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

ORIGINAL DATE 1/23/18
SPONSOR Trujillo, CA **LAST UPDATED** 1/31/18 **HB** 128

SHORT TITLE Broadband Component Gross Receipts **SB**

ANALYST Graeser

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY18	FY19	FY20	FY21	FY22		
	($580.0)	($580.0)	($580.0)	($580.0)	Recurring	Small Cities
	($390.0)	($390.0)	($390.0)	($390.0)	Recurring	Small Counties
	($270.0)	($270.0)	($270.0)	($270.0)	Recurring	Municipal Equivalent
	($2,620.0)	($2,620.0)	($2,620.0)	($2,620.0)	Recurring	General Fund

Parenthesis ( ) indicate revenue decreases

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY18	FY19	FY20	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
Total	$0.0	$0.0	$0.0	$0.0		

Parenthesis ( ) indicate expenditure decreases

TRD reports moderate operating budget impact, but asserts that the changes can be accommodated in the regular six-month updating cycle.

SOURCES OF INFORMATION
LFC Files

Responses Received From
Public Regulation Commission (PRC)
Taxation and Revenue Department (TRD)

SUMMARY

Synopsis of Bill

House Bill 128 proposes a gross receipts tax and compensating tax deduction for the value of broadband telecommunications network facilities components. The purpose of the deduction is to promote the deployment of broadband telecommunications services in the state. The deduction is to be separately stated, but there is no penalty for failure to separately state the value of the deduction. The Department is required to gather the data and report annually to the legislature as to the cost and benefits of the deduction. The technical requirement is that network facilities must meet or exceed the federal communications commission "connect America" standards.

The effective date of this bill is July 1, 2018. The provisions are repealed as of July 1, 2028.

FISCAL IMPLICATIONS

This bill may be counter to the LFC tax policy principle of adequacy, efficiency, and equity. Due to the increasing cost of tax expenditures, revenues may be insufficient to cover growing recurring appropriations.

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. TRD reports that requiring separate reporting, without providing for a statutory penalty for failure to separately report renders the requirement ineffective in generating useful cost data.

PRC has provided some useful information regarding a relatively narrow federal funding source known as the "Connect America Fund." Per the PRC FIR:

> The FCC Connect America Fund is a multi-million dollar fund that is being implemented in phases for both wireline and wireless broadband deployment throughout the country, including New Mexico. It is a component of the FCC's Federal Universal Service Fund. Currently the FCC is in the process of implementing the CAF Phase II Funding for Price Cap carriers, including CenturyLink and Frontier Communications. Windstream is also a price cap carrier in New Mexico, but declined the FCC's offer of CAF Phase II Funding in New Mexico. CenturyLink accepted $10,942,748 per year in funding for six years, and Frontier accepted $4,426,327 over the six year period, all in New Mexico. Windstream declined approximately $4 million per year in funding. CAF Phase II Funding is 40 percent completed at this point. However, those areas where a price cap carrier declined funding in a state will become available to prospective bidders in a CAF Phase II reverse auction which should take place in 2018. Also, the FCC will be conducting a Mobility Fund Phase II Auction which will allocate $4.5 billion over ten years nationwide for wireless 4G LTE broadband access, which will also probably take place in 2018. The FCC usually funds carriers at a 75 percent federal to 25 percent carrier funding match.
>
> Again, per the PRC FIR, "…the language in the bill may be construed to be permissive enough that it could apply to all providers of internet access service that meet either the wireline or wireless FCC CAF funding speed requirements, whether or not they actually receive FCC CAF funding. This may include price cap and rural local exchange carriers, wireless providers, fixed wireless providers, cable providers, and any other provider of internet access services. It may include any funding of any broadband telecommunications network facilities by these providers as long as they meet the FCC's

CAF funding transmission speed requirements relevant at the time of investment.
"Those providers who will be accepting FCC CAF Funding in New Mexico are required to deploy internet access services as required by the FCC, so the tax breaks should not affect those carriers deployments under that program since they are required to do so anyway. It is those broadband investments outside of CAF funding which may increase due to the tax savings to internet access providers under this bill. Most new broadband investment by internet access providers of all types exceeds CAF funding transmission speed requirements of the FCC."

(LFC) Accepting CAF funding will not affect the rapidity of deployment of broadband telecommunications/internet services to customers. However, it will affect both state and local revenues for any equipment purchased and installed after July 1, 2018. The benefits of this bill will probably not be experienced by customers, but by the internet service providers.

