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# FISCAL IMPACT REPORT

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|---|---|---|---|
| **SPONSOR** | Sens. Berghmans, Charley, and Nava/Rep. Chandler | **LAST UPDATED** | 02/26/2025 |
| | | **ORIGINAL DATE** | 02/12/2025 |
| **SHORT TITLE** | Increase Child Income Tax Credit | **BILL NUMBER** | Senate Bill 294 |
| | | **ANALYST** | Faubion |

**REVENUE***
**(dollars in thousands)**

| Type | FY25 | FY26 | FY27 | FY28 | FY29 | Recurring or Nonrecurring | Fund Affected |
|---|---|---|---|---|---|---|---|
| PIT | $0.0 | ($42,600.0) | ($43,700.0) | ($44,700.0) | ($45,700.0) | Recurring | General Fund |

Parentheses ( ) indicate revenue decreases.
*Amounts reflect most recent analysis of this legislation.

**ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT***
**(dollars in thousands)**

| Agency/Program | FY25 | FY26 | FY27 | 3 Year Total Cost | Recurring or Nonrecurring | Fund Affected |
|---|---|---|---|---|---|---|
| TRD | $0.0 | $75.0 | $75.0 | $150.0 | Recurring | General Fund |

Parentheses ( ) indicate expenditure decreases.
*Amounts reflect most recent analysis of this legislation.

### Sources of Information

LFC Files

Agency Analysis Received From
Early Childhood Education and Care Department (ECECD)
Taxation and Revenue Department (TRD)

## SUMMARY

### Synopsis of Senate Bill 294

Senate Bill 294 doubles the existing child income tax credit for children under the age of 6.

This bill does not contain an effective date and, as a result, would go into effect 90 days after the Legislature adjourns, or June 20, 2025, if enacted. The tax increase goes into effect for tax year 2025. The child tax credit expires after tax year 2031.

## FISCAL IMPLICATIONS

The child tax credit was claimed by nearly 239 thousand tax filers in tax year 2023, with a total expenditure of $131.2 million in FY24. To estimate the impact of doubling the credit for children under the age of 6, LFC estimated the share of New Mexico children under the age of 6 and applied that share to the total cost of the tax credit. This cost, in addition to the existing cost for the tax credit, represents a doubling of the credit for young children. U.S. Census data shows approximately 28.9 percent of children in New Mexico are under the age of 6. The estimate was grown each year by inflation estimates from S&P Global.

The Taxation and Revenue Department (TRD) used 2023 tax returns of taxpayers who claimed the New Mexico Child Tax Credit (CTC) to calculate the number of dependents in each adjusted gross income (AGI) range per Section 1(B). TRD then applied U.S. Census Bureau data to determine the percentage of New Mexico children under age 6 that would qualify for the CTC1. Approximately 6.5 percent of the total New Mexico population is under the age of 6 and 29 percent of those 18 years and younger. TRD estimates that 95 percent of New Mexico children under the age of 6 were claimed as a dependent by a parent or guardian for the CTC in 2023.

This bill creates or expands a tax expenditure with a cost that is difficult to determine but likely significant. LFC has serious concerns about the substantial risk to state revenues from tax expenditures and the increase in revenue volatility from erosion of the revenue base. The committee recommends the bill adhere to the LFC tax expenditure policy principles for vetting, targeting, and reporting or action be postponed until the implications can be more fully studied.

## SIGNIFICANT ISSUES

The child tax credit went into effect in tax year 2023. According to the *2024 Tax Expenditure Report,*[1] fifteen states including New Mexico have created their own child tax credits. New Mexico created its state Child Income Tax Credit (NM-CTC) during the 2022 legislative session, effective tax year 2023. NM-CTC is income-dependent, but available at all income levels and is fully refundable. The credit amount is annually adjusted for inflation. For tax year 2023, the credit originally ranged from $25 to $175; however, in 2023, the credit was legislatively increased for incomes under $75,000. Increasing the NM-CTC amount significantly enhanced targeting of NM-CTC to those most in need of tax relief.

TRD notes the following:

> Personal income tax (PIT) represents a consistent source of revenue for many states. For New Mexico, PIT is approximately 16 percent of the state's recurring general fund revenue. While this revenue source is susceptible to economic downturns, it is also positively responsive to economic expansions. New Mexico is one of 41 states, along with the District of Columbia, that impose a broad-based PIT (New Hampshire and Washington do not tax wage and salary income). Like several states, New Mexico computes its income tax based on the federal definition of taxable income and ties to other statues in the federal tax code. This is referred to as "conformity" to the federal tax code. 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.
>
> The proposed child tax credit will erode horizontal equity in the state income taxes. By basing the credit on the number of qualifying children, taxpayers with the same level of

[1] Tax Policy Examination – Child Income Tax Credit and Poverty Reduction, 2024 New Mexico Tax Expenditure Report, page 30

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 a greater number of children. However, a 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.

