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

SPONSOR Cisneros **ORIGINAL DATE** 1/31/18 **LAST UPDATED** **HB**

SHORT TITLE Gross Receipts Tax Changes **SB** 162

ANALYST Clark

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY18	**FY19**	**FY20**	**FY21**	**FY22**		
NFI	**$20,200.0**	**$14,500.0**	**$19,800.0**	**$26,000.0**	**Recurring**	**General Fund (total)***
NFI	$136,700.0	$142,400.0	$148,400.0	$154,600.0	Recurring	General Fund (hospitals)
NFI	$51,700.0	$53,000.0	$53,900.0	$55,000.0	Recurring	General Fund (MVX)
NFI	NFI	$19,800.0	$18,600.0	$17,800.0	Recurring	General Fund (Internet)
NFI	($168,200.0)	($169,700.0)	($170,100.0)	($170,400.0)	Recurring	General Fund (rate reduction)
NFI	NFI	($31,000.0)	($31,000.0)	($31,000.0)	Recurring	General Fund (out-of-state gross receipts tax impact)
NFI	Unknown but Positive and Significant				Recurring	Local Governments (out-of-state gross receipts tax impact)
NFI	NFI	$23,400.0	$24,300.0	$25,300.0	Recurring	Local Governments (Internet)

Parenthesis ( ) indicate revenue decreases

*The additional general fund revenues this bill would generate could be used to increase Medicaid provider rates, offsetting cuts in 2016 and at least partially offsetting the additional taxes levied on hospitals by leveraging federal funds. This could be done in the General Appropriation Act.

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

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

Parenthesis ( ) indicate expenditure decreases

Conflicts (regarding insurance "in lieu of" language) with SB68 and SB128
Duplicates SB175, SB17 (national laboratory provision)

SOURCES OF INFORMATION
LFC Files

Responses NOT Received From
Taxation and Revenue Department (TRD)

Responses Received From
Economic Development Department (EDD)
New Mexico Municipal League
Department of Health (DOH)
Office of Superintendent of Insurance (OSI)

SUMMARY

Synopsis of Bill

Senate Bill 162 is a gross receipts tax (GRT) reform package with a few key components. First, it brings hospitals into the state tax base and levels the playing field for hospitals at the state level regardless of corporate structure – for-profit, nonprofit, or governmental. Second, it increases the motor vehicle excise tax (MVX) rate from 3 percent to 4 percent. Third, it applies the GRT to remote sellers such as Internet retailers and platforms, including third-party sales through websites like Amazon. It also allows local sharing of remote seller revenues. Fourth, it uses the significant majority of the revenues generated by these provisions to lower the state GRT rate from 5.125 percent to 4.845 percent. Finally, it provides some tax code cleanup and repeals a variety of tax expenditures that are expired, unused, or have unknown costs where it appears the original intent may no longer exist.

It removes a potential loophole that would prevent taxation of the prime contractor of a national laboratory, such as Los Alamos National Laboratory (LANL), if the contract is awarded to a nonprofit instead of the current for-profit contractors. It removes another potential loophole in the insurance "in lieu of" provision, where the possibility exists for taxpayers in the future to merge with an insurance company or begin selling insurance policies to avoid nearly all other taxes, including GRT.

The effective date for most provisions of this bill is July 1, 2018, although the remote seller provisions are effective July 1, 2019.

FISCAL IMPLICATIONS

The fiscal impacts of the provisions that raise revenue are shown in isolation, irrespective of GRT rate reduction, for simplicity. However, the interactive effect of increasing the GRT base was calculated when determining the impact of rate reduction and remaining revenue.

Hospital Tax Reform
The table below shows the methodology used to estimate the fiscal impact of bringing all hospitals into the GRT base and applying the new universal hospital deduction. The additional general fund revenues this bill would generate could be used to increase Medicaid provider rates, offsetting cuts in 2016 and at least partially offsetting the additional taxes levied on hospitals by leveraging federal funds. This could be done in the General Appropriation Act.

