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

ORIGINAL DATE 2/25/15

SPONSOR Smith **LAST UPDATED** **HB**

SHORT TITLE Hold Harmless and GRT Changes **SB** 274

ANALYST Graeser

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY15	FY16	FY17	FY18	FY19		
$0	$90,900.0	$89,900.0	$88,300.0	$86,000.0	Recurring	General Fund, repeal of muni food hold harmless
$0	$15,300.0	$15,200.0	$14,900.0	$14,500.0	Recurring	General Fund, repeal of county food hold harmless
$0	($54,500.0)	($56,900.0)	($59,200.0)	($61,700.0)	Recurring	General Fund, GRT rate
$0	($1,280.0)	($1,360.0)	($1,440.0)	($1,440.0)	Recurring	General Fund, compensating tax rate
$0	($21,500.0)	($22,000.0)	($22,500.0)	($23,000.0)	Recurring	Increase in Working Families Tax Credit
	$28,920.0	$24,840.0	$20,060.0	$14,360.0	Recurring	General Fund Total
	($175.0)	($186.0)	($197.0)	($197.0)		Small Cities Assistance
	($175.0)	($186.0)	($197.0)	($197.0)		Small Counties Assistance (gross, ignoring any reversion)
	($123.0)	($130.0)	($138.0)	($138.0)		Municipal Equivalency
	*	*	*	*	Recurring	Municipalities
	*	*	*	*	Recurring	Counties

(Parenthesis ( ) indicate revenue decreases
[*] Note: some municipalities will gain somewhat more or somewhat less under the provisions of this bill than they will lose with the repeal of the 100% food hold harmless. See discussion below The conversion of the food deduction into a credit and the replacement of the 1.225% state shared GRT by a municipal gross receipts tax will be automatic, without further action by the city councils.

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY15	FY16	FY17	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
Total	150.0	50.0	0.0	200.0	Non-Recurring	TBD Operating Budget

Parenthesis ( ) indicate expenditure decreases

TRD reports a high impact on the IT division – approximately 2,000 hours. This estimate is approximately quantified above. While this will be non-recurring, it is unlikely that the changes can be successfully implemented before the July 1, 2015 effective date.

TRD may need additional IT resources to program these extensive changes into the GenTax system. All of the patterns are in place, but the tax tables will be extensively revised and the RP-500 report will have to be extensively reviewed and revised. The programming for the food hold-harmless can be abandoned, but the programming for the medical care hold harmless will have to be revised for the large municipalities.

SOURCES OF INFORMATION
LFC Files

Responses Received From
Office of the State Auditor (OSA)
Taxation and Revenue Department (TRD)

SUMMARY

Synopsis of Bill

Senate Bill 274 attempts to resolve the controversy surrounding 2010's phased repeal of the food and medical hold harmless distributions. These hold-harmless distributions were enacted in 2004 and served to, as the name implies, hold counties and municipalities harmless to the fiscal effects of a gross receipts tax deduction for food sold at retail stores and some medical services. This bill resolves the controversy by essentially reimposing the ***municipal and county tax rates*** on food sold at retail, but not re-imposing the state tax rate effective within municipal boundaries. The bill has several subtle details and adequate provisions to protect revenue bond covenants. A section by section description is included with this analysis as well as a summary matrix. The bill also increases the working families tax credit administered through the personal income tax system from 10 percent of the federal credit amount to 14 percent of the federal credit. This feature addresses a portion of the regressivity implicit in a transaction tax like the New Mexico Gross Receipts Tax.

The effective date of the act or the provisions of the act is essentially July 1, 2015, however, some of the sections dealing with distributions are technically effective August 1, 2015. The Working Families Tax Credit would be effective for the 2015 tax year. TRD could allow this credit by adjusting the Withholding Tables effective July 1, 2015, but might delay this provision and allow the full amount of the Working Families Tax Credit.

FISCAL IMPLICATIONS

Both TRD and LFC have built elaborate models to confirm the fiscal impacts reported in the table above. The design of the bill is for the General Fund and the Counties and Municipalities, in aggregate, to be approximately revenue neutral. Because there are so many moving parts, the analytical spreadsheets are, perforce, quite complex.

