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

SPONSOR HTRC **ORIGINAL DATE** 2/11/06 **LAST UPDATED** 2/16/06 **HB** 82, 128, 144. 295, 380, 390, 395, 424, 440, 441, 448, 455, 465, 501, 603, 674/HTRCS/aHFl#1/aHFl#2/aSFC/aSFL#1/aSFL#2/aSFL#3/aSFL#4

SHORT TITLE Navajo Nation Electric Compensating Tax Credit **SB**

ANALYST Francis/Schardin

APPROPRIATION (dollars in thousands)

Appropriation		Recurring or Non-Rec	Fund Affected
FY06	FY07		
	960.0	Recurring	State Aviation Fund

(Parenthesis ( ) Indicate Expenditure Decreases)

REVENUE (dollars in thousands)

Estimated Revenue			Recurring or Non-Rec	Fund Affected
FY06	FY07	FY08		
(31,982.0)	(62,586.9)	(77,317.8)	Recurring	General Fund
	(853.9)	(1,075.9)	Recurring	Local Govern-ments
	(16.0)	(13.7)	Recurring	Road Fund
	(320.3)	(642.3)	Recurring	Small Cities Assistance Fund
	(320.3)	(642.3)	Recurring	Small Counties Assistance Fund
	(2.2)	(1.9)	Recurring	Municipalities and Counties
	(1.2)	(1.2)	Recurring	County Gov. Road Fund
	(1.2)	(1.2)	Recurring	Municipal Road Fund
	(0.3)	(0.3)	Recurring	Municipal Arte-rial Fund
	960.0	2,004.0	Recurring	State Aviation Fund
	562.5	1,125.0	Recurring	Tribal Infra-structure Fund

(Parenthesis ( ) Indicate Expenditure Decreases)

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY06	FY07	FY08	3 Year Total Cost	Recurring or Non-Rec	Fund Affected
Total		330.0	330.0	660.0	Recurring	General Fund
		200.0		200.0	Non-Recurring	General Fund

(Parenthesis ( ) Indicate Expenditure Decreases)

SOURCES OF INFORMATION
LFC Files

Responses Received From
Taxation & Revenue Department (TRD)

SUMMARY

Synopsis of SFl Amendments

Senate Floor amendment #1 corrects a drafting error contained in the Senate Finance Committee amendment relating to the Navajo Nation electric compensating tax credit.

Senate Floor amendment #2 creates a tax credit for livestock owners whose livestock is destroyed by predatory animals.

Senate Floor amendment #3 increases the amount of the Working Families Tax Credit from 5 percent of the federal earned income tax credit (EITC) to 20 percent of the federal EITC.

Senate Floor amendment #4 adds social workers to the list of health practitioners that will become eligible for the expanded health care practitioner gross receipts tax deduction.

Synopsis of SFC Amendment

Navajo Nation Electric Compensating Tax Credit
The amendment would create a distribution to the tribal infrastructure project fund in the amount of 15 percent of compensating tax collections from the Desert Rock coal facility targeted in the Navajo Nation Electric Compensating Tax Credit. The amendment also reduces the amount of tax credit that may be claimed from 85 to 70 percent of the coal facility's compensating tax liability.

The fiscal impact of this provision has been corrected to reflect new analysis. It is now believed that the provision will reduce general fund revenue by about $4.5 million in FY08. This increase in fiscal impact is not related to the SFC amendments.

Advanced Energy Product Credit
This is amended to clarify that a taxpayer can only claim the credit if they have not claimed credits for the same expenditures pursuant to the Investment Credit Act, the Technology Jobs Tax Credit Act or the renewable energy production tax credit.

Working Family Credit
The amendment decreases the percentage of federal Earned Income Tax Credit to 5 percent. The current proposed Working Family Credit is for 7.5 percent of the federal EITC.

Delayed Repeals
All provisions in sections 15 through 22 and 30 are repealed effective January 1, 2015.

Underground Irrigations GRT deduction
This amendment sets the effective date to be July 1, 2006 rather than July 1, 2007.

Incorrect Reporting Penalty
The penalty for incorrect reporting for the food and medical deduction from gross receipts is changed to be a 15 percent penalty of the difference of the over-reporting or misreporting of the deduction and the correct deduction. Misreporting happens when the deduction is not attributed to the food and medical deduction line on the CRS-1 forms. There is no penalty for underreporting the deduction.

Department of Health Hospital Phased Gross Receipts Credit
The amendment extends the phase-in of the for-profit hospital tax credit to three years from the two year schedule included in HB82. One-third of the credit would be available in FY07, two-thirds in FY08 and the entire credit in FY09 and beyond.

Underground Irrigation Tool Gross Receipts
This would make this provision effective July 1, 2006, rather than July 1, 2007, as it is in HB 82. This conforms to SB 46, which has already passed the Senate.