Hospital Tax Reform Impacts (in millions)				
	FY19	**FY20**	**FY21**	**FY22**
Non-Profit				
Gross Receipts*	$2,218.3	$2,311.4	$2,408.5	$2,509.7
Taxable Base After Deduction	$1,109.1	$1,155.7	$1,204.3	$1,254.8
State Impact	$56.8	$59.2	$61.7	$64.3
Government				
Gross Receipts*	$2,597.7	$2,706.8	$2,820.5	$2,939.0
Taxable Base After Deduction	$1,298.9	$1,353.4	$1,410.3	$1,469.5
State Impact	$64.9	$67.7	$70.5	$73.5
For-Profit				
Gross Receipts*	$1,147.1	$1,195.3	$1,245.5	$1,297.8
Taxable Base After Deduction	$573.5	$597.6	$622.7	$648.9
State Impact (including credit repeal)	$14.9	$15.5	$16.2	$16.9
General Fund Impact	**$136.7**	**$142.4**	**$148.4**	**$154.6**

* 2015-2016 cost report data plus 4.2% - 5% trend per year (minus 1.5% due to prior Medicaid rate cuts)

Motor Vehicle Excise Tax
The fiscal impact is a simple calculation of an additional third of projected revenues based on the January 2018 consensus revenue update.

Remote Sellers and Marketplace Facilitators
The estimated fiscal impact is particularly uncertain. These are highly imprecise estimates that represent a conservative ballpark amount of GRT revenue lost through untaxed internet sales. Although the estimate assumes full compliance (thus the reason for the conservative ballpark), gaining revenues from the handful of largest marketplace facilitators and remote sellers would likely result in receipt of the vast majority of possible revenues.

It is important to note there is not universal agreement this bill would not violate the U.S Supreme Court Quill decision (see "Significant Issues" for a detailed discussion), potentially placing these revenues in jeopardy if courts order the taxes refunded to taxpayers.

LFC staff economists used a slightly different method from TRD economists to estimate the loss of GRT revenues through internet sales, taking the per capita amount of the national losses and then adjusting based on the state's population and differential in average real disposable income.

The general fund impact would be about $31 million higher each year but for an apparently unintended consequence of bill language impacting existing out-of-state GRT revenues. This language could possibly be adjusted in at least a couple of ways to remove this negative impact and further reduce the GRT rate (see Technical Issues).

Gross Receipts Tax Rate Reduction
The general fund revenues remaining after rate reduction are calculated using the expanded GRT base provided by the bill and the additional revenues that do not add to the GRT base. They are then compared against the consensus revenue group growth rates estimated in the January 2018 revenue update.

Other Impacts

The bill also has the potential to protect existing state revenues. For example, it provides a mechanism to protect the majority of the current revenue stream from national laboratories should the management contract be issued to a nonprofit organization. The estimate for the possible loss of state GRT revenues if the contract for LANL is issued to a nonprofit contractor is roughly $25 million to $30 million. The new contract would become effective after September 2018, potentially impacting revenues for most of FY18 and subsequent fiscal years. The Sandia contract was reissued in December 2016 to another for-profit entity and will not be reissued within the forecast period.

The projected potential loss for the LANL contract was estimated by LFC staff based on documents provided by the national lab contractors, including historical GRT payments. However, the documentation is somewhat limited in detail, and the $25 million to $30 million estimate is a ballpark number. The local government would also see a significant loss of GRT revenues if the contract were awarded to a nonprofit under current statute.

This bill would not allow the state to continue receiving corporate income tax (CIT) payments from a nonprofit prime contractor but would substantially reduce the possible overall fiscal impact by maintaining current GRT revenues.

As another example of protection for existing revenues, amending the insurance "in lieu of" provision and the GRT exemption could potentially save tens or hundreds of millions of dollars if taxpayers attempt to exploit the existing tax code in the future. Most of the other provisions would generate either no revenue impact or likely minimal revenue gains.

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

Hospital Tax Reform

The healthcare landscape changed significantly in the last decade. The industry is one of just two bright spots in New Mexico for job growth, yet it remains largely untaxed. Hospitals are virtually untaxed at the state level despite more than $5 billion in annual gross receipts. In addition, private hospitals pay partial local taxes while government and nonprofit hospitals are largely exempt, leading to significant revenue inequities. The uneven tax playing field for hospitals interferes with the market, creating economic inefficiencies with strong incentives for hospitals to adopt certain financial structures.

The bill corrects this decades-old inequity. It keeps the existing 50 percent gross receipts deduction but expands it to allow all for-profit, nonprofit, and government hospitals to take the deduction. This is similar to a prior proposal passed by the Legislature. Taxing nonprofit and government facilities along with for-profits would be a major step in applying the tax in an equitable manner.

