BILL ANALYSIS AND FISCAL IMPACT REPORT
Taxation and Revenue Department

January 19, 2024

Bill: HB-51 **Sponsor:** Representatives John Block and Tanya Mirabal Moya

Short Title: Gross Receipts Tax Credit

Description: This bill creates a gross receipts tax credit in an amount equal to 25% of a taxpayer's gross receipts tax liability on the state gross receipts portion if the taxpayer received no more than $1 million in gross receipts in the calendar year prior to the taxable period in which the credit is claimed. The amount of credit is limited to $20,000 per calendar year. If the tax credit exceeds the taxpayer's liability, the credit may be carried forward indefinitely and another credit may not be claimed in the same period that credit is claimed. The bill revises the distribution to municipalities under Section 7-1-6.4 NMSA 1978 to include the net receipts offset from the tax credit. The Taxation and Revenue Department (Tax & Rev) will report on the credit to the revenue stabilization tax policy committee and the legislative finance committee.

Effective Date: July 1, 2024. Applicable for periods beginning July 1, 2024.

Taxation and Revenue Department Analyst: Pedro Clavijo

Estimated Revenue Impact*					R or NR**	Fund(s) Affected
FY2024	FY2025	FY2026	FY2027	FY2028		
--	(Unknown but around $2,300)	(Unknown but around $2,400)	(Unknown but around $2,500)	(Unknown but around $2,500)	R	Section 1: General Fund – to municipalities
--	Unknown but around $2,300	Unknown but around $2,400	Unknown but around $2,500	Unknown but around $2,500	R	Section 1: Municipalities
--	(Unknown but around $9,300)	(Unknown but around $9,500)	(Unknown but around $9,800)	(Unknown but around $10,100)	R	Section 2: General Fund – GRT tax credit

* In thousands of dollars. Parentheses ( ) indicate a revenue loss. ** Recurring (R) or Non-Recurring (NR).

Methodology for Estimated Revenue Impact: Section 2: Tax & Rev does not have reports that list taxpayers by their amount of gross receipts. Therefore, Tax & Rev cannot anticipate whether a taxpayer will receive more than $1 million in gross receipts in a calendar year before the taxable period in which the credit is claimed to estimate a precise fiscal impact. However, according to data from the United States Census Bureau, there were 8,568 establishments with an annual payroll of $1 million or less in New Mexico in 2021, representing 19% of all establishments. Tax and Rev assumed that, in general, these establishments would receive $1 million or less in gross receipts during a calendar year to estimate the benchmark fiscal impact. It was assumed that each establishment would have exactly $1 million in gross receipts during a calendar year and, therefore, claim the maximum allowed tax credit of $20,000 per calendar year. The fiscal impact used the gross receipts tax (GRT) revenue growth from the December 2023 Consensus Revenue Estimating Group (CREG) forecast and is based on the state gross receipts tax rate.

Section 1: The fiscal impact also includes the new distribution under Section 7-1-6.4 NMSA 1978 to include the net receipts offset by the credits, which the bill's section 1 introduces to compensate

municipalities for the revenue lost due to the GRT credit under section 2 of the bill.

The establishments targeted by the bill are typically considered small businesses, which present a high rate of openings and closings, making it a highly volatile segment. This might cause the number of taxpayers claiming the credit to exceed those assumed here. On the other hand, the fact that the bill prevents a taxpayer from claiming the credit if they have claimed another credit against their gross receipts might reduce the impact. However, the magnitude of these effects is uncertain, given the unpredictability regarding the intrinsic dynamics of the small business segment and whether the maximum allowed tax credit set in the bill will generate the incentive to claim it.

Policy Issues: Small businesses are an economically important component of the state economy and a key driver of production, employment, and growth. Tax policies aimed at alleviating the tax burden of small businesses may foster job growth and the production of a dynamic sector of the economy. Even so, the bill goes against the principle of equity, which ensures that all businesses face the same tax regime. Apart from treating businesses differently, establishments that meet the bill's requirements might benefit differently. For instance, the bill will benefit a restaurant and a tech startup equally. However, these two establishments might differ significantly regarding their taxable activity. The bill further erodes equity by treating similar businesses differently; a business with $999,999 in gross receipts would qualify for the credit, while an establishment with $1,000,001 would not be able to get the credit.

The recent GRT ¼% state GRT rate reductions aim to benefit all taxpayers and support fewer tax incentives. While tax incentives may support particular industries or encourage specific social and economic behaviors, the proliferation of such incentives complicates the tax code. Adding more tax incentives: (1) creates special treatment and exceptions to the code, growing tax expenditures and/or narrowing the tax base, with a negative impact on the General Fund; and, (2) increases the burden of compliance on both taxpayers and Tax & Rev. Adding complexity and exceptions to the tax code does not comport generally with the best tax policy.

