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

SPONSOR HTRC	**ORIGINAL DATE** 01/30/17 **LAST UPDATED** 03/13/17	**HB**	202/HTRCS/aHFl#1/ aSFC/aSFl#1
SHORT TITLE Tax Of Businesses Without Physical Presence		**SB**	
		ANALYST	Clark/Graeser/Iglesias

REVENUE (dollars in thousands)

Total Revenue by Fund: General Fund, Road Funds, and Medicaid

Estimated Revenue*					R or NR **	Fund Affected
FY17	FY18	FY19	FY20	FY21		
$0.0	$114,202.6 or $156,061.0	$103,636.1 or $146,400.0	$92,929.2 or $136,619.1	$95,909.1 or $139,358.0	R	General Fund
$0.0	$26,400.0	$26,400.0	$26,400.0	$26,400.0	R	County Supported Medicaid Fund
$0.0	$125,939.9	$128,089.5	$0.0	$0.0	R	Tax Stabilization Reserve
$0.0	$55,154.8	$55,490.9	$166,309.2	$166,875.8	R	Road Funds

Parenthesis ( ) indicate expenditure decreases. ** R = recurring; NR = non-recurring

* The estimates assume $20 million for the internet sales section (a conservative midpoint), $12.7 million for the corporate income tax (CIT) rate delay, and either $0 or the full amount for the weight-distance tax permit fee (see individual impacts below and Fiscal Implications)

Total Revenue Sources by Bill Component

Estimated Revenue*					R or NR **	Fund Affected
FY17	FY18	FY19	FY20	FY21		
$0.0	$20,000.0	$20,000.0	$20,000.0	$20,000.0	R	Internet Sales
$0.0	$107,002.6	$96,436.1	$99,329.2	$102,309.1	R	Health Care
$0.0	$900.0	$900.0	$900.0	$900.0	N	Legislative Retirement
$0.0	$0.0 or $41,858.4	$0.0 or $42,763.9	$0.0 or $43,689.9	$0.0 or $43,449.0	R	Weight-Distance Tax Permit Fee
$0.0	$49,167.0	$51,000.0	$53,000.0	$54,000.0	R	Increase Motor Vehicle Excise Tax to 4%
$0.0	$131,927.7	$132,580.4	$113,309.2	$112,875.8	R	Fuel Tax Increases & Distribution Changes (Tax Stabilization Reserve & Road Funds Impact Only)
$0.0	$12,700.0	$12,700.0	$0.0	$0.0	N	CIT Rate Delay

Parenthesis ( ) indicate expenditure decreases. ** R = recurring; NR = non-recurring

Internet Sales Gross Receipts Tax

Estimated Revenue*					R or NR **	Fund Affected
FY17	FY18	FY19	FY20	FY21		
$0	$8,820.0 - $38,300.0	$9,240.0 - $39,800.0	$9,720.0 - $41,400.0	$10,140.0 - $43,100.0	R	General Fund
$0	$5,880.0 - $20,400.0	$6,160.0 - $21,200.0	$6,480.0 - $22,000.0	$6,760.0 - $22,900.0	R	Local Governments

Parenthesis ( ) indicate expenditure decreases. ** R = recurring; NR = non-recurring

* These revenue estimates are highly uncertain and might be challenged in court (see “Fiscal Implications” and “Significant Issues”)

Healthcare Tax Reform

Estimated Revenue					R or NR **	Fund Affected
FY17	FY18	FY19	FY20	FY21		
$0.0	$80,602.6	$70,036.1	$72,929.2	$75,909.1	R	General Fund
$0.0	$26,400.0	$26,400.0	$26,400.0	$26,400.0	R	County Supported Medicaid Fund

Parenthesis ( ) indicate expenditure decreases. ** R = recurring; NR = non-recurring

Legislative Retirement Fund

Estimated Revenue					R or NR **	Fund Affected
FY17	FY18	FY19	FY20	FY21		
$0.0	$900.0	$900.0	$0.0	$0.0	N	General Fund
$0.0	$0.0	$0.0	$900.0	$900.0	N	Judicial Retirement Funds

Parenthesis ( ) indicate expenditure decreases. ** R = recurring; NR = non-recurring

Weight-Distance Tax Identification Permit Fee

Estimated Revenue*					R or NR **	Fund Affected
FY17	FY18	FY19	FY20	FY21		
$0.0	$0.0 or $41,858.4	$0.0 or $42,763.9	$0.0 or $43,689.9	$0.0 or $43,449.0	R	General Fund
	0.0 or (4,200.0)	0.0 or (4,300.0)	0.0 or (4,400)	0.0 or (4,300.0)	R	Weight-Distance Tax Identification Administration Fund

Parenthesis ( ) indicate expenditure decreases. ** R = recurring; NR = non-recurring

* The estimates shown are not ranges – they are “either or” numbers. Imposition of a flat, per vehicle, non-apportioned registration fee on interstate trucking has been held to violate the commerce clause of the U.S. Constitution. It is possible that this effort to increase a $5.50 per vehicle identification permit to $95.50 per vehicle, irrespective of how many miles the trucks travel in New Mexico annually, could also be held to be in violation of the U.S. Constitution commerce clause. The industry might seek a temporary restraining order to prevent the new law from taking effect. Depending on the exact order, a judge may invalidate the “up to $10” administrative fee in 7-15A-13 NMSA 1978. If this were to happen, then the beneficiaries of the weight distance tax identification permit administration fund would also lose revenue.

