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FISCAL IMPACT REPORT-DRAFT Revision

ORIGINAL DATE 02/19/11
LAST UPDATED 03/12/11 **HB** _____

SPONSOR Rodriguez

SHORT TITLE Surcharges Imposed on Communications Services **SB** 422/aSJC/aSFC/aSFI#1

ANALYST Graeser/Aubel

REVENUE (dollars in thousand)*

Estimated Revenue			Recurring or Non-Rec	Fund Affected
FY11	FY12	FY13		
	\$2,300.0	\$2,300.0	Recurring	E-911

(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
E-911		\$2,300.0	\$2,300.0	\$4,600.0	Recurring	E-911
	\$151.0	\$50.0	\$50.0	\$201.0	Recurring	TRD operating (Primarily Gen- eral Fund)

(Parenthesis () Indicate Expenditure Decreases)

Duplicates House Bill 328 as amended
 Relates to House Bill 58
 Relates to Appropriation in the General Appropriation Act

SOURCES OF INFORMATION

LFC Files

Responses Received From

Department of Information Technology (DoIT)
 Department of Public Safety (DPS)
 New Mexico Public Regulation Commission (PRC)
 New Mexico Municipal league (NMML)
 Homeland Security and Emergency Management Department
 Department of Finance and Administration (DFA)
 Taxation and Revenue Department (TRD) (Response added)

SUMMARY

Executive Summary

The FIR has been substantially revised to reflect new concerns noted by LFC staff.

DFA and TRD differ significantly in their respective analyses of this bill. DFA's analysis responded to the revenue need side of the equation to ensure continued support for emergency 911 system to ensure public safety. TRD's analysis focused on the tax policy and administration implications of the bill's provisions. Neither agency is wrong but the conflict between the two positions requires resolution.

DFA's proposal to extend the \$0.51 per line surcharge to VoIP services is easy to administer and will cause only minimal administrative problems. However, the imposition of a retail sales tax in New Mexico with a vendor commission for the prepaid phone cards could be quite difficult and expensive to implement as fully described in the TRD analysis.

Perhaps even more importantly, the imposition of a sales tax holds the potential for serious unintended consequences, a concern that TRD did not address. At issue is the difference between a retail sales tax and the gross receipts tax (GRT).

Since the gross receipts tax was first implemented in 1935 as the Emergency School Tax, it has been a vendor sales tax, which means that the vendor is responsible for paying the tax as a cost of the privilege of doing business in the state. Most other states have a sales tax, in which the tax is the legal obligation of the buyer, and the seller has a fiduciary relationship with the government. While this may not seem important, it is. With a sales tax, vendors have been successful in many jurisdictions with getting legislation that allows the vendor to siphon off a portion of the tax collections as an administrative fee. Were that paradigm shift to be implemented in New Mexico, a 2% vendor commission would cost the state general fund and local funds nearly \$40 million in foregone revenues. This is a very small retail sales tax, but the tax policy implications are quite profound.

This issue might be addressed by removing the vendor commission and processing the prepaid card fee as part of the CR-1 forms that vendors currently use for the GRT. This would also address TRD's administrative concerns about vendors and the agency having to set up a separate tracking system for this new type of tax. TRD would need to analyze this possibility.

Synopsis of SFI#1 Amendment

The Senate Floor amendment #1 to Senate Bill 422/aSJC/aSFC changes the effective date for when prepaid wireless communication service transactions will be subject to the new E911 surcharge of 1.38% from March 19, 2011 to the date of July 1, 2011 contained in HB 328. The bills are now duplicates.

Synopsis of SFC Amendment

The Senate Finance Committee amendment to Senate Bill 422 includes the following four changes:

1. Strikes the SJC amendment, but reinstates the comma under item #4;
2. Removes Section 1, which is the act's original statutory findings and purpose section and renumbers the succeeding sections accordingly. Thus, the act would begin with the definition section. This change does not appear to alter the intent of the original bill.
3. Adds language to ensure that the 911 emergency surcharge shall not be assessed on

- broadband Internet access service; and
4. Adds back the comma to address the technical error.

The Senate Finance Committee amendment to Senate Bill 422 aligns with the two amendments made to House Bill 328, including clarifying that broadband Internet service is exempted from the 911 surcharge. This amendment would distinguish the Internet provider, which supplies a customer the connection to the Internet, from the VoIP application provider, which provides the communication service over the Internet. The surcharge would not apply to the Internet provider but would apply to the VoIP provider. ~~The remaining difference between the two bills is that SB 422 retains the date of May 19 for when prepaid wireless communication service transactions will be subject to the new E911 surcharge of 1.38% and HB 328 changes the date to July 1, 2011.~~

Synopsis of SJC Amendment

The Senate Judiciary Committee amendment corrects the technical error as noted by DFA in the original bill analysis by inserting the comma as suggested.

