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

ORIGINAL DATE 01/30/14
SPONSOR Harper & Keller **LAST UPDATED** 01/31/14 **HB** 131

SHORT TITLE Itemize Gross Receipts Deductions & Exemptions **SB**

ANALYST Graeser

APPROPRIATION (dollars in thousands)

Appropriation					Recurring or Nonrecurring	Fund Affected
FY14	FY15	FY16	FY17	FY18		
	$500.0				Nonrecurring	General Fund

(Parenthesis ( ) Indicate Expenditure Decreases)

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

Estimated Additional Operating Budget Impact*				Recurring or Nonrecurring	Fund(s) or Agency Affected
FY14	FY15	FY16	FY 14-16		
$0.0	$200.0	$200.0	$400.0	Recurring	General Fund (TRD)
$0.0	$250.0	$0.0	$250.0	Nonrecurring	General Fund (TRD)

(Parenthesis ( ) Indicate Expenditure Decreases)

Note: TRD would incur substantial systems and forms design costs to implement the provisions of this bill. In addition, data capture, data processing, report generation and other costs would be recurring. See “ADMINISTRATIVE IMPACT” below for a detailed analysis. Note that the appropriation contained in the bill would not be adequate to deliver the complicated changes required by the bill’s provisions.

Duplicates SB 29; also relates to bills requiring an annual or biennial tax expenditure report. These include HJR 5, SJR 5 and SB 30.

SOURCES OF INFORMATION
LFC Files

Responses Received From
Taxation and Revenue Department (TRD)

SUMMARY

Synopsis of Bill

House Bill 131, Section 1, requires a person that is exempt from or may take a deduction against gross receipts tax or compensating tax liability must separately state and itemize the exemption or deduction. The legislation provides for certain (extensive) exceptions to this requirement (see below) and requires the Taxation and Revenue Department to promulgate rules to enforce this requirement.

Sections 2 through 40 establish sunsets for certain existing GRT and Comp Tax exemptions and deductions, these tax preferences and their proposed sunset dates are listed below.

Section 41 appropriates $500,000 from the General Fund to the TRD for expenditure in FY15 and FY16 to:

- Purchase equipment and contract for services necessary to create and process an expanded reporting form for taxpayer reporting of deductions and exemptions required in the bill; and
- Provide public outreach to taxpayers regarding the new reporting requirements.

Section 1 of the bill becomes effective July 1, 2015, and Sections 2 through 41 of the bill become effective July 1, 2014.

Section 1 provides for substantial exemptions from the general reporting requirements. Remaining after excluding the exemptions is the following list of exemptions and deductions for which the reporting requirement is imposed. In general, these are new deductions or exemptions that have been added to the Gross Receipts and Compensating Tax Act since about 2000. Remaining are 51 sections of the GR&CTA subject to the separate reporting requirement.

7-9-13.3	Exemption; gross receipts tax and governmental gross receipts tax; stadium surcharge.
7-9-13.4	Exemption; gross receipts tax; sale of textbooks from certain bookstores to enrolled students.
7-9-13.5	Exemption; gross receipts tax and governmental gross receipts tax; event center surcharge.
7-9-20	Exemption; gross receipts tax; certain receipts of homeowners associations.
7-9-21	Repealed.
7-9-26.1	Exemption; gross receipts tax and compensating tax; fuel for space vehicles.
7-9-30	Exemption; compensating tax; railroad equipment, aircraft and space vehicles.
7-9-40	Exemption; gross receipts tax; purses and jockey remuneration at New Mexico racetracks; receipts from gross amounts wagered.
7-9-41.1	Exemption; gross receipts tax and governmental gross receipts tax; athletic facility surcharge.
7-9-41.2	Exemption; compensating tax; locomotive engine fuel. (Contingent effective date. See note.)
7-9-46	Deduction; gross receipts tax; governmental gross receipts; sales to manufacturers.
7-9-54.2	Gross receipts; deduction; spaceport operation; space operations; launching, operating and recovering space vehicles or payloads; payload services; operationally responsive