Motor Vehicle Excise Tax

Estimated Revenue					R or NR **	Fund Affected
FY17	FY18	FY19	FY20	FY21		
$0.0	$49,167.0	$51,000.0	$0.0	$0.0	R	Tax Stabilization Reserve
$0.0	$0.0	$0.0	$53,000.0	$54,000.0	R	NEW State Road Maintenance Fund

Parenthesis ( ) indicate expenditure decreases. ** R = recurring; NR = non-recurring

Fuel Taxes

Estimated Revenue*					Recurring or Nonrecurring	Fund Affected
FY17	FY18	FY19	FY20	FY21		
$0.0	$57,572.9	$57,889.5	$0.0	$0.0	Recurring	NEW Tax Stabilization Reserve (fuel taxes)
$0.0	$19,200.0	$19,200.0	$0.0	$0.0	Recurring	NEW Tax Stabilization Reserve (petroleum products loading fee)
$0.0	($19,200.0)	($19,200.0)	$0.0	$0.0	Recurring	Corrective Action Fund (petroleum products loading fee)
$0.0	$26,170.8	$26,230.0	$55,091.2	$54,827.9	Recurring	NEW State Road Maintenance Fund (fuel taxes)
$0.0	$17,455.9	$17,495.4	$36,745.8	$36,570.2	Recurring	NEW Municipalities – road maintenance (fuel taxes)
$0.0	$8,714.9	$8,734.6	$18,345.4	$18,257.7	Recurring	NEW Counties – road maintenance (fuel taxes)
$0.0	$1.1	$1.1	$1.1	$1.0	Recurring	Municipalities and Counties Fund
$0.0	$0.7	$0.7	$0.7	$0.7	Recurring	State Aviation Fund
$0.0	$0.4	$0.4	$0.4	$0.3	Recurring	Motorboat Fuel Tax Fund
$0.0	$0.8	$0.8	$0.8	$0.8	Recurring	County Government Road Fund
$0.0	$0.8	$0.8	$0.8	$0.8	Recurring	Municipal Roads Fund
$0.0	$0.8	$0.8	$0.8	$0.8	Recurring	Municipal Arterial Program of Local Governments Road Fund
$0.0	$1.0	$1.1	$1.1	$1.1	Recurring	Local Governments Road Fund
$0.0	$2,400.0	$2,400.0	$2,400.0	$2,400.0	Recurring	Tribal Tax Sharing Agreements (Pueblo of Santo Domingo and Nambe)
$0.0	$2,808.8	$3,026.3	$3,122.3	$3,215.5	Recurring	State Road Fund

Parenthesis ( ) indicate expenditure decreases. ** R = recurring; NR = non-recurring

Corporate Income Tax Rate Change Delay

Estimated Revenue*					R or NR **	Fund Affected
FY17	FY18	FY19	FY20	FY21		
$0.0	Up to $19,000.0	Up to $19,000.0	$0.0	$0.0	R	General Fund

Parenthesis ( ) indicate expenditure decreases. ** R = recurring; NR = non-recurring

* These estimates are imprecise due to the highly volatile nature of the underlying revenue source

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY17	FY18	FY19	3 Year Total Cost	R or NR **	Fund Affected
Total	High Impact	High Impact		High Impact	Mostly Nonrecurring	Taxation and Revenue Department

Parenthesis ( ) indicate expenditure decreases. ** R = recurring; NR = non-recurring

The Taxation and Revenue Department likely will report a high impact to implement the healthcare tax reform provisions, a small impact for the increase in motor vehicle excise tax and elimination of the deduction of sales to nonprofits, a moderate impact from the motor fuels tax increase, a high impact of internet sales gross receipts tax, and a moderate impact from the ID permit fee.

SOURCES OF INFORMATION

LFC Files

Responses Received From
Taxation and Revenue Department (TRD)
Office of the Attorney General (OAG)
New Mexico Department of Transportation (DOT)
Human Services Department (HSD)
New Mexico Municipal League

SUMMARY

Synopsis of SFl#1 Amendment

Senate Floor Amendment #1 strikes items one and five of House Floor Amendment #1, removing the repeal of one of the 1/8 percent hold harmless gross receipts tax increments for local governments that have not yet enacted all three 1/8 percent increments. The amendment allows local governments to retain the current hold harmless increment flexibility.

Synopsis of SFC Amendment

The Senate Finance Committee Amendment makes the following changes to the bill:

- Reduces the weight distance tax permit fee from $90 per permit to $55 per permit;
- Changes the health care tax reform to impact hospitals only with all new revenue generated distributed to the general fund except $26.4 million distributed annually to the county supported Medicaid fund, provides a 60 percent deduction in FY18 and a 65 percent deduction in FY19 and subsequent years, restores hold harmless payments related to healthcare practitioners in current statute;
- Changes the distribution of revenues to the legislative retirement fund for FY20 through FY22 to judicial retirement funds to assist with solvency;
- Creates the state road maintenance fund;
- Changes the distribution of the 1 percent increase in the motor vehicle excise tax from the general fund to a temporary distribution to the tax stabilization reserve and then to the state road maintenance fund once reserves hit 5 percent;
- Increases the gasoline tax by 10 cents per gallon (from 17 cents to 27 cents), provides a temporary distribution to the tax stabilization reserve and then to the state road maintenance fund once reserves hit 5 percent;
- Increases the special fuels tax by 5 cents per gallon (from 21 cents to 26 cents), provides a temporary distribution to the tax stabilization reserve and then to the state road maintenance fund once reserves hit 5 percent;
- Delays the five-year phased reduction of corporate income tax (CIT) enacted in 2013 by two tax years at first and then speeds up to a final delay of one year; the scheduled reduction to 6.2 percent for taxable income in excess of $500 thousand, which was to have been effective for TY 2017, will be held at 6.4 percent for taxable income in excess of $500 thousand and 6.6 percent for taxable income in excess of $1 million for TY16, TY17, and TY18; the subsequent reduction to 6.2 percent (on all taxable income over $500 thousand) is eliminated, with a final level of 4.8 percent for all taxpayers with net

income under $500 thousand and 5.9 percent for all taxpayers with net income over $500 thousand effective for TY19 and subsequent years; the phased-in sales-only provision for manufacturers (also referred to a single sales factor or single sales apportionment) would also be delayed; and

