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

ORIGINAL DATE 02/09/11
SPONSOR Ortiz y Pino **LAST UPDATED** **HB**

SHORT TITLE Soft Drink Sales Gross Receipts **SB** 256

ANALYST Golebiewski

REVENUE (dollars in thousands)

Estimated Revenue			Recurring or Non-Rec	Fund Affected
FY11	FY12	FY13		
	$9,100.0	$9,200.0	Recurring	County-Supported Medicaid Fund
	$3,600.0	$3,600.0	Recurring	General Fund

(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	$60.0	$10.0	$10.0	$80.0	Recurring	Taxation and Revenue Department

(Parenthesis ( ) Indicate Expenditure Decreases)

SOURCES OF INFORMATION
LFC Files

Responses Received From
Taxation and Revenue Department (TRD)
Department of Health

SUMMARY

Current statute makes food sold by retail food stores for home consumption deductible from the gross receipts tax. Senate Bill 256 would exclude soft drinks from this deduction, making them taxable. It would also create a new distribution to the County-Supported Medicaid Fund (CSMF) in an amount equal to the net receipts attributable to the gross receipts tax on the sale of soft drinks at a retail food store.

FISCAL IMPLICATIONS

TRD:

This estimate is based on the U.S. Bureau of Labor Statistics Consumer Expenditure Survey along with data on nonalcoholic liquid refreshment market shares from Beverage World's State of the Industry Report. It uses the current average tax rate that would be applied to deductible food purchases.

The majority of the increased revenue due to removing soft drinks from the food deduction will accrue to the CSMF in the form of the new distribution. In net the State General Fund will also receive some of the increased revenue.

The CSMF will receive a distribution equal to the net receipts attributable to the [State] gross receipts tax (currently at 5.125%) on the sale of soft drinks at a retail food store. The General Fund would receive both the revenue retained from the State gross receipts tax on newly taxable soft drinks (3.9% in municipalities and 5.125% outside of municipalities), and stop making food deduction "hold harmless" distributions to local governments on soft drinks that currently qualify for the food deduction. In net these gains will be greater than the new distribution to the CSMF by the amount of the food hold harmless distributions to local governments for local option gross receipts taxes. Local governments would collect their local option taxes and municipalities would receive the regular 1.225% distribution from the State on taxed soft drinks, offsetting the loss of "hold harmless" distributions from the State on the deductible soft drinks.

The U.S. Bureau of Labor Statistics Consumer Expenditure Survey provides data on at home "nonalcoholic beverage" expenditures. These expenditures are adjusted to remove bottled water and other beverages without any sweetener additives using market share data from Beverage World's State of the Industry Report.

SIGNIFICANT ISSUES

TRD:

This bill will increase the complexity of the gross receipts tax and increase the costs of administering and complying with New Mexico's gross receipts tax.

DOH:

SB 256 would result in an increase in the price of soft drinks relative to other beverages. Pricing strategies, such as these, have proven effective in decreasing the consumption of tobacco products in the United States. However, in a recent USDA pricing study, results showed it took a 20 percent price increase to decrease soft drink consumption (http://www.ers.usda.gov/Publications/err100/).

Studies among adults and children have found an association between high consumption of sugar-sweetened beverages and overweight status (*Lancet, 2001; NHANES III, 2000; Journal of the American Dietetic Association, 1997*). The Centers for Disease Control and Prevention (CDC) has identified the decrease of soft drinks and sweetened beverages in diets as a promising strategy for weight management (*CDC Division of Nutrition and Physical Activity Progress Monitoring Report, January 2006*). Key nutrition recommendations from the *2005 Dietary Guidelines for Americans* state that Americans should avoid excessive amounts of calories from added sugars.

Sweetened beverage consumption has doubled in adults and tripled in adolescents in the US since the 1970s. During the same time period, milk consumption decreased by 30%. (USDA Economic Research Service, 2002) Recently published studies in leading medical journals suggest a link between dairy consumption and lower body weight among adults and youth. As non-nutritive sweetened drink consumption in youth rises, including drinks sweetened with the sugar substitute aspartame, milk consumption declines. As the American Academy of Pediatrics notes, milk is the primary source of calcium in the diets of children and adolescents. Additionally, high fructose consumption is associated with non alcoholic fatty liver disease in children and adults. (*Nature Reviews – Gastroenterology and Hepatology, 2010*).

Obesity is a growing problem in the nation and in New Mexico. In 2009, 28.0% of youth ((New Mexico Youth Risk and Resiliency Survey data, 2010) and 61.8% of adults (New Mexico Behavioral Risk Factor Surveillance System data, 2010) living in New Mexico were either overweight or obese. Further, the prevalence of obesity continues to grow and occur at younger ages. In 2010, 30.3% of kindergarteners and 38.3% of third graders living in New Mexico were either overweight or obese (New Mexico Department of Health BMI Surveillance Report, 2010). The percentage of obese children participating in the Women, Infants and Children (WIC) Program increased from 10.6% in 2000 to 13.4% in 2008 (New Mexico Department of Health WIC data, 2009).

