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

**SPONSOR** SFC
**ORIGINAL DATE** 01/24/13
**LAST UPDATED** 02/25/13
**HB**

**SHORT TITLE** Tax Expenditure & Revenue Budget & Reporting
**SB** CS/7/SFCS/aSFL

**ANALYST** Walker-Moran

## ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

| FY13 | FY14 | FY15 | 3 Year Total Cost | Recurring or Nonrecurring | Fund Affected |
|---|---|---|---|---|---|
| $130.0 | $130.0 | $130.0 | $390.0 | Recurring | General Fund (TRD) |
| $70.0 | $70.0 | $70.0 | $210.0 | Recurring | General Fund (EDD) |
| $20.0 | $20.0 | $20.0 | $60.0 | Recurring | General Fund (DFA) |
| $20.0 | $20.0 | $20.0 | $60.0 | Recurring | General Fund (LFC) |
| $10.0 | $10.0 | $10.0 | $30.0 | Recurring | General Fund (DOT) |
| **$250.0** | **$250.0** | **$250.0** | **$750.0** | **Recurring** | **General Fund (Total)** |

(Parenthesis ( ) Indicate Expenditure Decreases)

Conflicts with SM 44 (STUDY STATE TAX INCENTIVES) and HB 490 (EVALUATE FILM PRODUCTION TAX CREDIT)

## SOURCES OF INFORMATION
LFC Files

Responses Received From
Taxation and Revenue Department (TRD)
Department of Finance and Administration (DFA)
Department of Transportation (DOT)
Economic Development Department (EDD)
Attorney General's Office (AGO)

## SUMMARY

Synopsis of Senate Floor Amendment

The senate floor amendment requires that the tax expenditure budget and the dedicated revenue budget be posted on the sunshine portal.

Synopsis of Original Bill

The Senate Finance Committee substitute for the Senate Public Affairs Committee substitute for Senate Bill 7 adds two new sections to the Tax Administration Act:

1. Tax expenditure budget – mandatory report – deadline, and
2. Dedicated revenue budget – mandatory report – deadline.

This bill provides a new section of the Tax Administration Act that requires the consensus revenue estimating group (CREG) to compile a tax expenditure budget and a dedicated revenue budget for the next fiscal year and provide a mandatory reporting of these two reports to the governor, the legislative interim revenue stabilization and tax policy committee and the legislative finance committee no later than October 15th of each year. The annual report will include those tax expenditures chosen by the CREG, provided that all tax expenditures with revenue impacts of more than $1 million dollars in the aggregate for a specific tax expenditure shall be reported before the end of the five-year period following the effective date of the provisions of this section, and each five-year period thereafter.

The tax expenditure budget shall: identify each tax expenditure and its statutory basis, purpose, year of enactment and date of repeal (if any); provide a total of all of the costs in each fiscal year for all tax expenditures, revenue sources and beneficiaries of general fund revenues foregone; provide additional details of the estimated foregone revenues for those specific tax expenditure selected in each annual report; aggregate the amount and number of businesses relying on the tax expenditure; and identify unexpected effects of the tax expenditure that were not within the original expected outcomes.

This bill authorizes the CREG to request information from a state or local government agency necessary to complete the tax expenditure and dedicated revenue budgets and authorizes agency officials to comply with such requests.

The CREG's annual report must include estimates of the jobs created and the number of businesses that potentially qualified for but failed to apply for a tax expenditure. The Economic Development Department is required to provide these estimates.

The bill amends section 7-1-8.8 NMSA 1978 to include state professional economists of the department of finance and administration, the department of transportation and the legislative finance committee, return information necessary, not including a taxpayer's name, address or government-issued identification number, to facilitate the compilation of the tax expenditure budget and the dedicated revenue budget.

The SFC substitute eliminated the requirement found in SPAC Substitute that mandated that taxpayers who are allowed tax expenditures by law authorize the taxation and revenue department to reveal information necessary for the purposes of analyzing tax expenditures and reporting to the legislature on the value, benefit and use of such tax expenditures.

There is no effective date of this bill. It is assumed that the new effective date is 90 days after this session ends (June 14, 2013).

## FISCAL IMPLICATIONS

Estimating the cost of tax expenditures is difficult. Confidentiality requirements surrounding certain taxpayer information create uncertainty, and analysts must frequently interpret third-party data sources. The statutory criteria for a tax expenditure may be ambiguous, further complicating the initial cost estimate of the expenditure's fiscal impact. Once a tax expenditure has been approved, information constraints continue to create challenges in tracking the real costs (and benefits) of tax expenditures.

Estimating the impact of compliance with this legislation is based on TRD's experience in preparing of the 2012 Tax Expenditure Report. There are more than four hundred known potential tax expenditures that must be analyzed separately (i.e., many tax expenditures may be applicable to as many as five different tax programs or taxpayer refund revenue tracking systems). If all of these individual tax programs must be investigated annually by TRD Tax Analysis, Research and Statistics staff, it is anticipated that 2.0 FTEs effort is required to extract, estimate and compile the foregone tax revenue data.

