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

		ORIGINAL DATE	02/07/10		
SPONSOR	Sapien	**LAST UPDATED**		**HB**	
SHORT TITLE	Veteran-Owned Business Gross Receipts			**SB**	163
				ANALYST	Gutierrez

REVENUE (dollars in thousands)

Estimated Revenue			Recurring or Non-Rec	Fund Affected
FY10	**FY11**	**FY12**		
	($24,860.3 - $116,717.8)	($26,103.3 - $122,553.7	Recurring	General Fund
	($4,202.3 - $19,729.7)	($4,412.4 - $20,716.1)	Recurring	Counties
	($11,039.8 - $51,831.2)	($11,591.8 - $54,422.8)	Recurring	Municipalities

(Parenthesis ( ) Indicate Revenue Decreases)

SOURCES OF INFORMATION
LFC Files

Responses Received From
Taxation and Revenue Department (TRD)

SUMMARY

Synopsis of Bill

Senate Bill 163 exempts from the gross receipts tax receipts of a veteran-owned business that are received from the federal government for services conducted pursuant to a contract or subcontract with the federal government.

The effective date of this bill's provisions is July 1, 2010.

FISCAL IMPLICATIONS

According to the U.S. Census Bureau's 2006-2008 American Community Survey, 12.1 percent of New Mexico's civilian population are veterans. New Mexico federal government expenditure for procurement contracts is assumed to be $6.9 billion in 2008 (Tax Foundation Special Report No. 158, "Federal Tax Burdens and Spending by State"). For this analysis it is also assumed that federal expenditures grow by 5 percent annually and that 65 percent of procurement contracts are made up of tangibles or non-qualifying services. The average gross receipts tax rate for municipalities is 1.495 percent, and the average county rate inside a municipality is 0.578 percent while outside a municipality is 0.973 percent with an assumed percent of service outside of municipalities being 32 percent. According to the Department of Energy and the Department of Defense, roughly 21 percent of the federal contracts to New Mexico are from veteran-owned businesses. This percentage was used to obtain the lower-bound impact to the general fund and local governments. However, this bill also allows for federal subcontracts. Because the amount of subcontracts is unknown and because it would be simple to subcontract through a shell company owned by a veteran, the upper-bound impact shows that 100 percent of the contracts could be sub-contracted to veteran-owned businesses.

TRD:

Estimated Revenue Impact (Upper Bound)*						**R or NR****	**Fund(s) Affected**
FY2010	**FY2011**	**FY2012**	**FY2013**	**FY2014**	**FY 10-14**		
0	(19,730)	(20,716)	(21,752)	(22,840)	(85,037)	R	Counties
0	(51,831)	(54,423)	(57,144)	(60,001)	(223,399)	R	Municipalities
0	(116,718)	(122,554)	(128,681)	(135,115)	(503,068)	R	General Fund
0	**(188,279)**	**(197,693)**	**(207,577)**	**(217,956)**	**(811,504)**	**R**	**Total**

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

The above impact represents the scenario where all eligible services are ultimately shifted to be veteran-owned businesses. This can happen in three ways: First, veteran-owned businesses will have tax advantage for all services provided to the Federal government, even if they cannot provide those services at lowest cost (before tax), and therefore will win contracts from competitors which may drive their competitors out of business over time. Secondly, this exemption creates a large incentive to place veterans in the leadership or ownership of companies. Thirdly, existing businesses may choose to become subsidiaries of veteran-owned businesses in order to survive or to take advantage of this tax expenditure.

Estimated Revenue Impact (Lower Bound)*						**R or NR****	**Fund(s) Affected**
FY2010	**FY2011**	**FY2012**	**FY2013**	**FY2014**	**FY 10-14**		
0	(4,202)	(4,412)	(4,633)	(4,865)	(18,113)	R	Counties
0	(11,040)	(11,592)	(12,171)	(12,780)	(47,583)	R	Municipalities
0	(24,860)	(26,103)	(27,409)	(28,779)	(107,151)	R	General Fund
0	**(40,102)**	**(42,108)**	**(44,213)**	**(46,424)**	**(172,847)**	**R**	**Total**

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

The above table shows the estimated impact as businesses are currently structured and organized, and without increasing their market share because of the new exemption. According to the U.S. Census 12.1% of New Mexico's civilian population 18 years and over are veterans. The percentage of veteran-owned businesses providing services to the Department of Energy (DOE) is assumed to be slightly higher at 15% and the percentage of veteran-owned businesses providing services to the Department of Defense (DOD) in New Mexico is assumed to be significantly higher at 48%. For other Federal spending (not by the DOD or DOE) the percentage is assumed to be the statewide average. These percentages may underestimate the true level of veteran-owned businesses because of coincident demographic features of business ownership and veteran status such as gender and age.

SIGNIFICANT ISSUES

LFC notes that while individual deductions from the gross receipts tax may have small fiscal impacts, their cumulative effect significantly narrows the gross receipts tax base. Narrowing the gross receipts tax base increases revenue volatility and requires a higher tax rate to generate the same amount of revenue.

The bill will reduce local government gross receipts tax collections. Many of New Mexico's local governments are highly dependent on gross receipts tax revenue.

TRD:

> The bill would create confusion among taxpayers for reporting purposes since services sold to the federal government would be exempt but tangible personal property sold to the federal government would need to be reported and deducted.

ADMINISTRATIVE IMPLICATIONS

This bill will have a minimal impact on TRD.

BLG/svb

The Legislative Finance Committee has adopted the following principles to guide responsible and effective tax policy decisions:

1. ***Adequacy:*** *revenue should be adequate to fund government services.*
2. ***Efficiency:*** *tax base should be as broad as possible to minimize rates and the structure should minimize economic distortion and avoid excessive reliance on any single tax.*
3. ***Equity****: taxes should be fairly applied across similarly situated taxpayers and across taxpayers with different income levels.*
4. ***Simplicity****: taxes should be as simple as possible to encourage compliance and minimize administrative and audit costs.*
5. ***Accountability/Transparency:*** *Deductions, credits and exemptions should be easy to monitor and evaluate and be subject to periodic review.*

More information about the LFC tax policy principles will soon be available on the LFC website at www.nmlegis.gov/lcs/lfc