Employer-sponsored Health Insurance Credit.
This amendment introduces a provision that amends the Income Tax Act and the Corporate Income and Franchise Tax Act by providing a credit for employers with an average of 10 or fewer employees during the tax year for which the credit is claimed who provide health insurance to their employees and who have not provided health insurance in the last twelve months. The credit is for 5 percent of the premiums paid by the employer for the employees' health care and is refundable meaning that if the credit exceeds tax liability, the remainder is refunded to the taxpayer. A taxpayer can only receive the credit for four years. Effective date: January 1, 2006.

Property Sales Subject to GRT
This addresses the recent NM Supreme Court decision in the Kmart case and allows the state to collect those revenues that the decision declared improperly collected. The amendment clarifies the definition of "property" to exclude trademarks, copyrights, and patents. This conforms to SB 590 as amended by Senate Corporations and Transportation Committee. TRD will have the responsibility of promulgating rules and regulations to clearly define "property" as it is intended here.

Renewable Energy Production Tax Credits
The amendment makes several changes to the Renewable Energy Production Tax Credit. The amount of the credit for solar energy is increased from 1 to 2 cents for the first 200 thousand megawatt hours of production, and the amount of generating capacity a facility must have to claim the credit is reduced from 10 to 1 megawatt. The amendment also creates a new renewable

energy production tax credit that can be claimed against the personal income tax. The existing renewable energy production tax credit may only be claimed against corporate income tax. All provisions of the new personal income tax credit mirror the existing corporate income tax credit. The amendment also provides that both the personal and corporate income tax credits will be allowed to be carried forward up to 10 years, rather than the current five years. These provisions will become effective on January 1, 2008.

The amendment contains a technical issue: the definitions of "biomass materials" will be different between the corporate income tax credit and the personal income tax credit.

Synopsis of HFl Amendment #1

House Floor Amendment #1 to the House Taxation and Revenue Committee substitute for House Bill 82 changes the effective dates of many provisions in the bill. The original bill synopsis has been edited to reflect these new effective dates.

Synopsis of HFl Amendment #2

House Floor Amendment #2 to the House Taxation and Revenue Committee substitute for House Bill 82 relates to the business services tax credit found in Sections 7 and 29. The amendment reduces the total receipts a business may have per year and still be eligible for the credit from $1 million to $300 thousand. It also removes language that would have prevented research and development services from receiving the credit.

Synopsis of Substitute Bill

The House Taxation and Revenue Committee substitute for House Bill 82 combines several tax bills into one omnibus bill. Note that effective dates were changed for some of these provisions. Each provision of this omnibus bill is summarized below:

Navajo Nation Electric Compensating Tax Credit
This section creates the intergovernmental compensating tax credit, which may be claimed by a taxpayer who has a compensating tax liability from construction or operation of a coal-fired electric generating facility on Navajo Nation land, so long as construction of the facility commences before December 31, 2007.

The amount of the credit shall be 85 percent of compensating tax liability from the construction or operation of the coal facility. The total amount of the credit for the construction and lifespan of each coal facility is capped at $60 million. Effective date: July 1, 2006.

Advanced Energy Product Tax Credit Act
This section creates the Advanced Energy Product Manufacturers Tax Credit for businesses that manufacture advanced energy products, which are defined as motor vehicles propelled in whole or in part by electricity, fuel cell systems, renewable energy systems, or any component of hybrid vehicles, fuel cell systems, renewable energy systems, or clean coal technologies.

A credit of up to 5 percent of a taxpayer's expenditures on advanced product manufacturing equipment may be deducted from a taxpayer's total liability from state gross receipts tax, compensating tax, withholding tax, interstate telecommunications gross receipts tax, 911 emergency surcharge, network and database surcharge, and telecommunications relay service surcharge. Any unused tax credit may be carried forward for three years.

To qualify for the credit, the manufacturer must employ at least one more full-time employee than in the previous year for every $500 thousand of equipment expenditures up to $30 million, and at least one more full-time employee than in the previous year for every $1 million of expenditures over $30 million. Existing employees can count toward the employment requirements if the taxpayer trained the existing employee, or the employee was hired to use the qualified equipment.

Advanced energy product manufacturers may apply for the credit any time within the calendar year following the calendar year in which they purchased qualified manufacturing equipment. If a taxpayer who receives this credit ceases operations in New Mexico for 180 or more consecutive days within two years after applying for the credit, the taxpayer rights to the credit and must pay all taxes for which the credit was awarded. Effective date: July 1, 2006.

Oil and Gas Produced Water Credits
This section reinstates a credit for produced water, a by-product of oil and natural gas drilling, delivered to the Pecos River. The credit was repealed effective January 1, 2006.
The credit is $1,000 per acre-foot of produced water, not to exceed $400,000 per year. It is applicable to either personal or corporate income tax liability.

The oil or gas well operator must deliver the water to the interstate stream commission (ISC) in compliance with all ISC and federal quality standards. Effective date: January 1, 2006.

Solar Market Development Income Tax Credit
This section creates a new credit against personal income tax liability for the purchase and installation of a solar thermal or photovoltaic system in a residence, business or agricultural enterprise. The credit is equal to 30 percent of the cost of the system less applicable federal tax credits up to a maximum of $9,000 and may be carried forward up to 10 years. Also included is a sunset date of 2015 on an eligible purchase. The total amount of credits available is $5 million: $2 million for solar thermal systems and $3 million for photovoltaic systems. Effective date: January 1, 2006.

