden for these families
- This suggests that any future legislation to exclude various income from PIT will not be well targeted towards the lowest-income New Mexicans



Source: TRD calculations based on Tax Foundation, States and IRS data

Other Tax Policy Tools for Families with Children: Low Income Comprehensive Tax Rebate

- Originally enacted in 1972
- Offsets regressive consumption taxes for low-income New Mexicans
- May be claimed by taxpayers with modified gross income (MGI) less than $22,000
- Rebate amount depends on MGI and number of exemptions claimed – between $10 and $450 per tax filer.
- Claimed by an average of 230,000 tax filers per year - 23% of New Mexico filers - for an average of $79 per filer
- At a statewide average GRT rate of 7.0%, a $79 credit would offset GRT on $1,129 of purchases
- But LICTR's MGI threshold hasn't been updated since 1998; inflation is causing fewer New Mexicans to qualify for LICTR each year

Other Tax Policy Tools for Families with Children: Low Income Property Tax Rebate

- Available to counties, only two currently use it (Santa Fe and Los Alamos)
- As property values and property taxes due rise, this is a tool to help low-income individuals retain their property
- County Commissions can enact the rebate by ordinance
- Low-income property owners claim the credit on their PIT return, then TRD invoices the county for the total of credits claimed in that county
- Property must be the taxpayer's principal residence and taxpayer must have MGI less than $24,000
- Claimed by about 1,900 tax filers per year (0.2% of filers) in an average amount of $310 per taxpayer
- These credits cost Santa Fe and Los Alamos Counties on average a combined $600,000 per year and could be expanded to other areas of the State by county commissions

Thank you!

Stephanie Schardin Clarke

StephanieS.Clarke@state.nm.us

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