- Specifies the petroleum products loading fee will be $150 per load, provides a temporary distribution to the tax stabilization reserve and then back to the corrective action fund once reserves hit 5 percent.

The table below provides detailed projections related to the health care component of the amended bill.

60% Deduction FY18 Then 65% Deduction; No Local Change; Medicaid Match (in millions)				
	FY18	FY19	FY20	FY21
Non-Profit				
Net Patient Revenues*	$ 2,046.0	$ 2,107.4	$ 2,170.6	$ 2,235.7
Taxable Base After Deduction	$ 818.4	$ 737.6	$ 759.7	$ 782.5
State Impact (5.125%)	$ 41.9	$ 37.8	$ 38.9	$ 40.1
Government				
Net Patient Revenues*	$ 2,396.0	$ 2,467.9	$ 2,541.9	$ 2,618.2
Taxable Base After Deduction	$ 958.4	$ 863.8	$ 889.7	$ 916.4
State Impact (5%)	$ 47.9	$ 43.2	$ 44.5	$ 45.8
For-Profit				
Net Patient Revenues*	$ 1,058.0	$ 1,089.7	$ 1,122.4	$ 1,156.1
Taxable Base After Deduction	$ 423.2	$ 381.4	$ 392.9	$ 404.6
State Impact (4.05%)	$ 17.1	$ 15.4	$ 15.9	$ 16.4
New State Revenues	**$ 107.0**	**$ 96.4**	**$ 99.3**	**$ 102.3**
Medicaid Appropriation	$ 26.4	$ 26.4	$ 26.4	$ 26.4
Total General Fund Impact	**$ 80.6**	**$ 70.0**	**$ 72.9**	**$ 75.9**
* 2015 base plus 3% trend per year (minus $80 million for FY18 due to prior Medicaid rate cuts)				

<u>Synopsis of House Floor Amendment #1</u>

The House Floor Amendment #1 strikes the repeal of the GRT deduction for sales to nonprofits, and the change in revenue is reflected in the tables above. The amendment also removes the ability for any local government that has not enacted all three "hold harmless" GRT increments by July 1, 2017 from enacting the third increment, limiting the total hold harmless increments to a maximum of 1/4 percent instead of 3/8 percent. This does not force local governments that have enacted all three 1/8 increments to repeal an increment, but it helps prevent GRT rates from potentially rising more in the remainder of the jurisdictions. Local governments in aggregate will see increased revenues as a result of the healthcare tax reform provisions of the bill. Finally, the amendment makes technical corrections, including repealing Section 7-1-6.57 NMSA 1978 (related to the tax administration suspense fund) – no longer needed due to the bill's actions.

<u>Synopsis of Original Bill</u>

The House Taxation and Revenue Committee Substitute for House Bill 202 proposes closing loopholes, generating tax revenue, and reducing distributions in a number of areas. These are aggregated roughly into six areas:

- Closing the loophole and leveling the playing field to allow collection of gross receipts tax (GRT) on internet sales;
- Leveling the playing field in the healthcare industry through comprehensive healthcare

tax reform and creation of a 60% "universal deduction";

- Increasing the motor vehicle excise tax from 3 percent to 4 percent;
- Repealing the deduction of GRT on sales to nonprofit organizations;
- Reducing monthly distributions to the legislative retirement fund and clarifying the distributions are from receipts of oil and gas withholding; and
- Adding a second part to the fee for weight distance tax applications – a $90 permit fee.

Internet Sales Gross Receipts Tax Provisions (Sections 5, 6, 9,10 and 13):

- Imposes the regular gross receipts tax, including local option taxes, on remote sellers conducting sales activities via the world-wide web.
    - o It does this by changing definitions to exclude any person without physical presence in the state and with less than $100 thousand in average gross receipts during the prior calendar year from gross receipts tax (GRT) and compensating tax liability. By specifically excluding those with less than $100 thousand in receipts, the bill therefore includes larger out-of-state sellers. The intent appears primarily to be to allow for collection of taxes from internet vendors.
    - o The bill also includes in the definition of gross receipts third-party sales made over a multi-vendor marketplace platform that acts as the intermediary between the seller and purchaser. This captures third-party sales made through websites such as Amazon.com and eBay.
- Prohibits the Taxation and Revenue Department (TRD) from enforcing the collection of GRT for a tax period prior to July 1, 2017 if the person lacked physical presence in the state and did not report taxable gross receipts for the period.
- Defines out-of-state sales by entities without a physical presence in the state as taking place at the location to which the property or the product of a service is delivered. This would require the seller to collect and remit GRT increments to the local governments.
- Allows the refund of gross receipts tax to be applied against any compensating tax owed by that person's customer as a result of transactions with that person.