Synopsis of Original Bill

Senate Bill 422 amends the Enhanced 911 Bond Act to update the act by expanding the definition of communication technology upon which a surcharge can be levied to support emergency services in the state. Current statute specifies only land lines and wireless are subject to the charge; the bill adds prepaid wireless services and Voice over Internet Protocol (VoIP) communication services while amending language to allow for future technological advances in communication devices to also be included as they arise. It also expands the ability to impose a fee for false alarms to counties, which municipalities currently have. Finally, the bill expands the vendors for reimbursement to all communication service providers to allow for future technologies.

FISCAL IMPACT (Updated to include TRD response and additional LFC analysis.)

Revenue for E-911

Revenue for supporting the infrastructure for emergency services in New Mexico is currently based on a \$0.51 monthly surcharge for cell phones and land lines. With the increase in VoIP and prepaid cell phone services, which are not currently charged the monthly fee, revenue to the E-911 fund is declining as people migrate to these technologies. The January 2011 E-911 report, based on older data, states the “estimated lost surcharge revenue to the E-911 fund is \$0.42 million each year for VoIP and \$1.7 million each year for prepaid wireless.” DFA provided an updated estimate using more recent data that shows \$1.9 million for prepaid and \$0.4 million for VoIP.

The bill adds the \$0.51 surcharge to Internet-based VoIP providers. The bill also imposes a surcharge of 1.38 percent on each retail transaction involving prepaid wireless communication service (defined as any communication capable of reaching 911). The bill sets forth rules for apportioning the cost of devices bundled with wireless access minutes for the purpose of the surcharge. It provides for 3 percent fee to the retailer for administrative costs. Thus, the estimated increase in revenue by including these communication devices as proposed by the bill is a recurring \$2.3 million through recapturing the revenue stream currently lost to the two technologies not currently covered.

The E-911 Program in the Local Government Division of the Department of Finance and Administration will use this additional revenue to support equipment and system upgrades at Public Safety Answering Points (PSAPs) as well as PSAP training and network services.

Operating Expenses

Regarding state expenditures, DoIT provides this assessment:

Section II – Subsection B lines(14 -17) states:

“The E911 surcharge should be assessed to the retail customer based upon the maximum number of active telephone numbers capable of simultaneously contacting the local public safety answering point;”

Perspective to the DoIT/state telephone structure, the above statement elicits an assumption that all available channels on existing trunk lines for all state agencies may be assessed the E911 surcharge. This assumption is correct. Currently the DoIT/state telephone E911 surcharge is billed on all available channels with relatively few exceptions. Therefore there is no immediate fiscal impact on the DoIT.

TRD concludes the combined compliance and administrative costs to the department for implementing the new surcharges would be significant when compared to the amount of new revenue generated, particularly related to the prepaid wireless communication services surcharge. The agency provides a detailed list of what it considers reasonable estimates of expenditure needs, including outreach activities costing up to \$50 thousand, adding 1-2 FTE valued at \$50 thousand each, \$43.2 thousand for information systems changes (assuming 480 hours), and \$4 thousand for new forms.

Tax Policy Implications

TRD analysis appears to understate the complexity of the issue and the related costs, as well as the larger tax policy implications. LFC notes in this regard that DFA’s analysis was prepared without regard to New Mexico’s long-established tax structure and associated administrative procedures.

This bill implements a retail sales tax. This is at odds with the state’s history going back to 1935. Since the gross receipts tax was first implemented in 1935 as the Emergency School Tax, it has been a vendor sales tax, which means that the vendor is responsible for paying the tax as a cost of the privilege of doing business in the state. Most other states have a sales tax, in which the tax is the legal obligation of the buyer, and the seller has a fiduciary relationship with the government. While this may not seem important, it is. With a sales tax, vendors have been successful in many jurisdictions with getting legislation that allows the vendor to siphon off a portion of the tax collections as an administrative fee. Were that paradigm shift to be implemented in New Mexico, a 2% vendor commission would cost the state general fund and local funds nearly \$40 million in foregone revenues. This is a very small retail sales tax, but the tax policy implications are quite profound.

SIGNIFICANT ISSUES (Updated for TRD and LFC analysis of both the public service and the tax policy implications of the bill as amended by both HBIC and HTRC.)

