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

LAST UPDATED ______

SPONSOR Block/Moya **ORIGINAL DATE** 1/24/2024

SHORT TITLE Gross Receipts Tax Credit **BILL NUMBER** House Bill 51

ANALYST Graeser

REVENUE*
(dollars in thousands)

Type	FY24	FY25	FY26	FY27	FY28	Recurring or Nonrecurring	Fund Affected
Direct GRT		($93,500.0)	($95,800.0)	($98,700.0)	($101,800)	Recurring	General Fund
Muni State Share		($26,700.0)	($27,400.0)	($28,400.0)	($29,300.0)	Recurring	General Fund

Parentheses ( ) indicate revenue decreases.
*Amounts reflect most recent analysis of this legislation.

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT*
(dollars in thousands)

Agency/Program	FY24	FY25	FY26	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
TRD	$270.0	$14.7		$284.7	Nonrecurring	General Fund
TRD	$122.0	$252.0	$252.0	$626.0	Recurring	General Fund
Total	$392.2	$266.7	$252.0	$910.7		General Fund

Parentheses ( ) indicate expenditure decreases.
*Amounts reflect most recent analysis of this legislation.

Sources of Information

LFC Files
LFC FIR for 2023 House Bill 163

Agency Analysis Received From
Taxation & Revenue Department (TRD)
Economic Development Department (EDD)

Agency Analysis was Solicited but Not Received From
New Mexico Municipal League (NMML)
New Mexico Counties (NMC)

SUMMARY

Synopsis of House Bill 51

House Bill 51 (HB51) proposes a 25 percent gross receipts tax credit against the tax liabilities of a small business. A qualifying small business is one with total receipts less than $1 million annually. The bill provides a credit for each municipality or county so that the entire cost of this deduction is borne by the general fund. Deductions must be separately reported and TRD must include the cost in the annual Tax Expenditure Report. A taxpayer that claims any other credit (such as high-wage or rural jobs credits) would be disqualified from claiming this credit.

This effectively gives an eligible small business a 25 percent decrease in the amount of gross receipts tax they would pay, but, at the same time, forces the state general fund to bear the entire fiscal burden of the credit.

The amount of credit is limited to $20 thousand per calendar year. If the tax credit exceeds the taxpayer's liability, the credit may be carried forward indefinitely.

The effective date of this bill is July 1, 2024. The provisions are sunset as of July 1, 2029. TRD suggests an effective date of January 1, 2025, because of the time needed to implement the changes in the GenTax system.

FISCAL IMPLICATIONS

This bill creates a tax expenditure with a cost that is difficult to determine but likely significant. LFC has serious concerns about the substantial risk to state revenues from tax expenditures and the increase in revenue volatility from erosion of the revenue base.

TRD reports the following fiscal impacts. TRD also reports that the fiscal estimate is approximate because data is not available.

Estimated Revenue Impact*					R or NR**	Fund(s) Affected
FY24	FY25	FY26	FY27	FY28		
--	(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

> TRD does not have reports that list taxpayers by their amount of gross receipts. Therefore, TRD 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 percent 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 thousand 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.

LFC staff also investigated the fiscal impact of the provisions of this bill and came to somewhat different estimates. However, the LFC staff estimate is also approximate. Although deleted in this year's bill, last year's HCEDC CS/HB163 included the restriction that in addition to the $1 million cap on annual total receipts for the previous fiscal year, the business could employ no more than four employees. The Workforce Solutions Department publishes the Quarterly Census of Wages and Employment (QCEW). Based on the four quarterly reports for FY23, LFC staff determined that the 1 – 4 employee restriction provided an appropriate estimate for the $1 million cap and, in addition, provided an estimate of 8 percent of employees worked for firms that plausibly had total receipts of under $1 million. Single member LLCs and owner only sole proprietorships are probably not counted in this total. Total state plus municipal plus county total liabilities for the five years of the CREG forecast times 9 percent provided a competing estimate of the cost of this proposal, using the argument that total revenue is proportional to wages paid.

		FY23	FY24	FY25	FY26	FY27	FY28
Total Gen Fund (incl F & M HH -- $ millions)		**3,951.2**	**3,960.7**	**4,061.5**	**4,172.3**	**4,310.9**	**4,455.6**
Gen Fund Rate (Incl F & M HH)		**4.191%**					
Total MTGR (Incl O/S -- $ millions)		96,945.8	94,515.6	96,921.0	99,565.1	102,872.5	106,325.6
Muni rate (incl F & M HH)				1.225%	1.225%	1.225%	1.225%
9% applied for $1 million cap	9%						
25% credit rate against liabilities	25%						
State general fund direct				($93,500.0)	($95,800.0)	($98,700.0)	($101,800.0)
Municipal state share				($26,700.0)	($27,400.0)	($28,400.0)	($29,300.0)

Note that the LFC staff estimate is about 10 times the amount of TRD's estimate. The 25 percent credit rate against liabilities, if applied to all taxpayers, would generate a general fund cost of about $1 billion. Applying the LFC staff determination based on nine percent of employment for firms with total revenue of less than $1 million leads to an order of magnitude general fund direct cost of around $90 million and a significant and somewhat less expense for the municipal state share component.