This effort is independent of the CREG's efforts to identify, define, and characterize the required statutory and substantive descriptions of all tax expenditures, or the time required to create a balance, logic five year plan to comprehensively investigate the benefits and other details of the identified tax expenditures. Prior to October 15, 2013 this initial structuring of the first year CREG Tax Expenditure Report can be reasonably anticipated to require TRD, DFA, LFC and DOT representatives to meet at least monthly. This would constitute an additional burden of an estimated 100 staff-days, with approximately 50 percent of those hours from TRD resources, 20 percent each from LFC and DFA resources, and 10 percent from DOT resources. TRD adds that the existing staff resources required to complete the CREG Tax Expenditure Report are otherwise committed throughout the six months prior to the October 15, 2013 due date.

EDD reports that the scope of its requirement to estimate the jobs created and the number of businesses that potentially qualified for but failed to apply for a tax expenditure is unclear. However, EDD estimates it will require at least one additional FTE to perform the task.

If additional budget appropriation is not allocated to each agency, this proposal will likely inhibit the ability of state economists to complete other projects and research required during the interim legislative session.

## SIGNIFICANT ISSUES

Many states currently prepare tax expenditure budgets as a means of tracking the impacts of special tax provisions that reduce state revenue in order to target certain populations or activities. As directed by Governor Martinez's executive order 2011-071, a tax expenditure budget was produced and presented in 2012 by the Taxation and Revenue Department. However, it appears the report is incomplete. It does not include all tax incentives, measure economic impact, and draw clear conclusions. Consequently, it poorly informs policy choices. An improved report addressing these issues could better inform policy decisions such as whether certain tax expenditures could be eliminated in favor of lower overall tax rates. A lower rate may be a more effective policy tool for economic development than targeted tax expenditures.

Several major challenges limit the usefulness of these reports such as proprietary or confidential information required for analysis and reliability of estimates of the full economic impacts of tax preferences.

## PERFORMANCE IMPLICATIONS

The LFC tax policy of accountability is met with the bill's requirement 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.

According to the AGO (SFCS), by amending NMSA 1978, Section 7-1-8.8 to include economists, information necessary for the compilation of the required budgets may be disclosed to the entities responsible for compiling these budgets without compromising individual taxpayer confidentiality and without a need for authorization by affected taxpayers to grant authorization for disclosure of necessary information. Further, so amending NMSA 1978, Section 7-1-8.8 eliminates the need to have independent disclosure authority within the new section of the Tax Administration Act created by SFC Substitute for SPAC Substitute for Senate Bill 7.

As reported by the AGO (aSFL), because the tax expenditure budget and dedicated revenue budget mandated by this legislation would very likely constitute public records subject to the provisions of the Inspection of Public Records Act, disclosure of such records to the public upon request would be mandatory. Requiring that they be posted on the sunshine portal would promote the interests of governmental transparency and maximizing public knowledge of the affairs of government, consistent with the principles of the Inspection of Public Records Act. However, prior to posting on the sunshine portal or providing copies of these budgets to individual requestors, careful scrutiny should be applied to ensure that no confidential individual taxpayer information is disclosed or is redacted.

## ADMINISTRATIVE IMPLICATIONS

All departments concur that compliance with the bill would require an additional professional FTE, for which the departments are not currently funded (see Fiscal Impact).

## TECHNICAL ISSUES

On page 2, line 14, the reference to "costs" is unclear. Recommend amending to "administrative costs" if this is the intention.

## OTHER SUBSTANTIVE ISSUES

According to the DFA, this proposal does not take into account the administrative implications, privacy issues, and effects on business. The bill may indirectly provide information to business competitors by disclosing private business practices. New Mexico policy makers should have knowledge of the cost of tax expenditures, but the plan should be developed with all stakeholders in mind.

One of the most difficult challenges in creating a tax expenditure budget is defining the revenue base against which tax expenditures should be measured. Much has been written about defining the base of income and excise taxes in other states and at the federal level, but New Mexico's gross receipts tax is unlike most sales taxes and will be more difficult to model.

As reported by TRD, a significant issue is raised in obtaining the data necessary for the analyses contemplated by this legislation. Currently many tax expenditures are not subject to reporting requirements by taxpayers, and substantial data collection efforts would be required of both the taxpayer and the CREG research team to develop detailed data of the character described by the bill. Moreover, there is already an Executive Order requiring that a tax expenditure report be prepared annually.

**ALTERNATIVES**

The EDD provides additional options pertaining to tax expenditures:

- Amend taxpayer confidentiality provisions to require recipients of tax expenditures to report the desired information to the appropriate departments; and
- Repeal tax expenditures while lowering rates and broadening the tax base.

**WHAT WILL BE THE CONSEQUENCES OF NOT ENACTING THIS BILL**

Tax Expenditure Budgets will be prepared in accordance with Governor Martinez's executive order 2011-071.

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:blm