On the other hand, both the Gross Receipts Tax and compensating tax reductions are straightforward and conform to the February Consensus Revenue Estimating Group's (CREG) revised revenue estimate. The Working Families Credit is similarly straightforward.

A key feature of the bill is a municipal credit, similar to the .5% municipal credit enforced between 1982 and 2004. In effect, the municipal credit was equivalent to a state GRT rate of 5% applicable to sales in county areas and 4.5% in municipal areas. Through the use of this virtually automatic credit device, the tax on food would be equal to 1.225% plus all local options in municipal areas and equal to the sum of county remainder local options in county remainder areas.

Working Families Credit				
Fiscal Year	Claims	Expenditures ($Thousands)	$/Claim	Increased GF Expenditures
FY 2009	194,118	$40,632.2	$209	
FY 2010	200,744	$45,798.3	$228	
FY 2011	213,199	$47,870.1	$225	
FY 2012	213,000	$49,078.0	$230	
FY 2013	211,210	$49,847.0	$236	
FY 2014 est	210,000	$50,400.0	$240	
FY 2015 est	209,000	$52,250.0	$250	
FY 2016 est	208,000	$54,080.0	$260	$21,500.0
FY 2017 est	207,000	$55,890.0	$270	$22,000.0
FY 2018 est	206,000	$57,680.0	$280	$22,500.0
FY 2019 est	205,000	$59,450.0	$290	$23,000.0

SIGNIFICANT ISSUES

See the section-by-section analysis appended to this document. The matrix details the complex changes proposed in this bill.

The bill has a number of moving parts but the overall effect will be as follows:

- The 2004 untaxing of food sold at retail and of some medical services will be partially reversed. The state will not participate in gaining any revenue from the conversion of the food deduction of 7-9-92 NMSA 1978 into a partial credit.
- The Counties and the Municipalities would tax food at a rate such that only the local option taxes plus the State shared 1.225% would be imposed.
- The food hold harmless would be repealed for all cities and counties.
- The medical care hold harmless would be, after a number of technical changes, be held completely harmless to these provisions.
- Technically, the means to accomplish the foregoing is to pull the current 1.225% state share for municipalities into the municipal local option tax act. This conversion of the food deduction at 7-9-92 NMSA 1978 into a partial credit equal to the state rate in counties of 5.125% (which becomes 5.0% pursuant to the provisions of the bill) or the state rate in municipalities of 5.125% - 1.225% = 3.90% (which becomes 5.0% - 1.225% = 3.775% pursuant to the provisions of the bill) is the key feature of this bill.
- The General Fund will be relieved of the obligation of paying the food hold harmless. This will generate an initial $106 million for FY 2016 and decline by $1 to $3 million a year until 2029 when the current phase-down schedule expires.
- The bill spends this money in three ways: (1) The bill reduces the statewide GRT rate from the current 5.125% to 5.00%. This brings the rate back to what it was prior to the change engineered by Laws 2010 (2nd S.S.), chapter 7, §9. It does not, however, reinstate the .5% municipal credit which was repealed in 2004 when the food and medical services deductions were first implemented; (2) the bill reduces the statewide compensating tax

rate from the current 5.125% to 5.00%.

- The bill also increases the Working Families Tax Credit from 10% of the Federal Working Families Tax Credit to 14%.
- To summarize the effect of the GRT portions of this bill, we will list an example: The current rate for all goods and services in the City of Santa Fe is 8.1875% broken down into:

  3.900% state rate
  1.225% state share
  1.8125% municipal option
  1.25% county option
  8.1875% total

  With the changes in this bill, the rate on all commodities except for food will be:

  3.775% state rate in municipal areas
  1.225% muni basic option
  1.8125% municipal option
  1.25% county option
  8.0625% total

  But for food, the state rate drops out:

  1.225% muni basic option
  1.8125% municipal option
  1.25% county option
  4.2875% total

