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FISCAL IMPACT REPORT

ORIGINAL DATE 02/17/14

SPONSOR Keller & McCamley LAST UPDATED _____ HB _____

SHORT TITLE Separate Report Tax Expenditures SB 30

ANALYST Graeser

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY14	FY15	FY16	FY17	FY18		
	**NFI	**NFI	**NFI	**NFI		All

(Parenthesis () Indicate Revenue Decreases)

** No direct revenue impact, particularly not in the first few years of universal tax expenditure reporting. If TRD is not funded to modify forms and capture the data, then there will be an enormous amount of data submitted and not used.

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

Estimated Additional Operating Budget Impact*				Recurring or Nonrecurring	Fund(s) or Agency Affected
FY14	FY15	FY16	FY 14-16		
\$0.0	\$200.0	\$200.0	\$400.0	Recurring	General Fund (TRD)
\$0.0	\$250.0	\$0.0	\$250.0	Nonrecurring	General Fund (TRD)

(Parenthesis () Indicate Expenditure Decreases)

Note: the bill requires every person that claims a tax expenditure used to reduce that person's liability in any tax program must separately report that tax expenditure to TRD. The bill does not require TRD to capture that information, nor render the reporting into useful information. The recurring and non-recurring impacts above are copied from the analysis for SB 29 and HB 131. This cost assumes that TRD would capture at least the Gross Receipts and Compensating Act deductions for the list of post-2000 GR&CTA deductions listed in HB 131 and SB 29. Implementing separate reporting, data capture and quantitative and qualitative reporting for other tax programs and the remaining exemptions and deductions from GR&CTA would increase these costs, perhaps by a factor of three or four.

SOURCES OF INFORMATION

LFC Files

Responses Received From

Taxation and Revenue Department (TRD)

SUMMARY

Synopsis of Bill

Senate Bill 30 requires a person that claims a tax expenditure in any tax program administered pursuant to the provisions of the Tax Administration Act (TAA) must separately report the exemption or deduction “on the person’s return.” This means that reporting must be done on a monthly (quarterly or semi-annually for taxpayers with smaller liabilities) basis for GR&CTA or selective excise taxes including liquor, tobacco and cigarettes or gasoline tax expenditures and other frequency for Motor Vehicle Excise tax. There are tax expenditures for the oil and gas and hard mineral severance taxes and other selective excise taxes that would require monthly reporting. Personal income tax and corporate income tax, with all of the pass-through entities such as LLCs, Subchapter S corporations, master limited partnerships (MLPs), etc., would require annual reporting. The proposed legislation requires the Taxation and Revenue Department to promulgate rules to enforce this requirement.

FISCAL IMPLICATIONS

Although this bill does not have a direct effect on revenue, the intention is clearly that with accurate and timely tax expenditure reporting, the State will have the information necessary to expand useful tax expenditures, curtail or eliminate those that are not meeting stated goals and modify those in-between tax expenditures to improve the effectiveness and equity of the State’s many tax exemptions, deductions and credits. If this effort is successful, it could mean more, less or the same revenue impact, but substantially greater economic impact on the state than we experience with the uncoordinated tax expenditures we now have.

SIGNIFICANT ISSUES

The most significant issue with the reporting requirement is the costs it will impose on the taxpaying public. In past years, the compliance costs to taxpayers reporting to New Mexico Taxation and Revenue Department (TRD) on the CRS-1 form were estimated at less than 2 percent of the taxes paid. Conventional accounting systems and programs can easily track gross receipts by location. However, conventional accounting systems are not easily adapted to track the multitudinous GRT deductions that are currently available. Compliance costs could easily exceed 10 percent of taxes paid for small to medium-sized businesses. With this level of costs and failure of the bill to provide significant penalties for non-reporting means that overall compliance will be very poor.

If TRD is not funded to capture the data, compile it, analyze and report to the legislature and Governor, then the costs and effort imposed on taxpayers will be wasted.

If taxpayers are not threatened with losing the value of any tax expenditure if the deduction or exemption is incorrectly reported may also result in the data, if captured, compiled and analyzed not being of sufficient coverage or accuracy from which to make policy decisions regarding retention, modification or repeal of particular tax expenditures.

At various times in history, TRD has attempted to “close the loop” for non-taxable transaction certificates (NTTCs) required to be able to claim a deduction from gross receipts. At one point, every taxpayer was required to report annually any NTTCs issued by CRS # of the recipient. This enormous effort was marginally supported by taxpayers, but TRD and the State did not have

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sufficient computer power to completely close the loop. Most of the voluminous data submitted by taxpayers could not be put to any effective use. In 1991, Section 7-9-43 NMSA 1978 was amended to require complete cancellation and reissue of and NTTCs and to require that reissue every ten years. In 2001 – the year of the required reissue of NTTCs, the ten-year period was amended to “twelve-years.” In 2003, the mandatory reissue was again delayed by two years. Finally, in 2005, the periodic cancellation and reissue of NTTCs was scrapped.

