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

SPONSOR Smith **ORIGINAL DATE** 1/25/07 **LAST UPDATED** 2/25/07 **HB**

SHORT TITLE Local Option Compensating Taxes **SB** 144/aSPAC

ANALYST Schardin

REVENUE (dollars in thousands)

Estimated Revenue			Recurring or Non-Rec	Fund Affected
FY07	FY08	FY09		
	$6,260.7		Recurring	Municipalities
	$2,683.2		Recurring	Counties

(Parenthesis ( ) Indicate Revenue Decreases)

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY07	FY08	FY09	3 Year Total Cost	Recurring or Non-Rec	Fund Affected
Total		$2,500.0		$2,500.0	Non-Recurring	General Fund
			$1,000.0	$1,000.0	Recurring	General Fund

(Parenthesis ( ) Indicate Expenditure Decreases)

Duplicates HB 265, Conflicts with SB 205, Relates to SB 518, HB 374

SOURCES OF INFORMATION
LFC Files

Responses Received From
New Mexico Municipal League (NMML)
Department of Finance and Administration (DFA)
Taxation and Revenue Department (TRD)

SUMMARY

Synopsis of SPAC Amendment

The Senate Public Affairs Committee amendment to Senate Bill 144 widens the range of tangible personal property that will be exempt from local option compensating taxes created by this bill.

In the original bill, tangible personal property was exempt from the new taxes if it was subject to depreciation for federal income tax purposes *and* could not be obtained from sources within New Mexico. The amendment changes the bill so that tangible personal property will be exempt from the new taxes if it meets *either* of these two conditions.

Synopsis of Original Bill

Senate Bill 144 imposes local option compensating taxes in counties and municipalities. Local option compensating taxes will be imposed at the rate of any local option gross receipts tax in effect in a county or municipality, and collected by TRD in the same manner as the current state compensating tax.

Local option compensating taxes will be owed to 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 original bill provides an exemption from local option compensating taxes for tangible personal property that is subject to depreciation under federal income tax purposes and tangible personal property that cannot be obtained from a source within New Mexico. The Senate Public Affairs Committee amendment allows tangible personal property meeting either of these two conditions to be exempt.

The bill 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 (see Technical Issues).

FISCAL IMPLICATIONS

TRD estimates the statewide compensating tax base will be about $1,577.5 million in FY08, and the statewide weighted average local option tax rate will be 1.67 percent. TRD roughly estimates that 65 percent 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 $9.2 million in FY08 (1,577.5 million X .35% eligible X 1.67% tax rate). Three percent of this amount, or $276.6 thousand, will be retained by TRD as an administrative fee. Of the remaining $8.9 million, TRD estimates 70 percent ($6.3 million) will go to municipalities and 30 percent ($2.7 million) will go to counties.

The compensating tax base that will be subject to local option compensating taxes is expected to grow by 5 percent per year.

SIGNIFICANT ISSUES

This bill makes 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. According to NMML, New Mexico businesses are currently at a disadvantage with out-of-state businesses because the compensating tax paid on goods and services from out-of-state is lower than the statewide gross receipts tax rate, which includes both a statewide tax and several local option taxes.

The bill will provide an additional stream of revenue to counties and municipalities that are currently very dependent on gross receipts tax collections. However, some local option gross receipts taxes are earmarked for specific uses. It is unclear whether some of these specific uses will be able to make use of more funding.

Local option gross receipts taxes that will be mirrored with new local option compensating taxes if the bill is enacted 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 allows an exemption from local option compensating taxes for certain tangible personal property that may depreciated for federal income tax purposes and tangible personal property 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 creates major administrative impacts. A new full-page CRS form will 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 be $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 purchasing scanners.

TRD notes that because the local option compensating tax exemptions for tangible personal property that can be depreciated for federal income tax purposes and tangible personal property that cannot be obtained in New Mexico do not also apply to the statewide compensating tax, administration will be more complex. Taxpayer reporting would be simpler if these exemptions were eliminated or if they also applied to the state compensating tax.

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

Senate Bill 144 duplicates House Bill 265.

Senate Bill 144 conflicts with Senate Bill 205, which also amends Section 7-20C-2 NMSA 1978. Senate Bill 205 amends this section to include Union County in the list of counties that may impose a local hospital gross receipts tax.

Senate Bill 144 relates to Senate Bill 518 and House Bill 374, which would create new local option gross receipts taxes that would be mirrored by local option compensating taxes if Senate Bill 144 is enacted. Senate Bill 518 creates a county senior citizen services gross receipts tax and House Bill 374 creates a municipal higher education facilities gross receipts tax.

TECHNICAL ISSUES

TRD noted the following technical issues:

Major computer systems changes will 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 bill does not give TRD enough time to make these changes.

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 of participation 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.” Senate Bill 144 contains exemptions for tangible personal property that may be depreciated for federal income tax purposes and for tangible personal property that cannot be obtained in New Mexico, but these exemptions apply in to all industries rather than the handful that were listed in the 2005 bill.

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