- Of concern to policy wonks and fiscal conservatives, the amount of "General Fund Total" accurately measures the plausible amount of net tax increase from the provisions of this bill only for the inaugural year of FY 2016. This is because the gain from the phased repeal has already been built into the revenue estimate for FY 2017 et. seq.
- There are three caveats concerning this revenue estimate. The revenue gain may be less than estimated if many food stores are claiming all food sales, including the sale of food to Supplemental Nutrition Assistance Program (SNAP) recipients, as deductible under 7-9-92 NMSA 1978 rather than exempt under the provisions of 7-9-18.1 NMSA 1978. The total amount of SNAP benefits redeemed in NM ~$680m in 2013. At an average statewide local option rate 0f 1.9% plus the 1.225%, this is a contingent total of $21 million less than the new food tax might be expected to generate. This is, of course, a substantial portion of the first year revenue amount of $106 million. The likelihood is that most retail food stores are able to distinguish between exempt sales to SNAP recipients, deductible food sales to non-SNAP customers and fully taxable sales of non-food items.
- The second caveat is that the current hold-harmless food distribution is limited for most larger cities and counties to pre-2007 GRT local option rates. With the changes proposed in this bill, these larger cities and counties will receive the revenue from the post-2007 enactments. This may be significant for some jurisdictions.
- The third caveat is that the bill allows municipalities and counties that have enacted all or a portion of the "Hold-Harmless Gross Receipts Tax" and have pledged revenues from this new tax for revenue bonds to retain that authorized rate in place until the bonds are paid off. There might be a rush to adopt and bond this hold-harmless GRT between the time the bill passes and the July 1, 2015 effective date. In any event, the nine jurisdictions that have already enacted a hold-harmless GRT might consider pledging this revenue for

bonds rather than have the authorization cancelled. At least some of the communities that have enacted the hold-harmless GRT even before the first 6% phase-down occurs as of July 1, 2015 may have used the promise of the revenue reductions to blame the tax increase on the State.

The bill expands the tax base for counties and municipalities to include food sold at retail. This is a substantial portion of the base and has been one of the components that has grown, despite the effects of the “Great Recession”.

Increasing the Working Families Credit by $22 or $23 million may have the effect of moderating the regressively of the tax.

ADMINISTRATIVE IMPLICATIONS

TRD reports a high impact -- 2,000 hours to implement system changes. Eliminating food hold harmless distribution and changing the food deduction to a credit will involve the changes on configuration and documents of combined reporting system (CRS) returns in Gentax, CRS Taxpayer Access Point, CRS rate structure, business objects (BOs) for daily distribution, monthly calculation for administrative fee and multiple reports in revenue accounting model, and the program for CRS rates updating. Working family credit will involve the configuration and document changes on the personal income tax return, which can be done with new year changes.

TECHNICAL ISSUES

The deletion of explicit reference on page 4, lines 21 and 22 may cause some confusion. The deletion is “plus one and two hundred twenty-five thousandths percent.” However, the definition earlier in the paragraph is “the combined rate of all municipal local option gross receipts taxes in effect…” is implicitly changed in Section 10 of the bill. The “municipal gross receipts tax” is now defined to be the sum of the current 1.500% municipal GRT plus an additional 1.225% tax rate that was formerly the state share.

LG/je/bb

	Current Treatment – Hold Harmless Distrib	Proposed Treatment Hold-Harmless Distrib	Proposed Local Tax Option
All other GRT			
All cities			
1.225% state share	**distributed**	**repealed**	**replaced by local option 1.225%**
1.225% of municipal GRT			**credited against tp's liab, effectively reducing state effective tax rate in munis to 3.775%**
Local options	**distributed**	**distributed**	**distributed**
All counties			
Local options	**distributed**	**distributed**	**distributed**
Food			
Small Cities not enacted hold harmless			
1.225% state share	**Distributed**	**repealed**	**replaced by credit which distributes 1.225%**
1.225% of municipal GRT			**credited against tp's liab, effectively reducing state effective tax rate to 3.775%**
Muni options pre 2007	**distributed**	**repealed**	**all local options distributed (no change)**
Muni options post 2007	**distributed**	**repealed**	**all local options distributed (no change)**
Small cities enacted hold-harmless option			
1.225% state share	**distributed, phased repeal**	**repealed**	**replaced by credit which distributes 1.225%**
1.225% of municipal GRT			**credited against tp's liab, effectively reducing state effective tax rate to 3.775%**
Muni options pre 2007	**distributed, phased repeal**	**repealed**	**all local options distributed**
Muni options post 2007	**not distributed**	**repealed**	**all local options distributed**
Large cities and small cities enacted			
1.225% state share	**distributed, phased repeal**	**repealed**	**replaced by credit which distributes 1.225%**
1.225% of municipal GRT			**credited against tp's liab, effectively reducing state effective tax rate to 3.775%**