The reporting requirements in this legislation may provide better information regarding the cost of tax expenditures. Without reporting on the use of exemptions and deductions, estimates of the impacts of many tax expenditures retain a high level of uncertainty. As pointed out, New Mexico TRD’s experience with reporting requirements when there are no penalties for reporting inaccurately or incompletely is taxpayers will not pay the same level of attention to the reporting of deductions and exemptions as to the reporting and payment of taxes.

Estimating the cost of tax expenditures is difficult. Confidentiality requirements surrounding certain taxpayer information create uncertainty, and analysts must frequently interpret third-party data sources. The statutory criteria for a tax expenditure may be ambiguous, further complicating the initial cost estimate of the expenditure’s fiscal impact. Once a tax expenditure has been approved, information constraints continue to create challenges in tracking the real costs (and benefits) of tax expenditures.

ADMINISTRATIVE IMPLICATIONS

TRD reports a potentially high impact to implement the provisions of this bill. The bill requires taxpayers that claim any tax expenditures to report them to TRD in a manner that would allow for subsequent analysis and reporting. This would have a very large impact on TRD, both in recurring and non-recurring costs. If TRD were not provided with supplemental funding, then the data reported by taxpayers might not be captured, compiled or analyzed at all, since the bill does not require the department to do anything with the data submitted by taxpayers.

The following analysis was provided by TRD for only the portion of this bill that requires separate reporting for GR&CTA deductions and exemptions. Implementing data capture, compilation and reporting for tax expenditures in other portions of Chapter 7 NMSA 1978 would be several times more expensive than discussed here. IT staff estimates that the reprogramming of the GenTax system would cost approximately \$250 thousand, as a one-time expense. TRD is currently in the process of several significant IT projects and existing staff is insufficient to accomplish another large scale project simultaneously. In order to complete the programming would require the hiring of several contract developers over the course of a six month development cycle, as well as diverting the few available staff from other responsibilities. As with the actual compilation of the report, these are staff resources that are currently dedicated to other important duties.

The Revenue Processing Division (RPD) of TRD would also be heavily impacted. In calendar year 2013, between 4,500 and 23 thousand paper CRS returns were processed in a given month, with an average of more than 9 thousand. The differences in the number of returns reflects seasonal variation and annual, quarterly, semi-annual and monthly filing patterns. Currently, the vast majority of these paper forms are submitted on the short-form CRS return. The short form is very quick to process. If a check is received with the return, the check and short form can be scanned in a specialized scanner that processes the check at the same time that it images the

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return at a rate of about 1,000 returns per hour. The return acts as a voucher, so that a separate voucher is not needed.

The itemization of CRS tax expenditures would necessitate the move from the short form to the long form CRS return for any tax payer claiming deductions – the short form lacks the physical space for itemized deductions. To process a long form return, staff creates a voucher, sends the newly created voucher through the scanner with any included check for processing, and then scans the return on a larger, slower scanner. The whole process takes several times as long as it takes to process a short form return. The scanner used for the long form is limited to 450 sheets per hour, but as long form CRS returns are multiple pages, the rate is an average of 225 returns per hour. RPD estimates that it would require 8,000 additional personnel hours a year, at a cost of about \$200 thousand recurring, to maintain current timelines with regard to processing CRS returns. Some of this could be mitigated, but it would necessitate delayed CRS closing dates, which would have the effect of delaying distributions to local governments.

Regardless of which form is used, short or long, all of the information on the forms is manually key entered by RPD staff. Increasing the amount of information on the forms necessarily increases data entry time. This is accounted for in RPD's estimate of additional staffing requirements. It also bears noting that increased data entry requirements can also lead to increased error rates. TRD would recommend that strengthening electronic filing requirements as a means of reducing the manual processing costs.

Realistically, TRD could not implement the separate reporting provisions of this bill in a single year for only the GR&CTA. A five-year, phased approach with each phase fully funded and staff brought on board and trained might lead to useful data, analysis and recommendations.

The apparent purpose of this bill is to fully support implementation of the Legislative Finance Committee's tax policy principles, with the exception of simplicity.

DUPLICATES, COMPANIONS, CONFLICTS

SB 29, as amended would require separate annual reporting of listed GR&CTA exemptions and deductions. HB 131 would require separate monthly reporting of listed GR&CTA exemptions and deductions. SJR 5 and HJR 5 would require the separate reporting of all tax expenditures and further require that the consensus revenue estimating group (CREG) capture and analyze all tax expenditures of whatever kinds and regularly report costs and benefits. Unlike HB 131 or SB 29, this bill does not have an appropriation.

ALTERNATIVES

Consider a stand-alone *annual* reporting mechanism with a penalty for inaccurate reporting or non-reporting. The threat of losing the entire deduction or exemption for failure to file would be, perhaps, sufficient to ensure accurate compliance.

LG/jl/ds