This legislation pits public services against good tax policy.

Public Service Implications

E-911 services connect an end-user to a PSAP, which routes the call to the appropriate emergency responder.

According to the January 2011 E-911 Report, E-911 revenue has been falling since FY09 while the cost to operate and upgrade the system is increasing. The report projects that as soon as FY12, “surcharge revenue will be insufficient to fund the critical equipment and network upgrades required to meet public safety needs.” (See the attached Table 1.)

The report explains:

Until FY09, New Mexico’s E-911 Fund revenue increased each year. This growth was driven by the addition of surcharges for wireless (cell) services. While New Mexico’s revenue was on the rise between FY04 and FY09, across the nation 911 revenue was dropping. National trends are often slow to reach New Mexico, and until FY09 the increase in surcharge revenue from monthly wireless service agreements outpaced and offset any revenue loss from consumers that replaced their landline service with cell service only. The current economic climate, however, is motivating consumers to move to more economical wireless services, some of which are not subject to the surcharges that fund E-911 services. As a result, the downturn in E-911 funds seen in many other parts of the nation is now manifesting in New Mexico.

The report concludes “that VoIP and prepaid wireless users benefit from E-911 services but do not contribute to the fund, costing the state more than \$2 million annually. The State could close this loophole and recapture lost revenue by changing the surcharge legislation to extend collection to VoIP and prepaid wireless services.”

DoIT provides detail on the bill (for the duplicate bill HB 328):

House Bill 328 amends the Enhanced 911 Bond Act, which was originally established in order to provide 911 service to (and authorize a related surcharge upon) commercial radio operators, to apply to users of modern telecommunication devices in addition to users of commercial radios. The bill contemplates existing technology as well as possible future advances.

The bill will also serve to impose the surcharge on other communication services once they become able to contact enhanced 911 services. “Communication Service” is defined to mean any service using telephone, internet protocol addresses, electronic data networks or their equivalents or successors that is capable of connecting with the enhanced 911 system by dialing, initializing or otherwise activating the enhanced 911 system in real time regardless of the transmission medium or technology employed.

The definition of “enhanced 911 system” is expanded to include:

- ESInet, an emergency services internet protocol network supporting local, regional, state, and national public safety communications services in addition to 911; and
- NG 911, a next generation 911 system to be comprised of network, hardware, software, data and operations to provide standard interfaces from call and message services; process all types of calls, including non-voice messages; integrate additional data to route

calls properly; deliver calls to appropriate emergency entities; support data and communications for coordinated incident response; and provide secure emergency communications.

The bill further provides that information regarding the identity of subscribers provided to a 911 emergency response service by a communication provider is not a public record; communication service providers are generally not liable for providing or maintaining enhanced 911 systems or transmitting 911 calls; counties (in addition to municipalities) may establish penalties for 911 false alarms; and that enhanced 911 bonds may be used to reimburse any communication provider (not merely a telephone company or commercial mobile radio provider).

The New Mexico Municipal League supports this legislation and has adopted a resolution, being Resolution 2010-43, regarding this legislation. DFA reports that this bill is one of NMML's top five legislative initiatives.

Tax Policy Implications

TRD's analysis responds primarily to tax administration and vendor compliance issues.

Although the amendment delays the date for the applying the 1.38% surcharge on prepaid wireless communication services, TRD remains concerned that "it will not be feasible for thousands of New Mexico businesses or the department to properly administer and comply with the new surcharge by the July 1, 2011 date." TRD suggests an effective date of January 1, 2012 would allow time for better compliance and proper administration.

TRD explains:

Every convenience store, grocery store, gas station, and other retail establishment in New Mexico that sells prepaid wireless services (such as cards adding minutes to prepaid cell phones) will be required to register for the new tax program proposed in this bill and file monthly with the Department. In order to comply with the new tax, retail establishments will reprogram their point of sale cash register systems and break out the new charges on their receipts. They will need time to make these changes.

TRD points out additional issues related to the wireless communication surcharge:

Section 4, Subsection B imposes a prepaid wireless E911 surcharge of 1.38% on each retail transaction. Although not specified in the bill, it is presumed that the surcharge applies to 1.38% of the retail transaction amount. A technical amendment may help clarify the application of the charge.

By creating... the prepaid wireless E911 surcharge, under the Enhanced 911 Act, this bill presumably requires that an additional distribution be made to Enhanced 911 Fund. If the intent is to make such a distribution, the new distribution should be reflected in the bill's title.