Healthcare Tax Reform Provisions (Sections 1, 3, 4, 7, 8, 11, 12, 14, 15, 16, 19 and 20):

- Brings non-profit hospitals into the gross receipts tax base. This will increase state and local government gross receipts tax revenue.
- Brings governmental hospitals into the governmental gross receipts tax (GGRT) base but distributes this additional revenue to the general fund, increasing state but not local GRT revenues.
- Allows all hospitals a deduction of 60% of net patient care revenues. The GRT or the GGRT will not be collected from non-profit or governmental hospitals on any other source of revenue, such as grants, research contracts, mill levies, or sales of tangibles (unless governmental hospitals are already paying GGRT on the sales of tangibles from facilities open to the general public).
- Repeals the for-profit hospital tax credit of 7-9-96.1 NMSA 1978.
- Repeals the Medicare deduction (7-9-77.1 NMSA 1978) applied to listed healthcare practitioners in favor of allowing a 60% deduction from all revenues. Some categories of practitioners and entities allowed the current Medicare deduction will not be allowed the 60% deduction. These include home healthcare services, nursing homes, hospice organizations, dialysis centers, athletic trainers, nutritionists and dietitians, pharmacists, audiologists, and massage therapists.
- Repeals the healthcare services hold harmless distributions to counties and

municipalities. Although this feature may have substantially differing impacts on individual counties and municipalities, the overall impact is positive for the repeal of hold harmless, the change in deductions for healthcare practitioners, and bringing the non-profit hospitals and government hospitals into the gross receipts tax base.

Motor Vehicle Excise Tax Provisions (Section 17)

- Increases the motor vehicle excise tax from 3% to 4%, effective for sales as of July 1, 2017.

Weight-Distance Identification Permit Fee (Section 18)

- Imposes a new weight-distance identification permit fee in Section 7-15A-13 of a flat $90 per vehicle.
- See discussion above and below concerning whether this imposition constitutes a breach of the federal commerce clause because the flat fee is not apportioned base on miles the vehicle travels in New Mexico.
- Distributes the new fee to the general fund.

Reduction of Monthly Distributions to the Legislative Retirement Fund (Section 2)

This section decreases the distribution from the Oil and Gas Proceeds and Pass-Through Entity Withholding Tax Act (known colloquially as OGAS Withholding) in current law of $75 thousand per month to an amount determined by the PERA actuaries based on the amount necessary to pay out the retirement benefits due under state legislator member coverage. Because the legislative retirement fund is overfunded, no distributions to the fund will be necessary during the forecast period.

Repeal of Section 7-9-60 NMSA 1978 – GRT Deduction for Sales to Nonprofits (Section 20)

This section repeals the deduction of GRT on sales to nonprofit organizations.

FISCAL IMPLICATIONS

Internet Sales Gross Receipts Tax

The estimated fiscal impact is particularly uncertain. These are highly imprecise estimates, with the low end representing the low end of the range provided by TRD and the high end representing the amount estimated by LFC staff as the likely ballpark amount of GRT revenue lost through untaxed internet sales. The high end is a conservative estimate of lost revenues through such sales, but in this context, it assumes full compliance to reduce lost revenues to zero, which is unrealistic. The revenues the state would gain from this bill are more realistically going to fall in the middle or lower range of the spectrum, at least in the early stages of implementation, because it could take some time to bring vendors into compliance.

It is important to note there is not universal agreement this bill would not violate the U.S Supreme Court Quill decision (see "Significant Issues" for a detailed discussion), potentially placing these revenues in jeopardy if courts order the taxes refunded to taxpayers.

LFC staff economists used a slightly different method from TRD economists to estimate the loss of GRT revenues through internet sales, taking the per capita amount of the national losses and then adjusting based on the state's population and differential in average real disposable income.

The full TRD methodology is presented below.

> Accurately estimating GRT revenue collections from sales by any internet-based retailer is extremely difficult, as there is a dearth of information that would allow for estimates without the application of numerous assumptions. For this estimate, the base was calculated using information from a representative sample of "internet-based retailers". TRD used publically available data from these companies' U.S. Securities and Exchange Commission (SEC) filings for 2015, which in turn, contained data on the entities' net sales and operating expenses in the U.S., North America, and other regions. Based on our analysis, gross sales in the U.S. were estimated at about $130 billion. TRD does not know which component of that base would be taxable or exempt under New Mexico's laws.
>
> The gross U.S. sales estimate of $130 billion was then divided by the U.S. population (318.9 million) to come up with a "gross sales per capita" amount of $407. This amount is used as a proxy of the average annual dollar amount spent on purchases fulfilled by "internet-based retailers". Using New Mexico's estimated actual average GRT rate in FY2016 of 6.93 percent, a sale of $407 would generate a combined GRT revenue of $28.19 for the state and local governments. This amount is multiplied by a hypothetical percent of the population[1]. In this case, TRD assumed 25 percent of the population, or approximately 520,254 individuals in the state, would engage in such practice, henceforth producing an estimated $14.7 million of "internet-based retailer" GRT revenue. The estimated revenue impact is presented in the form of a range to account for potential revenue collections outside of the sample of sales considered that are unaccounted for at this time.

Healthcare Tax Reform

This has been a particularly difficult item to score. Definitive data from the Centers for Medicare and Medicaid Services (CMS) have only been published through 2009 – prior to the implementation of the Affordable Care Act. Fairly complete data are available for Medicaid reimbursements, but the allocation of these expenditures to relevant tax status categories was difficult. Some relevant data which otherwise might be available from TRD are covered by confidentiality requirements surrounding certain taxpayer information.

