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FISCAL IMPACT REPORT

ORIGINAL DATE 02/21/17
 SPONSOR Sharer LAST UPDATED 02/28/17 HB _____

SHORT TITLE Tax Reform SB 123/aSCORC

ANALYST Clark

APPROPRIATION (dollars in thousands)

Appropriation					Recurring or Nonrecurring	Fund Affected
FY17	FY18	FY19	FY20	FY21		
\$0	Unknown, intended to maintain existing appropriation	Unknown, intended to maintain existing appropriation	Unknown, intended to maintain existing appropriation	Unknown, intended to maintain existing appropriation	Recurring	State Parks Division

Parenthesis () indicate expenditure decreases

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY17	FY18	FY19	FY20	FY21		
\$0	Unknown, See Fiscal Implications	Unknown, See Fiscal Implications	Unknown, See Fiscal Implications	Unknown, See Fiscal Implications	Recurring	General Fund, Local Governments, Other Funds

Parenthesis () indicate revenue decreases

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY17	FY18	FY19	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
Total	\$0	\$2,362.6	\$0	\$2,362.6	Nonrecurring	Taxation and Revenue Department

Parenthesis () indicate expenditure decreases

Conflicts with a variety of bills that make changes to the tax code

SOURCES OF INFORMATION

LFC Files

Responses Received From

Taxation and Revenue Department (TRD)
Economic Development Department (EDD)
New Mexico Department of Transportation (NMDOT)
Higher Education Department (HED)
New Mexico Municipal League

SUMMARY

Synopsis of SCORC Amendment

The Senate Corporations and Transportation Committee amendment makes minor adjustments to correct technical issues noted by LFC in the Technical Issues section.

Synopsis of Original Bill

Senate Bill 123 is a substantial tax reform package, making major modifications to the gross receipts tax (GRT), compensating tax, income taxes, and other taxes. It lowers tax rates and attempts to pay for the reductions by eliminating a wide array of tax exemptions, deductions, and credits. Below is a short list of key actions:

- Shorten timeframe to claim tax credits and refunds
- Reduce GRT rate from 5.125 percent to 1 percent
- Reduce GGRT rate from 5 percent to 1 percent
- Reduce municipal and county GRT rates to 0.5 percent maximum and remove restrictions for use of funds for individual increments
- Reduce comp tax rate from 5.125 percent to 2 percent for tangible property and from 5 percent to 1 percent for services
- Require the Taxation and Revenue Department (TRD) to adjust GRT rate for initial three years depending on revenue
- Reduce income tax rate to flat 2.5 percent (and only tax income above certain levels); subject wages to GRT
- Remove tax increment for development district bonding ability against state GRT increments
- Repeal certain exemptions
- Repeal certain deductions
- Repeal certain credits
- Tax internet sales
- Repeal Corporate Income and Franchise Tax Act
- Repeal estate tax
- Repeal motor vehicle excise tax
- Repeal leased vehicle GRT
- Repeal boat excise tax and make an appropriation from boat GRT
- Repeal supplemental municipal GRT
- Repeal Local Hospital GRT Act
- Repeal County Correctional Facility GRT Act
- Repeal Special County Hospital Gasoline Tax Act
- Replace county obligations with state obligations for county-supported Medicaid and

safety net care pool

- Provide temporary amnesty from penalties & interest
- Provide the repeal of certain taxes shall not impair outstanding bonds or loan guarantees

Below is a more detailed list of the bill's actions.

Section 1 – makes changes to bonding authority for municipal governments, including allowing GRT revenue bonds to be issued for any municipal purpose

Section 2 – enacts definitions for bond and revenue terms

Section 3 – amends definitions used in the Small Cities Assistance Act, including changing references to local GRT increments from 0.25 percent to 0.125 percent

Section 4 – updates reference related to the power to issue bonds

Sections 5-6 – remove references to the 1.225 percent GRT increment collected by the state in municipal areas and then distributed back to the municipalities

Section 7 – removes references to county funding for the county-supported Medicaid fund

Section 8 – changes the definition of a qualifying county in the Small Counties Assistance Act from one that has imposed GRT increments of at least 3/8 percent to at least 1/2 percent; changes a comp tax reference to a GRT reference

Section 9 – removes portions of statute relating to distributions from the small counties assistance fund