Note that this is not a GRT deduction, but a credit, hence there is no loss to county governments. The municipal hold harmless feature is attributable to the state shared 1.225 percent state share distribution to all municipalities.

See TRD's note under "TECHNICAL ISSUES" for confusion over the use of "$1 million in gross receipts for the calendar year previous to the reporting period." The qualification is based on total gross receipts, whereas the credit is based on tax liabilities determined after excluding allowed deductions and exemptions.

SIGNIFICANT ISSUES

This bill narrows the gross receipts tax (GRT) base. Many New Mexico tax reform efforts over the last few years have focused on broadening the GRT base and lowering the rates. Narrowing the base leads to continually rising GRT rates, increasing volatility in the state's largest general fund revenue source. Higher rates compound tax pyramiding issues and force consumers and businesses to pay higher taxes on all other purchases without an exemption, deduction, or credit.

TRD points out the following 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 percent 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 TRD. 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 percent. 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 TRD 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 TRD administration, TRD recommends this proposal instead be a GRT deduction rather than a GRT credit. Deductions are simply claimed on GRT returns by taxpayers, and TRD 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 TRD, which results in more administrative burden. Furthermore, TRD would have to track carryforward of unused credits forever.

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 credit and other information to determine whether the credit is meeting its purpose.

ADMINISTRATIVE IMPLICATIONS

TRD expects this to be a moderate implementation impact:

> TRD will need to update forms, instructions, and publications and make information system changes. TRD's Administrative Services Division (ASD) anticipates this bill will take approximately 40 hours, split between two existing full-time employees, to be implemented. TRD'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. TRD's Revenue Processing Division (RPD) will need three 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 thousand in staff workload costs to implement the bill.

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	TRD – ASD - Operating
$220.0	--	--	$220.0	NR	TRD – ITD – Contractual costs
--	$12.21	--	$12.21	NR	TRD – ITD – Staff workload
$122	$252	$252	$626	R	TRD – RPD FTE
$50	--	--	$50	NR	TRD – RPD Operating

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

TECHNICAL ISSUES

TRD points out a number of technical drafting issues:

> In 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 TRD 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 TRD, 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; TRD 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 TRD 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 TRD 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 TRD. 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 percent 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. TRD 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 TRD 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.

TRD 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. TRD recommend that the credit is available to claim prospectively (no lookbacks or ability to amend prior year returns), from the certification date.

OTHER SUBSTANTIVE ISSUES

TRD notes several other issues of importance:

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, TRD 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: TRD suggest including 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 on conviction of the offense. Charges stemming from these statutes address the "willful intent" to commit tax fraud or evasion/defeat of tax.

In assessing all tax legislation, LFC staff considers whether the proposal is aligned with committee-adopted tax policy principles. Those five principles:

- **Adequacy**: Revenue should be adequate to fund needed government services.
- **Efficiency**: Tax base should be as broad as possible and avoid excess reliance on one tax.
- **Equity**: Different taxpayers should be treated fairly.
- **Simplicity**: Collection should be simple and easily understood.
- **Accountability**: Preferences should be easy to monitor and evaluate.

In addition, staff reviews whether the bill meets principles specific to tax expenditures. Those policies and how this bill addresses those issues:

Tax Expenditure Policy Principle	Met?	Comments
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.	✓	Introduced last year as HB163
Targeted: The tax expenditure has a clearly stated purpose, long-term goals, and measurable annual targets designed to mark progress toward the goals. Clearly stated purpose Long-term goals Measurable targets	 ✗ ✗ ✗	Implicit purpose is to reduce tax burden on small business, but not explicit goals or target are set.
Transparent: The tax expenditure requires at least annual reporting by the recipients, the Taxation and Revenue Department, and other relevant agencies	✓	Separate reporting
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. Public analysis Expiration date	 ✓ ✓	
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. Fulfills stated purpose Passes "but for" test	 ? ?	
Efficient: The tax expenditure is the most cost-effective way to achieve the desired results.	?	
Key: ✓ Met ✗ Not Met ? Unclear		

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