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FISCAL IMPACT REPORT

ORIGINAL DATE 2/16/17
LAST UPDATED 3/06/17 **HB** 408/aHTRC/aHFI#1

SPONSOR Trujillo, CA

SHORT TITLE Tax Liability Changes & Definitions **SB** _____

ANALYST Iglesias

REVENUE (dollars in thousands)

Estimated Revenue					R or NR **	Fund Affected
FY17	FY18	FY19	FY20	FY21		
\$0.0	\$480.0	\$480.0	\$480.0	\$480.0	Recurring	Local Governments (Successor in Business)
\$0.0	\$720.0	\$720.0	\$720.0	\$720.0	Recurring	General Fund (Successor in Business)
(Indeterminate)					Recurring	General Fund (Refund Claims)
Indeterminate					Recurring	General Fund (Interest on Certain Credits)
\$0.0	\$720.0	\$720.0	\$720.0	\$720.0	Recurring	TOTAL General Fund

Parenthesis () indicate expenditure decreases. ** R = recurring; NR = non-recurring

SOURCES OF INFORMATION

LFC Files

Responses Received From

Taxation and Revenue Department (TRD)

SUMMARY

Synopsis of HFL Amendment #1

The House Floor Amendment #1 adds a subsection clarifying the time a claim for a refund is deemed appropriate.

Synopsis of HTRC Amendment

The House Taxation and Revenue Committee (HTRC) amended House Bill 408 to remove changes to Section 7-1-6.41 NMSA 1978 that would have allowed the Taxation and Revenue Department (TRD) to retain unexpended balances of certain administrative fees collected.

The amendment also replaces some of the amended language in Section 7-1-11 NMSA 1978 to clarify the language that is to be kept confidential as related to the methods, techniques and analysis used to select taxpayers for audit.

The committee amendment adds an additional section to the bill to amend Section 7-1-21 NMSA 1978 regarding installment agreements for installment payments of taxes in order to extend the

months in which payments can be made to 72 months (up from 60 months).

Lastly, the amendment corrects what appear to be two typos and reorders sections to correspond with the amendments.

Synopsis of Original Bill

This bill makes numerous changes to the Tax Administration Act, which are discussed below. There are several non-substantive corrections, which are clean-up in nature, that remove or update outdated or incorrect statutory references or other language.

Section 7-1-6.41 NMSA 1978 is amended to allow the Taxation and Revenue Department (TRD) to retain at the end of the fiscal year, for purposes of carrying out provisions of the Tax Administration Act (TAA), unexpended balances of certain administrative fees collected.

Sections 7-1-8.8 NMSA 1978 is amended and Section 7-1-8.11 NMSA 1978, which is already existing law, is added, so that the statutes reflect existing confidentiality provisions related to the Secretary of the Human Services Department, and information that may be revealed to a water and sanitation district.

Section 7-1-11(F) NMSA 1978 is amended to clarify the meaning of audit selection criteria, which is confidential information under current law. The clarification covers data analytics used to make audit selections or to identify potential fraud. If made public, this information could be used for tax evasion and fraud.

Sections 7-1-23 and 7-1-24 NMSA 1978 are amended to clarify that, in the protest of an assessment, payment of the disputed tax liability is not required in order to protest, but payment of any undisputed amounts is. Amendments to Section 7-1-24 NMSA 1978 also provide that if a protest to a notice of assessment is not filed within the time required the amount of tax determined to be due becomes final and the taxpayer is deemed to have waived the right to question it, unless the taxpayer were to pay the tax and claim a refund.

Section 7-1-26 NMSA 1978 is amended to provide that taxpayers have an elective right to treat a refund claim as “denied,” for purposes of protesting or filing an action in district court, if TRD has failed to act on the refund claim within 180 days. It also prescribes that a claim for refund is not complete if the Department requests additional relevant documentation from the taxpayer who submitted the claim and the taxpayer does not provide that documentation. The date this complete claim is submitted is then used to determine when the one hundred eighty days begin. This notion of a complete return is also used in Section 7-1-68 NMSA 1978 to determine when the computation of interest on overpayment may begin.

Section 7-1-61 NMSA 1978 is amended to include that penalties and interest are included in the meaning of “tax” as related to a successor in business and amounts due from former owners. Section 7-1-68 is amended to add several other investment or employment based tax credits to the current list of credits (film credit and high-wage jobs tax credit) for which interest is not paid.

There is no effective date of this bill. It is assumed that the new effective date is 90 days after this session ends.

FISCAL IMPLICATIONS

According to TRD, this bill is primarily a clean-up bill. However, several of the substantive clarifying changes have marginal positive or negative general fund revenue impacts. Some of those impacts are indeterminate.

