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

SPONSOR Egolf

ORIGINAL DATE 02/10/11
LAST UPDATED 02/14/11

HB 222

SHORT TITLE Reduce Unequal Treatment of Taxes & Credits

SB

ANALYST Burrows

REVENUE (dollars in thousands)

Estimated Revenue			Recurring or Non-Rec	Fund Affected
FY11	FY12	FY13		
	($120,000.0)	($126,000.0)	Recurring	General Fund – Gross Receipts Tax
	($3,663.0)	($3,853.0)	Recurring	General Fund – Compensating Tax
	$66,000.0	$71,300.0	Recurring	General Fund – Motor Vehicle Excise Tax
	$3,200.0	$3,200.0	Recurring	General Fund – Resources Excise Tax
	$40,400.0	$41,600.0	Recurring	General Fund – Oil & Gas School Tax
	($14,063.0)	**($13,753.0)**	**Recurring**	**Total General Fund**
	($458.0)	($480.0)	Recurring	Compensating Tax – Small Cities
	($458.0)	($480.0)	Recurring	Compensating Tax – Small Counties
	($246.0)	($258.0)	Recurring	Compensating Tax – Municipalities
	($40.0)	($42.0)	Recurring	Aviation Fund – GRT
	$14,668.0	$14,668.0	Recurring	Severance Tax Bonding Fund – Coal Surtax
	**	**	Recurring	Severance Tax Bonding Fund – O&G Severance Tax deductions
	**	**	Recurring	General Fund – O&G School Tax deductions
	**	**	Recurring	Property Tax beneficiaries – O&G Ad Valorem Tax deductions

(Parenthesis ( ) Indicate Revenue Decreases)

SOURCES OF INFORMATION
LFC Files

Responses Received From
Taxation and Revenue Department (TRD)

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

Other Responses Received
Other responses

SUMMARY

Synopsis of Bill

House Bill 222 proposes to amend the Tax Administration Act so that tax rates are equitable for similar forms of taxation. The bill proposes the following changes:

- decrease the gross receipts rate from 5.125 percent to 4.875 percent,
- decrease the compensating tax from 5.125 percent to 4.875 percent,
- decrease the compensating tax on services performed in New Mexico from 5 percent to 4.875 percent,
- increase the motor vehicle excise tax from 3 percent to 4.875 percent,
- increase the resources tax on potash from 0.5 percent to 0.75 percent,
- increase the resources tax on molybdenum from 0.125 percent to 0.75 percent,
- increase the processors tax on potash from 0.125 percent to 0.75 percent,
- increase the processors tax on molybdenum from 0.125 percent to 0.75 percent,
- increase the oil and gas school tax on oil, carbon dioxide, helium, and non-hydrocarbon gases from 3.15 percent to 4 percent, and
- caps the processing and transportation deduction for the oil and gas severance, oil and gas school, and ad valorem production taxes to 25 percent of cost.

The bill repeals the coal severance surtax exemption for certain contracts. House Bill 222 would also remove the lower tax rates on the oil and gas school tax, which are effective in instances when the price of oil or gas falls below a certain threshold in the preceding fiscal year.

The effective date of the provisions of this bill is July 1, 2011.

FISCAL IMPLICATIONS

TRD reports fiscal impacts are based on the consensus revenue estimate of each revenue. The coal surtax repeal impacts are based on detailed reports from coal producers. Surtax exempt volumes fluctuate from year-to-year but have averaged about 13 million tons per year in recent years so this figure was used to forecast impacts.

**TRD does not have the information necessary to estimate the impacts of limiting deductions on certain transactions for purposes of the oil and gas taxes. However, capping the deductions at 25 percent of cost would likely have a positive impact on the general fund, the severance tax bonding fund and property tax beneficiaries.

The removal of provisions allowing a lower tax rate in instances in which the price of oil or gas falls below a certain threshold would not likely impact revenue. The price thresholds set by these provisions are much lower than current forecasts of oil and gas price, and prices are not likely to fall to these levels in the foreseeable future.

