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

ORIGINAL DATE 02/03/12
SPONSOR Maestas **LAST UPDATED** **HB** 275

SHORT TITLE Self-Employed Business Gross Receipts **SB**

ANALYST Walker-Moran

REVENUE (dollars in thousands)

Estimated Revenue		Recurring or Nonrecurring	Fund Affected
FY12	FY13		
0	($2,700.0)	Recurring	General Fund
0	($1,700.0)	Recurring	Local Governments

(Parenthesis ( ) Indicate Expenditure Decreases)

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

FY12	FY13	FY14	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
NA	($15)	($20)	($25)	Recurring	General Fund (EDD)
	($10)	0	$10	NonRecurring	General Fund (TRD)

(Parenthesis ( ) Indicate Expenditure Decreases)

SOURCES OF INFORMATION
LFC Files

Responses Received From
Taxation and Revenues Department (TRD)
joint analysis with Department of Finance and Administration (DFA)
Economic Development Department (EDD)

SUMMARY

Synopsis of Bill

House Bill 275 adds a new deduction to the gross receipts and compensating tax act. Receipts from providing a service may be deducted from the gross receipts for one year by a person who is self-employed and registered as an individual sole proprietorship or sole owner.

The purpose of the deduction is to encourage individuals to become small business entrepreneurs and establish a business to provide a service.

The effective date of this bill is July 1, 2012. 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.

It is difficult to determine exactly how many new small businesses entrepreneurs will apply for this deduction each year. It has been estimated that the general fund would lose $2.7 million each year and local governments would lose $1.7 million each year. The TRD estimated that approximately 5,900 new registrants in service industries each year would deduct an average of about $750 in taxes for the first year. In this calculation, it is assumed that any new registrant whose first-year gross receipts tax was in excess of $5,000 for the year would not be a sole proprietor and would not qualify for the benefits of this bill.

ALL NAICS CODES

Year of Registration	**Total Number Registrants**	**New Registrants paying some tax during year (but less than $5,000)**	**Average Tax due for this group**
2006	29,003	9,074	$795
2007	29,428	8,395	$756
2008	26,636	7,972	$735
2009	25,235	7,636	$755
2010	24,862	6,336	$767
2011	23,784	8,269	$760
Average		7,947	$761

Note: The average tax paid by new registrants is calculated for the same year as the registration. To get to a 12-month-following-registration impact, we must adjust by some factor. However, the “New Registrants paying some tax during year” may include partnerships, LLCs and a few C corps as well as. So, on balance, if we multiply the overestimate of the qualifying registrants times an underestimate of the average tax deducted, the errors may well cancel.

SERVICES NAICS

Year of Registration	**New Registrants paying some tax during year (but less than $5,000)**	**Average Tax due for this group**
2006	6,342	$776
2007	6,480	$784
2008	5,991	$733
2009	5,576	$726
2010	5,276	$739
2011	4,092	$775
Average	5,626	$756

SIGNIFICANT ISSUES

Some studies suggest that small business generates the majority of new jobs in any economy. To receive the deduction, the claimants must provide a large amount of information to the Economic Development Department (EDD), including, whether the claimant was previously unemployed, whether the claimant has hired anyone besides the claimant, and the amount of that deduction claimed. However, there is no penalty for failure to file this information, nor is there any authority for either the EDD or TRD to require the information through any other means.

According to the EDD, many New Mexico communities, particularly small rural areas, consider self-employed persons, or "Lone Eagles," a target in their economic growth plans. This has been a trend in economic development for the last 5-6 years. Target markets are urban areas where individuals may be considering a rural lifestyle in a place where they can conduct business via a broadband connection. This deduction would provide an important incentive to lure these "Lone Eagles" and contribute to the success rate of entrepreneurs in the first critical year of business.

PERFORMANCE IMPLICATIONS

The LFC tax policy of accountability is met since the EDD and the TRD are required in the bill to report annually to the Revenue Stabilization and Tax Policy 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.

As reported by EDD, Eagle Nest, Silver City and Taos are examples of New Mexico communities pursuing these individuals. This tax deduction would be a good incentive to relocate new self-employed persons to New Mexico. It would also encourage residents to consider self-employment, particularly if they are discouraged with the current job market.

ADMINISTRATIVE IMPLICATIONS

The TRD report a moderate to high impact, depending upon the reporting needs. TRD does not normally collect this much information concerning any deduction. Depending upon the ability that the economic development department has to collect the data required to compile the annual reports, TRD could be charged with collecting and capturing data that would increase the cost of processing returns. Pre-approval for the deduction may be considered. Development of instructions, forms and publications could require as much as $10,000 to develop. Coordination between the EDD and TRD would be necessary. Systems would need to be developed for collecting the new data. New web applications would need to be considered.

TECHNICAL ISSUES

The TRD has pointed out the following technical issues:

Section A (2) line 24 add; "with the Department" after 'registered'

Because GRT is filed monthly, quarterly or semiannually, the 365 day test will be unverifiable. The restriction should be changed to 12 months for monthly filers, four quarters for quarterly filers and two semi-annual periods for semi-annual filers.

This bill appears to apply to only those who register with the Department after the effective date of 7/1/12. So a taxpayer who registered as a sole proprietorship prior to 7/1/12 would not qualify even if they registered on 6/30/12.

It may be inefficient to allow the claimant to take the deduction from the date of registration with the Department. For various reasons, taxpayer dates of registration generally do not coincide with the date they began business. A taxpayer who registers early will not get the full benefit of the deduction, and a taxpayer who registers late will get more benefit than intended. It is suggested that the date of registration be changed to the date the business generated its first sales.

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

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