This bill may unintentionally hinder economic growth by creating a cliff effect. A small business that might be poised to grow more may opt not to do so because doing so will increase its effective GRT rate by 25%. Similarly, an establishment poised to exceed the cap in gross receipts might reduce economic activity if the credit loss exceeds the amount of new net receipts.

The tax code, including revenue distributions to the state and local governments, should conform to the principle of simplicity. The proposed changes to 7-1-6.4 NMSA 1978 to tie the distribution from the state to municipalities to lost revenue from the credit adds complexity. This added complexity increases the costs of administration. This creates risks for Tax & Rev related to IT programming, incorrect distributions, and taxpayer amended returns that result in claw-backs from local governments.

For ease of taxpayer use as well as ease of Tax & Rev administration, Tax & Rev recommends this proposal instead be a GRT deduction rather than a GRT credit. Deductions are simply claimed on GRT returns by taxpayers, and Tax & Rev simply processes them. This is much more straightforward than the proposal in this bill. Here, taxpayers would be required to apply for the credit on forms and in the manner required by Tax & Rev, which results in more administrative burden. Furthermore, Tax & Rev would have to track carryforward of unused credits forever.

Technical Issues: Section 2: The bill does not define "taxable period" and uses the term in different places to refer to potentially different periods, which creates confusion. On page 4, lines 10-14, the bill allows a taxpayer to claim a tax credit relating to its tax liabilities "in a taxable period…" In other words, the credit is determined by the tax liabilities in a particular time frame, which will usually be monthly, assuming that "tax period" refers to the time when the gross receipts tax liability is incurred. But in the

next sentence, the qualification with respect to gross receipts is determined by reference to "the taxable period in which the credit is claimed." It is not clear that the taxable period by reference to which the credit is calculated is the same as the taxable period in which the credit is claimed. Indeed, because the taxpayer must apply to Tax & Rev to be eligible for the credit, it is likely that the two taxable periods will not be the same. Using the same term to refer to different time periods may result in both taxpayer and administrative uncertainty.

Page 4, lines 8-16 restricts the credit to taxpayers that have received no more than $1 million of "gross receipts" in the calendar year prior to the "taxable period" in which the credit is claimed. This phrasing raises two issues. First, the large majority of businesses pay gross receipts tax monthly, and therefore would be claiming any credit on a monthly basis. Assuming that the undefined term "taxable period" refers to the period for which the tax liability is incurred, this language will require businesses to recalculate their gross receipts each month that they claim the credit, which imposes an additional burden on both taxpayers, in determining whether they can claim the credit, and on Tax & Rev, in auditing taxpayers for compliance with the cap.

Second, the use of the term "gross receipts" is potentially problematic. While "gross receipts" are defined by statute, Section 7-9-3.5 NMSA 1978, taxpayers do not report receipts that are exempt from the gross receipts tax (although they do report deductible gross receipts). Therefore, a taxpayer might have total gross receipts, as defined in statute, that greatly exceed the $1 million cap, but only be required to report gross receipts that do not exceed the cap; Tax & Rev notes that there are dozens of exemptions contained in the Gross Receipts and Compensating Tax Act, some of them significant. There will need to be clarity about whether receipts that are deductible or exempt are included in the under $1 million of receipts. Without clarity in the statute, it would be very difficult for Tax & Rev to ensure compliance with this portion of the statute. Furthermore, a taxpayer might reasonably assume that the $1 million cap did apply solely to its reported (non-exempt) gross receipts, and claim the credit even though its gross receipts, inclusive of any exempt receipts, did exceed the cap. The "nexus" statute, in determining whether a taxpayer has an obligation to register with Tax & Rev and pay gross receipts taxes, looks to a taxpayer's *taxable* gross receipts. Section 7-9-3.3 NMSA 1978. But using that definition will potentially cause taxpayers with revenues greatly in excess of $1 million to be eligible for the credit.

Page 4, Lines 8-11. The total gross receipts tax imposed on any business consists of two elements, the state gross receipts tax plus any local option gross receipts taxes, (the "combined gross receipts tax" for purposes of this discussion). The credit provided may only be taken against the state gross receipts tax due, even though "tax liabilities" are defined as the combined gross receipts tax liability. This difference results in administrative complexity for Tax & Rev. It will also be administratively burdensome for the taxpayers to determine how much credit they can apply per tax period. The tax rate presented to taxpayers by location combines both the state rate and the local rates. Taxpayers with the assistance of a revised GRT return will need to isolate their state GRT and local option GRT liabilities to apply the credit amount correctly.