LFC staff have prepared a comprehensive model of the healthcare sector and have cross validated these data from numerous sources, including:

- The 1991 – 2009 comprehensive compendium of healthcare costs by sector from CMS -- these data include an estimate of total healthcare costs for all residents of New Mexico, Medicaid costs, and Medicare costs;
- 2012 Economic Census of the Healthcare and Social Services sector, sub-allocated into for-profit entities and not-for-profit entities and further sub-allocated into patient care revenues, grants, appropriations and other sources of income;
- TRD's RP-80 GRT history for calendar 2012 and the period June 2015 through May 2016, with differences between aggregate state totals and the sum of the detail reallocated to the redactions for confidentiality;
- Some updated information available from Kaiser Family Foundation;
- Extensive history and forecasts from HSD on Medicaid enrollments and expenditures;
- Extensive data from hospital cost reports (CMS) with a comprehensive analysis

[1] New Mexico's population as of July 1, 2016 was estimated at 2,081,015 inhabitants, according to the U.S. Census Bureau's website located at http://www.census.gov/quickfacts/table/PST045216/35

assembled by LFC staff for the SM-37 investigation;

- IHS Global-Insight forecasts of national healthcare services and tangibles inflation and natural growth; and
- 2015 and 2016 editions of the TRD Tax Expenditure Report.

FY 18 Impact -- 60% universal deduction; repeal hold harmless

	Non-profits				For-Profit Entities						
	Hospitals *		Other **		Practitioners ***		Hospitals		Other ****		Total
	Tax Revenue	Hold Harmless	Tax Revenue	Hold Harmless	Tax Revenue	Hold Harmless	Tax Revenue	Hold Harmless	Tax Revenue	Hold Harmless	
Current State Revenue	$0	$0	$0	$0	$59,900	-$18,500	$0	-$4,300	$25,900	-$1,555	$61,457
Current Local Revenue	$0	$0	$0	$0	$44,500	$18,500	$18,100	$4,300	$20,000	$1,555	$107,024
Proposed State Revenue	$53,600	$0	$0	$0	$55,700	$0	$30,000	$0	$33,700	$0	$173,076
Proposed Local Revenue	$27,100	$0	$0	$0	$41,100	$0	$23,600	$0	$26,125	$0	$117,834
Change in State Revenue	$53,600	$0	$0	$0	-$4,200	$18,500	$30,000	$4,300	$7,779	$1,555	$111,620
Change in Local Revenue	$27,100	$0	$0	$0	-$3,500	-$18,500	$5,400	-$4,300	$6,114	-$1,555	$10,810
* Includes Government and Non-Profit Hospitals											
** Includes Outpatient Care, Home Health, Other Ambulatory Care and Nursing and residential care facilities											
*** Includes: Physicians, Dentists, Other Health Practitioners, Outpatient Care and Medical Laboratories											
**** Includes: Home Health, Other Ambulatory Care, Nursing and Residential Care Facilities											

Note that the bulk of the revenue increase attributed to provisions of this bill will be borne by the non-profit and government hospitals and to a lesser extent, by the for-profit hospitals.

FY 18 ($ millions)	Patient Care Revenue	Increase in State Revenue	Increase in Local Revenue	Total Effective Rate	Current Effective Rate
For Profit Hospitals	$1,939	$34.31	$1.19	2.76%	0.93%
Non-profit hospitals	$2,271	$34.50	$27.07	2.68%	0.00%
Government Hospitals	$1,003	$19.14	$0.00	1.89%	0.00%

FY 18 ($ millions)	Gross Receipts	Increase in State Revenue	Increase in Local Revenue	Total Effective Rate	Current Effective Rate
Practitioners	$2,745	$14.33	($22.01)	3.395%	3.66%
Other	$941	$9.33	$4.56	6.277%	4.82%

Doctors, dentists and other Healthcare practitioners will enjoy a small tax reduction from this proposal. Other healthcare entities, including home health agencies, nursing homes, dialysis (outpatient care) centers, audiologists, and massage therapists will experience a tax increase.

While the aggregate impact on local communities appear to be positive, the impact on individual communities will be somewhat difficult to determine. If there is state or local revenue impact, there could be a local economic impact.

Category	Local Revenue Impact	State Revenue Impact
Local government with a private hospital within its jurisdiction	Increase in deduction from 50% to 60% causes decrease in local revenue.	State taxes increase because of repealing state-level credit.
Local government with a non-profit hospital within its jurisdiction	Increase in tax base by inclusion of 40% of receipts of non-profit hospital.	State taxes increase by inclusion of 40% of receipts of non-profit hospital.
Local healthcare practitioners with low levels of Medicare reimbursements/high levels of Medicaid, MCO, and fee-for-service reimbursements	The 60% deduction for all sources of income will decrease local taxes, and these providers will see an overall tax decrease.	State taxes will decrease by changing to a 60% deduction for all sources of income.
Local healthcare practitioners with high levels of Medicare reimbursements/low levels of Medicaid, MCO, and fee-for-service reimbursements	The 60% deduction may be less than the current 7-9-77.1 and 7-9-93 NMSA deductions. Local taxes will increase, and these providers will see an overall tax increase.	State taxes will increase by removing 7-9-77.1 and changing 7-9-93 to 60%.
Nursing homes, hospice services, home health services paid by Medicaid or Medicare.	These entities do not qualify for the new 60% deduction. Local taxes will increase, perhaps significantly.	State taxes would also increase, perhaps significantly.