Section 10 – makes changes to bonding authority for county governments, including allowing GRT revenue bonds to be issued for any county purpose

Section 11 – enacts definitions for bond and revenue terms

Section 12 – amends the Local Economic Development Act to restrict loan guarantees to not exceed local GRT revenues dedicated for economic development

Section 13 – cleans up language to reflect other bill actions

Sections 14-15 – remove tax increment for development districts' (TIDDs') ability to bond against state GRT increments

Sections 16-21 – clean up language and make comparatively minor changes

Section 22 – strikes from the applicability of the Tax Administration Act those items being repealed, including the Venture Capital Investment Act, investment credit, rural job tax credit, laboratory partnership with small business tax credit, technology jobs and research and development tax credit, film production tax credit, affordable housing tax credit, high-wage jobs tax credit, and Corporate Income and Franchise Tax Act

Senate Bill 123/aSCORC – Page 4

Section 23 – changes the distribution to the small cities assistance fund from 15 percent to 0.003 percent of comp tax receipts

Section 24 – changes the distribution to the small counties assistance fund from 10 percent to 0.00175 percent of comp tax receipts

Section 25 – reduces distributions to the state aviation fund

Section 26 – changes the county equalization distributions

Section 27 – changes the county-supported Medicaid fund to a state fund with distributions to the fund equal to 0.014 percent of net GRT revenues; adds a safety net care pool fund with distributions to the fund equal to 0.018 percent of net GRT revenues

Section 28 – cleans up language to reflect other bill actions

Section 29 – provides additional language to determine the place of business where gross receipts are to be reported

Section 30 – shortens the timeframe for claiming a credit or refund from a maximum of three years (and up to nearly an additional year depending on timeframe) to “prior to the end of the calendar year”

Section 31 – adds part of the language contained within a separate proposed bill to tax remote sellers without a physical presence in New Mexico (contains an apparent drafting error by referring to the GRT as “sales tax”)

Section 32 – increases the penalty for willful failure to pay taxes from 50 percent to 100 percent of the tax

Section 33 – adds language to protect GRT distributions to TIDDs necessary to make required bond debt service payments

Section 34 – creates a boat suspense fund from GRT revenues from boat sales and appropriates revenue from the fund to the State Parks Division of the Energy, Minerals and Natural Resources Department for improvements and maintenance of lakes and boating facilities (appears at odds with the remainder of the bill eliminating special funds and earmarks, but it is necessary to maintain the current funding level for the State Parks Division due to an equivalent earmark that is being eliminated)

Section 35 – changes the definition of “base income” to remove certain existing language and add new exemptions

Section 36 – changes personal income tax rates to a flat 2.5 percent rate on incomes above certain levels (ranging from \$141,975 to \$283,950), adjusted annually for inflation

Section 37 – exempts donations to 501(c)(3) organizations from income tax

Section 38 – cleans up language to reflect other bill actions

Sections 39-41 – require withholding tax to include withholding based on GRT applied to wages

Section 42 – makes changes to definitions of net income for the Oil and Gas Proceeds and Pass-Through Entity Withholding Tax Act

Section 43 – cleans up language and removes reference to personal services businesses

Section 44 – allows a person to opt to pay a 0.75 percent tax on gross receipts from sales in or into New Mexico in lieu of paying an income tax in certain situations

Section 45 – cleans up language to reflect other bill actions

Section 46 – contains language to include in GRT remote sellers with no physical presence in the state but with more than \$100 thousand of gross receipts in the state

Section 47 – removes the exclusion of local florist receipts from GRT when the sale is made through an out-of-state florist for filling and delivery by the local florist

Section 48 – lowers the state GRT rate from 5.125 percent to 1 percent and requires TRD to adjust the rate on each July 1 in 2019 – 2021 to ensure the revenue from the tax exceeds the previous fiscal year’s budget by no more than 3 percent and no less than 1.5 percent; TRD, in consultation with DFA and LFC, shall estimate the revenue for fiscal years 2019 – 2021 no later than May 1 of those years (language appears to have a drafting error – the revenue estimate should be for the following fiscal year)

Section 49 – lowers the governmental gross receipts tax (GGRT) rate from 5 percent to 1 percent