Incorrect Gross Receipts Reporting Penalty
This section changes the penalty for incorrect reporting of food and medical gross receipts tax deductions. Current law sets the penalty at twice the difference of the correct deduction and the incorrectly reported deduction. That would change to just the difference up to $10 thousand. Effective date: July 1, 2006.

Biomass-Related Material Tax Deduction
This section amends the renewable energy production tax credit by changing the definition of “biomass” to match the definition for “biomass material” found in Section 7-9-98 NMSA 1978, which provides a compensating tax deduction for biomass equipment and materials.

The bill amends the existing compensating tax deduction found in Section 7-9-98 NMSA 1978 to include equipment for harvesting, transportation, composting or mulching. The bill also creates a new deduction from the gross receipts tax for biomass equipment and materials to match the amended compensating tax deduction in Section 7-9-98 NMSA 1978.

The bill repeals amendments to the credit that were included in the omnibus tax bill of 2005 (HB410) because they were signed one day before HB950, which contained identical amendments to the renewable energy production tax credit. Effective date: July 1, 2006.

Increase Penalty for Failure to Pay Taxes
This section increases the penalty for failure to pay taxes to match the IRS guidelines in setting punitive and overpayment rates. The baseline is the federal funds rate. The maximum penalty is increased from 10 percent to 16 percent. Effective date: July 1, 2007.

Health Care Practitioner Gross Receipts
This section expands a gross receipts tax deduction for the receipts of certain health care practitioners from third-party administrators of Medicare and the federal TRICARE program. The deduction would be expanded to include doctors of oriental medicine, athletic trainers, chiropractic physicians, counselor and therapist practitioners, dentists, massage therapists, naprapaths, nurses, nutritionists, dieticians, occupational therapists, optometrists, pharmacists, physical therapists, psychologists, radiologic technologists, respiratory care practitioners, audiologists, and speech-language pathologists. Effective date: July 1, 2006.

Laboratory & Small Business Tax Credits
This section expands the existing laboratory partnership with small business tax credit. The bill increases the credit that a national laboratory may claim for assistance to a small business in a rural area from $5 to $10 thousand per year, and increases the credit that a national laboratory may claim for assistance to each small business in a non-rural area from $10 to $20 thousand per year. The total amount of credits that can be claimed by a national laboratory is increased from $1.8 to $2.4 million per year.

The proposal expands eligibility requirements for claiming the laboratory partnership with small business tax credit. To be eligible for the credit, the national laboratory providing small business assistance will be required to 1) offer each small business receiving assistance the option of obtaining ownership of license to property developed through the assistance; 2) acknowledge that the small business assistance is rendered only after it is completed; and 3) provide forms for small business assistance requests and for completion of small business assistance that are in accordance with state and federal laws.

The bill will also require national laboratories claiming this credit to submit an annual report to TRD by October 15 of each year if only one national laboratory claims the credit, or to TRD, EDD and the appropriate interim legislative committee if more than one national laboratory claims the credit. The annual report will summarize program results, describe projects funded, provide survey results, quantify the total amount of credits claimed, and include an economic impact study of jobs created and retained. TRD will be required to track credits claimed by national laboratories by the small business assisted to ensure that credits awarded are associated with specific small business assistance requests.

Finally, if more than one national lab claims the credit, those labs will be required to coordinate their efforts. Effective date: July 1, 2006.

Aviation Division Collection Reversions
This section creates a new distribution to the state aviation fund from gross receipts tax revenue that would otherwise go to the general fund. This distribution will be $80 thousand per month FY07, $167 thousand per month in FY08, and $250 thousand per month in FY09 and beyond. These distributions will be used for planning and program administration, construction, equipment, materials and maintenance of a system of airports, navigation aids and related facilities. Effective date: July 1, 2006.

Underground Irrigation Tool Gross Receipts
This section expands the definition of agricultural implements that receive a 50 percent deduction from gross receipts tax to include above and below-ground produce irrigation systems that are used where produce is grown. Effective date: July 1, 2007.

School Bus Gas Tax Deduction
This section amends the Gasoline Tax Act to allow school buses contracted with the Public Education Department (PED) or a public school district to deduct the amount of gasoline excise tax they currently

pay. The claim by a school bus operator can be filed quarterly and for no less than one hundred gallons. Effective date: July 1, 2006.

Working Families Tax Credit
This section amends the Income Tax Act to provide a Working Family Credit (WFC) for tax filers with earned income. The WFC is equal to 7.5 percent of the existing federal Earned Income Tax Credit (EITC). It is a refundable credit meaning that if it exceeds the tax liability of the tax filer, the balance is refunded to the filer. A tax filer can take advantage of this credit or the Low Income Tax Comprehensive Tax Rebate (LICTR) but not both. Effective date: January 1, 2006.

Business-Related Service Gross Receipts
This section creates the business services tax credit. The credit may be claimed against the state gross receipts tax or compensating tax. A credit that exceeds a taxpayer's tax liability may be carried forward for up to three years.

