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

ORIGINAL DATE 2/8/18
SPONSOR HBIC **LAST UPDATED** 2/11/18 **HB** CS/HB206/aHTRC

SHORT TITLE Compensating & Gross Receipts Tax Changes **SB**

ANALYST Clark

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY18	**FY19**	**FY20**	**FY21**	**FY22**		
None	Minimal but Likely Positive; Helps Preserve Existing Revenues (See Fiscal Implications)				Recurring	General Fund, Local Governments

Parenthesis ( ) indicate revenue decreases

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY18	FY19	FY20	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
Total		Minimal				TRD Operating Budget

Parenthesis ( ) indicate expenditure decreases

Conflicts with SB68
Relates to SB128

SOURCES OF INFORMATION
LFC Files

Responses Received From
Taxation and Revenue Department (TRD)
New Mexico Finance Authority (NMFA)

SUMMARY

Synopsis of HTRC Amendment

The House Taxation and Revenue Committee amendments to House Business and Industry Committee Substitute for House Bill 206 fix two technical issues: strikes the repeal of the small cities distribution, which was part of comprehensive compensating tax changes in the first version of the bill but no longer belonged in this bill; and also adds the companion half of the blended biodiesel facilities credit to the list of repeals, now repealing both the personal income tax and corporate income tax portions of the credit.

Synopsis of Original Bill

The House Business and Industry Committee Substitute for House Bill 206 performs various tax code cleanup functions, including repealing unused, little used, or expired tax expenditures. Additionally, it clarifies the treatment of transactions in interstate and foreign commerce for gross receipts tax (GRT) purposes. It also narrows a GRT deduction for the sale of chemicals and reagents to prevent the sort of attempted exploitation of the deduction the state has seen over the last two years, resulting in taxpayer protests of about $165 million for this one deduction. However, while the deduction is narrowed to prevent exploitation and possible significant loss of state revenues, the intent is to leave the deduction intact for the oil and gas and mining industries for all the uses for which the deduction was intended and the industries have historically used it.

The bill also amends Section 7-9-66 NMSA 1978 to remove the provision from the deduction for commissions for operating a "dealer store" at which property is sold for third parties.

The effective date of all but one provision of the bill is July 1, 2018, and the section that repeals tax expenditures affecting income taxes is effective January 1, 2019.

FISCAL IMPLICATIONS

The $165 million tied up in protests regarding the chemicals and reagents deduction is a matter that will need to be resolved by the Administrative Hearings Office and the courts; this cleanup legislation could help protect future revenues in the tens or hundreds of millions of dollars.

However, recent reporting indicates the oil and gas and mining industries are probably using the 18-ton language in statute, and striking that language might cause a significant and unintentional revenue increase. The Taxation and Revenue Department (TRD) notes it does not have precise information on the amount being deducted currently under this provision. In addition, TRD is currently involved in litigation on the issue, and the proposal could have a positive effect on revenues depending on the outcome of the litigation.

The other provisions of the bill would likely generate no revenue but would remove expired, unused, or little used tax expenditures from statute.

Estimating the cost of tax expenditures is difficult. Confidentiality requirements surrounding certain taxpayer information create uncertainty, and analysts must frequently interpret third-party data sources. The statutory criteria for a tax expenditure may be ambiguous, further complicating the initial cost estimate of the expenditure's fiscal impact. Once a tax expenditure has been approved, information constraints continue to create challenges in tracking the real costs (and benefits) of tax expenditures.

SIGNIFICANT ISSUES

Tax professionals and others worked to narrow the chemicals and reagents deduction to exclude attempted exploitation of the deduction as a loophole while avoiding unintentional impacts on the oil and gas and mining industries. A significant number of company officials from these industries, accountants, attorneys, other industry representatives, and tax professionals, recently met with legislative and executive staff to discuss the deduction. The discussion was useful and productive overall, but no decision regarding statutory changes was made during the meeting. The language in the bill is the result of an attempt to protect the oil and gas and mining industries while narrowing provisions to exclude known or suspected forms of attempted exploitation leading to the $165 million backlog of protests after the Taxation and Revenue Department deemed certain deduction claims invalid. However, very recent information from the industry noted the current language may still cause issues (as discussed in Fiscal Implications). Additional information from these industries on how to word the amended language to avoid unintentional impacts would be extremely useful.