Offsetting any potential negative local economic impacts are two factors: (1) Medicaid reimbursements to all hospitals will probably increase, since one reason for this bill is to restore and expand Medicaid eligibility and reimbursements; and (2) without this and other revenue raisers, the state budget could shrink on an inflation-adjusted basis and require budgets of all state-funded institutions to decline. This may affect local government and private direct, indirect, and induced employment.

Motor Vehicle Excise Tax Increase

The fiscal impact of an increase from 3% motor vehicle excise tax to 4% is derived directly from the February Consensus Revenue Estimating Group (CREG) revenue forecast.

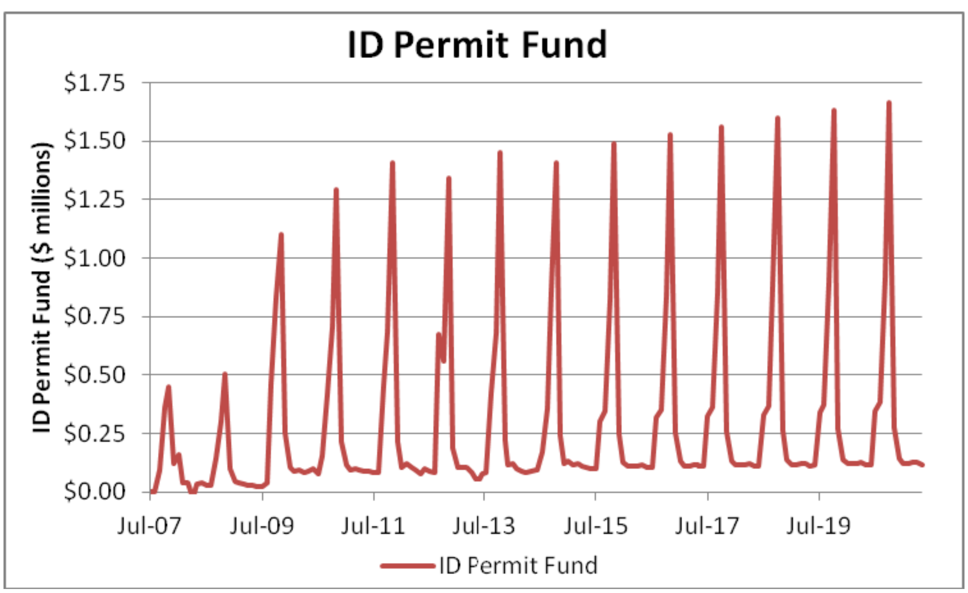
Motor Vehicle Excise Tax		
	February CREG	Increase to 4%
FY 17	143,500.0	
FY 18	148,000.0	49,300.0
FY 19	153,000.0	51,000.0
FY 20	159,000.0	53,000.0
FY 21	162,000.0	54,000.0

Per usual practice, there is no attempt to determine if a 1% increase in price would result in any noticeable decrease in the volume of cars sold. This proposal might stimulate a small amount of shifting of vehicle purchases and motor vehicle excise tax collections from FY18 into FY17.

Weight-Distance Identification Permit Fee

The table below shows the current collections, number of permits, and the new annual revenues with the $90 fee. However, as noted in the fiscal impact tables above, imposition of a flat, per vehicle, non-apportioned registration fee on interstate trucking has been held to violate the commerce clause of the U.S. Constitution. Many courts have come to this conclusion – most notably, New York and Pennsylvania. This is an effort to increase a $5.50 per vehicle identification permit to $95.50 per vehicle, irrespective of how many miles the trucks travel in New Mexico annually. It is possible that this permit fee will also be held to be in violation of the U.S. Constitution commerce clause. If the state is likely to lose this fee in a court hearing, the industry is equally likely to seek a temporary restraining order to prevent the new law from taking effect. Depending on the exact order, a judge may invalidate the "up to $10" administrative fee in 7-15A-13 NMSA 1978. If this were to happen, then the beneficiaries of the weight distance tax identification permit administration fund would also lose revenue.

	ID Permit Collections	# IDs @	Revenue @
		$5.50	$90
FY 08	$1,314,449	238,991	
FY 09	$1,301,752	236,682	
FY 10	$3,264,250	593,500	
FY 11	$3,449,351	627,155	
FY 12	$3,549,382	645,342	
FY 13	$3,444,268	626,230	
FY 14	$3,551,097	645,654	
FY 15	$3,831,484	696,633	
FY 16	$4,004,437	728,079	
FY 17	$4,095,128	744,569	
FY 18	$4,185,836	761,061	$68,495,498
FY 19	$4,276,394	777,526	$69,977,348
FY 20	$4,368,990	794,362	$71,492,564
FY 21	$4,344,895	789,981	$71,098,276



Reduction of Monthly Distributions to the Legislative Retirement Fund

Monthly distributions to the legislative retirement fund total $900 thousand ($75 thousand per month) or the amount necessary to make the required payment distributions. The bill strikes the specific dollar amount, leaving the language requiring the amount necessary for payments. Due to current overfunding, LFC staff projections indicate no distributions to the fund will likely be necessary during the forecast period. However, minor language adjustments may be useful to make it explicit that fund balances should be included in the determination of needed funds to make the required payments in the following year.

Repeal of Section 7-9-60 NMSA 1978 – GRT Deduction for Sales to Nonprofits

The TRD 2016 Tax Expenditure Report (TER) estimates the cost of this deduction at $15 million annually. However, the TER assigned this deduction the lowest possible reliability factor due to the unavailability of direct data, so this is a rough estimate.