	space program services.
7-9-54.3	Deduction; gross receipts tax; wind and solar generation equipment; sales to governments.
7-9-54.4	Deduction; compensating tax; space-related test articles.
7-9-54.5	Deduction; compensating tax; test articles.
7-9-56.3	Deduction; gross receipts; trade-support company in a border zone.
7-9-57.2	Deduction; gross receipts tax; sale of software development services.
7-9-61.2	Deduction; receipts from sales to state-chartered credit unions.
7-9-73	Deduction; gross receipts tax; governmental gross receipts; sale of prosthetic devices.
7-9-73.1	Deduction; gross receipts; hospitals.
7-9-73.2	Deduction; gross receipts tax and governmental gross receipts tax; prescription drugs; oxygen.
7-9-77.1	Deduction; gross receipts tax; certain medical and health care services.
7-9-83	Deduction; gross receipts tax; jet fuel.
7-9-84	Deduction; compensating tax; jet fuel.
7-9-86	Deduction; gross receipts tax; sales to qualified film production company.
7-9-88.1	Credit; gross receipts tax; tax paid to certain tribes.
7-9-88.2	Credit; gross receipts tax; tax paid to Navajo Nation on receipts from selling coal.
7-9-90	Deductions; gross receipts tax; sales of uranium hexafluoride and enrichment of uranium.
7-9-92	Deduction; gross receipts; sale of food at retail food store.
7-9-93	Deduction; gross receipts; certain receipts for services provided by health care practitioner.
7-9-94	Deduction; gross receipts; military transformational acquisition programs.
7-9-95	Deduction; gross receipts tax; sales of certain tangible personal property; limited period.
7-9-97	Deduction; gross receipts tax; receipts from certain purchases by or on behalf of the state.
7-9-98	Deduction; compensating tax; biomass-related equipment; biomass materials.
7-9-99	Deduction; gross receipts tax; sale of engineering, architectural and new facility construction services used in construction of certain public health care facilities.
7-9-100	Deduction; gross receipts tax; sale of construction equipment and construction materials used in new facility construction of a sole community provider hospital that is located in a federally designated health professional shortage area.
7-9-101	Deduction; gross receipts; equipment for certain electric transmission or storage facilities.
7-9-102	Deduction; compensating tax; equipment for certain electric transmission or storage facilities.
7-9-103	Deduction; gross receipts; services provided for certain electric transmission and storage facilities.
7-9-103.1	Deduction; gross receipts tax; converting electricity.
7-9-103.2	Deduction; gross receipts; electricity exchange.
7-9-104	Deduction; gross receipts; nonathletic special event at post-secondary educational institution.
7-9-105	Credit for penalty pursuant to Section 7-1-71.2 NMSA 1978.
7-9-106	Deduction; military construction services.
7-9-107	Deduction; gross receipts tax; production or staging of professional contests.
7-9-110.1	Deduction; gross receipts tax; locomotive engine fuel.

7-9-110.2	Deduction; compensating tax; locomotive engine fuel.
7-9-111	Deduction; gross receipts; hearing aids and vision aids and related services.
7-9-112	Deduction; gross receipts; solar energy systems.
7-9-113	Deduction; gross receipts; special fuel, dyed diesel. (Repealed effective July 1, 2014.)
7-9-114	Advanced energy deduction; gross receipts and compensating taxes.

The bill provides a number of sunsets at various times, including July 1, 2025, July 1, 2027 and July 1, 2029. A complete list of the sunsets is included in Appendix B.

FISCAL IMPLICATIONS

The sunset of these exemptions and deductions specified in the bill will have a positive impact; however, the sunsets occur well outside the forecast period, and are indeterminate.

SIGNIFICANT ISSUES

The most significant issue with the reporting requirement is the costs it will impose on the taxpaying public. In past years, the compliance costs to taxpayers reporting to New Mexico Taxation and Revenue Department (TRD) on the CRS-1 form were estimated at less than 2 percent of the taxes paid. Conventional accounting systems and programs can easily track gross receipts by location. However, conventional accounting systems are not easily adapted to track the multitudinous GRT deductions that are currently available. Compliance costs could easily exceed 10 percent of taxes paid for small to medium-sized businesses. With this level of costs and failure of the bill to provide significant penalties for non-reporting means that overall compliance will be very poor.

The reporting requirements in this legislation may provide better information regarding the cost of tax expenditures. Without reporting on the use of exemptions and deductions, estimates of the impacts of many tax expenditures retain a high level of uncertainty. As pointed out above, New Mexico TRD's experience with reporting requirements when there are no penalties for reporting inaccurately or incompletely is that taxpayers will not pay the same level of attention to the reporting of deductions and exemptions as to the reporting and payment of taxes.