Section 50 – lowers the compensating tax rate for the privilege of using tangible personal property in New Mexico from 5.125 percent to 2 percent and lowers the compensating tax rate for the privilege of using services rendered in New Mexico from 5 percent to 1 percent

Section 51 – adds language to prevent TRD from collecting GRT on remote sellers for periods prior to July 1, 2018 if the remote seller had no physical presence in the state and did not report taxable gross receipts (contains an apparent drafting error by referring to the GRT as “sales tax”)

Section 52 – removes all exemptions to GRT and comp tax listed in Sections 7-913 through 7-9-42 NMSA 1978

Section 53 – cleans up language to reflect other bill actions

Section 54 – cleans up language to reflect other bill actions

Sections 55-56 – leave in place the deductions for uranium enrichment plant equipment and sales of uranium hexafluoride and enrichment of uranium through June 30, 2034

Section 57 – leaves in place the deduction for locomotive engine fuel through June 30, 2034 and extends this GRT deduction to include comp tax as well and adds a purpose statement, qualifications, and reporting

Section 58 – exempts receipt of donations by 501(c)(3) organizations from GRT

Section 59 – creates a tiered GRT credit based on federal poverty guidelines, ranging from a 164 percent credit for those under 100 percent of the poverty level to a 7 percent credit for those between 200 percent and 210 percent of the poverty level; the credit is refundable if it exceeds liability

Sections 60-61 – repeal the existing statutes for municipal and county local option GRT increments and create replacement statutes allowing these governmental bodies to enact GRT increments of 0.05 percent or multiples of 0.05 percent up to a maximum 0.5 percent

Section 62 – cleans up language to reflect other bill actions

Section 63 – removes county distributions to the county-supported Medicaid fund

Sections 64-71 – clean up language, primarily to reflect other bill actions

Section 72 – creates a temporary provision stating the repeal of certain taxes shall not impair outstanding revenue bonds or loan guarantees and instructs counties and municipalities how to deal with such a situation with regard to local GRT increments

Section 73 – creates a temporary amnesty from penalties and interest for payment of outstanding tax liabilities

Section 74 – creates a temporary provision changing references in law from “county-supported Medicaid fund” to “Medicaid fund”

Section 75 – clarifies the provisions of law repealed by Section 77 shall not apply to taxable years beginning on or after January 1, 2018

Section 76 – repeals a variety of sections of statute, including many deductions and credits

Section 77 – repeals many existing portions of income tax statutes

Section 78 – states the provisions of Sections 35 and 36 (income tax) apply to taxable years beginning January 1, 2018

Section 79 – states the effective date of the provisions of Sections 1-76 is January 1, 2018; the effective date of the provisions of Sections 77 (repeal of portions of existing income tax statutes) is January 1, 2019

FISCAL IMPLICATIONS

It is impossible to score precisely the fiscal impact of any significant tax reform bill, but it is particularly challenging to score a reform bill of this magnitude due to limitations in available data. The significant number of interactive effects in this bill could have unanticipated consequences that could lead to revenue shortfalls for the state and local governments or unanticipated revenue windfalls from tax increases for certain groups of taxpayers.

LFC staff suggest a study of the fiscal implications could be performed in the interim with TRD and DFA staff, but it would be helpful to have additional data for components of the bill for which the agencies currently have no information on which to build an impact analysis. There are reports some additional data may be provided by privately-contracted studies performed during 2017.

This bill creates a new fund and provides for continuing appropriations. LFC has concerns with including continuing appropriation language in the statutory provisions for newly created funds, as earmarking reduces the ability of the Legislature to establish spending priorities.

The New Mexico Municipal League notes that come January 1, 2018, no municipal GRT rate may exceed 0.5 percent. It is likely that for many, perhaps a majority of, municipalities will see a decline in the total municipal GRT revenues.

The Higher Education Department (HED) provided the following fiscal implications.

The bill strikes 3-31-1 (J) NMSA 1978 in its entirety (Page 11, Line 22 through Page 12, Line 23). Many of the higher education institutions throughout the state rely heavily on general obligation bonds and severance tax bonds to fund their infrastructure maintenance. Building renewal and replacement funds are limited and removing the ability to impose or authorize a municipal higher education facilities gross receipts tax reduces the available funding mechanisms.

