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

ORIGINAL DATE 03/01/11
SPONSOR Gentry **LAST UPDATED** **HB** 542

SHORT TITLE Public Works Performance Bond Reductions **SB**

ANALYST Archuleta

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY11	FY12	FY13	3 Year Total Cost	Recurring or Non-Rec	Fund Affected
Total	NA	$363.3*	$363.3*	$726.6*	Recurring	State Issued Bonds

(Parenthesis ( ) Indicate Expenditure Decreases)

SOURCES OF INFORMATION
LFC Files

Responses Received From
Public School Facilities Authority (PSFA)
New Mexico Municipal League (NMML)

No Response Received From
Department of Finance and Administration (DFA)
General Services Department (GSD)

SUMMARY

Synopsis of Bill

House Bill 542 amends the Public Works Act regarding construction contract performance and payment bonds. Provides that prior to solicitation, a central purchasing office may reduce the amount of the required performance bond to exclude the gross receipts taxes on payments received under the construction contract awarded to the contractor for which the bond was issued if the purchasing office agrees to indemnify the issuer of the performance bond for any payment that the issuer of that bond is required to make to the Taxation and Revenue Department for gross receipts taxes due on payments received by the contractor.

FISCAL IMPLICATIONS

The Public School Facilities Authority provided the following information:

> It has been reported that PSFA is the only public entity in New Mexico that is not allowing sureties to charge premiums to contractors on public works construction project contract amounts, inclusive of gross receipts tax.

Increased costs to public school projects would vary depending on the "bondability" of the general contractor. Examination of 369 PSCOC-funded projects involving major renovation and new construction of public schools throughout NM totaling $1.1 billion, since June 2005, reveals a total expenditure of approximately $9.2 million (.82% of total contract) directly attributable to payment and performance bonds of the general contractor, in addition to $10.9 million (.98% of total contract) for bonding costs of subcontractors to the general contractor.

Based on these figures, allowing bonding of the gross receipts tax would have added approximately $1 million to the cost of the projects. The PSFA is not aware of any calls on any of these bonds due to the failure of the general contractor to pay the gross receipts tax to the State.

The PSFA has developed standard contracts that clearly define the contract price, separate from the gross receipts tax applicable to the project amount which will be paid to the general contractor through periodic payments of completed work. Most school districts have adopted the PSFA standard agreements for all their district-only capital projects and therefore include similar provisions.

The actual cost of bonding the gross receipts tax will vary by project, but based on estimated annual construction contracts entered into for public schools of $523.3 million, and assuming an average gross receipts tax rate of 7%, and an average 1% bond cost; there would be a potential $363.3 thousand fiscal year impact by bonding of the gross receipts tax.

*NMML indicates the legislation essentially allows the state purchasing officer or a central purchasing officer of a political subdivision to self insure the gross receipts tax due on a construction project. Assuming an average 7.5% gross receipts tax rate this would amount to $75,000 on a $1 million project. Also, the legislation if applied to very large construction projects could result in a political subdivision committing itself to a significant payment in the event of payments being required to be made under a performance bond. There is no provision in the legislation to limit the amount that the state purchasing officer or a central purchasing officer could indemnify the issuer of the performance bond for payments of gross receipts tax.

SIGNIFICANT ISSUES

PSFA also indicates:

Section 13-4-18, known as the "Little Miller Act", requires all construction contracts awarded pursuant to the procurement code in excess of $25,000 to include a performance bond and a payment bond each equal to 100% of the "price" specified in the contract. The payment bond is intended to protect subcontractors and material suppliers by providing a remedy for recovery of monies due for performing work or providing materials on a state or local construction project. The performance bond protects the owner and taxpayers by providing a mechanism to guarantee delivery of the contracted work should the awarded contractor fail to perform.

The Procurement Code does not specifically define "price", but requires that the bid amount exclude the applicable state gross receipts tax or applicable local option tax. §13-

1-108 further provides that “the contracting agency shall be required to pay the applicable tax including any increase in the applicable tax becoming effective after the date the contract is entered into. The applicable gross receipts tax or applicable local option tax shall be shown as a separate amount on each billing or request for payment made under the contract”.

Section 13-4-19 provides that the State also has the right to sue on a payment bond when the contractor does not have its principal place of business in New Mexico. This is assumed to be a separate bond based on the requirements of Section 7-1-55 which requires an out of state contractor to provide a bond or other acceptable form of security equivalent to the amount of gross receipts tax expected to be paid on the construction project to the secretary of the taxation and revenue department. This section further provides that the bond or security be increased or decreased with each change in the contract of 10% or more.

OTHER SUBSTANTIVE ISSUES

The bill seeks to allow the state purchasing agent or central purchasing office to indemnify a surety against losses due to the failure of all in-state as well as out-of-state contractors to pay gross receipts taxes owed on performing construction contracts. It is doubtful that most public entities would be willing to assume this risk of taxpayer dollars which rightfully should fall on the contractor.

Collecting on a bond requires notice of default and typically involves an extended time period. The state taxation and revenue department has other legal remedies to recover taxes owed by in-state contractors pursuant to the Gross Receipts and Compensating Tax Act.

Section 7-1-55 further prohibits the issuance of a building permit to an out-of-state contractor until such bond or security based on the estimated gross receipts tax to be paid on the construction project is delivered to the secretary of the taxation and revenue department.

ALTERNATIVES

PSFA suggests defining or seeking an AG opinion on the proper interpretation of "price specified in the contract”.

WHAT WILL BE THE CONSEQUENCES OF NOT ENACTING THIS BILL

Bonding of the gross receipts tax will remain only applicable to out-of-state contractors.

DA/svb