All Provisions

This bill addresses the LFC tax policy principles of adequacy, efficiency, and equity. The increasing cost of tax expenditures has contributed to revenue problems. The provisions of this bill may partially reduce some revenue leakage attributed either to loopholes or to shifts in commercial patterns.

SIGNIFICANT ISSUES

Internet Sales Gross Receipts Tax Provisions

The Association of Counties reports, "NMAC has a policy to support any legislation and tax reform efforts that improve economic efficiency, economic development, ease of administration, and overall fairness of the state and local tax system. It is essential that NMAC fully participates in legislative and executive efforts to restructure and reform the state and local tax system. Therefore, NMAC would support this bill to broaden the tax base and level the playing field with our local small businesses. We do have concerns as to how the tax would flow to local tax districts."

TRD provided the following analysis.

> The bill implicates several principles of tax policy. It addresses revenue adequacy by increasing revenues to the state and local governments. It addresses equity and "main street" fairness issues by eliminating the competitive tax disadvantage borne by local, in-state vendors. The bill would however, increase tax burdens borne by New Mexico citizens on purchases from certain remote vendors. In the current landscape, and because constitutional principles of "nexus" (physical presence) have expanded and loosened in the last five to 10 years, especially through judicial decisions, some internet or remote vendors are already subject to GRT. Others, however, are not.
>
> As written, the bill facially challenges the US Supreme Court's decision in *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992). It begs resolution to two questions: (1) does the constitutional physical presence requirement apply to New Mexico's GRT; and (2) if so, whether the *Quill* decision should be reversed. The New Mexico Supreme Court applied the *Quill* decision in their decision in *N.M. Taxation & Revenue Dep't v.*

> *Barnesandnoble.com LLC* (2014). Once the department identifies a taxpayer as having no physical presence in the state, the department cannot tax that person. Other states do tax internet retail companies that do not have a traditional nexus with the taxing state, but their statutes do not use the term "without a physical presence." If the bill's purpose of amending the statute is to collect gross receipts taxes from persons that make a threshold amount of internet sales to New Mexico buyers, that goal can be accomplished by redefining what it means to engage in business in New Mexico, without using the term "no physical presence". For example, "engaging in business in New Mexico includes out-of-state retailers who make more than X amount of sales to purchasers in New Mexico."
>
> Section 7-1-29(C) NMSA 1978 is problematic because of a potential violation of confidentiality laws. The practical application of this is the bill would allow TRD to offset a refund of gross receipts tax paid from one taxpayer against the compensating tax liability of a different taxpayer. Unlike offsetting credits within the same tax program for the same taxpayer, the proposed amendment allows TRD to offset a refund of gross receipts taxes from one taxpayer against another taxpayer's compensating tax liability based only on a purchase which would have to be shared with the department by the seller in order to locate the correct account(s), at a minimum this would violate the confidentiality of both taxpayers.

The following analysis contains historical and technical details from the New Mexico Tax Research Institute related to internet taxation issues.

In 1992, the U.S. Supreme Court in the Quill case said that some physical presence was necessary for a state to assert a sales tax collection obligation on a person selling to purchasers in a state. There was no internet retail commerce in 1992. Fast forward, and the volume of dollars at issue is huge and growing. Budget woes and fairness concerns have focused attention on overturning Quill, which was the genesis of the Streamlined Sales and Use Tax Agreement and proposed federal legislation including the Marketplace Fairness Act.

Alabama, South Dakota and others have now enacted legislation designed to provide the basis for a challenge to Quill. Large internet sellers are responding, in many cases, by simply agreeing to begin paying tax.

One important development in the Direct Marketing Association (DMA) case affects New Mexico directly. In that case, the 10th Circuit Court of Appeals (our federal circuit) held that Quill was limited to sales and use tax reporting obligations exclusively. DMA filed a petition with the Supreme Court on another issue but chose not to appeal the question of whether Quill's physical presence limit applies to anything other than sales and use tax collection requirements. So in this circuit, at least, the issue is settled. Additionally, the Supreme Court recently declined to hear the DMA appeal. There is no longer any reason to assume that Quill applies to our gross receipts tax – which is substantially different from a sales tax collection obligation.

The legislative intent behind our gross receipts tax "engaging in business" statute has long been much broader than the physical presence requirement of Quill. But enforcement of the tax was constrained on the assumption that Quill applied. The Legislature can now provide clarification that, given all these developments, there is no longer any reason to make that assumption.

The approach in the proposed legislation amending the engaging in business statute could prove the fastest approach at improving voluntary compliance by remote sellers. It simply clarifies that it is now clear that Quill's limitation does not apply to the tax and, at the same time, provides an exception for a small businesses that has limited receipts and no physical presence. It further ensures that there will be no looking backward on unsuspecting taxpayers who may have assumed that Quill applied to the gross receipts tax.

Healthcare Tax Reform Provisions

In 2004 and subsequent years, the Richardson administration enacted health care industry tax expenditures in excess of $80 million; however, the health care landscape changed significantly in the intervening years. The industry is one of just two bright spots in New Mexico for job growth, yet it remains largely untaxed. Fueled by the Affordable Care Act and Medicaid expansion, the industry would likely grow substantially regardless of the tax expenditures in place, resulting in significant and perhaps unnecessary costs to the state. The revenue issue is exacerbated by the growing cost of the state's Medicaid payments. The changes proposed in these sections of the bill would generate about $111 million in new revenue for FY18 (with a July 1, 2017 effective date), increasing slowly in subsequent years.