Under 7-2-2(B) (4) (a) NMSA 1978, base income includes amounts for which taxpayers took New Mexico income tax deductions in prior years for contributions to the 529 program and then, in the current year, rolled over their NM 529 assets into the 529 program of another state. By deleting this provision, New Mexico is supporting the 529 plan of the state receiving the rolled-over money. This results in a loss of tax revenue to New Mexico by allowing the rollover with no tax consequence.

Under 7-2-2-(B) (4) (b) NMSA 1978 base income includes amounts withdrawn from the New Mexico 529 plan and not used for "qualified education expenses" as defined by federal law. Under current law, withdrawals used for higher education purposes have tax protections. The proposed deletion would provide tax protection for amounts not used for higher education expenses. This would result in lost tax revenue when withdrawals were made for non-educational purposes.

The New Mexico Department of Transportation (NMDOT) provided the following fiscal implications related to the leased vehicle gross receipts tax impact and the impact on the Aviation Division revenue distributions.

The bill repeals the Leased Vehicle Gross Receipts Tax (LVGRT), 75 percent of which is distributed to the Highway Infrastructure Fund (HIF) and 25 percent of which is distributed to the Local Governments Road Fund. It also eliminates certain revenue distributions to the Aviation Division which amount to about 35% of the current funding to the Aviation Division.

Estimated Revenue			Recurring or Non-Rec	Fund Affected
FY18	FY19	FY20		
(3,141)	(6,549)	(6,780)	Recurring	Highway Infrastructure Fund (LVGRT)
(1,022)	(2,121)	(2,198)	Recurring	Local Governments Road Fund (LVGRT)
(470)	(1,000)	(1,085)	Recurring	Aviation Division (Jet Fuel)
(472)	(990)	(1,040)	Nonrecurring	Aviation Division (Air Assistance)

SIGNIFICANT ISSUES

NMDOT reported, “The portion of the LVGRT distributed to the HIF is a pledged revenue source for all NMDOT bond issues. Repealing the LVGRT will directly impact NMDOT’s outstanding bonds. The HIF is a restricted fund established in NMSA 1978, Section 67-3-59.2. If the LVGRT is repealed, it will result in an impairment to all current outstanding bonds and will directly impact bond ratings and coverage ratios.”

TRD provided the following analysis.

This bill provides for the comprehensive revision, repeal, and/or replacement of numerous, but not all, current tax programs. As such, it represents a massive overhaul of the state’s tax code that would necessitate significant changes in reporting requirements by taxpayers, significant reformation and/or repeal of the New Mexico Administrative Code’s tax-related provisions, and significant changes in tax administration, including, but not limited to, changes in monitoring software, forms, and publications. As an initial observation, and given the massive changes, it may be preferable to comprehensively repeal various sections of the tax code, such as the Gross Receipts and Compensating Tax Act, and re-write the code from scratch to avoid inconsistencies and unintended consequences.

The bill purports to simplify the state’s tax structure by moving New Mexico to a predominantly broad-based GRT system. Specifically, it:

- lowers the GRT rate to one percent (state rate) but significantly expands the tax base by:
 - repealing a significant number of exemptions, deductions, and credits from the statute; and
 - broadening the GRT tax base to include “wages and receipts from “investments;”
- repeals the Corporate Income and Franchise Tax Act; and
- imposes an individual income tax at the rate of 2.5% only on married individuals filing separately if income is at least \$141,975, heads of houses/married individuals filing jointly if income is at least \$283,950, and single individuals or estates and trusts if income is at least \$189,300.

Through the combination of how the proposed bill defines “wages” for GRT purposes and the repeal of the corporate income tax, the proposed bill may reduce the tax burdens

for multistate businesses that avail themselves of the New Mexico market, and shift that burden more exclusively to New Mexico residents and businesses.

The New Mexico Municipal League provided the following analysis.

(1) The transition to the reformed municipal GRT regime is not automatic. To receive any gross receipts tax revenues after January 1, 2018, each municipality must enact an ordinance imposing some increment of reformed municipal GRT. As the bill is written, none of these ordinances can become effective before July 1, 2018 since the tax itself does not exist until January 1, 2018. Therefore, EVERY municipality will receive NO municipal gross receipts revenue from March through August 2018, due to accrual versus distribution periods.

