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

		ORIGINAL DATE	02/02/12		
SPONSOR	Larrañaga	**LAST UPDATED**	02/04/12	**HB**	159
SHORT TITLE	Dept. of Defense Satellite Gross Receipts			**SB**	
				ANALYST	Smith

REVENUE (dollars in thousands)

Estimated Revenue			Recurring or Nonrecurring	Fund Affected
FY13	**FY14**	**FY15**		
(7,700.0)	(7,700.0)	(7,700.0)	Recurring	General Fund
(6,300.0)	(6,300.0)	(6,300.0)	Recurring	Local Governments
(14,000.0)	(14,000.0)	(14,000.0)	Recurring	Total

(Parenthesis ( ) Indicate Revenue Decreases)

This FIR is being revised to incorporate previously unavailable analysis from TRD.

SOURCES OF INFORMATION
LFC Files

Response From
Taxation and Revenue Department (TRD)

SUMMARY

Synopsis of Bill

House Bill 159 creates two new gross receipts and compensating tax deductions:

- Research and development services related to directed energy or satellites when sold pursuant to a contract with the U.S. Department of Defense; and

- Development services related to directed energy or satellites pursuant to a contract with the U.S. Department of Defense.

FISCAL IMPLICATIONS

The Economic Development Department estimates that the Air Force Research Laboratory located at Kirtland Air Force Base is the primary purchaser of directed energy and satellite research and development services with a procurement budget of $700 million. EDD further estimates 65 percent is spent out of state and the remaining 35 percent spent in NM. Of the $245 million spent in NM, this analysis assumes only 70 percent or $171.5 million would qualify for the gross receipts deduction. A tax rate of 7.0 percent is applied assuming qualifying firms operate within Albuquerque, and the estimated negative impact on GRT collections is about $12 million, resulting in an average loss of $6.7 million to the General Fund and $5.3 million to other local funds. Because the procurement budget of AFRL is subject to the Federal appropriations process, zero growth is assumed for that amount; in fact, fiscal uncertainty due to the possibility of mandatory Federal spending cuts could lead to a drastically smaller impact.

The Los Alamos National Lab and Sandia National Laboratories both have contracts that would qualify for this credit, but they estimate that tax liability to represent only a small proportion of total gross receipts from those contracts due to other credits and deductions. This analysis estimates the deduction will save the labs roughly $2 million in gross receipts taxes.

Section 1, subsection B of the bill extends the deduction for direct subcontractors. Currently, those subcontractors pay no gross receipts taxes through the use of a nontaxable transaction certificate. If the bill had not included the provision for subcontracting, the subcontractors would no longer be able to use such a type-6 NTTC (sale for resale) and they would have to pay gross receipts tax for goods and services sold. Based on the status quo, no revenue impact from this bill is attributed to its provision for subcontracting.

By creating a more competitive environment for government contracts in directed energy and satellite technology, this deduction might allow for more in-state contracts and create an incentive for additional facilities associated with those contracts. Although this possibility is not included in the current estimate, a full feedback model would accord some revenue collections from second round economic activity (indirect and induced jobs and revenue).

SIGNIFICANT ISSUES

Federal law allows the state to impose tax on the services of a federal contractor. Such receipts constitute a substantial part of the gross receipts tax base. In fact, anecdote indicates that the gross receipts tax was specifically designed to tax this specific type of activity. If the legislature wishes to exempt business to federal government sales, then the current structure needs to be remodeled in a more conventional "sales tax" manner. If there is a movement toward exempting these sorts of sales, then perhaps the economic distortions caused by the business to business pyramiding inherent embedded in this tax causes more net harm to the economy than the extra revenue that it generates.

TRD's arguments for the bill are reported below verbatim:

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As per the ERDA settlement (see United States of America v. State of New Mexico 1980), the State of New Mexico may assess its gross receipts tax on the receipts from services of a *contractor sold pursuant to a contract with the Federal government. In this respect, New Mexico represents a rather unique environment for Federal contracts; these contracts are more costly than in other states because the contractor will pass on the cost of its tax payment.*

A point of debate is whether NM's tax environment adversely affects the State's ability to attract and retain federal contracts. The argument for making the State more friendly to government contracts has led to similar gross receipts tax exemptions for the sale of military construction services pursuant to a defense contract (Section 7-9-106 NMSA 1978). It is possible, however, that these contracts would have existed in the absence of any tax deduction.

OTHER SUBSTANTIVE ISSUES

This bill may be counter to the LFC tax policy principle of adequacy. According to the LFC staff General Fund Recurring Appropriation Outlook for FY14 and FY15, December 2011 forecasted revenues will be insufficient to cover growing recurring appropriations.

Does the bill meet the Legislative Finance Committee tax policy principles?

1. **Adequacy**: Revenue should be adequate to fund needed government services.
2. **Efficiency**: Tax base should be as broad as possible and avoid excess reliance on one tax.
3. **Equity**: Different taxpayers should be treated fairly.
4. **Simplicity**: Collection should be simple and easily understood.
5. **Accountability**: Preferences should be easy to monitor and evaluate

Perhaps the sponsor might wish to consider a "sunset clause" so that the efficacy of the deduction can be evaluated.

SS/svb:amm:lj