The bill brings nonprofit hospitals into the state GRT and governmental hospitals into the governmental gross receipts tax (GGRT) base and prevents local governments from adding on local taxes. It repeals the for-profit hospital tax credit of Section 7-9-96.1 NMSA 1978, leveling the playing field for hospitals at the state tax level.

Motor Vehicle Excise Tax

Motor vehicle excise taxes in New Mexico are less than half the rates in many locations in Arizona, Colorado, and Texas. New Mexico's rate is 3 percent, while rates in surrounding areas can be as high as about 8 percent after adding in local rate increments. The Arizona and Texas statewide rates alone are nearly double New Mexico's. The motor vehicle excise tax rate is less than half the effective GRT rate across most of New Mexico, creating a disparity in rates for consumer goods.

The taxable base for motor vehicles is much more stable than the base for the GRT, which has become more volatile over time; the higher tax rate applied to the more volatile revenue source and the lower rate applied to the more stable source amplify the volatility. The bill would take a step to better align the motor vehicle excise tax rate with GRT rates by adding 1 percent to the rate for a total tax rate of 4 percent.

Remote Sellers and Marketplace Facilitators

Nontaxed Internet sales are eroding New Mexico's retail sales tax base and reducing general fund revenues by tens of millions of dollars annually. Taxing local retailers but not large, online retail operations creates significant disparities and makes it very difficult for local shops to compete with remote sellers. Amazon is now paying tax on direct sales but not on sales by other parties that use Amazon as a sales platform. Recent reporting in *The Wall Street Journal* noted third-party sales represent 70 percent of all sales through Amazon, indicating New Mexico continues to lose tax revenue on the majority of Amazon sales. Further, Amazon is only paying the state portion of the GRT, not the local government portion, which creates a disparity in the total rate that favors out-of-state sellers over local businesses and means local governments are not receiving any tax revenue.

The bill would level the playing field for local businesses and large, online retailers. All remote sellers and marketplace facilitators (e.g. Amazon, eBay, etc.) that sell at least $100 thousand within New Mexico would collect and pay GRT on all sales – direct and third-party platform sales. Sales would be determined to take place at the location to which the product or service is delivered, and local GRT rates would apply.

These provisions of the bill have a delayed effective date to provide plenty of time for a thorough review of the language and impacts and another chance for corrections and modifications in the 2019 60-day legislative session.

Gross Receipts Tax Rate Reduction

To maintain revenues in the wake of the Great Recession, the statewide GRT rate increased 1/8 percent to 5.125 percent. Combined with local options, the GRT rate is nearly 9 percent in some municipalities. The increase in GRT rates has also exacerbated the effect of tax pyramiding, still an issue in many industries. A lower GRT rate has the effect of reducing pyramiding. The bill would use most of the revenue generated by other tax reform components to reduce the state GRT rate by 0.28 percent – this reduction is more than twice the 0.125 percent increase in the state GRT rate in 2010.

Repeals

The tax deductions and credits slated for repeal in this bill are either expired, unused or little used, or might create unintended revenue losses.

7-1-6.57	Distribution adjustment for hospital credit
7-2-18.4	Business facility rehabilitation credit (PIT)
7-2-18.5	Welfare-to-work credit
7-2-18.8	Certain electronic equipment credit
7-2-18.21	Blended biodiesel fuel credit (PIT)
7-2-18.27	Physician participation in cancer treatment credit
7-2A-15	Business facility rehabilitation credit (CIT)
7-2A-23	Blended biodiesel fuel credit (CIT)
7-2D-1 thru 7-2D-14	Venture capital investments credit
7-9-65	Chemicals and reagents
7-9-96.1	Hospital credit
7-9-106	Military construction services

The New Mexico Municipal League supports this legislation and provided the following analysis.

(1) Out-of-state vendors selling into New Mexico
Background: Vendors without physical presence in New Mexico have been considered immune from New Mexico's gross receipts tax under prevailing interpretations of federal interstate commerce law. This interpretation recently has come under fire and many states are challenging it both legislatively and in court.

Section 3, 4 & 7: Section 4 is the main provision. It divides out-of-state vendors without physical presence in New Mexico into two categories -- remote sellers and marketplace facilitators (i.e., Amazon, E-bay, etc.) The receipts of these businesses from sales into New Mexico become gross receipts, notwithstanding the business's lack of physical presence, if the amount of New Mexico sales exceeds $100 thousand in the current or previous calendar year. Marketplace facilitators are deemed to be agents of the remote sellers using their electronic marketplaces. Thus, if the facilitator has nexus with New Mexico, so do the remote sellers selling into New Mexico through the facilitator's marketplace. TRD can require the facilitator to provide info about the sellers using its marketplace.