(2) Even assuming point (1) above is resolved, many municipalities have dedicated proceeds from one or more of their gross receipts tax impositions to the payment of bonded indebtedness, including coverage covenants. It is not clear that the revenues from the reformed municipal gross receipts tax will cover both the debt repayment obligations and the associated coverage requirements. This may force at least technical defaults.

(3) Even if the debt repayment obligations can be covered, the remainder of gross receipts tax proceeds flowing to the municipal general fund may be insufficient to even minimally fund the municipality's core functions.

(4) The problem of adequacy of revenue is compounded by two additional fiscal blows to municipalities. (a) The municipal distribution at 7-1-6.4 is subsumed into the reformed municipal GRT, as if it were another local option GRT. This revenue stream currently is a sizeable chunk of the gross receipts-derived revenues of every municipality. (b) The hold harmless distributions to local governments are summarily cut out -- and not just for the larger municipalities and counties.

(5) The repeal of these distributions makes it highly likely that total municipal tax revenues in most municipalities will be seriously eroded, threatening delivery of police, fire, justice, health, and other core functions -- even if the municipalities enact the maximum 0.5 percent tax.

(6) Section 72's attempt to assuage bondholders is not likely to succeed. Local governments are required to act. Suppose they don't. Yes, that would violate state law, but how are the bondholders protected? The pledge to hold bondholders harmless has to be seamless and cannot require local government action.

(7) Barring tax increment for development districts from pledging gross receipts tax revenues is tantamount to eliminating them as useful economic development tools for local governments. This is a sufficiently important topic that it should be debated separately, not buried inside a mammoth tax bill.

HED provided the following analysis.

Section 3-31-1 NMSA et. seq. governs the authority of municipalities to issue revenue bonds. Section 3-31-1 (J) allows municipalities to issue gross receipts tax (GRT) revenue

bonds “for the purpose of acquisition, construction, renovation or improvement of facilities of a four-year post-secondary public educational institution located in the municipality and acquisition of or improvements to land for those facilities”.

The bill strikes 3-31-1 (J) in its entirety (Page 11, Line 22 through Page 12, Line 23). While this presumably would prevent municipalities from issuing gross receipts tax revenue bonds for the purpose of capital projects related to four-year postsecondary institutions, the bill also modifies section 3-31-1 (D) to allow municipalities to issue GRT revenue bonds “for any municipal purpose” (Page 4, Line 4 and Page 6, Line 2). Moreover, 3-18-4 NMSA gives municipalities authority to construct, maintain and manage public buildings.

Pursuant to 12-1-21 NMSA; 21-13-14D NMSA; 21-14-12D NMSA; and 5.3.10 NMAC, the Higher Education Department reviews and approves all capital projects for higher education institutions prior to project initiation, irrespective of their funding source. HED is unaware of any municipally-issued GRT revenue bonds that support capital projects at public postsecondary institutions.

The Education Trust Board (ETB) manages the 529 College Savings Program for New Mexico. “529” refers to the section of the federal Internal Revenue Code that established a tax-free method for families to save for postsecondary education expenses.

Section 7-2-2(B) (4) NMSA provides two inclusions in "base income" that protect the New Mexico 529 College Savings Program. Section 35 of the bill would remove these inclusions in base income and affect New Mexico's 529 College Savings Program (Page 105, Line 25 through Page 106, Line 11).

Under 7-2-2(B) (4) (a) NMSA, base income includes amounts for which taxpayers took New Mexico income tax deductions in prior years for contributions to the 529 program and then, in the current year, rolled over their NM 529 assets into the 529 program of another state. By deleting this provision, New Mexico is supporting the 529 plan of the state receiving the rolled-over money. This results in a loss of tax revenue to New Mexico by allowing the rollover with no tax consequence.

Under 7-2-2-(B) (4) (b) NMSA base income includes amounts withdrawn from the New Mexico 529 plan and not used for "qualified education expenses" as defined by federal law. Under current law withdrawals used for higher education purposes have tax protections. The proposed deletion would provide tax protection for amounts not used for higher education expenses. This would result in lost tax revenue when withdrawals were made for non-educational purposes. Under federal law, such non-education withdrawals are subject to income tax and a ten per cent (10 percent) tax penalty.

The Economic Development Department (EDD) provided the following analysis.