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.

The apparent reason for including some deductions and exemptions in the list and not including others is to require reporting for deductions and exemptions that were enacted after 2000. However, in general, complexity discourages compliance. The complexity of selecting 51 exemptions and deductions that will require separate reporting, the cost to taxpayers to separately track and account for these deductions and the lack of any penalty for non-compliance will probably render the data relatively worthless.

ADMINISTRATIVE IMPLICATIONS

TRD reports a high impact to implement this bill. The bill requires taxpayers that use certain tax expenditures to report them to TRD in a manner that would allow for the required reporting. This would have a very large impact on TRD, both in recurring and non-recurring costs.

TRD IT staff estimates that the reprogramming of the GenTax system would cost approximately $250,000, as a one-time expense. TRD is currently in the process of several significant IT projects and existing staff is insufficient to accomplish another large scale project simultaneously. In order to complete the programming would require the hiring of several contract developers over the course of a six month development cycle, as well as diverting the few available staff from other responsibilities. As with the actual compilation of the report, these are staff resources that are currently dedicated to other important duties.

The Revenue Processing Division (RPD) of TRD would also be heavily impacted. In calendar year 2013, between 4,500 and 23,000 paper CRS returns were processed in a given month, with an average of more than 9,000. The differences in the number of returns reflects seasonal variation and annual, quarterly, semi-annual and monthly filing patterns. Currently, the vast majority of these paper forms are submitted on the short-form CRS return. The short form is very quick to process. If a check is received with the return, the check and short form can be scanned in a specialized scanner that processes the check at the same time that it images the return at a rate of about 1,000 returns per hour. The return acts as a voucher, so that a separate voucher is not needed.

The itemization of CRS tax expenditures would necessitate the move from the short form to the long form CRS return for any tax payer claiming deductions – the short form lacks the physical space for itemized deductions. To process a long form return, staff creates a voucher, sends the newly created voucher through the scanner with any included check for processing, and then scans the return on a larger, slower scanner. The whole process takes several times as long as it takes to process a short form return. The scanner used for the long form is limited to 450 sheets per hour, but as long form CRS returns are multiple pages, the rate is an average of 225 returns per hour. RPD estimates that it would require 8,000 additional personnel hours a year, at a cost of about $200,000 recurring, to maintain current timelines with regard to processing CRS returns. Some of this could be mitigated, but it would necessitate delayed CRS closing dates, which would have the effect of delaying distributions to local governments.

Regardless of which form is used, short or long, all of the information on the forms is manually key entered by RPD staff. Increasing the amount of information on the forms necessarily increases data entry time. This is accounted for in RPD’s estimate of additional staffing requirements. It also bears noting that increased data entry requirements can also lead to increased error rates. TRD would recommend that strengthening electronic filing requirements as a means of reducing the manual processing costs.

Although the bill contains an appropriation of $500.0 for FY 15 and FY 16, the estimated costs for the period are $400.0 recurring and $250.0 non-recurring.

Although it provides for exceptions, the reporting requirement in this legislation increases the reporting burden on the taxpayer and the administrative burden on the TRD. Without a report from TRD the extent to which this added administrative burden would require additional staff hours or would necessitate development of new tax forms is difficult to determine. It is also uncertain whether the non-recurring appropriation would be adequate for a major redesign and implementation of the CRS processing system.

The apparent purpose of this bill is to fully support implementation of the Legislative Finance Committee's tax policy principles, with the exception of simplicity.

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

LG/ds

Appendix A

The following are exemptions from the reporting requirement, including for **deductions** of receipts from:

