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

ORIGINAL DATE 02/02/12
SPONSOR Little **LAST UPDATED** **HB** 189

SHORT TITLE Small Business Gross Receipts **SB**

ANALYST Walker-Moran

REVENUE (dollars in thousands)

Estimated Revenue			Recurring or Nonrecurring	Fund Affected
FY12	**FY13**	**FY14**		
$0.0	(half year) ($12,500.0)	($25,500.0)	Recurring	General Fund
$0.0	(half year) ($8,000.0)	($16,300.0)	Recurring	Local Governments

(Parenthesis ( ) Indicate Revenue Decreases)

Duplicate SB 260

SOURCES OF INFORMATION
LFC Files

Responses Received From
Economic Development Department (EDD)
Taxation and Revenue Department (TRD)

SUMMARY

Synopsis of Bill

House Bill 189 adds a new section to the Gross Receipts and Compensating Tax Act. A new deduction for a small business that receives $50,000 or less in total gross receipts, inclusive of receipts that are exempt or deductible pursuant to other sections of the Act.

According to the bill, the purposes of the deduction are to 1) reduce the tax burden on the smallest businesses in New Mexico and thereby provide additional financial resources to sustain and grow small businesses; and 2) offset the disproportionate costs of tax compliance and reporting for small businesses.

The eligible taxpayer is required to file an annual report with the department (TRD) stating their total gross receipts for the preceding year in which they took the deduction and any other information required by the department to determine if the taxpayer is eligible to take the deduction.

The **effective date** of this bill is January 1, 2013. There is no sunset date. The LFC recommends adding a sunset date.

FISCAL IMPLICATIONS

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.

There will be a high number of taxpayers who will qualify for this deduction and the negative impact to the general fund and local government is significant. The individual taxpayer benefit is not high. The total gross receipts tax paid by 56 thousand taxpayers is $40 million. On average each individual taxpayer will receive about $700 from this deduction. This deduction will help only one percent of those who pay the gross receipts tax.

This may violate the LFC tax policy of equity. Not all taxpayers will benefit from this deduction.

According to TRD, in FY11, approximately 56,300 taxpayers reported total gross receipts of less than $50,000 per year, which is about 54 percent of gross receipts taxpayers. Based on FY11 gross receipt tax (GRT) returns, the taxable gross receipts (TGR) of this group was approximately $564 million. Total GRT was approximately $39 million or 1.1 percent of total GRT collections, of which $23 million or 60 percent was distributed to the general fund and the remainder to local governments. Assuming total gross receipts for this group of businesses grew at the same rate as general fund GRT revenue, the estimated impact to the General Fund will grow by 6.9 percent from FY11 to FY13. The growth rate is assumed to slow to 2 percent in the out years.

SIGNIFICANT ISSUES

Per the TRD:
This provision could help small businesses as well as new, un-established businesses. The largest beneficiary of this provision would likely be the arts, entertainment and recreation sector, of which 85 percent of FY11 taxpayers would qualify. Businesses engaged in administrative support, waste management or remediation as well as educational services would also benefit from this proposal, in each sector over 65 percent of taxpayers would qualify for the exemption. Since many of such small businesses are quarterly or biannual filers under current law, the annual application and reporting requirements should not create an increased reporting burden.

Per EDD: New Mexico taxes at least 158 business services. Only six other states tax more than 100. Neighboring states do not tax services at all. Small business owners in other states who come to New Mexico are puzzled and frustrated by the GRT and this hurts relocation and recruitment. Relief from this tax sends a signal to our small business owners that the state's economic climate is consistent and predictable reducing uncertainty. New Mexico has been ranked dead last in terms of its ability to attract new economic investment and this will help our state better to compete for jobs and grow the private sector.

PERFORMANCE IMPLICATIONS

The taxpayer is not required to file an annual report with the TRD. The LFC tax policy of accountability is <u>not</u> met since TRD is <u>not</u> required in the bill to report annually to an interim legislative committee regarding the data compiled from the reports from taxpayers taking the deduction and other information to determine whether the deduction is meeting its purpose.

ADMINISTRATIVE IMPLICATIONS

Per TRD, the bill is structured to allow the Department to implement automatic application. Around February 15 each year, the Department would interrogate the CRS database and generate notices of potential approval for the next calendar year for any taxpayer that reported some gross receipts in the previous year and had no non-filing periods. This notification would be a mail-back application, asking the taxpayer to confirm the accuracy of the automatic application. The only manual applications would be for new taxpayers and for taxpayers that were asking for approval based on one intervening year after a year with an excess of $50,000 in total gross receipts. The Department would regulate the circumstances in which a taxpayer failed to apply to the Department for approval for the deduction, but later determined that the taxpayer qualified. This procedure would be implemented under the general provisions of the claim for refund statute.

TRD would be required to develop an application and an annual report form and instructions at a cost of about $8,000 and develop a process of approving the applications and reviewing the annual reports. The numbers of taxpayers that would qualify would be high, so a half FTE, at a cost of about $30,000 would be required for verification, processing monitoring and tracking. In the bill on page 2, line 24, any other information to determine that the taxpayer is eligible will include exemptions taken and the gross receipts of related persons. However, since Gross Receipts are generally reported on an entity basis, and the organizational structure is declared at the time of registration, this is not an insurmountable objection. The annual report described on page 3, paragraph E, will include even more reporting requirements.

TECHNICAL ISSUES

Per EDD, businesses that exceed $50,000 in total gross receipts the preceding calendar year may also claim the deduction by stating the taxpayer's total gross receipts for the calendar year, taking the deduction allowed for the first $50,000, and paying gross receipts tax on the balance. There is no upper limit on this provision. Technically, a very large business could take advantage of this deduction, at least once according to the bill.

Per TRD, page 4, subsection F, paragraph 3, - it is going to be difficult to determine all persons who own, directly and indirectly, any interest in the capital or profits in a business. However, with a $50,000 cap on total gross receipts, this is likely a deduction for single-owner businesses.

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

EWM/svb