Specific to EDD, the bill would eliminate significant financial attached to cities and counties, thus broadening their ability to bond for projects. This would mean a city or county could bond for any project they deem to be a municipal or county purpose. On one hand, this gives local governments much more control of their monies and could be a benefit to economic development since the city/county would not be limited to using

economic development gross receipts for projects. It could also mean that economic development gross receipts taxes could be used to build other non-economic development projects such as civic centers rather than for job-producing economic development infrastructure.

This act also eliminates the ability of the state investment officer to loan money to a film production company (at market rate) based on their estimated tax credit. This does relieve the film office of having to estimate these credits.

The bill removes the language that identifies a performing artist and personal service business provider as a pass through entity in reference to net income.

In response to a similar proposal in the 2016 regular legislative session, TRD provided the following analysis related to taxing wages through the GRT.

Including wages in the GRT tax base raises several policy issues. First, the sourcing of wages under the proposed bill may result in New Mexico residents bearing all of the tax burden, while removing a portion of the tax burden from companies that do business or perform services in New Mexico through employees that perform services in the state, but are not operating out of a New Mexico business location. For example, under the proposed bill, wages of a Texas technology company's employees for setting up a network at a facility in New Mexico may not be subject to gross receipts tax if the employer does not have a New Mexico business location. Likewise, given the higher threshold for individual income tax reporting, the Texas employees may not be required to file individual New Mexico income tax returns. While the Texas company would be subject to gross receipts tax for services performed here, the wages paid to employees may escape both gross receipts and individual income tax.

Second, the compliance burdens on taxpayers and businesses should be considered. Subjecting W-2 wages to gross receipts tax, without adjusting return due dates, would subject regular W-2 wage earners to 12 monthly gross receipts tax returns, as opposed to one annual income tax return. Additionally, while a credit is given to address progressivity under the proposed bill, the credit also requires the separate filing of a refund claim. In short, individual wage earners may be required to make 13 separate filings as a result of including W-2 wages in the tax base. There may also be administration and compliance issues with respect to the gross receipts tax withholding required for wages as many businesses will have to withhold for New Mexico taxes differently than in other states.

ADMINISTRATIVE IMPLICATIONS

The New Mexico Municipal League notes this bill significantly broadens the number of taxpayers subject to the state and local gross receipts taxes. Virtually all New Mexico working age adults will be required to register and be instructed in the art of filing gross receipts tax returns. Further, employers will have to be advised on how to withhold gross receipts tax in addition to income tax from their employees. There is no appropriation in this bill (or HB2) to fund the extraordinary outreach/training programs that TRD will have to conduct to achieve even minimal success in registrations and withholding.

TRD reported the following administrative implications.

This bill is a massive overhaul of the state’s tax code that would require significant changes in reporting requirements by taxpayers, significant restructuring and/or repeal of the New Mexico Administrative Code’s tax-related provisions, and significant changes in tax administration. It would require changes in software, forms, and publications. Through the combination of how the proposed bill defines “wages” for Gross Receipts Tax purposes and the repeal of the corporate income tax, the proposed bill may reduce the tax burdens for multistate businesses that have an economic presence in the New Mexico market, also reducing the liability of persons without physical presence in New Mexico that have less than \$100 thousand in gross receipts. This would shift that burden more exclusively to New Mexico residents and businesses. This bill would require extensive time to revise all systems, forms, instructions and publications impacted. Employees will need to be retrained and taxpayers will need to be educated.

Moderate impact to the Financial Distributions Bureau (FDB) financial distribution business processes. System changes will be required to GenTax to account for the distribution changes. FDB will need to verify GenTax system changes by performing selected tests (data, functionality, reporting (Generic Distribution Report by RA period, and CRS matrix report)), including running a mock distribution prior to authorizing GenTax to move changes to production. New funds will need to be created in the state treasury for the collection of tax revenues associated with Sections 27 and 34 of this bill. New revenue and distribution accounts will also need to be created in SHARE for Sections 27, 33 and 34. FDB would need to obtain the beneficiaries accounting string (fund, account, subaccount, budget reference and classification) for sections 27, 33 and 34 to distribute the gross receipts tax. FDB testing would need to be completed by December 15, 2017. Estimate 100 hours of FDB staff time to complete testing. No additional FTE required.