The successor in business amendment requiring the payment of penalties and interest will increase collections by about \$1.2 million per year with \$720 thousand to the general fund and \$480 thousand to local governments. TRD derived this figure is based on a four-year average (2012-2016) of penalty and interest amounts assessed on successor in business assessments.

The impact of TRD retaining unexpended balances of administrative fees collected, subject to an appropriation, rather than reverting them to the general fund is \$400 thousand, based on a three-year average. The provision was stricken in the HTRC amendment.

TRD estimates the amendment allowing taxpayers an election to treat unprocessed refund claims as denied after 180 days will have a marginal negative impact on general fund revenues, as some claims that are denied based on TRD inaction are not paid out. Similarly, the removal of interest on certain credits would have a marginal positive impact to general fund revenues, though it is infrequent that these claims are processed with any delay. Finally, the amendment that requires taxpayers to pay undisputed portions of assessments at the time the protest is due does not ultimately impact revenues, but would impact timing by allowing the state to collect portions of tax owed earlier.

TRD states the HTRC amendment to extend installment agreements to 72 months (6 years) from the existing 60 months (5 years) will have a negligible impact on revenues. The House floor amendment has no fiscal impact.

SIGNIFICANT ISSUES

As a corrections and clarifications bill, TRD states this proposal is intended to correct and make current existing law, add clarification to existing law, and make some substantive changes to address problem areas in the fairness and efficiency of administration of the tax programs administered by TRD.

The Tax Administration Act (§§ 7-1-1 through 7-1-83) (the “TAA”) contains the overall framework that governs administration of the New Mexico tax programs that are under TRD’s control. The TAA contains, for example, the Taxpayer Bill of Rights, taxpayer confidentiality statutes, the provisions governing assessment and refund claim procedures, administrative appeals procedures, the statute of limitations, penalty and interest provisions for assessments and refund claims, lien and levy procedures, and revenue distribution provisions. The bill proposes to amend numerous provisions of the Tax Administration Act (TAA) (§§ 7-1-1 et seq.) through a series of both non-substantive technical corrections and substantive amendments and clarifications. It has been almost ten years since a corrections bill, addressing the TAA, has been enacted by the New Mexico Legislature.

TRD indicates the vast majority of the changes in the bill are true technical corrections, addressing outdated terms and incorrect, or non-specific, cross references. The purposes and goals of the major clarifying and substantive amendments are set forth below.

Defining Audit Selection Criteria. Under current law, “audit selection criteria” are protected from disclosure to the public under § 7-1-11. The bill proposes a clarifying amendment to modernize what constitutes “audit selection criteria” to cover modern data analytics, computer modeling, and fraud detection tools. Public disclosure of data analytics, scoring models, and the metadata used to detect fraud significantly increases the opportunity for noncompliance and outright fraud: it gives fraudsters and taxpayers a road map as to what data is important to audit selection and fraud detection. Maintaining the confidentiality of this information benefits all New Mexicans by increasing thwarting tax system abuses.

Modifying Protest Procedures to Require Payment of Unprotested Amounts and Fix Liabilities. This aspect of the proposal modifies current protest rules. It serves a dual purpose. First, it aims to eliminate unnecessary TRD resource use and aid in appeal administration. Second, it seeks to efficiently collect taxes, penalties and interest that are undisputedly due, but the collection of which may be delayed under the existing protest statute.

With regard to the first goal, taxpayers have two options for challenging assessments: (a) filing a protest under Section 7-1-24; or (b) paying the assessment and filing a refund claim under Section 7-1-26. Legal Service Bureau (LSB), Audit and Compliance Division (ACD), and Administrative Hearing Office (AHO) resources are often expended unnecessarily because the current protest statute fails to state that a failure to protest an assessment within 90 results in the tax liability being fixed and determined. Relatively frequently, taxpayers fail to timely file a protest, but then attempt to challenge the substantive basis for the tax assessment under some other action taken by the Department, such as a notice of abatement or a notice of levy. The Administrative Hearing Office typically disallows these challenges, but they continue to periodically appear, diverting resources unnecessarily. This amendment clarifies that the failure to file a timely protest eliminates the option to challenge the tax liability determined due on audit unless the taxpayer pays the tax and files a refund claim.

The second aim implicates what are known as pay-to-play rules. Under current law, a taxpayer does not have to pay any portion of an assessment in order to file a protest. Situations arise in which only a portion of the assessment is challenged or only penalties and interest are challenged. This bill amends the protest statutes so that any portions of an assessment that are not disputed by a taxpayer must be paid on or before the date the protest is due.

