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FISCAL IMPACT REPORT

ORIGINAL DATE 03/01/09
 SPONSOR King LAST UPDATED 03/06/09 HB 753
 SHORT TITLE Air Force Base Battlespace Gross Receipts SB _____
 ANALYST Gutierrez

REVENUE (dollars in thousands)

Estimated Revenue			Recurring or Non-Rec	Fund Affected
FY09	FY10	FY11		
	(\$61.0)	(\$123.0)	Recurring	Local Governments
	(\$485.0)	(\$968.0)	Recurring	General Fund

(Parenthesis () Indicate Revenue Decreases)

SOURCES OF INFORMATION

LFC Files

Responses Received From

Taxation and Revenue Department (TRD)

SUMMARY

Synopsis of Bill

House Bill 753 provides a new deduction from the gross receipts tax for receipts from performing research and development services for battlespace environment programs at a New Mexico air force base pursuant to contracts entered into with the United States Department of Defense (DOD).

The effective date of this bill's provisions is July 1, 2009.

NOTE: TRD has revised their analysis.

TRD:

The operating budget of the Air Force's Battlespace Environment Division is currently nearly \$89 million;¹ however, only a portion of its operating budget goes to private industry who would qualify for the deduction. Even though the Air Force reports that many of the new Battlespace

¹ U.S. Air Force News Release. Office of Public Affairs, 377th Air Base Wing, Kirtland Air Force Base. Release #08-31. October 30, 2008

Environment job opportunities at their Kirtland Air Force Base (AFB) research laboratory “will become available as early as June 2009”¹, this estimate does not expect the division to become fully operational at Kirtland AFB until 2011.

Preparations for the Air Force Research Laboratory’s Battlespace Environment Division’s relocation from Hanscom AFB to Kirtland AFB have already begun. The relocation is expected to be complete by 2011 so FY12 is the first fiscal year where the deduction has a full impact. Nevertheless, because the Air Force reports that “many of the job opportunities will become available as early as June 2009” this estimate assumes a partial impact in FY10 and further ramp up in FY11.

According to a July 2007 presentation on the Battlespace Environment Division at Kirtland AFB by Major General Ted Bowlds, the Battlespace Environment Division expects to contract out \$25 million during calendar year 2011. Casey DeRaad, the chief of technology and education outreach for the Air Force’s Research Laboratory at Kirtland AFB, where the Battlespace Environment Division will be located, states that “most of the workers are contract employees from private companies hired by the Air Force to assist in research and development.” The estimate uses Bowlds expectation of the amount funds contracted out and DeRaad’s generalization that “about 80 percent of [the contracting budget] goes out of state.”² Using these numbers \$20 million is expected to be spent on out-of-state contractors and \$5 million on in-state contracts in CY11.

Based on Bowlds presentation, the estimate assumes that Battlespace Environment Division’s contracting budget grows by 5.75 percent annually. A gross receipts tax rate of 7.07 percent is used for the receipts in New Mexico.

Because receipts of subcontractors in New Mexico would still be taxable, as noted in the technical comments, the total impact is reduced for instate receipts. This estimate assumes 10 percent of R&D services are subcontracted and therefore still taxable. The table below summarizes the effect of making in-state receipts deductible (it shows all amounts in thousands):

	<u>FY2010</u>	<u>FY2011</u>	<u>FY2012</u>	<u>FY2013</u>
Percent of Battlespace Div. Budget in effect at Kirtland	45%	85%	100%	100%
Expenditures on Eligible R&D Contracts from Kirtland AFB	10,354	20,682	25,731	27,211
Eligible Contracts in NM (20% of Total minus subcontractors)	1,864	3,723	4,632	4,898
Local Government Impact	(61)	(123)	(153)	(161)
General Fund Impact	(70)	(141)	(175)	(185)
Total Impact	(132)	(263)	(328)	(346)

The receipts from performing R&D services out-of-state are taxable if initial use is in New Mexico. The table below summarizes the effect of making out-of-state receipts deductible (it shows all amounts in thousands):

² Robinson-Avila, Kevin. “Kirtland Boosts Space Industry.” *New Mexico Business Weekly*, June 6, 2008.

	<u>FY2010</u>	<u>FY2011</u>	<u>FY2012</u>	<u>FY2013</u>
Percent of Battlespace Div. Budget in effect at Kirtland	45%	85%	100%	100%
Expenditures on Eligible R&D Contracts from Kirtland AFB	10,354	20,682	25,731	27,211
Eligible Contracts Out-of-State (80% of Total)	8,283	16,546	20,585	21,769
Local Government Impact	0	0	0	0
General Fund Impact	(414)	(827)	(1,029)	(1,088)
Total Impact	(414)	(827)	(1,029)	(1,088)

SIGNIFICANT ISSUES

Under current law, certain service contractors who enter into a contract with the Department of the Defense (DOD) may be able to execute Type 15 nontaxable transaction certificates (NTTCs) to be used for purchases of tangible personal property if their contract with the DOD meets certain requirements. One of those requirements is that the receipts from the service contract must be subject to gross receipts tax. Under this proposal the receipts of the subcontractor would not be subject to gross receipts tax, therefore the Type 15 NTTCs would not be allowed for the purchase of tangible personal property.

LFC notes that while individual credits, deductions and exemptions from the gross receipts tax may have small fiscal impacts, their cumulative effect significantly narrows the gross receipts tax base. Narrowing the gross receipts tax base increases revenue volatility and requires a higher tax rate to generate the same amount of revenue.

The bill will reduce local government gross receipts tax collections. Many of New Mexico’s local governments are highly dependent on gross receipts tax revenue.

ADMINISTRATIVE IMPLICATIONS

TRD:

The lack of a definition for “battlespace environment programs” could lead to taxpayer confusion and difficulties administering the proposed deduction; otherwise, the bill has a minimal impact on the Department.

TECHNICAL ISSUES

There is no definition for “battlespace environment programs.”

On line 19, page 1, “pursuant to contracts entered into with the USDOD”, the assumption is that the deduction is meant only for the prime contractor who entered into a contract with the DOD. If the prime contractor subcontracts out some of the R & D services, then the receipts of the subcontractor are presumed to be subject to gross receipts tax. A resale deduction would not be available to the subcontractor since the receipts of the prime contractor would be deductible under this proposal.

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The Legislative Finance Committee has adopted the following principles to guide responsible and effective tax policy decisions:

- 1. Adequacy:*** revenue should be adequate to fund government services.
- 2. Efficiency:*** tax base should be as broad as possible to minimize rates and the structure should minimize economic distortion and avoid excessive reliance on any single tax.
- 3. Equity:*** taxes should be fairly applied across similarly situated taxpayers and across taxpayers with different income levels.
- 4. Simplicity:*** taxes should be as simple as possible to encourage compliance and minimize administrative and audit costs.
- 5. Accountability/Transparency:*** Deductions, credits and exemptions should be easy to monitor and evaluate and be subject to periodic review.

More information about the LFC tax policy principles will soon be available on the LFC website at www.nmlegis.gov/lcs/lfc