If we assume that the bulk of the equipment is subject to the compensating tax and not the gross receipts tax, then we can look up the history of compensating tax as follows:

($ in thousands)						
	FY 17 Total	100% to Internet	15% to Small Cities	10% to Small Counties	7% Muni Equivalent	Residual to Gen Fund
Information	$5,511					
Telecomms	$3,858	($3,858)	($579)	($386)	($270)	($2,623)
	FY 16 Total					
Information	$4,221					
Telecomms	$2,954	($2,954)	($443)	($295)	($207)	($2,009)
	FY 15 Total					
Information	$3,629					
Telecomms	$2,541	($2,541)	($381)	($254)	($178)	($1,728)

These estimates approximately confirm the Connect America funding estimates provided by PRC. We will use the FY 2017 estimates for the purposes of this FIR.

TRD has estimated that the costs will be somewhat less:

Estimated Revenue Impact*						
FY18	FY19	FY20	FY21	FY22	R or NR**	Funds(s) Affected
--	($910)	($910)	($910)	($910)	R	General Fund
--	($750)	($750)	($750)	($750)	R	Local Governments

However, TRD acknowledges that their data source is not compelling:

The fiscal impact estimates are only approximate. Data was not readily available on the expenditures for broadband network components in New Mexico. The estimates were inferred from national studies and industry reports on the costs of delivering such infrastructure. The estimate assumes the expenditure to expand broadband networks in the state will occur over several years.

SIGNIFICANT ISSUES

TRD notes the following concern:

> The bill would effectively make the components of nearly all telecommunications facilities, including some used for cable television, exempt from all gross receipts and compensating tax. According to information from Broadbandnow.com, New Mexico ranks 37th among the states for connectivity. Notably, however, 75% of all New Mexicans already have broadband access at speeds higher than indicated in the proposed bill. Fiber optic wired coverage remains low at 7.5%, however, New Mexicans' access to wired connections at speeds of at least 10 mbps has improved from 72.8% to 83.5% since 2011. See http://broadbandnow.com/New-Mexico.

PERFORMANCE IMPLICATIONS

The LFC tax policy of accountability may be met since TRD is required in the bill 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. However, in the 2016 edition of the TRD Tax Expenditure Report, the Department reports that there is no penalty in statute for not separately reporting deductions, such as the Back-to-School deduction. Thus, the information provided to the Department is underreported and the costs reported in the Tax Expenditure Report are considered at the lowest level of reliability. This deduction would probably face the same reporting unreliability problem. As noted below at "Administrative Implications," TRD does not have any means of determining benefits from this tax expenditure.

ADMINISTRATIVE IMPLICATIONS

The bill would have a moderate impact on TRD's Information Technology Division of approximately 200 hours, or about $14,000 in employee time and effort, as the new deduction would require a new location code and changes to configurations, documents and reports in GenTax and TAP. The combined reporting system program documentation will need to be updated. However, the costs associated with the change can be absorbed with semi-annual review of the tax program documentation. TRD does not have resources to collect information necessary to evaluate the effectiveness of this deduction.

OTHER SUBSTANTIVE ISSUES

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

The provisions of this bill violate all five tax policy principles.

Does the bill meet the Legislative Finance Committee tax expenditure policy principles?

1. **Vetted**: The proposed new or expanded tax expenditure was vetted through interim legislative committees, such as LFC and the Revenue Stabilization and Tax Policy Committee, to review fiscal, legal, and general policy parameters.
2. **Targeted**: The tax expenditure has a clearly stated purpose, long-term goals, and measurable annual targets designed to mark progress toward the goals.
3. **Transparent**: The tax expenditure requires at least annual reporting by the recipients, the Taxation and Revenue Department, and other relevant agencies.
4. **Accountable**: The required reporting allows for analysis by members of the public to determine progress toward annual targets and determination of effectiveness and efficiency. The tax expenditure is set to expire unless legislative action is taken to review the tax expenditure and extend the expiration date.
5. **Effective**: The tax expenditure fulfills the stated purpose. If the tax expenditure is designed to alter behavior – for example, economic development incentives intended to increase economic growth – there are indicators the recipients would not have performed the desired actions "but for" the existence of the tax expenditure.
6. **Efficient:** The tax expenditure is the most cost-effective way to achieve the desired results.

Arguably, this bill has ineffective reporting requirements, hence it cannot meet the LFC tax expenditure policy guidelines.

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