

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 FIRs (in HTML & Adobe PDF formats) are available on the NM Legislative Website (legis.state.nm.us). Adobe PDF versions include all attachments, whereas HTML versions may not. Previously issued FIRs and attachments may be obtained from the LFC in Suite 101 of the State Capitol Building North.

## FISCAL IMPACT REPORT

ORIGINAL DATE 03/05/09

SPONSOR Gutierrez LAST UPDATED \_\_\_\_\_ HB 809

SHORT TITLE Bakery Goods Gross Receipts SB \_\_\_\_\_

ANALYST Gutierrez

### REVENUE (dollars in thousands)

Estimated Revenue			Recurring or Non-Rec	Fund Affected
FY09	FY10	FY11		
	(\$3,376.9)	(\$3,512.0)	Recurring	General Fund
	(Indeterminate but minimal)	(Indeterminate but minimal)	Recurring	Local Governments

(Parenthesis ( ) Indicate Revenue Decreases)

Relates to SB69 and SB88

### SOURCES OF INFORMATION

LFC Files

#### Responses Received From

Taxation and Revenue Department (TRD)

### SUMMARY

#### Synopsis of Bill

House Bill 809 amends Section 7-9-92 NMSA 1978 expanding the definition of “food” that qualifies for the gross receipts deduction for the sale of food at a retail food store. This bill adds “food produced and sold by a bakery that is a small business” to the definition of food and adds a bakery to the definition of a retail food store. This bill also defines a bakery as “an establishment where food such as bread, cake, cookies, pastry or other flour-based products are produced and sold to retail or wholesale customers” and defines a small business as a business with gross receipts of \$200,000 (see technical issues).

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

### FISCAL IMPLICATIONS

This fiscal impact assumes the technical issue is fixed and thus the fiscal impact is for all businesses with less than or equal to \$200,000 annual gross receipts. This estimate also assumes an average tax rate of 7.07 percent and an annual growth rate of 4 percent.

The bill’s definition of bakery allows the food deduction to encompass all food sales of many small restaurants and cafes because it includes small businesses that produce and sell *any* amount

of flour-based products. The estimate assumes any business that sells food will produce and sell at least a token amount of flour-based products to qualify for the food deduction on all of their other food sales. A sampling of current taxpayer reporting indicates that roughly 300 businesses statewide would qualify based on the above criteria. These small businesses have average taxable gross receipts of \$147 thousand for a total of \$44 million in taxable gross receipts affected by the proposal.

In addition to reducing general fund revenues, the proposal will have a minimal impact on counties and municipalities who have had the rate of their food and medical hold harmless distributions frozen based on the local options they had enacted on January 1, 2007. It will have a minimal negative impact on local governments that have increased their local option rates since January 1, 2007. However, moving these sales from taxable to deductible under the food deduction will actually have a small positive impact for local governments who have decreased their rates (currently only Albuquerque). The legislation freezing the rate of certain local governments' food and medical hold harmless distributions did not envision a local government lowering their rates. Even though less revenue would be collected in Albuquerque under this proposal, hold harmless distributions to Albuquerque would increase by a greater amount as long as their current rate remains lower than their January 1, 2007 rate.

## **SIGNIFICANT ISSUES**

TRD:

The original intention of Section 7-9-92 NMSA 1978 was to deduct sales of home consumed food, as defined by the federal food stamp program, bought from stores that accept food stamps or meet the requirements to accept food stamps.

New Mexico's food deduction makes use of federal definitions and requirements. To qualify, a retail store must conform to at least one of two following criteria. It either must (criterion A) stock and offer a variety of foods on a continuous basis in each of four staple food categories – two of which must be perishable foods – or (criterion B) function as a specialty store attributing 50% or more of its gross retail sales to staple foods. The four categories of staple foods are:

- Breads/cereals
- Dairy products
- Fruits and vegetables
- Meat, fish, poultry

Retail bakeries can currently meet the requirements to qualify for the food deduction. They only need more than half of their sales to come from staples such as breads and cereals.

The bill would allow any “small business” that “produces” and sells any amount of flour-based products to qualify. Businesses such as pizza parlors that make their own crusts, sandwich shops that make their own bread, bars that make their own pretzels, or coffee shops that bake their own muffins would now qualify for the food deduction on *all* the food they sell.

## **ADMINISTRATIVE IMPLICATIONS**

TRD:

The proposal will have minimal systems, instructions, and publications impact on the Department; however, there is a high need for taxpayer education.

Implementation of the original food deduction proved very complex for the Department and especially for business taxpayers indicating that this change to the food deduction will require greater than average taxpayer education and employee training. The bill only allows a short time

for taxpayers to educate their staff and to make necessary changes to their computer systems- it may be advisable to extend the effective date to January 2010.

Any taxpayer errors in reporting the food deduction create improper hold harmless distributions from the General Fund to local governments. The Department strives to monitor and correct any incorrect reporting. Time spent by the Audit and Compliance Division and the Revenue Processing Division ensuring that taxpayers have reported the deduction correctly will reduce the amount of time that can be spent bringing in additional revenue to the State.

## RELATIONSHIP

House Bill 809 relates to:

- SB69 which removes “soft drinks” from the list of foods eligible to receive a gross receipts tax deduction for retail food
- SB88 which expands the definition of retail food store so that establishments with over 75 percent of sales attributable to bottled water, ice and coffee can receive the gross receipts tax deduction for retail food

## TECHNICAL ISSUES

This bill defines “small business” as “a business, the gross receipts of which are two hundred thousand dollars (\$200,000)”. It is unclear if the intent of this bill was to include those with gross receipts *less than or equal* to \$200,000 but even this definition would have some problems. First, it does not say whether this is an annual (which is assumed for this fiscal impact estimate), quarterly or other sum of gross receipts and if it is annual, it does not refer to which year the receipts are earned. If it refers to total receipts in the current year, a taxpayer would not know what to collect, report, and pay until after the end of the year. If it refers to total receipts in the prior year, it would allow new businesses or businesses who reopened under a new name to take the deduction regardless of the amount of receipts they have in the current year.

The proposed definition of bakery would allow a business with any production and sale of any flour-based products to qualify. There is no definition of what it means for the business to have “produced” the flour-based product.

BLG/mc

***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](http://www.nmlegis.gov/lcs/lfc)***