The credit on "qualified expenditures" will equal 3.775 percent of gross receipts in municipalities and 5 percent in unincorporated areas of New Mexico counties.

The credit would be available for business expenditures that are deductible when calculating net income according to Section 162 of the Internal Revenue Code (IRC). This section states that all ordinary and necessary expenses paid or incurred in the course of business may be deducted, including a reasonable allowance for salaries and compensation, travel expenses, rentals or other payments used for business, and capital contributions to the Federal National Mortgage Association. Some items that will not be eligible for the business services tax credit are charitable contributions, illegal bribes and kickbacks, lobbying and political expenditures, application and dues of tax-exempt organizations, fines or penalties, damage payments under antitrust laws, foreign advertising, stock reacquisition expenses, and group health plan payments. However, qualified expenditures will not include services for linen supply, entertainment or recreation, intrastate telephone and telegraph, janitorial, landscaping, repair and maintenance, sewer and solid waste disposal, or services whose price is eligible for any other New Mexico tax credit.

Taxpayers eligible for the business services tax credit include anyone liable for payment of any tax or anyone who owes a tax. The business will also be required to have total receipts of less than <u>$300 thousand</u> per year to qualify for the credit. Governmental entities, nonprofit facilities and other entities that are exempt from the gross receipts tax such as retirement homes and insurance companies are not eligible to receive the credit. Effective date: January 1, 2007.

Clinical Laboratory Service Gross Receipts
This section expands the list of health practitioners who receive a gross receipts tax deduction for receipts from managed care providers, commercial health insurers and Medicare part C to include accredited clinical laboratories not located in a physician's office or hospital. Clinical laboratories were not included in 2004 legislation that made many other health provider receipts deductible from gross receipts tax. Effective date: July 1, 2007.

Department of Health Hospital Phased Gross Receipts Credit
This section provides a gross receipts tax credit for hospitals licensed by the Department of Health (for-profit hospitals). The credit equals one half of the state gross receipts tax rate in FY07 and the entire state gross receipts tax rate in FY08 and beyond. Effective date: July 1, 2006.

FISCAL IMPLICATIONS

Table 1: Summary of Fiscal Impacts

Recurring Appropriation Impacts

		FY06	FY07	FY08	
HB441	AVIATION DIVISION COLLECTION REVERSIONS	-	960.0	2,004.0	State Aviation Fund
	TOTAL APPROPRIATION IMPACTS	**-**	**960.0**	**2,004.0**	

Recurring Revenue Impacts

		FY06	FY07	FY08	
HB82 a SFL#1	NAVAJO NATION ELECTRIC GENERATING CREDIT	-	(2,235.0)	(5,100.0)	General Fund
		-	562.5	1,125.0	Tribal Infrastructure Project Fund
		-	(318.8)	(637.5)	Small Cities Assistance Fund
			(318.8)	(637.5)	Small Counties Assistance Fund
HB128	ADVANCED ENERGY PRODUCT TAX CREDIT ACT	-	(175.0)	(193.0)	General Fund
		-	(25.0)	(28.0)	Local Governments
HB144	OIL & GAS PRODUCED WATER TAX CREDITS	-	(0.3)	(0.3)	General Fund
HB295	SOLAR MARKET DEVELOPMENT	(352.3)	(655.5)	(1,234.0)	General Fund
HB380	INCORRECT GROSS RECEIPTS	-	(130.0)	(130.0)	General Fund
		-	(0.9)	(0.9)	Local Governments
HB395	BIOMASS-RELATED MATERIAL TAX DEDUCTION	-	(200.0)	(240.0)	General Fund
		-	(130.0)	(130.0)	Local Governments
HB390	INCREASE PENALTY FOR FAILURE TO PAY TAXES	-	-	(490.0)	General Fund
		-	-	(180.0)	Local Governments
HB424 a SFL#4	HEALTH CARE PRACTITIONER GROSS RECEIPTS	-	(716.0)	(774.0)	General Fund
		-	(477.0)	(516.0)	Local Governments
HB440	LABORATORY & SMALL BUSINESS TAX CREDITS	-	(600.0)	(1,200.0)	General Fund
HB441	AVIATION DIVISION COLLECTION REVERSIONS	-	(960.0)	(2,004.0)	General Fund
			960.0	2,004.0	State Aviation Fund
HB448	UNDERGROUND IRRIGATION TOOL	-	(331.0)	(331.0)	General Fund
		-	(221.0)	(221.0)	Local Governments
HB455	SCHOOL BUS GAS TAX DEDUCTION	-	(16.0)	(13.7)	State Road Fund
		-	(2.2)	(1.9)	Municipalities and Counties
		-	(1.2)	(1.2)	County Government Road Fund
		-	(1.2)	(1.2)	Municial Road Fund
		-	(0.3)	(0.3)	Municipal Arterial Fund
		-	(0.1)	(0.1)	State Aviation Fund
		-	(0.0)	(0.0)	Motor Boat Fuel Fund
		-	11.6	10.0	General Fund
		-	1.5	1.2	Small Cities Assistance Fund
		-	1.5	1.2	Small Counties Assistance Fund
HB465 a SFL#3	WORKING FAMILIES TAX CREDIT	(30,018.1)	(61,086.9)	(63,224.9)	General Fund
HB501	BUSINESS-RELATED SERVICE GROSS RECEIPTS	-	(1,500.0)	(3,300.0)	General Fund
		-	(3.0)	(6.0)	Small Cities Assistance Fund
		-	(3.0)	(6.0)	Small Counties Assistance Fund
HB603	CLINICAL LABORATORY SERVICE GROSS RECEIPTS	-	-	(540.8)	General Fund
	PROPERTY SALES AS GROSS RECEIPTS		13,000.0	13,455.0	General Fund
HB674	DEPT. OF HEALTH PHASED GROSS RECEIPTS CREDIT	-	(3,760.6)	(8,047.6)	General Fund
SB544	EMPLOYER SPONSORED HEALTH CARE	(200.0)	(425.0)	(450.0)	General Fund
SFL#2	LIVESTOCK KILLED BY PREDATORY ANIMALS CREDIT	(1,411.6)	(2,823.2)	(2,823.2)	General Fund
SB469	RENEWABLE ENERGY PRODUCTION TAX CREDIT	-	-	(700.0)	General Fund
	TOTAL REVENUE IMPACTS	**(31,982.0)**	**(62,579.7)**	**(76,567.7)**	