“Deemed Denials” of Refund Claims. This aspect of the bill addresses an important issue of taxpayer fairness. Unlike almost any other state, New Mexico taxpayers have to take, sometimes multiple, affirmative actions to preserve the validity of a refund claim that has been properly filed. If they fail to take these steps, and TRD does not act on the claim within 210 days, the refund claim is lost. The purpose of the current statute was to ensure timely TRD claim processing. But because of the requirement of further taxpayer action, it often has a perverse result and acts as a trap for unary taxpayers. This bill corrects that unintended result, by allowing taxpayers to treat any refund claim that has not been acted upon by TRD within 180 days as “denied.” Taxpayers can then either file a protest or an action in court to have the merits of the claim reviewed.

Penalty and Interest on Successor in Business Assessments. This aspect of the proposal reverses a recent New Mexico Court of Appeal’s decision by ensuring that penalties and interest apply to successor in business assessments. When the ownership of businesses or business assets are transferred to new owners, New Mexico statutes, in certain circumstances,

place liability for the original owner's unpaid CRS taxes on the successor. Successor liability serves two critical functions: (1) it secures the collection of legally owed taxes by placing derivative liability on a new owner, who may generally be in a better financial position to pay back due taxes than the previous owner; and (2) prevents tax evasion by owners that restructure operating business to try to avoid accrued liabilities. Under statute, successors have the opportunity to avoid the imposition of successor liability entirely by withholding from the purchase price (which can include debt forgiveness) an amount sufficient to cover the previous owner's tax liabilities until TRD issues a certificate of clearance that no taxes are owed by the prior owner or by paying that amount over to TRD. § 7-1-61(C). If a successor does not do this, assessments for the previous owner's tax liabilities can be issued directly to the successor. Note that a successor is automatically released from liability if the Department neither mails the certificate nor issues an assessment within 60 days of the request for a certificate. § 7-1-62(A) & (B).

The Court of Appeals held, as a matter of law, successor liability can only extend to the amount of actual tax due from the previous owner; it does not extend to the penalties and interest due from the previous owner. This decision reflects a radical change in legal interpretation. Outside of lost revenue, the decision creates a perverse result with respect to New Mexico's permanent statutory amnesty program (called "managed audits"). This program is designed to have non-compliant taxpayers come forward and offers elimination of penalties and interest in exchange. With the court's decision, taxpayers can achieve the same result without ever coming forward.

Administrative Fee Reversion. Current § 7-1-6.41 prescribes to TRD an administrative fee for collection and processing of certain revenues, most notably and significantly city and county gross receipts taxes. Because of month-to-month volatility, and unpredictable variables such as amended returns, in the GRT regime, the amount of these fees is extremely difficult to project for budgeting purposes. At year end, fees in excess of budgeted fees revert to the general fund. There have been two massive statutory changes with respect to local GRT administration in recent years: (1) the hold-harmless phase out; and (2) HB 581. These changes dramatically increase costs and complexity of TRD IT systems. As the original fee was relegated to TRD for purposes of administering these specific tax programs with respect to IT, this proposal allows the Department to retain the fee for that purpose.

The HTRC amendment strikes this provision from the bill.

ADMINISTRATIVE IMPLICATIONS

TRD states this bill will have a low impact (approximately 200 hours) on the Information Technology Division, as implementation requires configuration changes to bill items in GenTax.

TRD indicates there are prerequisites that must be completed before the development effort can commence, including (1) a legal interpretation of the final bill, and (2) complete business requirements. Considering the prerequisites and the effort and an estimated one month needed to implement, TRD states it will be challenging to have all these changes in place by the effective date.

TECHNICAL ISSUES

It appears the intent of the bill is to appropriate the entirety of the administrative fees to TRD for the prescribed uses; however, by adding the language "subject to appropriation by the

legislature,” any funds in excess of the annual appropriation will not be available for use. This issue is addressed in the HTRC amendment, as the committee removed the provisions allowing TRD to retain the unexpended balances of the fees.

Since the original bill made an appropriation, LFC recommended this bill be referred to HAFC. However, the HTRC amendment removes the appropriation.

Does the bill meet the Legislative Finance Committee tax policy principles?

1. **Adequacy:** Revenue should be adequate to fund needed government services.
2. **Efficiency:** Tax base should be as broad as possible and avoid excess reliance on one tax.
3. **Equity:** Different taxpayers should be treated fairly.
4. **Simplicity:** Collection should be simple and easily understood.
5. **Accountability:** Preferences should be easy to monitor and evaluate

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