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

		ORIGINAL DATE	01/30/11		
SPONSOR	Chavez, Eleanor	**LAST UPDATED**	02/24/11	**HB**	161/aHFL#1
SHORT TITLE	Tax Expenditure Budget Development and Report			**SB**	
				ANALYST	Burrows

REVENUE (dollars in thousands)

Estimated Revenue			Recurring or Non-Rec	Fund Affected
FY11	**FY12**	**FY13**		
	NFI	NFI		

(Parenthesis ( ) Indicate Revenue Decreases)

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY11	FY12	FY13	3 Year Total Cost	Recurring or Non-Rec	Fund Affected
Total		$100.0	$100.0	$300.0	Recurring	TRD Operating Budget

(Parenthesis ( ) Indicate Expenditure Decreases)

Duplicates SB47

SOURCES OF INFORMATION
LFC Files

Responses Received From
Department of Taxation and Revenue (TRD)

Responses Not Received From
Department of Finance and Administration (DFA)

SUMMARY

Synopsis of House Floor Amendment #1

House Bill 161 was amended on the House Floor to require the Department of Taxation and Revenue (TRD) to annually compile a dedicated revenue budget for the upcoming fiscal year, including analysis of expenditures, for review by the governor, the interim legislative revenue and tax stabilization committee, and the legislative finance committee. The budget shall report on dedicated annual revenues of $500,000 or more in the aggregate for a specific beneficiary, and should include:

- analysis of the projection of dedicated revenue forgone to the general fund;
- statutory basis including year of enactment, date of repeal, and purpose;
- the beneficiaries of the dedicated revenue;
- the outcomes resulting from the expenditure of dedicated revenue;
- and should identify significant unintended effects of the dedicated revenue.

The amendment defines "dedicated revenue" as "income derived by the state from taxes assessments, penalties or fees that are earmarked of dedicated to a specific fund, program or agency," and requires the budget to be completed prior to October 15 of each year.

The proposed amendment may require additional TRD operating budget funding.

Synopsis of Original Bill

House Bill 161 would require the Department of Taxation and Revenue (TRD) to annually compile a tax expenditure budget for the upcoming fiscal year, including analysis of tax expenditures, for review by the governor, the interim legislative revenue and tax stabilization committee, and the legislative finance committee. The budget shall report on tax expenditures with revenue impacts exceeding $5 million, and should include

- analysis of the projection of tax revenue losses;
- statutory basis including year of enactment, date of repeal, and purpose;
- the beneficiaries of the tax expenditures;
- and should identify significant unintended effects of the tax expenditures.

The bill defines "tax expenditure" as "a deduction, credit, exemption, exclusion, rebate, offset, preferential tax rate, subtraction or allowance or related tax structure that reduces tax liability when compared with a normal tax system as determined by the secretary," and requires the budget to be completed prior to October 15 of each year.

Because no effective date is provided in the bill, its provisions will become effective 90 days after the 2011 legislative session adjourns, on June 17, 2011.

FISCAL IMPLICATIONS

No impacts on state revenues.

SIGNIFICANT ISSUES

Like programs (or entitlements) on the spending side of the budget, most tax expenditures do not go through a direct appropriations process each year. Tax expenditures give preferential tax treatment to specific groups to encourage certain types of economic activity. From a tax policy standpoint, these mechanisms by which the revenue base is eroded should be evaluated as rigorously as appropriations.

Without knowing the amount of revenue foregone due to tax expenditures, policymakers and the public cannot know how much tax relief is being granted and to whom the benefits are accruing. Also, a narrower tax base requires that a higher tax rate be imposed to provide enough revenue to meet the state's spending needs. Moreover, a narrower tax base leads to increased revenue volatility, which makes fiscal planning more difficult.

Currently, the cost of New Mexico's tax expenditures are only estimated when they are first enacted in Fiscal Impact Reports. However, the costs of tax expenditures are rarely revisited to assess whether they cost more or less than expected, whether costs are growing as anticipated, or whether tax expenditures are effective.

Like most states, New Mexico's tax code contains hundreds of tax expenditures. While many of New Mexico's tax expenditures have very small costs, they cumulatively represent a significant erosion of the state's revenue base.

According to TRD, many states currently prepare tax expenditure budgets as a means of tracking the impacts of special tax provisions that reduce state revenue in order to target certain populations or activities. Three major challenges limit the usefulness of these reports: (1) significant amounts of detailed information are required, much of which is proprietary in nature; (2) reasonable people can disagree on definition of tax expenditure, thus, a report is unlikely to satisfy all parties to the debate; (3) the state of the art of economic research does not enable reliable estimates of the full economic impacts of tax preferences.

PERFORMANCE IMPLICATIONS

Periodic review of tax expenditures adds transparency, fiscal discipline, and political accountability to the budget process. By uncovering the cost of New Mexico's tax expenditures, a tax expenditure budget will allow the state's policymakers to tailor tax incentives and appropriations to better achieve the state's goals.

ADMINISTRATIVE IMPLICATIONS

According to TRD, the tax expenditure budget mandated by this bill will necessitate additional administrative costs to TRD. Assuming the report would be like those of many other states, essentially a listing of provisions along with their approximate fiscal impacts, one additional FTE would be required with a salary of approximately $30 per hour. The costs in the table include benefits, overhead and some special database software purchases. An alternative approach would be to contract for the report with researchers at an in-state university. The costs of such report would probably be lower than those in the table, but a commitment of TRD resources would be needed to support the contractor's work, yielding a similar overall resource cost.

Some of the reporting requirements, such as revenue invested and jobs created, may be difficult, if not impossible to determine.

DUPLICATION

Senate Bill 47 duplicates the provisions of this bill.

TECHNICAL ISSUES

TRD states it is unclear what is intended by the language on page 2, lines 12-13: "A tax expenditure budget shall…quantify the revenue invested by the state from each tax expenditure." Also TRD reports language on page 2, lines 14-18 requires the budget to identify the number of businesses that potentially qualified for but failed to use the tax expenditure. It is not clear how TRD would conduct such an analysis.

OTHER SUBSTANTIVE ISSUES

The ease of estimating the cost of tax expenditures depends on tax reporting requirements. Tax credits are explicitly reported on tax forms, which makes calculating their cost straightforward. However, deductions and exemptions are not reported explicitly. Without explicit reporting, the costs associated with deductions and exemptions must be estimated. These estimates are time consuming and contain some degree of uncertainty.

One of the most difficult challenges in creating a tax expenditure budget is defining the revenue base against which tax expenditures should be measured. Much has been written about defining the base of income and excise taxes in other states and at the federal level, but New Mexico's gross receipts tax is unlike most sales taxes and will be more difficult to model.

WHAT WILL BE THE CONSEQUENCES OF NOT ENACTING THIS BILL

The amount of New Mexico's general fund revenue eroded due to tax expenditures will continue to be unknown. Policymakers will continue to be unable to decide whether the benefits of tax expenditures are great enough to justify their costs.

LKB/bym:mew