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

ORIGINAL DATE 1/25/17
SPONSOR Thompson **LAST UPDATED** **HB** 152

SHORT TITLE Tax Expenditure Budget **SB**

ANALYST Iglesias

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

FY18*	FY19*	FY20*	3 Year Total Cost*	Recurring or Nonrecurring	Fund/Agency Affected
$500.0	$200.0	$200.0	$900.0	Recurring	General Fund (TRD)
$220.0	$220.0	$220.0	$660.0	Recurring	General Fund (LFC)
$100.0	$100.0	$100.0	$300.0	Recurring	General Fund (DFA)
$100.0	$100.0	$100.0	$300.0	Recurring	General Fund (DOT)
$100.0	$100.0	$100.0	$300.0	Recurring	General Fund (NMEDD)
$1,200.0	**$720.0**	**$720.0**	**$2,460.0**	**Recurring**	**General Fund (Total)**

* Because the bill does not specify how the research activities and assignments are distributed and coordinated among the Consensus Revenue Estimating Group members, it is not possible to exactly quantify the costs. See additional details in the fiscal impact section.

SOURCES OF INFORMATION
LFC Files

Responses Not Received From
Department of Finance and Administration (DFA)

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

SUMMARY

Synopsis of Bill

House Bill 152 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.

This bill authorizes 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 unless statutorily prohibited from doing so due to confidentiality provisions.

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 (EDD) is required to provide these estimates.

There is no effective date of this bill. It is assumed that the new effective date is 90 days after this session ends (June 15, 2017).

FISCAL IMPLICATIONS

This proposed amendment would have no direct revenue impact, but would have significant compliance and administrative impact.

Estimating the impact of compliance with this legislation is based on TRD's experience in preparation of the tax expenditure reports. There are hundreds of 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).

This effort is independent of 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 balanced, logical five-year plan to comprehensively investigate the benefits and other details of the identified tax expenditures. Prior to October 15, 2017, this initial structuring of the first year CREG tax expenditure report can be reasonably anticipated to require TRD, Department of Finance and Administration (DFA), LFC and DOT representatives to meet at least monthly, and each of the 10 economists would need at least one day preparation time before the meeting. This would constitute an additional burden of an estimated 120 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 indicates the provision requiring taxpayers that use any tax expenditures to report them to CREG in a manner that would allow for the required reporting would have a very large impact on TRD, both in recurring and non-recurring costs.

TRD Information Technology Division staff estimate the reprogramming of the GenTax system would cost approximately $300,000, as a one-time expense. TRD is currently in the process of several significant information technology projects, and existing staff is insufficient to accomplish another large scale project simultaneously. In order to complete the programming, TRD 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.

Additionally, TRD indicates the bill would also require significant changes to forms for Combined Report System (CRS) returns to allow for the itemization of all CRS tax expenditures, significantly affecting their Revenue Processing Division (RPD) budget. RPD estimates that it would require 8,000 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.

All departments concur that compliance with the bill would require an additional professional FTE, for which the departments are not currently funded. In addition to TRD's personnel costs discussed above, an estimate of $100 thousand is added for LFC, DFA, DOT, and EDD for the salary and benefits of an additional staff member. DOT indicates the purchase of specific database software and a data warehouse would also be required. In order to do a complete and thorough analysis of the costs and benefits of tax expenditures, LFC indicates the licensing of dynamic scoring software would be required, a recurring cost of about $120 thousand.

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.

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.

SIGNIFICANT ISSUES

CREG would be unable to comply with the requirements of this bill to report all expenditures without changes in the GenTax system, additional taxpayer reporting, and additional FTE.

TRD currently produces an annual tax expenditure report identifying all tax expenditures, items that are not tax expenditures, and arguable tax expenditures. The current report provides the latest five years of data or attempts to use third party data to provide an estimate of what the expenditure revenue loss is. The data ranges from a reliability of 1 to 4 with 1 & 2 being the most reliable data that is reported to the department and 3 & 4 being the least reliable data that is not reported to the department. This bill appears to require actual cost quantification of all expenditures. About half of the provisions TRD classifies as "tax expenditures" in its annual report are either not reported to TRD or not separately reported in a manner that facilitates calculation of actual costs. A significant change in the way taxpayers report data would be required, and significant programming changes in the GenTax system would also be required.

TRD indicates the bill also requires collection of data that is inherently unknowable or unquantifiable. For example, CREG is required to identify the "unexpected effects" of the tax expenditure. The majority of tax expenditures currently do not have a legislatively defined purpose statement. Moreover, many that do have very general purpose statements focus on indirect benefits. Without a fully defined purpose statement and desired outcome, CREG is required to define and measure what is "unexpected," which is highly subjective, at best. Moreover, New Mexico is not a "legislative history" state. Rather, New Mexico employs a "plain meaning" rule, in which the text of the statute is the primary, essential source of its meaning (Section 12-2A-19 NMSA 1978). If a taxpayer falls within the plain meaning of an expenditure, but that result is somehow an unintended consequence, CREG may have no mechanism to become aware of a subject expectation that differs from the statutory language.

