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

ORIGINAL DATE 1/23/06
SPONSOR HTRC **LAST UPDATED** 2/9/06 **HB** 198/HTRCS

SHORT TITLE LOCAL OPTION COMPENSASTING TAX **SB**

ANALYST Schardin

REVENUE (dollars in thousands)

Estimated Revenue			Recurring or Non-Rec	Fund Affected
FY06	**FY07**	**FY08**		
		$7,739.1	Recurring	Municipalities
		$3,316.7	Recurring	Counties

(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			$2,200.0	$2,200.0	Non-Recurring	General Fund

(Parenthesis ( ) Indicate Expenditure Decreases)

SOURCES OF INFORMATION
LFC Files

Responses Received From
Taxation and Revenue Department (TRD)
New Mexico Association of Counties (NMAC)
New Mexico Municipal League (NMML)

SUMMARY

Synopsis of Bill

The House Taxation and Revenue substitute for House Bill 198 imposes local option compensating taxes in counties and municipalities. The local option compensating tax would be imposed and collected by TRD in the same manner as the current state compensating tax, and would be imposed at the rate of any local option gross receipts tax in effect in a county or municipality as of July 1, 2007.

To calculate local compensating tax due, Section 6 defines location and use of property as the jurisdiction in which 1) the buyer's place of business is located if the buyer is engaging in business in New Mexico and uses the property in furtherance of that business, 2) the buyer's principal office is located if the buyer is a state or local government agency, or 3) the buyer's residence is located if the buyer is not engaging in business in New Mexico.

Section 9 changes the timelines for local governments to hold an election to approve or disapprove imposition of local option taxes. Currently, such an election must be held within five months of the date when a local option tax would take effect. The bill reduces that timeline to three months before a local option tax would take effect.

The substitute provides an exemption from local option compensating taxes for tangible personal property that is subject to depreciation under federal income tax purposes that cannot be obtained from a source within New Mexico.

The substitute will allow TRD to retain 3 percent of all local option compensating tax collections as an administrative fee.

The bill has an effective date of July 1, 2007.

FISCAL IMPLICATIONS

TRD estimates the statewide compensating tax base will be about $1,365 million in FY08, and the statewide weighted average local option tax rate will be 1.67 percent. TRD roughly estimates that half of this base will be eligible for the local option compensating tax exemptions provided in the bill. This suggests that total local option compensating taxes will be about $11.4 million in FY08 ($1,395 million X 50% eligible X 1.67% tax rate). Three percent of this amount, or $342 thousand, will be retained by TRD as an administrative fee. Of the remaining $11.1 million, TRD estimates 70 percent ($7.7 million) will go to municipalities and 30 percent ($3.3 million) will go to counties.

SIGNIFICANT ISSUES

The purpose of House Bill 198 is to make the compensating tax rate equivalent to the gross receipts tax rate to eliminate an incentive for New Mexico buyers to purchase goods from out-of-state vendors.

Local option gross receipts taxes that will be mirrored with new local option compensating taxes if HB198 goes into effect include the supplemental municipal gross receipts tax, the municipal local option gross receipts tax, the local hospital gross receipts tax, the county local option gross receipts tax, and the county correctional facility gross receipts tax.

The bill will allow an exemption from local option compensating taxes for certain tangible personal property that is depreciated under federal income tax purposes that cannot be obtained within New Mexico. According to TRD, federal income tax guidelines allow most types of tangible property, such as buildings, machinery, vehicles, and furniture to be depreciated.

ADMINISTRATIVE IMPLICATIONS

TRD reports that this bill would have major administrative impacts. A new full-page CRS form would be necessary for TRD to distribute local option compensating taxes to local governments. This, in turn, would require at least four scanners at a cost of about $550 thousand each ($2.2 million non-recurring) and maintenance for each scanner of about $160 thousand each ($640 thousand recurring). Finally, five additional FTE would be required to enter data and verify distributions. The salaries, benefits, and other recurring costs associated with these five FTE are estimated to cost $250 thousand. Without these additional resources, local option compensating tax distributions would likely be late. The bill awards TRD an administrative fee for collection of the new local option compensating taxes. This administrative fee should cover the recurring administrative costs imposed on TRD by the bill, but will not be sufficient to pay for the nonrecurring costs of scanners.

Major computer systems changes would be necessary to make the appropriate local revenue distributions. Reprogramming the system is possible but is estimated to take 3,000 FTE hours. The July 1, 2007 effective date contained in the House Taxation and Revenue Committee substitute for House Bill 198 gives TRD enough time to incorporate these changes.

TRD notes that because the local option compensating tax exemptions created by the substitute bill do not also apply to the statewide compensating tax, administration will be more complex. Taxpayer reporting would be simpler if these new exemptions also applied to the state compensating tax.

TECHNICAL ISSUES

TRD noted the following technical issues:

Page 19, lines 1-4: the supplemental municipal compensating tax is imposed on the use of property, not on the use of services. This makes the reference to “use or service” in lines 3-4 confusing. TRD suggests deleting the words “or service” from lines 3-4.

The bill provides that where a local gross receipts tax is in effect on July 1, 2007 the corresponding local compensating tax is automatically imposed at the same rate. If the local gross receipts tax was adopted by a vote of the electorate, the subsequent addition of local option compensating tax may be vulnerable to challenge because it falls outside the scope of the ballot questions approved by voters.

The bill will cause some conflicts with various tax laws that refer only to local option gross receipts taxes. For example, many tax credits, such as the investment tax credit found in Section 7-9A-8 NMSA 1978, restrict the amount of credit that may be applied against local option gross receipts taxes.

OTHER SUBSTANTIVE ISSUES

Equalizing gross receipts and compensating tax rates would help New Mexico comply with future requirements if it participates in the Streamlined Sales Tax Agreement.

A similar bill was passed by the legislature and vetoed by the governor in 2005 (HB 581). The governor's veto message stated that the bill was vetoed because it was "riddled with exemptions that might unfairly subject certain entities to the tax but not others." House Bill 198 does not include the exemptions that led to the veto of HB 581 in 2005.

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