New Mexico has recently shown dramatic improvement in eradicating poverty, especially child poverty, as evidenced by the Supplemental Poverty Measure issued by the U.S. Census Bureau. The New Mexico Child Tax Credit is one of several tax incentives that provides tax relief to families to help offset the costs of raising children and can effectively reduce poverty rates. 2023 U.S. Census data reports that although New Mexico has the highest official poverty rate in the nation for those under 18, supplemental measures at the federal and state level reduced poverty in New Mexico dramatically. New Mexico's supplemental poverty rate for those under 18, taking into account the federal child tax credit, and federal and state tax provisions and programs is 8.9 percent, compared to New Mexico's official poverty rate of 27.4 percent. No other state saw as dramatic a reduction between the two measures for the period 2021 through 2023.

## PERFORMANCE IMPLICATIONS

The LFC tax policy of accountability is met with the bill's requirement to report annually in the tax expenditure budget regarding the data compiled from the reports from taxpayers taking the credit.

## ADMINISTRATIVE IMPLICATIONS

Introducing an age-specific requirement necessitates additional verification steps to ensure that only eligible children under the age 6 receive the increased credit. This complicates the return review processes, requiring more resources and time to validate each claim. Currently, TRD does not systematically track or map the ages of dependents, making it challenging to verify the eligibility of each qualifying child.

This lack of systematic tracking increases the risk of errors and misreporting, placing additional burdens for verification by TRD or misuse of the credit. To address the challenges associated with the age requirement, it is recommended to separately state the credit for qualifying children under age six. This approach would allow for clearer reporting and easier verification of eligibility. By requiring taxpayers to separately state the credit amount for each qualifying child, the department can more effectively track and validate claims, reducing the risk of errors and simplifying the process.

TRD will update forms, instructions and publications and make information system changes. Staff training to administer the credit will need to take place. This implementation will be included in the annual tax year changes. TRD will require more resources to validate the claiming of this credit. This will necessitate that TRD's Revenue Processing Division (RPD) reduce the vacancy rate by 3 percent or 2 Pay band 60 FTEs at $75,000 per FTE. Implementing this bill will have a moderate impact on the Information Technology Division (ITD) with approximately 480 hours or about 3 months needed at an estimated staff workload cost of $31,987.

## TECHNICAL ISSUES

For taxpayer and administrative clarity, TRD suggests in subsection C to add the following on line 12 after the word "six" and before the comma, "at any time during the tax year". Line 12 would then read "C. For each qualifying child under age six at any time during the tax year,".

## OTHER SUBSTANTIVE ISSUES

In assessing all tax legislation, LFC staff considers whether the proposal is aligned with committee-adopted tax policy principles. Those five principles:

- **Adequacy**: Revenue should be adequate to fund needed government services.
- **Efficiency**: Tax base should be as broad as possible and avoid excess reliance on one tax.
- **Equity**: Different taxpayers should be treated fairly.
- **Simplicity**: Collection should be simple and easily understood.
- **Accountability**: Preferences should be easy to monitor and evaluate

In addition, staff reviews whether the bill meets principles specific to tax expenditures. Those policies and how this bill addresses those issues:

| Tax Expenditure Policy Principle | Met? | Comments |
|---|---|---|
| **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. | ✗ | No record of an interim committee hearing can be found. |
| **Targeted**: The tax expenditure has a clearly stated purpose, long-term goals, and measurable annual targets designed to mark progress toward the goals.<br>Clearly stated purpose<br>Long-term goals<br>Measurable targets | ✗ | There are no stated purposes, goals, or targets. |
| **Transparent:** The tax expenditure requires at least annual reporting by the recipients, the Taxation and Revenue Department, and other relevant agencies | ✓ | The credit must be reported publicly in the TER. |
| **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.<br>Public analysis<br>Expiration date | ✓ | The credit does have an expiration date. |
| **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.<br>Fulfills stated purpose | ? | There are no stated purposes, goals, or targets with which to measure effectiveness or efficiency. |

| | | |
|---|---|---|
| Passes “but for” test | | |
| **Efficient:** The tax expenditure is the most cost-effective way to achieve the desired results. | ? | |
| Key: ✓ Met ✗ Not Met ? Unclear | | |

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