	Current Treatment – Hold Harmless Distrib	Proposed Treatment Hold-Harmless Distrib	Proposed Local Tax Option
Muni options pre 2007	distributed, phased repeal	repealed	all local options distributed
Muni options post 2007	distributed, phased repeal	repealed	all local options distributed
Small counties not enacted hold-harmless	distributed	repealed	all local options distributed
Large counties and small counties enacted	distributed, phased repeal	repealed	all local options distributed
Medical Services			
Small Cities not enacted hold harmless			
1.225% state share	distributed	repealed	replaced by credit which distributes 1.225%
1.225% of municipal GRT			credited against tp's liab, effectively reducing state effective tax rate to 3.775%
Muni options pre 2007	distributed	distributed	no change
Muni options post 2007	distributed	distributed	no change
Large Cities and small cities enacted			
1.225% state share	distributed, phased repeal	repealed	replaced by credit which distributes 1.225%
1.225% of municipal GRT			credited against tp's liab, effectively reducing state effective tax rate to 3.775%
Muni options pre 2007	distributed, phased repeal	distributed, phased repeal	no change
Muni options post 2007	not distributed		no change
Small counties not enacted hold-harmless	distributed	distributed	no change
Large counties and small counties enacted	distributed, phased repeal	distributed, phased repeal	no change

Note: "Small County" is one with population less than 48,000 at the most recent decennial census. "Small City" is one with population less than 10,000.
Note: Los Alamos County, a class-H county has special provisions.
Note: the distribution for counties is separated into a piece for gross receipts within municipal boundaries and a separate piece for gross receipts in remainder county areas.
Note: four cities and five counties have already imposed the 3/8% municipal or county hold-harmless gross receipts tax local option rate. These rates will be cancelled as of the effective date of the bill unless the jurisdiction pledges this revenue for bonds.

Section-by-section analysis and description:

Section 1 amends 7-6-4 NMSA 1978 to provide the 1.225% state share distribution only on state fairgrounds and ancillary land, such as airports, owned by a municipality outside the corporation boundaries. In effect, the section repeals the 1.225% state share distribution to municipalities. Note: while retaining the distribution to Albuquerque for gross receipts at Expo, it is difficult to envision a policy reason to retain the 1.225% on muni-owned land outside corporation boundaries. However, since this is "the deal," leaving the language in the bill as in current law is the only means to ensure the transfer of funds to the municipalities.

Section 2 amends 7-1-6.46 NMSA 1978 to provide:

- For communities under 10,000 population that have not imposed a municipal hold harmless local option GRT to retain the medical hold-harmless distribution for deductions claimed under the provisions of 7-9-93. These municipalities are will have the 1.225% state share replaced with a new 1.225% municipal gross receipts tax. The food hold harmless distribution is repealed for all municipalities.
- For other municipalities, whether over 10,000 population or those that have imposed a hold harmless distribution the food hold harmless distribution is repealed as of the effective date of the act. The phased out medical hold-harmless distribution is retained for the full amount of the medical deduction multiplied times the municipal option rate in place as of January 1, 2007 including the 1.225% state share. The percentage reduces by six or seven percentage points each year until July 1, 2029 when the medical hold-harmless distribution is fully phased out.

Section 3 amends 7-1-6.47 NMSA 1978 to provide similar treatment for small counties with less than 48,000 population. Thus, the food hold harmless distribution is repealed as of the effective date of this act. The medical hold-harmless is retained without reduction for small counties. The medical hold-harmless for larger counties is retained with the six or seven percentage point reduction each year until July 1, 2029 when the medical hold harmless distribution is fully phased out.