- sale of tangible property or services for resale;
- sale of tangible property for leasing;
- lease for subsequent lease;
- sale of construction material and services to persons engaged in the construction business;
- lease of construction equipment to persons engaged in the construction business;
- sale or lease of real property and lease of manufactured homes;
- sale of tangible personal property to governmental agencies;
- sale of aerospace services for resale to the United States Air Force;
- transactions in interstate commerce;
- intrastate transportation and services in interstate commerce;
- internet services and hosting world wide web sites;
- sale of certain services to an out-of-state buyer;
- sales through world-wide-web sites;
- sales of livestock feed and fertilizers;
- warehousing, threshing, cleaning, growing, cultivating or harvesting agricultural products;
- selling tangible personal property to 501(c)(3) organizations;
- charges made in connection with the origination, making, or assumption of a loan or for handling loan payments;
- fifty percent of the receipts from selling agricultural implements, farm tractors, aircraft or vehicles that are not required to be registered under the Motor Vehicle Code;
- maintaining, refurbishing, remodeling or otherwise modifying a commercial or military carrier over ten thousand pounds gross landing weight;
- publishing newspapers or magazines;
- selling newspapers;
- selling chemicals or reagents;
- commissions on sales of tangible personal property which are not subject to the GRT;
- real estate commissions on that portion of the transaction subject to GRT;
- refunds and allowances made to buyers or amounts written off as an uncollectible debt;
- furnishing goods or services to the purchaser of tangible personal property to fulfill a warranty obligation;
- administrative, managerial, accounting and customer services performed by a business entity for an affiliate on a nonprofit or cost basis;
- rental or leasing of vehicles used in the transportation of passengers or property for hire in interstate commerce;
- the portion of a seller’s receipts represented by a trade-in of tangible personal property of the same type being sold;
- sale of property used in the manufacture of jewelry;
- selling the service of combining or processing components or materials to a person engaged in the manufacturing;
- travel agents’ receipts from commissions paid by maritime transportation companies and interstate airlines, railroads and passenger buses;
- resale of a manufactured home;
- leasing or licensing of theatrical and television films and tapes;

- 50 percent of the value of agricultural implements, farm tractors, aircraft (comp tax);
- receipts from payments by the US government for provision of medical and other health services;
- use of tangible personal property for leasing;
- equipment and replacement parts to used enrich uranium in a uranium enrichment plant;
- up to two fundraising events annually by a 501(c) other than a 501(c)(3) organization;
- lottery retailer receipts;
- sales to certain accredited diplomats and missions;
- contributions of inventory to certain organizations and governmental agencies;
- receipts from performing management or investment advisory services for mutual funds, hedge funds or real estate investment trusts;
- veterinary medical services, medicine or medical supplies used in medical treatment of cattle;

The bill provides for exemptions from this reporting requirement, including for **<u>exemptions</u>** from GRT of receipts from:

- having a worldwide web site as a third-party content provider on a computer physically located in New Mexico but owned by another nonaffiliated person; and using a nonaffiliated third-party call center to accept and process telephone or electronic orders from out-of-state buyers;
- cash discounts allowed and taken;
- New Mexico GRT, GGRT, and leased vehicle GRT payable on transactions;
- taxes imposed pursuant to the provisions of any local option GRT payable on transactions;
- gross receipts or sales taxes imposed by an Indian nation, tribe or pueblo;
- any type of time-price differential;
- amounts received solely on behalf of another in a disclosed agency capacity;
- amounts received by a New Mexico florist from the sale of flowers, plants or other products made pursuant to orders placed with an out-of-state florist for filling and delivery in New Mexico by a New Mexico florist;
- sales by government agencies;
- services performed outside the state, the product of which is initially used in New Mexico;
- sales subject to GRT or other taxes (exempt from GGRT);
- use of property by government agencies and Indian nations (exempt from comp tax);
- use of property by organizations have been granted exemption from the federal income tax (exempt from comp tax);
- operation by nonprofit entities of facilities providing accommodations for retired elderly persons;
- wages, salaries, commissions or from any other form of remuneration for personal services;
- selling livestock and other agricultural products;
- food stamps;
- feeding or pasturing livestock;
- selling vehicles and boats subject to other tax;
- use of vehicles and boats subject to other tax (exempt from compensating tax);
- insurance premiums and earnings of bondsmen;
- dividends or interest from or sale of stocks, bonds or securities;
- selling using use gasoline, special fuel or alternative fuel;
- use by an individual of personal or household effects brought into the state (exempt from

com tax);

- isolated or occasional sale of or leasing of property;
- organizations that have been granted exemption from the federal income tax;
- carrying on chamber of commerce, visitor bureau and convention bureau functions;
- resale activities of an armed forces instrumentality;
- sale of or leasing of oil, natural gas or mineral interests;
- products subject to Oil and Gas Emergency School Tax Act;
- refiners and persons subject to Natural Gas Processors Tax Act;
- natural resources subject to Resources Excise Tax Act;
- oil and gas consumed in the pipeline transportation of oil and gas products;
- use of oil and gas in the pipeline transportation of oil and gas products;
- use of electricity in the production, conversion and transmission of electricity;
- interstate and certain other telecommunications services;
- fees from social organizations;
- religious activities;
- sales by disabled street vendors; and
- officiating at New Mexico activities association-sanctioned school events.