Currently, Section 63-9D-8 (B) NMSA 1978 states, "all surcharges collected and remitted to the department shall be deposited in the [enhanced 911] fund." Yet, the existing definition of "surcharge" includes only the 911 emergency surcharge. If the intent is to deposit the prepaid wireless E911 surcharge in the same fund, Section 63-9D-8 should be

amended to specifically identify each surcharge to be deposited to the fund.

PERFORMANCE IMPLICATIONS

The NMPRC assumes that the bill will allow for additional funding for the E-911 network and PSAPs, therefore, will assist in the enhanced performance of the E-911 network. The additional funding will presumably help update the system so that “Next Generation” emergency calls can be made, such as texting. Currently, the system cannot accept emergency 911 calls from texting; the call must be a voice call.

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

Senate Bill 422 as amended now duplicates House Bill 328 as amended.

Senate Bill 422 relates to House Bill 54, which proposes to relocate the E-911 program to the Department of Public Safety.

TECHNICAL

HBIC amendment solves this drafting issue.

~~DFA points out a drafting error and a possible remedy:~~

~~A technical error exists in Section 63-9D-5A. A comma is omitted from the following, "There is imposed a 911 emergency surcharge in the amount of fifty one cents (\$.51) to be billed to each subscriber access line by a communications service provider on each active number for a commercial mobile service subscriber,..."~~

~~The omission of the comma confuses that there are multiple impositions of the surcharge on different services: access lines, commercial mobile service subscribers and active VoIP service subscribers. Without this comma, there could be confusion on whether the surcharge applies to landline subscribers.~~

~~A comma should be inserted between the words provider and on. This needs to read, "There is imposed a 911 emergency surcharge in the amount of fifty one cents (\$.51) to be billed to each subscriber access line by a communications service provider, on each active number for a commercial mobile service subscriber,..."~~

OTHER SIGNIFICANT ISSUES

DFA responded to TRD’s concerns analysis with the following comments, which do not appear to fully appreciate the subtleties of the GRT versus the sales tax issue:

This proposed legislation does not create a “new” tax. Rather it extends the existing surcharge for E-911 to consumers (prepaid and VoIP consumers) who because of a change in merchandising now avoid the existing surcharge. Those consumers still have E-911 service. However, they do not pay for it today as they did in the past. These changes in merchandising are requiring changes in the collection methods, not imposing a new tax.

It is also the recommended method used in several states, as explained by DFA:

DFA legal discussed this proposed legislation with TRD legal in 2009 and was assured that retailers, although they would complain, have systems in place already to collect and remit taxes to TRD and that this would not place a significant burden on retailers or TRD. Also, the retail model for prepaid collection in HB 328 was adopted in July 2009 by the National Conference of State Legislators (NCSL) at the recommendation of NCSL's Executive Committee Task Force on State & Local Taxation of Communications and Electronic Commerce. It is also supported by the CTIA (National Wireless Association). Maine, Texas, Colorado, Wisconsin, Tennessee, Michigan, Minnesota, Louisiana, Kansas and Oklahoma have enacted legislation using the retail point of sale model. HB 328 would avoid increasing the tax burden on the communication services currently paying into the fund while also ensuring that there is sufficient revenue to meet public safety needs, effectively closing a loophole and making the E-911 funding structure more equitable.

DFA concluded:

According to Yankee Group, a Boston-based research firm, the number of U.S. prepaid wireless consumers grew by an estimated 19 percent in 2008 because of the economic recession. In 2009, the number of prepaid users was projected to increase another 13 percent compared with just three percent for post-paid subscribers. Given that national projections show continued growth of prepaid and VoIP services, New Mexico needs to adjust its collection method to capture lost VoIP and prepaid surcharge revenue.

It is important to note that tax structures and administrative systems are unique to each state. It is a rare piece of national model tax legislation that can be implemented in even a significant minority of states without modification.

ALTERNATIVES

It would not be particularly difficult to impose this surcharge on VoIP and prepaid wireless cards as a manufacturer's excise tax, embedded in the cost of the services promised and provided by a relatively limited number of carriers. LFC recommends that this approach be explored in the interim resulting in an administrable, equitable program that results in restoring the vanishing revenues to the E-911 program.

WHAT WILL BE THE CONSEQUENCES OF NOT ENACTING THIS BILL

Revenue to support New Mexico's E-911 system will continue to decline as people migrate from land lines and cell phones to other communication devices. Reimbursement for E-911 funds will remain limited to a telephone company or commercial mobile radio provider. Counties will not be able to impose a "nuisance fee" for 911 false alarms.

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