Section 4 amends 7-2-18.15 NMSA 1978 to increase the percentage of Federal Working Families Tax credit from the current 10% to 14% to address a portion of the regressively of the increase in gross receipts tax pursuant to the provisions of this bill.

Section 5 amends 7-9-4 NMSA 1978 to decrease the state gross receipts tax rate from 5.125% to 5.000%.

Section 6 amends 7-9-7 NMSA 1978 to decrease the compensating tax rate from 5.125% to 5.000%.

- On net, however, the new tax imposed on food sold at retail will only be about ¼ of the amount of the value of the food deduction for food consumers. For FY 2016, the repeal of the food hold harmless will be about $106 million. The reduction in GRT rate will be about $54 million and the FY 2016 amount for the Working Families Tax Credit increase will be about $22 million. Since the cities and counties are essentially held revenue neutral to this proposal, the net amount of $28 million for FY 2016 is the best measure of the amount of "new tax." The amount of new tax will grow each year, even though the General Fund fiscal estimate becomes a smaller and smaller each year until it vanishes. This is because the effect of the phased-down food hold-harmless has already been included in the revenue estimate.

Note: no adjustment is made to 7-9-4.3 NMSA 1978 -- the governmental gross receipts tax rate. This rate was not increased in 2010 when the gross receipts tax rate was increased. Also, no adjustment has been made to the interstate telecommunications tax rate in section 7-9C-3 NMSA 1978. This has been 4.75% since enactment in 1992.

Section 7 amends 7-9-92 NMSA 1978 to change the 100% deduction for the value of food sold at retail food store into a credit at the rate of the state gross receipts tax less the municipal state share. This would be 5.000% - 1.225% = 3.775% for food sold at retail food store located within a municipal boundary and 5.000% for food sold in remainder county areas.

Section 8 enacts a new section of the GR&CTA to allow a credit against the taxpayer's gross receipts tax liabilities in the amount of the taxable gross receipts times the rate in effect pursuant to Subsection C of 7-19D-9 NMSA 1978. This section is the new 1.225% municipal gross receipts tax. The imposition of this 1.225% municipal gross receipts tax is automatic and subject neither to a positive or negative referendum.

Section 9 amends 7-19D-7 NMSA 1978 to approximately hold harmless the amount of administrative fee imposed on municipal distributions. Currently, the administrative fee – now 3% -- is not collected on the 1.225% state share plus the first .5%. The 1.225% state share has been repealed for all municipalities, so the equivalent total of 1.725% is now allowed against the total municipal gross receipts tax. In Section 10 of this bill, the maximum authorized enactment of municipal gross receipts tax amendment in increased to 1.5% plus 1.225%, so this section simply holds to current practice.

Section 10 amends 7-19D-9 NMSA 1978 – the Municipal Gross Receipts Tax Act to impose the current 1.225% state share as a municipal option gross receipts tax. This imposition can be done by ordinance, without positive or negative referendum.

Section 11 is a new section that will not be compiled. This section ensures that any covenants for revenue bonds pledged against any of the municipal local options, the food and medical hold harmless distributions or the current 1.225% state share are properly dealt with.

Section 12 repeals Sections 7-19D-18 and 7-20E-28 NMSA 1978. The former sections is the 3/8% municipal hold harmless in-lieu tax and the latter is the county 3/8% hold harmless tax rate. No provision is made for repealing rates imposed by Las Cruces, Lovington, Espanola or Corrales enacted under the provisions of 7-19D-18 or by Cibola, Grant Harding, Sierra or Valencia Counties pursuant to the provisions of 7-20E-28 NMSA 1978.

Section 13 provides applicability dates: The provisions of the swap are applicable for reporting periods beginning on or after July 1, 2015. The provisions of the increase in Working Families Tax credit are applicable for the 2015 Tax Year et. Seq.

Section 14 makes section 1 through 3 effective with the first distribution of reported gross receipts taxes reported from July sales. That is August 1, 2015. Sections 5 through 12 are effective July 1, 2015.