The bill repeals the following exemptions, deductions, and credits against GRT and/or comp tax (all sections are part of NMSA 1978):

- 7-9-26.1 Exemption for fuel for space vehicles
- 7-9-54.1 Deduction for sale of aerospace services to certain organizations
- 7-9-57 Deduction for sale of services to out-of-state buyer (implemented in new language in the bill apart from the existing language requiring a nontaxable transaction certificate or NTTC)
- 7-9-74 Deduction for sale of property used to make jewelry
- 7-9-76 Deduction for travel agents' commissions paid by certain entities
- 7-9-76.2 Deduction for films and tapes
- 7-9-79.2 Biodiesel blending facility tax credit
- 7-9-86 Deduction for sales to film production companies
- 7-9-91 Deduction for contributions of inventory to certain organizations and governmental agencies
- 7-9-94 Deduction for military transformational acquisition programs
- 7-9-96 Governmental sale for resale credit
- 7-9-97 Deduction for certain purchases by the state from certain funds
- 7-9-99 Deduction for certain services used in construction of certain public health care facilities
- 7-9-100 Deduction for certain sales of goods used in construction of a sole community provider hospital
- 7-9-101 and 7-9-102 Deduction for equipment for certain electric transmission or storage facilities
- 7-9-103.1 Deduction for converting electricity
- 7-9-103.2 Deduction for electricity exchange
- 7-9-105 Credit for a penalty pursuant to 7-1-71.2
- 7-9-106 Deduction for military construction services

The bill also repeals the following exemptions, deductions, and credits against income taxes (all sections are part of NMSA 1978):

- 7-2-18.4 and 7-2A-15 Qualified business facility rehabilitation credit
- 7-2-18.5 and 7-2A-8.8 Welfare-to-work tax credit
- 7-2-18.8 Certain electronic equipment credit
- 7-2-18.21 Blended biodiesel fuel credit
- 7-2D-1 through 7-2D-14 Venture capital investments credit

ADMINISTRATIVE IMPLICATIONS

TRD reported the elimination of deductions and credits will require changes to the agency's publications, systems, and internal processes, and it is not clear this can be accomplished by July 1, 2018.

CONFLICT, DUPLICATION, RELATIONSHIP

Relates to, and partially duplicates, tax expenditure repeals included in SB68 and SB128. It conflicts with SB68's repeal of 7-9-65 NMSA 1978, which is amended in this bill and in SB128.

TECHNICAL ISSUES

The bill seems to inadvertently repeal the small cities distribution (Section 7-1-6.55 NMSA 1978).

The bill removes the personal income tax credit for blended biodiesel facilities but leaves the corporate income tax credit in place; this may be an error and both credits should be repealed.

The bill removes a deduction for commissions of the owner of a dealer store, although it is possible this deduction might not be used currently – analysis from TRD would be needed.

TRD reports language in Section 1 of the bill stipulates that, to be eligible for deduction, receipts from sale or leasing or licensing of property delivered or used outside the state the order must be "placed from outside the state." The requirement that the order be placed from outside the state is a departure from traditional application of GRT to such transactions and it is not clear why it is being added.

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

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

1. **Vetted**: The proposed new or expanded tax expenditure was vetted through interim legislative committees, such as LFC and the Revenue Stabilization and Tax Policy Committee, to review fiscal, legal, and general policy parameters.
2. **Targeted**: The tax expenditure has a clearly stated purpose, long-term goals, and measurable annual targets designed to mark progress toward the goals.
3. **Transparent**: The tax expenditure requires at least annual reporting by the recipients, the Taxation and Revenue Department, and other relevant agencies.
4. **Accountable**: The required reporting allows for analysis by members of the public to determine progress toward annual targets and determination of effectiveness and efficiency. The tax expenditure is set to expire unless legislative action is taken to review the tax expenditure and extend the expiration date.
5. **Effective**: The tax expenditure fulfills the stated purpose. If the tax expenditure is designed to alter behavior – for example, economic development incentives intended to increase economic growth – there are indicators the recipients would not have performed the desired actions "but for" the existence of the tax expenditure.
6. **Efficient:** The tax expenditure is the most cost-effective way to achieve the desired results.

JC/sb/al/jle