LFC Requester:	Jon Clark

AGENCY BILL ANALYSIS
2017 REGULAR SESSION

WITHIN 24 HOURS OF BILL POSTING, EMAIL ANALYSIS TO:

LFC@NMLEGIS.GOV

and

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{Include the bill no. in the email subject line, e.g., HB2, and only attach one bill analysis and related documentation per email message}

SECTION I: GENERAL INFORMATION

{Indicate if analysis is on an original bill, amendment, substitute or a correction of a previous bill}

Check all that apply:

Original ___ **Amendment** X

Correction ___ **Substitute** ___

Date 2/20/17

Bill No: SB344a/SEC

Sponsor: Senator Bill Tallman

Short Title: INCOME TAX RATES & PRE-K FUNDING

Agency Code: 924

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SECTION II: FISCAL IMPACT

REVENUE (dollars in thousands)

Estimated Revenue			Recurring or Nonrecurring	Fund Affected
FY19	FY20	FY21		
$0	$19,745.8	$41,632.4	Recurring	PED Pre-K Fund
$0	$118,474.7	$83,264.7	Non-recurring	Public School Fund

(Parenthesis ( ) Indicate Expenditure Decreases)

SECTION III: NARRATIVE

BILL SUMMARY

Synopsis:

SB 344a establishes a new top personal income tax (PIT) bracket, raises taxes on impacted taxpayers, and limits deductions on capital gain income to no more than $1,000. For FY 20 SB 344a distributes 2.6 percent of net PIT proceeds equally between the Children, Youth and Families Pre-Kindergarten Fund and the Public Education Department's Pre-Kindergarten Fund. For FY 21 and beyond, SB 344a distributes 5.2 percent of net PIT proceeds equally between the Children, Youth and Families Pre-Kindergarten Fund and the Public Education

Department's Pre-Kindergarten Fund. These funds are to be used for early childhood care and education services provided for prenatal care through third grade and the applicable enabling language for the funds is adjusted accordingly. Additionally for FY 20, SB 344a distributes 7.8 percent of PIT proceeds to the public school fund for distribution through the state equalization guarantee (SEG). For FY 21 and beyond, SB 344a distributes 5.2 percent of PIT proceeds to the public school fund for distribution through the SEG.

FISCAL IMPLICATIONS

The table below shows the distribution by fiscal year by receiving fund as a percent of total personal income tax (PIT) proceeds. As illustrated, SB344a diverts more funds to the SEG in FY 20 than in FY 21 and beyond.

SB 344a Impacts on PIT Proceeds
(in percent)

Recipient of Proceeds	FY 20	FY 21 and Subsequent Years
CYFD Pre-K Fund	1.3	2.6
PED Pre-K Fund	1.3	2.6
Public School Fund	7.8	5.2
Total Distribution of PIT yearly proceeds	**10.4**	**10.4**

According to the Legislative Finance Committee, the SEC amendment to change the effective date of the distributions provisions of the bill to January 1, 2019 results in a positive General Fund impact of about $10 million in FY18, approximately no fiscal impact in FY19, and mild positive fiscal impacts in subsequent fiscal years. Additionally, the LFC and TRD discuss the challenges and opportunities raising taxes on the highest taxpayers and eliminating some deductions to capital gains tax in the original bill's FIR. This analysis uses the estimates for FY 20 and FY 21 developed by the LFC and TRD in the FIR of the original bill to focus on impacts to PED's Pre-K Fund and the Public School Fund which distributes the SEG.

Using the December 2016 consensus revenue forecast and information from 2014 New Mexico federal taxpayer data and New Mexico tax expenditure data reported in the TRD 2015 Tax Expenditure Report (TER) , the LFC predicted the original bill's distribution to the Pre-Kindergarten Fund to be $78,983,100 in FY 20 and $83,264,700 in FY 21. These amounts were 5.2 percent of the adjusted PIT proceeds under the original bill's provisions. Without discussing the merits of these assumptions, these amounts are modestly higher than current forecasts from the December 2016 consensus revenue forecast for PIT proceeds to account for the additional revenues collected. The Senate Education Committee amendments made these two years the focus of analysis given that the amended provisions indicate that the distributions to the Public School Fund and the Public Prekindergarten Fund begin in those fiscal years, though the distributions lag the beginning of the tax collections to conform to a fiscal year calendar.