Extremely high impact on RPD of \$219 thousand. The costs associated with revising forms, instructions, and publications could top \$157 thousand for 2 FTE analyst writers/editors and 0.5 FTE manager writer/editor. Subject matter tax experts for the affected tax programs would be required to review and consult on document changes at a cost of \$50.4 thousand (0.25 FTE each for the equivalent of four experts during one year) and to help build and test updates in GenTax and TAP at a cost of \$11.6 thousand. This includes helping build and testing updates required in tax tables due to rate changes and related business rule changes.

CONFLICT

This bill conflicts with a variety of bills that make changes to the tax code.

TECHNICAL ISSUES

The title should contain “making an appropriation”. Section 34 of the bill creates a fund and appropriates revenue to the State Parks Division of the Energy, Minerals and Natural Resources Department for improvements and maintenance of lakes and boating facilities.

Sections 31 and 51 contain drafting errors by referring to GRT as sales tax.

Section 48 appears to have a drafting error – the revenue estimate should be for the following fiscal year; additionally, the bill assumes the estimate can fall exactly within the specified range and does not provide for what should happen if it falls outside the range – perhaps it would be better to provide a single GRT rate TRD should use as a target. Furthermore, implementing a new rate on July 1 after determining the revenue estimate by May 1 is a very short period of time for the department and everyone in the state affected by the change to update forms, computer systems, etc. It may be far easier to implement the change if the revenue estimate used was the one provided during the regular legislative session.

Large, complex bills such as this increase the possibility for errors to be introduced in either drafting or in theory regarding implementation and effects. New Mexico has experienced such errors before in far smaller bills that had serious negative consequences for the general fund, such as a prior attempt to “fix” the high-wage jobs tax credit that created a new loophole, leading to costs rising by more than an order of magnitude. The significant number of interactive effects in this bill could have unanticipated consequences that could lead to revenue shortfalls for the state and local governments or unanticipated tax increases for certain groups of taxpayers.

TRD reported the following technical issues.

Gross Receipts Tax Changes:

Repeal of exemptions/deductions/credits: Unless a particular exemption, deduction, or credit was enacted to codify a constitutional or federal prohibition against state taxation, exemptions, deductions, and credits are matters of legislative grace. There may be instances, however, on particular facts where a taxpayer was enticed to locate a business in New Mexico in reliance on the availability of certain credits, deductions, or exemptions, and in which a taxpayer could conceivably, though not necessarily successfully, challenge the repeal on equitable estoppel grounds.

Including “wages” in the tax base:

Including wages in the GRT tax base raises several policy issues. First, the sourcing of wages under the proposed bill under Section 7-1-14(E) NMSA 1978 may result in New Mexico residents bearing all of the tax burden, while removing a portion of the tax burden from companies that do business or perform services in New Mexico through employees that perform services in the State, but are not operating out of a New Mexico business location. For example, under the proposed bill, wages of a Texas technology company’s employees for setting up a network at a facility in New Mexico may not be subject to gross receipts tax if the employer does not have a New Mexico business location. Likewise, given the higher threshold for individual income tax reporting, the Texas employees may not be required to file individual New Mexico income tax returns. While the Texas company would be subject to gross receipts tax for services performed here, the wages paid to employees may escape both gross receipts and individual income tax.

Second, the compliance burdens on taxpayers and businesses should be considered. Subjecting W-2 wages to gross receipts tax, without adjusting return due dates, would subject regular W-2 wage earners to 12 monthly gross receipts tax returns, as opposed to one annual income tax return. Additionally, while a credit is given to address

progressivity under the proposed bill, the credit also requires the separate filing of a refund claim. In short, individual wage earners may be required to make 13 separate filings as a result of including W-2 wages in the tax base. There may also be administration and compliance issues with respect to the gross receipts tax withholding required for wages as many businesses will have to withhold for New Mexico taxes differently than in other states.

Repealing the Corporate Income Tax:

The proposed bill repeals the corporate income tax, but makes no amendments to New Mexico's Uniform Division of Income for Tax Purposes Act (UDITPA). While the allocation and apportionment provisions of UDITPA expressly apply to individual income taxpayers that have sources of income both within and outside the State, some technical changes to UDITPA may be necessary since that act was drafted to apply to apportioning corporate income.