Estimated Additional Operating Budget Impact

		FY06	FY07	FY08	
HB440	LABORATORY & SMALL BUSINESS TAX CREDITS		100.0	100.0	General Fund- Recurring
HB295	SOLAR MARKET DEVELOPMENT		30.0	30.0	General Fund-Recurring
HB501	BUSINESS-RELATED SERVICE GROSS RECEIPTS	-	200.0	200.0	General Fund- Recurring
			200.0		General Fund- Nonrecurring

Navajo Nation Electric Compensating Tax Credit

Assuming that Sithe will owe about $7.5 million of compensating tax per year, the general fund is expected to lose about $5.1 million, and the small cities and counties assistance funds are expected to lose about $638 thousand per year. The tribal infrastructure project fund is expected to receive about $1.1 million per year due to the distribution created in Senate Floor amendment #1.

Advanced Energy Product Tax Credit Act
TRD assumes that investments eligible for the new tax credit will total $4 million each year. With a gross receipts tax of 5 percent, this means credits will total $200 thousand per year. TRD anticipates that tax liability for claimants of the credit will be large enough to absorb the entire $200 thousand. The credit will primarily impact the general fund, but several other funds will experience small impacts. Overall, general fund revenue will be reduced by about $175 thousand and local government revenue will be reduced by about $25 thousand.

The SFC amendment stipulates that the taxpayer cannot claim credit for expenditures if those expenditures have been used to claim other credits pursuant to the Investment Credit Act, the Technology Jobs Tax Credit Act or the renewable energy production tax credit

Oil and Gas Produced Water Credits
TRD reported in 2005 that the total credits issued since the bills inception in 2002 has been $300 thousand. Several matters have impeded the adoption of this credit by operators. Since they appear to require significant legal issues involving the control, ownership and transmission of water resources in the Pecos River Compact, it seems unlikely that the credits will be used to any further extent in the near future. Should legal and technical issues be resolved, the credit could reach as high as $2.4 million, assuming six companies near the Pecos River qualify for the maximum credit.

Solar Market Development Income Tax Credit
In FY06, the amount claimed against income taxes is estimated to be $352 thousand, with $180 thousand for photovoltaics and $172 thousand for solar thermal. In FY07, the amount claimed will almost double in size as more people take advantage of the credit and the industry matures. The reduction in revenues will be $655 thousand in FY07 and $1.2 million in FY08. It is assumed that all of the credits will be used since there has been an extraordinary degree of interest in developing renewable sources and the combination of this credit and the federal credit of $2,000 makes the purchase and installation much more affordable. Additional budget impacts include ½ FTE for TRD to coordinate with EMNRD on the credit process. This is estimated to cost $30 thousand based on the FTE cost of a typical TRD employee.

Incorrect Gross Receipts Reporting Penalty
Total collections of penalties are approximately $100,000 per year. An additional $400,000 is currently protested. Experience suggests that a substantial portion of the latter amount will be abated. Thus, total collections are uncertain but probably about $200,000 to $300,000 per year. The proposal would reduce these substantially by eliminating the penalty on underreporting and changing the penalty to 15 percent of the difference of overreporting and misreporting. Misreporting is when the deduction is put on the incorrect line of the CRS-1 form.

Biomass-Related Material Tax Deduction
TRD estimates that about $5 million worth of sales will be eligible for the new gross receipts deduction each year. Taxed at an effective statewide rate of 6.6 percent, the gross receipts tax deduction will reduce revenue by about $330 thousand. About 60 percent of this deduction will accrue to the general fund, and about 40 percent to local governments.

Increase Penalty for Failure to Pay Taxes
The bill is expected to decrease revenue collections by $810 thousand in FY07. About 75 percent of this revenue decrease will accrue to the general fund, and about 25 percent will accrue to local governments.

