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## FISCAL IMPACT REPORT

ORIGINAL DATE 2/07/2007

SPONSOR Neville LAST UPDATED 3/14/2007 HB \_\_\_\_\_

SHORT TITLE Food Tax Definition Changes SB 530/aSFC/aHBIC

ANALYST Schuss/Schardin

### REVENUE (dollars in thousands)

Estimated Revenue			Recurring or Non-Rec	Fund Affected
FY07	FY08	FY09		
	*(\$1,229.7)	*(988.5)	Recurring	General Fund
	*(\$288.3)	*(\$605.4)	Recurring	Local Governments

(Parenthesis ( ) Indicate Revenue Decreases)

\*Note: Table reflects the net effects of a revenue decrease due to the proposed water, ice and coffee deduction and a revenue increase due to the proposal to freeze local hold harmless distributions to some counties and municipalities (See Fiscal Implications).

### SOURCES OF INFORMATION

LFC Files

#### Response Received From

Taxation and Revenue Department (TRD)

### SUMMARY

#### Synopsis of HBIC Amendment

The House Business and Industry Committee amendment changes provisions related to the food and medical services local government hold harmless provision that was amended into the bill by the Senate Finance Committee. The Senate Finance Committee amendment would have frozen the local government hold harmless distributions for the food and medical services deductions at the local option tax rates imposed on January 1, 2007 in *all counties and municipalities*.

The House Business and Industry Committee amendment would only freeze the local government hold harmless distributions to municipalities with either a population over 10 thousand in the most recent decennial census or per capita taxable gross receipts above the statewide average in the previous calendar year. The amendment would only freeze the hold harmless distribution to counties with populations over 48 thousand.

Synopsis of SFC Amendment

The Senate Finance Committee amendment to Senate Bill 530 amends Sections 7-1-6.46 and 7-1-6.47, which were enacted in 2004 as part of the legislation to create gross receipts tax deductions for food and medical services (HB 625). Those sections hold counties and municipalities harmless from the food and medical service deductions by requiring TRD to distribute to each local government an amount equal to what would have been received if the deductions did not exist.

The provisions freeze the hold harmless distributions to local governments at the rate of the local option tax imposed as of January 1, 2007 rather than the current local option tax rate imposed at the time of the distribution.

Synopsis of Original Bill

Senate Bill 530 expands the definition of retail food store so that establishments with over 75 percent of sales attributable to bottled water, ice and coffee can receive the gross receipts tax deduction for food enacted in 2004.

**FISCAL IMPLICATIONS**

Deduction for Water, Ice and Coffee: TRD estimates that taxable gross receipts eligible for the proposed deduction for water, ice and coffee will be about \$23 million per year. With a statewide tax rate of 6.6 percent, revenue will be reduced by about 1,518.0 thousand. Since the food deduction expanded in this bill contains a local government hold harmless provision, the entire revenue loss will be borne by the general fund. The deduction is expected to grow by about 5 percent per year.

Freeze Local Government Hold Harmless Distributions: The House Business and Industry amendment will cause a gradual shift of revenue from local governments to the general fund as local option tax rates gradually creep higher. TRD reports that in the recent past, the local option gross receipts tax rate have increased by about 0.01 percent per year. Statewide, food and medical deductions are expected to total \$3.1 billion in FY08. About 93 percent of those deductions, or \$2.9 billion, are expected to occur in counties and municipalities that will have hold harmless distribution rates frozen at January 1, 2007 levels. An additional 0.01 percent tax would cause a shift of about \$288.3 thousand ( $\$3.1 \text{ billion} \times 93\% \times 0.0001$ ). The fiscal impact will grow over time as local option tax rates creep higher and the size of the deductions grows. The table above assumes rates continue to increase by 0.01 percent per year and that the deductions grow by 5 percent per year.

**SIGNIFICANT ISSUES**

Deduction for Water, Ice and Coffee: LFC notes that while individual deductions from the gross receipts tax may have small fiscal impacts, their cumulative effect significantly narrows the gross receipts tax base. Narrowing the gross receipts tax base increases revenue volatility and requires a higher tax rate to generate the same amount of revenue.

Freeze Local Government Hold Harmless Distributions: Current law requires TRD to transfer to each county and municipality an amount equal to what would have been received if the food and

medical service deductions enacted in 2004 did not exist. That amount is calculated by multiplying deductions by the local option tax rate imposed in the area. These distributions are meant to hold local governments harmless from any revenue loss associated with the food and medical deductions.

As local option tax rates creep higher, the size of the hold harmless distributions the state pays local governments grow larger. The House Business and Industry Committee amendment protects the state general fund from losing additional revenue as the state's larger local governments impose higher local option gross receipts taxes.

Alternatively, the bill limits larger local governments' ability to raise revenue through imposing higher local option gross receipts taxes. All increments imposed after January 1, 2007 would generate less revenue due to the provisions of the House Business and Industry Committee amendment. Therefore, the amendment reduces the state's 2004 commitment to hold local governments harmless to the food and medical deductions.

Medical service receipts tend to grow faster than the rest of the gross receipts tax base, and food receipts are one of the more stable parts of the tax base. The bill will therefore slightly reduce the rate of growth in larger local government gross receipts tax revenues and slightly increase revenue volatility.

Currently, New Mexico's local governments are authorized to impose up to 4.6875 percent of local option gross receipts taxes (that figure excludes several additional local option taxes that have been authorized for selected local governments). On average, a local option gross receipts tax of about 1.6 percent is actually imposed by local governments statewide. Combined with the state gross receipts tax of 5 percent, the statewide tax rate is therefore 6.6 percent.

### **ADMINISTRATIVE IMPLICATIONS**

TRD will potentially need to troubleshoot systems, revise forms and instructions, prepare taxpayer education materials and instructions, and retrain personnel.

Implementation of the food and medical deductions has been unusually complicated and expensive for TRD because of the programming needed to do hold harmless distributions for local governments. Increasing the list of food items eligible for the food gross receipts tax deduction will increase the cost of administering the local hold harmless distributions.

### **CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP**

The House Business and Industry Committee amendment to Senate Bill 530 inserts provisions similar to those found in Senate Bill 1182. Senate Bill 1182 freezes the local hold harmless rate for all local governments at the tax rate imposed on January 1, 2007.

### **TECHNICAL ISSUES**

TRD noted that original intent of the food deduction enacted in 2004 was to include food for home consumption as defined by the federal Food Stamp program. This bill would include receipts from companies that sell water to businesses as well as to individuals for home

consumption. Companies delivering bottled water to both homes and businesses will have to separate home and business sales to qualify for the deduction.

BS/SS/csd