Using the amounts projected in the LFC's FIR of the original bill, the changes to percent distributions by fund would reflect a 75% reduction to the Public Prekindergarten Fund's FY20 distribution from the original bill and a 50% reduction to the Public Prekindergarten Fund's FY

21 distribution from the original bill. These funds are then added to reductions to the CYFD's funds to create a distribution to the Public School Fund for the SEG. Using the assumptions and methodology of the LFC in the original bill, PED projects that the public Prekindergarten Fund would receive approximately $19.7 million in FY20 funding and $41.6 million in funding for FY 20. Similarly, the PED projects that the Public School Fund of the General Fund would receive approximately $118.5 million in FY20 and $83.3 million in FY 21. **It is important to note where these funds go. The public school fund is part of the general fund and receives approximately $500 million annually from various sources that are directed to fund public education. The legislature then appropriates additional general fund revenue to fund public education. In the past, the legislature has used increases to the Public School Fund and reduced the amount of additional funding from the general fund supplanting these additional funds contrary to the intent of legislation. The provisions of this bill could result in no additional funding for education if the budgeteers use the same strategy.**

For FY 17 the General Appropriations Act included $24.5 million in revenues to the Public Prekindergarten Fund (including $3.5 million in federal Temporary Assistance to Needy Families (TANF) funds). It is unclear from the provisions of SB 344a whether or not the additional $19.7 million in FY 20 would supplement or replace the current practice of a non-categorical ("below the line") distribution in the General Appropriations Act. If the provisions supplement the current level of $21 million, then the provisions of SB 344a would result in a large increase in funding almost doubling the size of the program. This would result in scaling challenges at local school districts as well as the PED. Though some of the issues that the LFC recognized in the original bill's FIR regarding capacity limitations with availability of physical plant assets or locating available teachers could provide significant hurdles to expanding access. The PED has funding Prekindergarten in the past thoughtfully and a rate that has met demand. The provisions of this bill may substantially overfund the program if demand does not rise accordingly.

If however, the intent of SB 344a is to replace the below the line appropriation with a direct funding source, the current mechanism may produce funding in FY20 that is below recent appropriation amounts. This could result in PED program staff having tough conversations regarding available funds for current staffing levels of programs, only to turn around and expand to nearly double funding in FY21. Absent some supplementing appropriation to keep the current level of funding, the PED and sub-grantees in the school districts would be turning away kids and teachers one year only to ask them all to come back and bring friends the next year.

Similarly, it is unclear from the provisions of SB 344a whether or not the additional $118.5 million in FY 20 would supplement or replace the current appropriation level of the SEG in the General Appropriations Act. Absent any clause that indicates that the funding shall supplement and not supplant traditional revenues to the Public School Fund, the provisions of SB 344a may not provide any additional funding to the SEG in these years if appropriators take credit for this revenue stream to reduce General Fund appropriations in future years. The provisions of SB 344a would create a dedicated revenue stream to the Public School Fund for distribution through the SEG, though the availability of funds depends upon PIT, a traditionally volatile part of the state's revenue stream.

SIGNIFICANT ISSUES

The Pre-Kindergarten Act, Sections 32A-23 through 32A-23-9 NMSA 1978, provides "Any money appropriated for pre-kindergarten programs shall be divided equally between the public education department and the children, youth and families department." The provisions of SB

344 adhere to this requirement by providing equal distributions from the PIT.

The LFC, in their original bill analysis, indicates that an equal distribution requirement may result in the inability of the Public Education Department (PED) to expand services as quickly as the Children, Youth and Families Department (CYFD) due to capital infrastructure needs for additional classrooms in public schools and those school districts may look at contracting for additional capacity growth. The PED Pre-K program has always prioritized high expectations of quality and service while partnering with our school district and other sub-grantees. Phasing in long term capacity, while maintaining a high quality program, is a challenge to rapid expansion of access. The PED believes that sustained, long term growth of the program to expand access to Pre-K without negatively impacting program quality is the most beneficial approach to serving these children. Again, challenges resulting from expanding programs and access are much preferable to having to tell school districts, and by extension parents, that they cannot provide Pre-K to kids because of a lack of funding.

ALTERNATIVES

The legislatures could continue the current practice of providing non-categorical “below the line” appropriations for the prekindergarten program.