Importantly, the facilitator gets to pay the remote sellers' taxes as well as its own. Some provisions limit the facilitator's liability when errors occur. A procedure is set up which allows the individual sellers to pay tax themselves, even on sales through the marketplace.

These vendors acquire a "place of business" wherever the property or the product of the service is delivered in New Mexico. Section 3 ensures that local option tax rates should apply.

Section 7 bars TRD from going after remote sellers and marketplace facilitators prior to July 1, 2019, the effective date of Sections 3, 4 and 7.

(2) Treatment of hospitals
Section 2, 6 & 10: Throws governmental hospitals back under the governmental gross receipts tax but takes all of the revenue generated into the state general fund by excluding those hospital GGRT from distribution under 7-1-6.38 [75 percent of which goes to the public projects revolving fund]. To soften the blow, these hospitals are allowed to deduct 50 percent of their revenues under Section 7-9-73.1.

Section 1 & 9: Partially excludes hospitals licensed by the Department of Health from the exemption for receipts of 501(c)(3) organizations. They are subject to the state gross receipts tax but remain exempt from local option taxes. The state takes all of the revenue into the state general fund by excluding these hospital tax revenues from the 1.225 percent municipal distribution.

(3) Insurance
Section 8 & 13: In conjunction with a companion amendment of the (insurance) premium tax, the gross receipts exemption for receipts of insurance companies is narrowed to only those receipts subject to the premium tax. Local option taxes should also apply to any receipts that are no longer exempt.

ADMINISTRATIVE IMPLICATIONS

TRD will likely report there will be a minimal to moderate, nonrecurring impact to make changes to GenTax and reporting forms.

The Department of Health (DOH) reported the following impacts.

> The bill would require hospitals managed by DOH to track and pay governmental gross receipts. The agency manages three licensed hospitals—New Mexico Behavioral Health Institute, New Mexico Rehabilitation Center, and Turquoise Lodge Hospital—that would be impacted by this bill. Depending on the fiscal impact of this bill, DOH may need to include a provision on provider payer contracts to collect and remit the governmental gross receipts taxes; otherwise, DOH will have a projected loss of revenue in the amount of the gross receipts taxes imposed.
>
> The three DOH facilities and the agency's Financial Accounting Bureau would each need an additional entry level FTE position to properly capture the information needed to calculate and remit the governmental gross receipts tax, a total operating budget impact estimated at $135 thousand annually. The bill does not include any appropriation to support these needs.
>
> DOH suggests a possible amendment could exclude hospitals managed by DOH from the tax.

CONFLICT, DUPLICATION, RELATIONSHIP

Duplicates SB175 and slightly conflicts (regarding insurance "in lieu of" language) with SB68 and SB128. Additionally, it duplicates the national laboratory provision in SB17.

TECHNICAL ISSUES

The amended language for Section 7-1-14 NMSA 1978 determining an in-state location for reporting gross receipts by sellers engaging in business but without physical presence causes an apparently unintended negative general fund impact. The bill could be amended to make that amended language applicable only to marketplace facilitators in the remote sellers section – this would have the effect of eliminating the $31 million negative general fund impact but only allowing local governments to share in the revenues of marketplace facilitators but not remote sellers who sell directly to customers. Alternatively, the bill could possibly be amended to eliminate the local sharing entirely; this would remove the negative general fund impact, and that provision and the related remote seller provisions have a later effective date of July 1, 2019, allowing additional time and a 60-day session to determine if, and how, to allow local governments to share in the revenues as intended without the unintentional impact.

The "in lieu of" language should be reviewed and possibly amended to ensure the bill does not unintentionally apply other taxes to persons and companies paying the premium tax. OSI provided the following comments on this issue in a similar bill:

> The bill proposes to exempt gross receipts tax for a service that is also not subject to premium tax. Does the legislation intend to exempt premiums collected by the agent on behalf of the insurer? Those premiums would be subject to premium tax and should not be subject to gross receipts taxes. Compensation for services provided by an agent should be subject to GRT.

WHAT WILL BE THE CONSEQUENCES OF NOT ENACTING THIS BILL

If this bill or another bill with a provision to protect national laboratory revenues is not enacted and the LANL contract is issued to a nonprofit entity, the state and local governments would each lose tens of millions of dollars.

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.

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