Subsection C, page 4 lines 20-22, allows for a carry forward of a credit that exceeds the taxpayer's liability. It is unclear how the credit can exceed the tax liability given a taxpayer can only claim 25 % of the taxpayer's liability against state gross receipts tax in a taxable period. The taxpayer would still be liable to pay the remaining portion of state GRT and local option GRT liabilities. If a carry forward option remains, the bill does not have a set number of years to claim the carry forward. Tax & Rev would suggest a cap on the carry forward amount to four years to match the statute of limitations for claiming a refund in Section 7-1-26 NMSA 1978. This will assist Tax & Rev administratively regarding processing returns, audits, and providing data on this credit. The Gentax system is not designed to carry forward tax credits indefinitely.

Page 4, Line 23 restricts the taxpayer from claiming other incentive tax credits they may qualify for if they claim this credit. It is not clear whether, if a taxpayer carries forward any GRT credit, they are also precluded from claiming any other credit in that period, or whether the exclusion applies solely to the taxable period in which the taxpayer initially claims the small business tax credit.

Tax & Rev is now required by Section 7-1-84 NMSA 1978 (Laws 2023) to compile and present a tax expenditure budget, which includes the number of taxpayers that claim and the amount of claims for a tax expenditure. Credits are seen as a tax expenditure and will be included on this report. For that reason, page 5, lines 4-11 may be stricken in full.

Sections 2 & 3: Although Section 3 specifies that this section applies to tax liabilities beginning on or after July 1, 2024, the first eligible tax period that the credit may be claimed is unclear on page 4, line 21. When this is not clarified for tax credit language, the taxpayers will amend tax returns already filed and request refunds of payments already made toward tax. Tax & Rev recommend that the credit is available to claim prospectively (no lookbacks or ability to amend prior year returns), from the certification date.

Other Issues: Section 1: Section 7-1-6.4 NMSA 1978 refers to certain general fund revenues being distributed back to municipalities and has been in effect for many years. Governmental Accounting Standards Board 84 (GASB 84) changed the presentation of the accounting/financial statement for amounts paid from state-sourced taxes. With the concurrence of auditors, Tax & Rev has taken the position that amounts from legacy legislation, such as these, will not be disaggregated. Thus, it is not recommended that more amounts be diverted to local governments in this manner, creating more commingled revenues. It is suggested that the Department of Finance (DFA) analysis regarding this substitution also be reviewed.

Section 1 requires that the impact of the awarded tax credit be identified by the location of the tax credit applied. Currently, tax credit administration is not programmed to handle a separate location for the application of tax credits. This would require a significant update for software development and tax forms. This is not achievable by July 1, 2024. Further, implementing other requirements to review this tax credit would not be available for forms and system updates by the effective date. An effective date of January 1, 2025, is recommended to allow time for proper implementation.

Section 2: Tax & Rev suggest including that taxpayers charged under Sections 7-1-72 NMSA "Attempt to Evade or Defeat Tax" and 7-1-73 NMSA "Tax Fraud" would not be allowed to receive such credit based on conviction. Charges stemming from these statutes address the "willful intent" to commit tax fraud or evasion/defeat of tax.

Administrative & Compliance Impact: Tax & Rev will need to update forms, instructions, and publications and make information system changes. Tax & Rev's Administrative Services Division (ASD) anticipates this bill will take approximately 40 hours, split between two existing full-time employees, to be implemented. Tax & Rev's Information Technology Division (ITD) estimates that implementing the bill will require both staff workload and contractual costs for a total cost of $232,210. Implementation will need approximately 1,220 hours or over seven months. Tax & Rev's Revenue Processing Division (RPD) will need 3 full-time equivalent (FTEs) staff to validate the credits applied on numerous taxpayers returns and track the credit limit of $20,000 per calendar year per each taxpayer. The FTE estimated costs are based on staff at a payband 65, Tax Auditor 2 or Account Auditor Advanced position designations. RPD also estimates $50,000 in staff workload costs to implement the bill.

Tax & Rev suggests an effective date of January 1, 2025, to implement given Tax & Rev's implementation timeline.

Estimated Additional Operating Budget Impact*				R or NR**	Fund(s) or Agency Affected
FY2024	FY2025	FY2026	3 Year Total Cost		
--	$2.5	--	$2.5	NR	Tax & Rev – ASD - Operating
$220.0	--	--	$220.0	NR	Tax & Rev – ITD – Contractual costs
--	$12.21	--	$12.21	NR	Tax & Rev – ITD – Staff workload
$122	$252	$252	$626	R	Tax & Rev – RPD FTE
$50	--	--	$50	NR	Tax & Rev – RPD Operating

* In thousands of dollars. Parentheses ( ) indicate a cost saving. ** Recurring (R) or Non-Recurring (NR).

Related Bills: Similar to HB -163 (2023 Session)