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

ORIGINAL DATE 1/27/15
SPONSOR McCamley **LAST UPDATED** **HB** 18

SHORT TITLE Separate Deductions and Exemptions **SB**

ANALYST van Moorsel/Graeser

APPROPRIATION (dollars in thousands)

Appropriation					Recurring or Nonrecurring	Fund Affected
FY15	**FY16**	**FY17**	**FY18**	**FY19**		
	$500.0				Nonrecurring	General Fund

Parenthesis ( ) indicate expenditure decreases

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

FY15	FY16	FY17	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
	$200.0	$200.0	$400.0	Recurring	General Fund (TRD)
	$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 IMPLICATIONS” 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.

SOURCES OF INFORMATION
LFC Files

Responses Received From
Taxation and Revenue Department (TRD)

SUMMARY

Synopsis of Bill

House Bill 18 requires a person that who is exempt from or who 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 39 establish sunsets for certain existing GRT and Comp Tax exemptions and deductions, these tax preferences and their sunset dates are listed below.

Section 40 appropriates $500 thousand from the general fund to the TRD for expenditure in FY16 and FY17 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 provides for substantial exemptions from the general reporting requirements. After excluding those not required to separately report and those already required to separately report, the following list includes 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 49 sections of the act newly subject to the separate reporting requirement. Thirty-eight of the sections are explicitly sunsetted at various dates, while 11 of the sections are not sunsetted, but are subject to the separate reporting requirement.

Sunsetting July 1, 2024:	
7-9-77.1	Deduction; gross receipts tax; certain medical and health care services.
Sunsetting July 1, 2025:	
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.
7-9-26.1	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.
7-9-54.2	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.
7-9-57.2	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.
Sunsetting July 1, 2027:	
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.
7-9-95	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.
7-9-107	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.
Sunsetting July 1, 2029:	
7-9-93	Deduction; gross receipts; certain receipts for services provided by health care practitioner.

Not Sunsetting in the bill or current statute, but subject to the separate reporting requirement of the bill

7-9-3.4	Definitions; construction and construction materials.
7-9-108	Deduction; gross receipts; receipts from performing management or investment advisory services for mutual funds, hedge funds or real estate investment trusts.
7-9-109	Deduction; gross receipts tax; veterinary medical services, medicine or medical supplies used in medical treatment of cattle.

Erroneously Sunsetting in the bill

7-9-41.2	Deleted in current statute and should not be included in this reporting requirement.

Required in Current Statute to Separately Report

7-9-46	Deduction; gross receipts tax; governmental gross receipts; sales to manufacturers.
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 [Note: this section is sunset as of July 1, 2029.].
7-9-114	Advanced energy deduction; gross receipts and compensating taxes.

The bill provides two effective dates: section 1 of the bill becomes effective July 1, 2016, and Sections 2 through 41 of the bill becomes effective July 1, 2015. The separate reporting section of the bill is delayed one year, to allow TRD to design, organize and program the complex changes required.

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.

The appropriation of $500 thousand contained in this bill is a nonrecurring expense to the general fund. Any unexpended or unencumbered balance remaining at the end of FY 17 shall revert to the general fund.

TRD notes that the bill would have no direct revenue impact but would have significant administrative and compliance impact.

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 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 – particularly when a single business claims a number of different exemptions or deductions. Compliance costs could easily exceed 10 percent of taxes paid for small to medium-sized businesses. This level of costs and failure of the bill to provide significant penalties for non-reporting means that overall compliance may 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, 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 49 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 could cause the collected information to be of questionable reliability.

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 thousand, 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 thousand paper CRS returns were processed in a given month, with an average of more than 9 thousand. 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 one thousand 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 thousand additional personnel hours a year, at a cost of about $200 thousand 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.

The bill does not provide a penalty for incorrect reporting of the 49 deductions or exemptions in the bill. It would also increase the complexity of auditing CRS returns, since the accuracy of the separate deductions would have to be verified. If the auditor found an error in reporting, however, there would be no penalty for misstating the deduction, only an error if the taxpayer erroneously claimed a deduction or exemption and that error affected the reported tax liability.

Although the bill contains an appropriation of $500 thousand for FY 16 and FY 17, the estimated costs for the period are $400 thousand recurring and $250 thousand 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

TECHNICAL ISSUES:

1) Section 7-9-41.2 NMSA 1978 has been deleted. Section 10 of the bill should be deleted.
2) A taxpayer with only exempt income is not required to be registered and is not required to file a tax return. This is not changed pursuant to the provisions of this bill.

OTHER SUBSTANTIVE ISSUES

The separate reporting requirement for Sections 7-9-92 and 7-9-93 is already required. 7-9-92 NMSA 1978 allows a deduction for food for home consumption sold at a food market. 7-9-93 NMSA 1978 allows a deduction for most services provided by health care practitioners. 7-7-90 NMSA 1978 already requires separate reporting to TRD. The section allows a deduction for sales of uranium hexafluoride and enrichment of uranium. Sections 7-9-104, 7-9-106 and 7-9-114 NMSA 1978 contain explicit sunset provisions in the section.

SUGGESTED AMENDMENTS

1) Section 7-9-41.2 NMSA 1978 has been deleted. Section 10 of the bill should be deleted.
2) Delete separate reporting for exemptions. Pursuant to 7-9-5 NMSA 1978, "Any person engaged solely in transactions specifically exempt under the provisions of the Gross Receipts and Compensating Tax Act shall not be required to register or file a return under that act." The provisions of this bill do not and cannot impose a registration or filing requirement for exempt income.
3) If information on some exemptions is desired, convert the exemption into a deduction.

This will then impose a registration and reporting requirement on the taxpayer. For example: 7-9-13.3, stadium surcharge; 7-9-13.4, sale of textbooks from certain bookstores to enrolled students; 7-9-13.5, event center surcharge; 7-9-40, tax; purses and jockey remuneration at New Mexico racetracks; or 7-9-41.1, athletic facility surcharge exemptions could be converted into deductions and made subject to the separate reporting requirement.

4) Without a penalty to accurately report the deductions, there will be disappointing compliance. The penalty amount for erroneous reporting or non-reporting must be at least equal to the benefits conferred on the taxpayer that does not choose to separately track deductions.

PvM/LG/bb