SIGNIFICANT ISSUES

TRD:

> Lowering the gross receipts and compensating tax rates contributes to a more efficient tax policy. Increasing the motor vehicle excise tax reduces the disparity between this tax and the GRT, but, because vehicles are also subject to the tax when they are re-sold, could cause an excessively high effective rate of taxation in some cases.
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> Increasing the resources excise and the O&G school tax puts these mineral products on an equal footing with other minerals, but the higher rate of tax may make New Mexico production less competitive with production from other states. As well, repealing the coal severance surtax may put New Mexico coal into a less competitive position relative to coal from other states. The surtax exemption was originally adopted to help make New Mexico coal more competitive as more electricity is being sold under competitive contracts rather than under rate of return regulated rates.
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> The proposal to limit deductions for certain oil and gas taxes would change the way these taxes are applied and could create the potential for double taxation. The oil and gas production taxes are generally applied to the value of products at the production unit. Costs of processing or transporting from the production unit to the first place of market are generally deductible. However, these costs are taxed under other taxes. For example, the natural gas processors tax applies to natural gas processing. The gross receipts tax applies to pipeline transportation except when the latter is in interstate commerce. In addition, these products are typically taxable under the gross receipts tax when they are sold to a final consumer. Thus, eliminating deductions for processing and transportation is likely to increase the multiple taxation or "pyramiding" of tax on these products.

ADMINISTRATIVE IMPLICATIONS

TRD reports that impacts to TRD's oil and gas tax processing could be substantial if the technical issues mentioned below are not addressed. Significant systems changes would be needed by both the Department and taxpayers to comply.

CONFLICT

Senate Bill 244 raises the motor vehicle excise tax to 5 percent of value above $10,000.
Senate Bill 100 temporarily raises the oil and gas school tax on oil to 4.15 percent of taxable value.

TECHNICAL ISSUES

Taxable value for purposes of oil and gas monthly taxes is applied separately under current law to 1) transactions between unrelated parties, and to 2) transactions between related parties or when the value of products is not established at the production unit. Page 6, lines 2-5, which applies to related parties or instances of indeterminate product value, provides a definition of taxable value that conflicts with the definition provided in Section 7-29-4.1C, which applies to unrelated parties. Similar conflicts exist on page 9, lines 11-14 (see Section 7-31-5C), and page 10, lines 16-19 (see Section 7-32-5C). A possible amendment could avoid this conflict by amending subsection C from Sections 7-29-4.1, 7-31-5, 7-32-5 to be consistent with the proposed bill language. TRD is unable to determine – absent an audit – which valuation statute producers are applying for any given transaction.

The amendments on page 10, lines 8 and 10 are not necessary. Current language already includes Section 7-32-4 NMSA 1978 and Section 7-34-4 NMSA 1978.

TRD reports it has a number of existing valuation settlements between the state and oil and gas producers that have been agreed upon by both the state and TRD. The proposal would require that those agreements all be revisited. As an alternative, it might include grandfather language for instances in which the state has previously come to a settlement of valuation issues with a taxpayer.

Under current law, the treatment of deductions is identical in the four monthly oil and gas taxes – severance, school, conservation and ad valorem production. The proposal changes the treatment of three of these but excludes conservation. For purposes of reporting and processing payments, the current system enables all four taxes to be processed together. To maintain this simplicity, it would be preferable to extend the revisions to the conservation tax.

TRD reports the proposed limitation on deductions uses the word "or" between transportation and processing. Use of the word "or" in this context creates uncertainty. Although the intention appears to be to limit deductions for processing *and* transportation, the way the bill language reads 100 percent of one category of deductions would be eliminated.

Moreover, TRD states it is unclear if the effective date of the bill refers to production after that date or any taxes due after that date. TRD would like clarification, but would also recommend using sales months after July 1, 2011.

OTHER SUBSTANTIVE ISSUES

This bill will place a larger share of the tax burden on extraction-related revenue, which is an inherently volatile revenue source. Moreover, although the decrease in general fund revenue is offset by an increase in severance taxes through the removal of the coal surtax exemption, the severance tax bonding fund is restricted by statute to capital outlay and cannot be used to fund operating budgets.

New Mexico mineral producers have expressed concern that the increase in extraction will raise the processors tax by 600 percent, while increasing the oil and gas school tax by only 27 percent. At the higher tax rate, a mineral producer who owed $400 thousand for the processors tax in FY10, would face a tax liability of $2.4 million under this bill.

WHAT WILL BE THE CONSEQUENCES OF NOT ENACTING THIS BILL

Gross receipts, compensating, motor vehicle excise, resources, processors, and oil and gas school tax rates would all remain as under current law. For purposes of determining taxable value of oil and gas school, severance and ad valorem production taxes, 100 percent of transportation and processing costs would remain deductible. The coal surtax exemption would remain in effect.

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