Health Care Practitioner Gross Receipts
TRD reports that about 16 percent of New Mexicans receive health insurance through Medicare. Gross receipts information from TRD's Report 80, "Analysis of Gross Receipts by North American Industry

Classification System" was examined for the types of practitioners included in this bill. Gross receipts tax revenue is expected to fall by $1,193 thousand. About 60 percent of this revenue loss will accrue to the general fund, while 40 percent will be to local governments. Since health insurance costs and the state's aging population are expected to grow quickly, the costs of this deduction should also be expected to grow quickly.

Laboratory & Small Business Tax Credits
Under current law, Sandia National Laboratories are eligible to claim $1.8 million per year in credits. By increasing the total amount of credits that a national laboratory can claim per year by $600 thousand, the bill will reduce state gross receipts tax collections from Sandia National Laboratories by $600 thousand per year.

Due to the new contract signed by Los Alamos National Lab, it is likely that LANL will soon become eligible to claim the credit as well. If Los Alamos becomes eligible the cost of the credit will increase by another $2.4 million per year. Absent the provisions of this bill, LANL would only be eligible to claim a $1.8 million credit.

Aviation Division Collection Reversions
DOT's analysis of this section includes both direct impacts and indirect, or dynamic, impacts that were estimated using the REMI model.

Direct Fiscal Impact: The bill creates a new monthly distribution to the state aviation fund from gross receipts tax collections that are distributed to the general fund under current law. The distribution will total $960 thousand in FY07, $2.0 million in FY08, and $3 million in FY09 and beyond. All money in the state aviation fund is automatically appropriated to the Aviation Division of DOT.

Indirect Fiscal Impact: Additional federal matching funds generated by this bill will be used for airport construction. While state funds will only pay about 2.5 percent of construction costs, the effective gross receipts tax rate in municipal areas is 3.775 percent. This means the state is expected to make more money through the gross receipts tax on airport construction than it spends to secure the additional federal match. The REMI model also suggests personal income tax collections will increase due to higher wages and salaries generated by airport construction activity.

Underground Irrigation Tool Gross Receipts
According to TRD, the USDA Census of Agriculture's publication "2003 Farm and Ranch Irrigation Survey," New Mexico farms spent nearly $17 million on irrigation equipment and machinery in 2003. The amendment makes the deduction available beginning July 1, 2006.

School Bus Gas Tax Deduction
Based on information PED provided TRD, total gasoline tax payments for school bus operators are estimated to be $21,000 in FY07 and $18,000 in FY08. The deduction will cause gasoline tax revenues to decline by those amounts. Revenue losses will accrue to several funds, as detailed in Table 1. Since the amount of the deduction is no longer part of the gasoline tax, it becomes taxable under the compensating tax. Compensating tax revenues are expected to increase by $14.5 million in FY07 and $12.4 million in FY08.

Working Families Tax Credit
Approximately 200 thousand New Mexicans file for the federal EITC each year, and 270 thousand New Mexicans use LICTR. These two programs target different populations: EITC benefits families who have earnings from working, while LICTR assists those who have little or no earnings and phases out quickly as modified gross income reaches $22 thousand. With a credit equal to 20 percent of the federal EITC (Senate Floor amendment #3), in FY06, which includes half of tax year 2006, the provision will reduce personal income tax revenues by $30.0 million. In FY07, the reduction is $61.1 million and in FY08, the

impact is $63.2 million.

Business-Related Service Gross Receipts
TRD estimates that business-to-business services for companies with total receipts under $300 thousand per year will total $100 million in FY07. Assuming a statewide average tax rate of 3.9 percent, credits will total $3.9 million per year. TRD's analysis assumes that about 76 percent of eligible credits will be claimed, bringing the fiscal impact to $1.5 million in the last half of FY07 and to $3.3 million in FY08. Because the bill can be claimed against the compensating tax, of which 20 percent is distributed to the small cities and counties assistance funds, revenues to each of these funds will be reduced by about $3 thousand in FY07 and $6 thousand in FY08 and beyond. Because the credit applies only to the state share of gross receipts tax liability, the bill does not impact local governments.

Clinical Laboratory Service Gross Receipts
TRD estimates total taxable gross receipts in FY07 for laboratories not located in a physician's office or a hospital to be $32 million. Based on information from the federal Centers for Medicaid and Medicare Services (CMS) and from industry representatives, about 25 percent of these receipts come from managed care insurers. Therefore, the fiscal impact to the general fund is estimated to be $520 thousand in FY07 ($32 million X 25 percent eligible receipts X 6.5 percent statewide tax rate). This impact includes the direct impact of making these clinical laboratory receipts deductible, as well as the impact of holding local governments harmless from the new deductions.

Department of Health Hospital Phased Gross Receipts Credit
A New Mexico Hospital Association survey on hospital gross receipts payments for FY05 indicates that for-profit hospitals paid gross receipts tax of $16.4 million, of which about $9.9 million went to the state. Assuming that the impacted tax base will grow by 7 percent each year, the credit will reduce general fund revenue by about $3.8 million in FY07, $8.1 million in FY08 and $12.1 million once it is fully phased-in in FY09.

