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F I S C A L I M P A C T R E P O R T

SPONSOR: Tripp DATE TYPED: 2/20/03 HB 575

SHORT TITLE: Repeal State Portion of Food Tax SB

ANALYST: Smith

REVENUE

Estimated Revenue				Recurring or Non-Rec	Fund Affected
FY04	**FY05**	**FY06**	**FY07**		
(13,300.0)	(28,100.0)	(43,500.0)	(59,400.0)	Recurring	General Fund
See Fiscal Narrative	*	*	*	Recurring	Local Governments

(Parenthesis ( ) Indicate Revenue Decreases)

SOURCES OF INFORMATION

Responses Received From

TRD

SUMMARY

Synopsis of Bill

House Bill 575 provides a credit against the state's share of gross receipts tax on receipts from sales of food for home consumption. The credit is phased in 25% increments over four years (fully phased-in by FY 2007). The full amount of the credit is equal to 5% for transactions occurring outside municipalities and 3.275% for transactions occurring within municipal boundaries. This will effectively limit the gross receipts tax on food to the local government portion, which varies from as little as 0.125% in some unincorporated areas to as much as 3.725% in some municipalities, depending on the local options imposed. Sections 7-1-6.4 NMSA 1978 (1.225% state-shared gross receipts tax receipts to municipalities) and 7-1-6.16 NMSA 1978 (county equalization distributions) are amended to maintain local government revenues at the same level as under present law.

For the purposes of the bill, "food" and "retail food store" are defined by reference to the federal food stamp program. According to program definitions, "food" includes most staple grocery food items and cold prepared foods packaged for home consumption. Specifically excluded from the definition of food for home consumption are alcoholic beverages, tobacco, and prepared hot foods sold for immediate consumption. "Retail food store(s)" must meet one of two criteria specified in the federal act. Under the first criterion, a retail food store must stock and offer for sale a variety of foods on a continuous basis in each of the four defined staple food categories, with perishable foods in a least two of those categories. Under the second criterion, more than 50 percent of a retail food store's total gross retail sales must be in staple foods. The purpose of the second criterion is to encompass legitimate food retailers that may specialize in specific types of food, such as fish, meat, poultry or produce.

FISCAL IMPLICATIONS

TRD constructed the estimate as follows:

- The 1997 Economic Census provides data at the national level on the proportion of total sales by various industry groups that is derived from sales of food for home consumption.
- Total retail sales in New Mexico for each of these industries were identified using the 1997 Census of Retail Trade in New Mexico.
- The proportion of sales attributable to food from step (1) were then applied to the 1997 retail sales figures.
- Growth patterns for the industry groups in New Mexico were derived from the Report-80 and applied to the 1997 figures in order to estimate FY 2002 (and subsequent years') applicable food sales. Using this method, the growth rate of New Mexico food expenditures has been estimated to be about 1.7% per year.
- USDA estimates of FY 2002 New Mexico food stamp program benefits (approximately $154 million) were subtracted from the taxable base because these sales are already exempt.

*Amendments to local government distributions are made which are intended to maintain local government gross receipts tax revenue at the same level as under current law. ***However, it is absolutely critical that food retailers report the exact amount of all food tax credits attributable to each location.*** If all food retailers report credits correctly, the provisions contained in this bill will accomplish this goal. However, as with most changes in tax law, reporting behavior can be irregular. The actual impact on a specific local government's gross receipts tax revenue is unpredictable.

ADMINISTRATIVE IMPLICATIONS

TRD notes a host of administrative issues:

- Reprogramming the system to track the credits by location is possible. However, the department is in the process of converting to a new computer system for processing gross receipts tax. The changes required by this bill would have to be implemented in the new system. This system is currently scheduled to become operational in October 2003. Thus, it is unlikely the department will be able to implement the changes by the July 1, 2003 effective date specified in this proposal. An effective date of January 1, 2004 should give the department enough time to incorporate the changes.

- Forms will need to be redesigned to accept and track the new credit. Taxpayer education efforts will be greater than for normal changes. For effective administration of local distributions, taxpayers must separately calculate and report the credits claimed for each business location. This would create an additional layer of administrative complexity, not only for the department, which must track the credits and incorporate them into monthly local distribution calculations, but also for larger food retailers who may report gross receipts to several different locations.
- Ensuring that retailers apply the credit only for qualified food sales might be a problem. While most retailers are likely to claim only legitimate credits, it will be almost impossible to identify those who don't. Typically when examining retail businesses with large sums of cash flowing through, auditors have only cash register tapes with no (or very cryptic) descriptions of purchases at their disposal.
- No state administers a sales tax exemption for food without litigation, protest and controversy. The definitional problems are acute and continuing. Fortunately, New Mexico can adopt other state's regulations to create better "bright lines". The Department will undoubtedly still face a significant regulatory effort however.
- Provisions contained in the bill may add another layer of complexity for taxpayers who do not currently participate in the federal food stamp program, especially for smaller retailers who may lack computer pricing and scanning technology.

OTHER SUBSTANTIVE ISSUES

TRD makes the following tax policy arguments:

- A couple of provisions of current law mitigate to some extent the regressive impacts of the GRT on food: One is the exemption allowed for food purchased with food stamps. 66,000 low-income families in New Mexico, with 170,000 persons, are food stamp recipients. Receipts from food purchased with food stamps (approximately $154 million in FY 2002) are already exempt from gross receipts. The other mitigating provision is the Low Income Comprehensive Tax Rebate (LICTR) which is intended to offset to some degree the regressive impacts of the GRT. LICTR is a refundable credit of up to $450 per year for households with income of less than $22,000.
- There is no guarantee that tax savings from the partial credit for food sales will be passed-on to consumers. A refundable income tax credit is a much more efficient and reliable means for targeting tax relief to a specific group of taxpayers than a cumbersome partial credit mechanism. If the benefit is passed on to the consumer, the consumer will still pay tax at the register, but at a reduced rate from that of other purchases. This scenario may present a significant compliance burden to retail grocers.
- Food expenditures historically are a very stable component of consumption. Gross receipts tax collections from food may help dampen volatility of state tax revenue collections. Over the last ten years, gross receipts tax collections on food have grown at a stable 1.7% compound rate per year.
- A broad gross receipts tax base helps to limit the tax rate. Thus, cutting the base by an industry this large shifts a noticeable amount of tax burden to remaining taxpayers.

SS/njw