The bill would correct a decades-old inequity in which differing levels of tax are imposed for the same services delivered depending on the legal status of the hospital or clinic and on the nature of the payment – be it Medicare, Medicaid, TRICARE, Indian Health, private health insurance, or self-payment.

The bill would subject 40% of patient care receipts of private, non-profit, and government general hospitals, specialty hospitals, and behavioral health facilities to the gross receipts tax. Currently, the law only applies to for-profit facilities. Taxing nonprofit and government facilities would be a major step in applying the tax in an equitable manner.

It repeals 7-9-77.1 NMSA 1978, which provides a deduction for receipts services by doctors and other health care providers from Medicare, receipts from palliative services by hospice and nursing homes paid by Medicare, receipts from services by doctors and other health care providers from TRICARE and IHS, and receipts from Medicare for services provided by medical labs, home health services, and dialysis centers. The bill repeals the 7-9-96.1 NMSA 1978 private hospital credit. These repeals are in favor of the 60% universal deduction referenced above. Or, in the case of dialysis centers, nursing homes, hospice care, audiologists, naprapaths, and others.

It would also level the playing field for doctors, dentists, and other healthcare practitioners related to source of payment for services, treating all sources of payment, including private payment, equally. The current law allows a deduction for payments from managed health care providers, health care insurers for commercial contract services, or Medicare Part C services (amending 7-9-93 NMSA 1978).

Because the provisions of the bill will generate a substantial amount of own-source revenue for municipalities and counties, the bill repeals the healthcare practitioner services hold harmless payments to municipalities and counties (7-1-6.46 and 7-1-6.47 NMSA 1978). Additional revenue from health care practitioners would result in a reduction in the state's medical services hold harmless payments, although subject to bond impairment provisions. Additional revenue from taxing non-profit health care facilities are not subject to the hold harmless provisions and would remain with the local governments.

Motor Vehicle Excise Tax Provisions

Motor vehicle excise taxes in New Mexico are less than half the rates in many places in Arizona, Colorado, and Texas. New Mexico's rate is 3 percent, while rates in surrounding areas can be more than 8 percent after adding in local rate increments. The Arizona and Texas statewide rates alone are approximately double New Mexico's. Each additional percent added to New Mexico's rate would generate about $50 million for the general fund.

Weight-Distance Identification Permit Fee

There is no particular policy implication here, but there is a legal question of whether such a fee can successfully be imposed and stand up to possible court challenges. Imposition of a flat, per vehicle, non-apportioned registration fee on interstate trucking has been held to violate the commerce clause of the U.S. Constitution by the U.S. Supreme Court in a case involving Pennsylvania, and courts in New York, Alabama, Maine, and Maryland have since struck down the legality of flat registration fees based on the Supreme Court ruling.

The Office of the Attorney General and the New Mexico Department of Transportation note it is possible that this effort to increase a $5.50 per vehicle identification permit to $95.50 per vehicle, irrespective of how many miles the trucks travel in New Mexico annually, could also be held to be in violation of the U.S. Constitution commerce clause. To solve this issue, the fee could be apportioned based on mileage.

Depending on the outcome of a potential legal challenge to this proposed fee increase, a judge may also invalidate the current "up to $10" administrative fee in 7-15A-13 NMSA 1978. A defense that the fee is a relatively small amount would likely be insufficient, as the Supreme Court has rejected the notion of a 'de minimus' defense to an allegation that a tax is discriminatory under the commerce clause. In cases involving flat fees that were struck down, the fees ranged substantially but were as little as $4 once every three years.

Reduction of Monthly Distributions to the Legislative Retirement Fund

The only policy implication here is to clarify that distributions to the legislative retirement fund are from receipts from oil and gas withholding, which was the original intent when legislation was first drafted to create the retirement fund.

Repeal of Section 7-9-60 NMSA 1978 – GRT Deduction for Sales to Nonprofits

TRD's 2016 TER lists this as a "citizen benefits" tax expenditure, presumably enacted to subsidize the activities of certain types of nonprofit entities.

ADMINISTRATIVE IMPLICATIONS

The Taxation and Revenue Department likely will report a high impact to implement the healthcare tax reform provisions, a small impact for the increase in motor vehicle excise tax and elimination of the deduction of sales to nonprofits, a high impact of internet sales gross receipts tax, and a moderate impact from the ID permit fee.

TECHNICAL ISSUES

With regard to internet sales, TRD notes, "The proposed refund of GRT being applied to a compensating tax liability could lead to a significant decrease of GRT revenue distributions to local governments. Compensating tax only applies to the state jurisdiction (5 percent for services and 5.125 percent for sale of tangible personal property) and not the local government jurisdiction. The potential decrease in GRT revenue would affect distributions and could be severe enough as to cause an adverse event for small cities and counties that would prompt them to seek relief under Section 7-1-6.15 NMSA 1978 (HB-581 2015 Session).

Under current law, buyers of goods and services using the Internet from out-of-state vendors without a physical presence are subject to the corresponding compensating tax rate. If the bill becomes law, the state and local GRT assessed would exceed the equivalent compensating tax portion that would only have been assessed from the state jurisdiction for the same period. If the department refunds the GRT back to the seller once they prove they have no nexus in the state based on the $100 thousand gross receipts threshold, the seller would benefit from the total GRT rate differential when the buyer is subject to the compensating tax. For this reason, TRD proposes the bill is amended to deposit into an escrow account the proceeds of the difference between the GRT rate and the compensating tax rate differentials, until they are refunded to the taxpayer who is the buyer."

LG & JC & DI/sb/al/jle