Renewable Energy Production Tax Credits
The Senate Finance Committee amendment adds a fiscal impact due to inclusion of these sections. Under current law, the renewable energy production credit is capped by a provision that limits corporate income tax credits to 2 million megawatt hours per year (2 billion kilowatt hours). This means the corporate income tax credit is capped at $20 million per year (2 billion kwh X $0.01= $20 million). Amending the bill so that solar projects receive 2 cents per kwh will increase the cap slightly: existing and planned wind projects in New Mexico will generate nearly 1.8 million megawatt hours, so the cap will rise to about $22 million if the solar credit is increased to 2 cents. This additional fiscal impact will not occur for several years. This existing cap is also doubled to about $44 million by creating a new personal income tax credit. Again, this fiscal impact will not occur for several years. The provisions of this section will decrease general fund revenue somewhat, depending on how many solar operations claim a 2 cent credit, how many biomass operations producing between 1 and 10 megawatts become eligible to receive the credit, and how many personal income tax credits are claimed. TRD assumes that an additional 10 percent of the credits will be claimed each year.

Livestock Killed by Predators Credit
The US Department of Agriculture keeps statistics on livestock killed by predators. Using these figures and excluding dogs and other, 75 percent of livestock is killed by qualified predators according to the amendment. The USDA data on livestock with estimated values is shown in Table 2. Other animals useful to man is a rough estimate and not based on USDA statistics. The credit results in a reduction of personal and corporate income taxes of $2.8 million per year. In FY06, the reduction would be $1.4 million to reflect half of the tax year. This is likely to be lower than

the actual amount since estimates for ratites (emus, ostriches, etc) and buffalos were not available. This credit can be applied against personal or corporate income tax and amounts exceeding liability can be carried forward for three consecutive years. See Significant Issues below for more information.

Table 2: USDA Reported Predatory Kills

	Head	Adjusted	Value	Methodology
Cattle	700	525	330,000	USDA Reported
Calves	5,000	3,750	1,136,250	USDA Reported
Sheep	6,700	5,025	502,500	$100/head
Goats	2,226	1,670	166,950	$100/head
Swine	2,500	1,875	187,500	$100/head
Ratites	*		*	$100/head
Other animals useful to man	5,000	3,750	500,000	$100/head
	22,126		2,823,200	

Source: USDA (http://usda.mannlib.cornell.edu/reports/nassr/livestock)

SIGNIFICANT ISSUES

Navajo Nation Electric Compensating Tax Credit
Navajo Nation's Diné Power Authority has selected Sithe Global Power to develop, finance, construct and operate two 750 megawatt coal-fired generating facilities called "Desert Rock" 30 miles southwest of Farmington. The total cost of this facility is estimated at $2.2 billion.

Advanced Energy Product Tax Credit Act
According to EMNRD and EDD, the credit encourages the recruitment and retention of an advanced energy cluster economy.

Biomass-Related Material Tax Deduction
According to EMNRD, the gross receipts tax deduction for biomass equipment and materials will level the playing field for New Mexico businesses who compete with out-of-state businesses for the sale of biomass equipment.

Health Care Practitioner Gross Receipts
HPC and DOH report that eliminating the gross receipts tax burden on these types of health care practitioners will assist the state in recruiting and retaining them because health care practitioners do not pay a gross receipts tax in most other states.

Laboratory & Small Business Tax Credits
According to TRD, this credit benefited 278 small businesses in 2004.

Aviation Division Collection Reversions
According to DOT, this section will help leverage additional matching funds from the Federal Aviation Administration (FAA) for use on statewide airport construction projects. These airport construction projects need only 5 percent in combined state and local funds to earn a 95 percent federal match.

Working Families Tax Credit
Seventeen states, including the District of Columbia, currently offer a state level EITC. EITC

has proven to be a simple and efficient credit. It is also popular since it only goes to individuals and families with earned income.

Business-Related Service Gross Receipts

This section attempts to reduce the tax burden on businesses caused by pyramiding, which results when transactional taxes such as New Mexico's gross receipts and compensating taxes are charged on the sale of business services from one business to another. As services are sold from one business to another in the course of production, the tax is levied multiple times and results in higher business costs and final product prices.

Clinical Laboratory Service Gross Receipts

According to DOH, recruitment and retention of health providers has been difficult in New Mexico because of the gross receipts tax. Although much of this problem was addressed by the 2004 Legislature, some healthcare practitioners in New Mexico still pay gross receipts tax, while their counterparts in most other states do not.

Department of Health Hospital Phased Gross Receipts Credit

For-profit hospitals compete with non-profit hospitals in New Mexico and hospitals in neighboring states that do not pay gross receipts tax. The New Mexico Hospital Association reports that this bill will remove a competitive disadvantage against New Mexico's for-profit hospitals. The amendment changes the phase in to three years.

Livestock Killed by Predators Credit

It is unclear how predatory kills will be verified and it is likely that the reported livestock killed by predators will increase dramatically due to the credit.