Childhood obesity has resulted in increases in youth-onset Type II diabetes. Further, a CDC study found that 60% of overweight children have at least one metabolic risk factor for heart disease or stroke, including elevated total cholesterol, triglycerides, insulin, and high blood pressure.

ADMINISTRATIVE IMPLICATIONS

TRD:

This bill will have a high overall impact on the Department and on New Mexico’s food retailers. There are no taxpayer penalties for not reporting or misreporting their soft drink sales; based on past experience, proper reporting compliance is expected to be low.

There will be a high initial and moderate continuing compliance cost to taxpayers. Currently the set of products that qualify for the Supplemental Nutritional Assistance Program (formerly known as the Food Stamp Program) are also the same products that qualify for New Mexico’s food deduction. This bill would create a new class of products that does not coincide with any other current use in retailers’ POS computer systems. It will be difficult for them to re-program their systems in the amount of time given.

In order to calculate the proposed distribution to the CSMF the Department must know taxpayers’ sales of these soft drinks; however, there are no taxpayer penalties for misreporting or failing to report. Currently a structurally similar distribution exists to the State’s Aviation Fund based on the amount of taxable Jet Fuel sales in New Mexico. There are also no penalties for misreporting or failing to report these sales to the Department. Experience with the Aviation Fund distribution has proven that good compliance is very difficult to achieve with this much smaller group of taxpayers even with continued efforts by the Department to educate taxpayers.

This bill will have a high overall impact on the Department. It will necessitate high taxpayer education with little time to distribute and insure comprehension of all require information. The sales would need to be separately reported and identified on the CRS-1 Form, using either a new special rate code or a new location code, so that proper distributions could be made. More lines of detail would result in lengthier returns, thus affecting processing of CRS-1 Forms for the retail stores, as more of the full-page CRS-1 long forms are filed. This proposal would place an additional burden on the Audit and Compliance Division to examine, in more detail, the deductible sales, to ensure that the gross receipts tax on soft drinks was paid. Instructions and publications will need revision at minimal costs.

In addition, the Department's five-year experience with the current (simpler) food deduction indicates that a high number of errors would occur in reporting, which would adversely affect "hold harmless" distributions to local governments and the new distribution to the CSMF. These taxpayer reporting errors would often require significant resources to research, correct, and explain to local officials and other distribution recipients.

Creating the ability to make a new distribution based on the amount of the gross receipts tax revenue from soft drinks at a retail food stores will have a moderate IT impact broken down as follows:

1) Changes to the pipeline for E-DCR - 60 hours
2) Changes to configuration for the new rate type – 160 hours
3) Changes to revenue accounting – 160 hours
4) Changes to TAP and NMWebFile – 160 hours
5) Testing – 40 hours

Total IT impact 580 hours

TECHNICAL ISSUES

TRD:

1) The proposal's requirement that "the beverage is… commonly referred to as a soft drink" is ambiguous. It could easily be interpreted two ways with very different outcomes. "Soft drink" can be used to mean any beverage that does not contain alcohol. "Soft drink" can also be used to mean an artificially carbonated beverage. 2) The bill may intend to remove any "powder, syrup, concentrate or any other base product intended for mixing to produce a drink commonly referred to as a soft drink;" however, it only removes beverages made with these products from the food deduction. 3) If "soft drink" is interpreted broadly to mean a drink that does not contain alcohol, this proposal would exclude items such as chocolate milk, Pedialyte and some infant formula from the current food deduction.

Because a beverage "commonly referred to as a soft drink" is ambiguous, the proposal would make the food deduction very difficult to interpret. For example, a store might sell Coca-Cola, Red Bull and fructose-sweetened green tea. Under the proposal Coca-Cola would not be eligible for the food deduction; however, it is unclear what the approach would be with the other two products. Red Bull, for example, is marketed as an "energy drink" and is sweetened with glucose rather than the more common sucrose, or fructose. It is unclear if Red Bull would remain eligible for the food deduction by virtue of its use of glucose, or by virtue of its marketing campaign as an "energy drink." Additionally it would be unclear if fructose-sweetened green tea would remain deductible.

The Streamlined Sales Tax Agreement allows certain deviations from the basic definition of food, such as excluding soft drinks; however, it does not allow the definition of soft drinks used in this bill[1]. If adopted, therefore, New Mexico would not qualify for Streamlined without repealing the changes in the bill.

OTHER SUBSTANTIVE ISSUES

TRD:

Currently, the gross receipts tax does apply to sales of soft drinks at restaurants, bars, vending machines, movies, sporting events or other concession locations, and any retail location that does not qualify for the food deduction. Because of federal preemption, soft drinks would still be exempt from the gross receipts tax when purchased with food stamps.

JAG/svb

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[1] Under definitions of the Streamlined Sales and Use Tax Agreement, Adopted November 12, 202 and amended through September 30, 2009: **"Soft drinks"** means non-alcoholic beverages that contain natural or artificial sweeteners. "Soft drinks" do not include beverages that contain milk or milk products, soy, rice or similar milk substitutes, or greater than fifty percent of vegetable or fruit juice by volume.