The economic literature does not fully agree on what a tax expenditure program is, nor on how to evaluate and estimate the revenue losses related to tax expenditure programs. Further, there is no established approach to evaluate how a tax expenditure alters demand. There is also no method of accounting for dynamic fiscal impacts resulting from a reduced tax. Relying on simplified assumptions to address the aforementioned problematic issues might limit the usefulness of these reports.

It is also unclear how the research assignments will be shared between the CREG economists, and how CREG can formally reach a consensus in case the economists, or possibly industry lobbyists, disagree on the definition of tax expenditures or on the estimation methods.

The requirement to estimate jobs created and number of businesses that potentially qualified for but failed to apply for a tax expenditures would be a very difficult task. EDD would be required to determine the entire universe of potential businesses, identify each individual expenditure they could potentially qualify for, and guess at why they did not apply for an expenditure.

Currently, there are only a few tax expenditures that are statutorily administered by EDD. Without access to data on other tax expenditures, EDD states it will be difficult to estimate this and provide meaningful projections. EDD focuses on economic-based businesses that create a significant impact to the economic development of the state. The bill does not specify any particular type of business but includes all businesses. Thus, it will be extremely difficult and cumbersome for EDD to provide accurate numbers on businesses which have had no contact with EDD.

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.

Since CREG has no staff of its own, and members have a wide range of responsibility within their respective departments, it is unclear whether responsibility for preparation of the tax expenditure budget and dedicated revenue budget might detract from CREG's ability to focus on improvements to general fund revenue forecast methodologies.

According to EDD, it may not be possible for EDD to perform this task with an assurance of accuracy. It will require additional staff time. If a method was found that assisted EDD in obtaining the necessary list of businesses, contacting those businesses would be very time consuming.

ADMINISTRATIVE IMPLICATIONS

Adding a forecast of one year of all tax expenditures, as required by this bill, would create a significant burden on the economists. CREG currently forecasts a select number of tax expenditures as part of its quarterly consensus revenue estimate to improve the accuracy of the forecast. This requires very accurate data and significant time. Due to the large number of tax expenditures and the significant number that are not reported directly to the department this would be a very difficult and time consuming task for the CREG economists to perform on all tax expenditures. All departments, including those with CREG members and EDD, indicate additional staff would be needed to meet the requirements of the bill.

TECHNICAL ISSUES

TRD points out that revealing of confidential taxpayer information to individuals who are not employees of TRD is restricted by Sections 7-1-8.2 – 7-1-8.10 NMSA 1978.

On page 2 line 16, the bill says the report shall quantify the revenue expended; however, tax expenditures are defined broadly on page 4 as to include anything that reduces tax liability where no revenue is expended or spent. Perhaps forgone would better reflect tax expenditures as defined in the bill.

EDD notes the bill defines “dedicated revenue” to be an expenditure of a tax or fee that is dedicated to a specific program or purpose. It then defines “tax expenditure” to be a deduction, credit, exemption, exclusion, rebate, offset, preferential tax rate, subtraction, or allowance or other deviation from a tax system that reduces tax liability as determined by the consensus revenue estimating group. Based on these definitions, EDD deduces that there is no clear-cut difference between a tax expenditure and a dedicated revenue. Also, EDD points out the bill mentions “the department” but does not explicitly define who/what “the department” is.

OTHER SUBSTANTIVE ISSUES

The bill allows CREG to request from state agencies and local government agencies all information necessary to complete the tax expenditure budget and the dedicated revenue budget. However, the bill does not specify if state or local government agencies have a timeframe for complying with the request.

The bill also allows CREG to request information from taxpayers (unless this is not prohibited by another section of the law). However, for many tax expenditures it is not clear how CREG can identify the taxpayers that benefit from a particular tax expenditure program. In case the identification of the taxpayer is possible, it is not clear if the taxpayer is required to comply or could comply on a voluntary basis. Consequently, CREG might not be able to obtain the relevant information for preparing the reports.

TRD indicates creating the two mandatory reports (tax expenditure budget and dedicated revenue budget) in this bill is a complex task as these reports must contain multiple details on tax expenditures and specific elements including the approximate projected dedicated revenue for the following fiscal year that will be unavailable to the general fund. Considering the effort and estimated time needed to implement, the effective date of June 15, 2017, 90 days following the adjournment, is not feasible. This report would only provide the detail that is currently reported separately by taxpayers. The economists currently gather this data at significant time and difficulty by different methods.

AMENDMENTS

EDD suggests a possible amendment could require other offices to forward a list of New Mexico businesses to EDD. However, business registration data may be the most accurate method for finding new businesses. All business registrations are granted by local governments. Therefore, all 33 counties and the more than 100 incorporated municipalities would have to cooperate in sending business registration information to EDD or another state agency.

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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