ADMINISTRATIVE IMPLICATIONS

Solar Market Development Income Tax Credit

According to TRD, manual processing of this credit will require 1/2 FTE to monitor, approve and track the tax credit. This is expected to cost about $30 thousand.

Laboratory & Small Business Tax Credits

This provision creates significant administrative impacts for TRD by requiring TRD to track the credit received by each individual small business that receives assistance from a national laboratory through this credit. TRD would need to verify that each of these businesses requested and received assistance meeting the necessary requirements. This tracking would need to be done manually and would require two additional FTEs. The salaries and other costs associated with these two FTEs are estimated to be $200 thousand per year.

Business-Related Service Gross Receipts

TRD reports that this provision would require major changes to the Combined Revenue System. Because an estimated 95 thousand firms will be affected by the amended bill, credits could not be processed manually like other existing credits. TRD estimates nonrecurring system changes would cost about $200 thousand.

In addition, about four additional FTE would be required for the additional workload imposed on TRD's revenue processing division. The salaries, benefits, and other recurring costs associated with these four FTE are estimated to cost $200 thousand.

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

The Advanced Energy Product Tax Credit Act duplicates Senate Bill 254. The Solar Market Development Income Tax Credit duplicates Senate Bill 269. The Incorrect Gross Receipts Reporting Penalty conflicts with House Bill 384. The Increase Penalty for Failure to Pay Taxes provision duplicates Senate Bill 318 and conflicts with House Bills 383 and 384, and Senate Bills 319 and 321. The Biomass-Related Material Tax Deduction conflicts with Senate Bill 469. The Underground Irrigation Tool Gross Receipts provision duplicates House Bill 316 and Senate Bill 46. The Business-Related Service Gross Receipts provision relates to Senate Bill 334. The Clinical Laboratory Service Gross Receipts provision conflicts with House Bill 325 and Senate Bill 29. The Department of Health Hospital Phased Gross Receipts Credit relates to Senate Bill 527 and Senate Bill 207.

TECHNICAL ISSUES

Navajo Nation Electric Compensating Tax Credit
The section does not define commencement of construction, which could be interpreted to include activities such as assessment studies or other planning.

Advanced Energy Product Tax Credit Act
TRD believes that the employment requirements stated in Section 19 should be clarified so that all of a taxpayer's employees must be counted in determining the calculation, and so that the replacement of one worker by another does not count as adding an employee.

The credit states that advanced energy products that will be eligible for the credit include components of "integrated gasification combined cycle coal facilities." However, the proposed credit will not be available for such equipment because the credit is only available for equipment used to "manufacture" advanced energy products. Modifying the credit to include purchases of integrated gasification combined cycle coal facilities would greatly increase the fiscal impacts of the bill.

Oil and Gas Produced Water Credits
ISC recommends amending page 30, line 21 after the 1st occurrence of "to" to insert "meeting the state's" for clarity.

Solar Market Development Income Tax Credit
The procedures for applying for and claiming the credit could be clarified. For example, it is not clear over what time period the "maximum annual aggregate" amount of credit is to be calculated. This provision would be easier to administer if the calculation were specified to be "total credits approved by TRD during one calendar year may not exceed". There is little guidance regarding when the taxpayer may apply for the credit or if there is a statute of limitation for applying for the credit.

Laboratory & Small Business Tax Credits
Section 38 contains different reporting requirements for years in which one or more national laboratories claim the credit. If only one national laboratory claims the credit the report will only be submitted to TRD, but if more than one national laboratory claims the credit it will be submitted to TRD, EDD and the appropriate interim legislative committee.

Department of Health Hospital Phased Gross Receipts Credit
TRD notes that the credit could be taken by hospitals after the deduction in Section 7-9-73.1 NMSA 1978, but it is unclear if the credit could be taken before or after the deduction in Section 7-9-93 NMSA 1978. A taxpayer may be able to claim the credit for receipts that are also eligible for the deduction in Section 7-9-93 NMSA 1978.

Livestock Killed by Predator Credit
The amendment does not stipulate a methodology for proving that livestock was killed by one of the qualified predators. TRD or some appropriate agency will have to develop rules for determining and evaluating livestock deaths.

OTHER SUBSTANTIVE ISSUES

Health Care Practitioner Gross Receipts/Clinical Laboratory Service Gross Receipts/Department of Health Hospital Phased Gross Receipts Credit
TRD notes that receipts from the health industry have historically grown more quickly than general revenue. Deducting services from high-growth sectors such as health care from the existing tax base makes it harder for tax revenue growth to keep pace with inflation.

Business-Related Service Gross Receipts
New Mexico's state and local governments are heavily dependent on the gross receipts tax as a large and stable revenue source. Tax changes that narrow the gross receipts tax base should be expected to increase revenue volatility.

WHAT WILL BE THE CONSEQUENCES OF NOT ENACTING THIS BILL

Oil and Gas Produced Water Credits
The current personal and corporate income tax credits for produced water credit were repealed effective January 1, 2006, so unless a new credit is enacted, this credit will no longer exist.

NLF/SS/mt:yr:nt