Appendix B

Sunsetting July 1, 2025 are selected exemptions and deductions from GRT or Compensating Tax of receipts from or use of:

- sales at a minor league baseball stadium on which a stadium surcharge is imposed;
- sale of textbooks from certain bookstores to enrolled students;
- sales at a municipal event center or related to activities occurring at the event center on which an event center surcharge is imposed;
- certain receipts of homeowners associations;
- selling or using fuel for space vehicles;
- use of railroad equipment, aircraft and space vehicles;
- purses and jockey remuneration at New Mexico racetracks and receipts from gross amounts wagered;
- a university athletic facility surcharge;
- use of fuel to be loaded or used by a common carrier in a locomotive engine;
- launching, operating or recovering space vehicles or payloads in New Mexico;
- preparing a payload in New Mexico;
- operating a spaceport in New Mexico;
- providing research, development, testing and evaluation services for the US Air Force operationally responsive space program;
- selling wind generation equipment or solar generation equipment to a government for the purpose of installing a wind or solar electric generation facility;
- space-related test articles used in New Mexico exclusively for research or testing;
- equipment and materials used in New Mexico for research or testing;
- test articles upon which research or testing is conducted in New Mexico pursuant to a contract with the United States department of defense;
- sale of software development services;
- sales to state-chartered credit unions;
- receipts from selling prosthetic devices;
- 50 percent of the receipts of hospitals licensed by the Department of Health;
- sale of prescription drugs and oxygen and oxygen services;
- payments by the US government for provision of medical and other health services;
- payments by a third-party administrator of the federal TRICARE program;
- payments by or on behalf of the Indian health service of the US Department of Health and Human Services for provision of medical and other health services;
- payments by the US government for medical services provided by a clinical laboratory to Medicare beneficiaries pursuant to Title 18 of the federal Social Security Act (SSA); and
- payments by the US government for medical, other health and palliative services provided by a home health agency to Medicare beneficiaries pursuant Title 18 of the SSA.

Sunsetting July 1, 2027 are exemptions and deductions from GRT or Compensating Tax of receipts from or use of:

40 percent of the receipts from the sale of fuel specially prepared and sold for use in turboprop or jet-type engines;

- 40 percent of the value of the fuel specially prepared and sold for use in turboprop or jet-type engines;

- sales to a qualified film production company;
- sale at retail on the first weekend in August of clothing or footwear less than one hundred dollars ($100), a desktop, laptop or notebook computer less than $1,000, school supplies that are items normally used by students in a standard classroom for educational purposes;
- sale of property or services purchased by or on behalf of the state from funds obtained from the forfeiture of financial assurance pursuant to the New Mexico Mining Act;
- biomass-related equipment and biomass materials;
- sale of engineering, architectural and new facility construction services used in construction of certain public health care facilities;
- sale of construction equipment and construction materials used in new facility construction of a sole community provider hospital that is located in a federally designated health professional shortage area;
- sale of equipment for certain electric transmission or storage facilities;
- equipment installed as part of an electric transmission facility or an interconnected storage facility acquired by the Renewable Energy Transmission Authority (RETA);
- providing services to the RETA for the planning, installation, repair, maintenance or operation of an electric transmission facility or an interconnected storage facility;
- transmission of electricity where voltage source conversion technology is employed;
- operating a market or exchange for the sale or trading of electricity, rights to electricity and derivative products;
- producing or staging a professional boxing, wrestling or martial arts contest;
- sale or use of fuel to a common carrier to be loaded or used in a locomotive engine;
- sale of vision aids or hearing aids or related services;
- sale and installation of solar energy systems;
- selling or leasing tangible personal property or services that are eligible generation plant costs.

Sunsetting July 1, 2029 are exemptions and deductions from GRT or Compensating Tax receipts from payments by a managed health care provider or health care insurer for commercial contract services or Medicare part C services provided by a health care practitioner that are not otherwise deductible.