Another potential policy issue with repealing the corporate income tax (CIT) is the extent to which New Mexico wants to tax or immunize multistate or out-of-state businesses that exploit New Mexico customers or that derive income from New Mexico's sources. There may be numerous circumstances in which an out-of-state taxpayer has New Mexico customers, but could avoid gross receipts tax (based on a lack constitutional nexus) and would be immune from corporate income taxation as a result of the repeal.

Individual Income Tax:

The differing income thresholds between single individuals and married individuals filing separately may, on certain facts, raise equal protection issues. Additionally, as a policy matter, the proposed bill eliminates certain types of income, such as net rents and gifts, from "modified gross income." With net rents excluded, the proposed bill may preclude taxation of individuals that earn substantial income from rents on real property from taxation.

Amnesty:

This bill provides for an amnesty program that applies to all tax programs. We currently have a managed audit program that can act as an amnesty, and is much less costly to implement.

One-year refund and credit limit:

Changing the statute of limitations to claim a refund or credit from within three years to "prior to the end of the calendar year in which: (a) the payment was originally due or the overpayment resulted from an assessment by the department pursuant to section 7-1-17 NMSA 1978, whichever is later:" This bill would impact the oil and gas industry adversely. The statute would not allow sufficient time for taxpayers to claim a credit or refund in the following scenarios: an assessment issued and paid in error, amend a return which would result in a credit then request a refund, and an audit resulting in a credit, if the transaction was processed during the last month of the year. The taxpayer remedies (FYI 402) allow the taxpayer the option to protest the denial of a refund or credit which would greatly impact the TRD Protest Unit based on the scenarios presented.

Transition for tax credit repeals:

Tax credits are repealed in this bill, but the bill includes no transition rules. For example, can taxpayers apply any carry-forwards to future taxes? Historically, this is problematic.

OTHER SUBSTANTIVE ISSUES

TRD provided the following additional analysis.

Implementing the changes proposed in SB123 bill would have an extremely high impact on the Information Technology Division (ITD) \$2,143,600. Given current TRD resource constraints, the costs of implementing this proposal cannot be absorbed by the agency. An appropriation would be required. The ITD impacts are discussed in more detail immediately below.

Impact on Tax Systems:

- Implementing the proposed tax related changes in the bill will have an extremely high impact requiring approximately 3,000 hours or nineteen months of effort for an estimated cost of \$210,000 as many changes, to multiple tax programs and subsystems will have to be made to GenTax, the tax system of record for New Mexico. This effort will require several state development resources, business resources as well as contract resources from FAST Enterprises, LLC to work together to implement all the changes proposed in this bill. The resources needed from FAST Enterprises, LLC include one full-time revenue expert, one full-time financial resource and potentially one testing resource, each at \$100,000 per quarter or \$400,000 per year. The estimated cost for 3 FAST resources for 19 months is approximately \$1,900,000. Due to the number and complexity of these changes, extensive testing would also be required.
- In consideration of the effort noted above, an effective date of January 1, 2018 for the provisions in Sections 1 through 76 and January 1, 2019 for Section 77 is not feasible. An amended effective date of January 1, 2019 for the provisions in Sections 1 through 76 and January 1, 2020 for section 77 is recommended.

Impact on Motor Vehicle Division (MVD) Systems:

- Repealing of Motor vehicle excise tax will require changes to the motor vehicle Issuance and titling processes, fees, business rules, and distributions.
- Updated requirements will need to be detailed and implemented for vehicle titling and registration process and training documents.
- Additionally it requires complete system testing of vehicles and financial distribution modules.
- Estimated time to complete, test and implement changes in the MVD Systems is estimated at 480 hours or 3 months with an estimated cost of \$33,600.

Does the bill meet the Legislative Finance Committee tax policy principles?

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

Does the bill meet the Legislative Finance Committee tax expenditure policy principles?

1. **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.
2. **Targeted:** The tax expenditure has a clearly stated purpose, long-term goals, and measurable annual targets designed to mark progress toward the goals.
3. **Transparent:** The tax expenditure requires at least annual reporting by the recipients, the Taxation and Revenue Department, and other relevant agencies.
4. **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.
5. **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.
6. **Efficient:** The tax expenditure is the most cost-effective way to achieve the desired results.

JC/jle/al