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FISCAL IMPACT REPORT

ORIGINAL DATE 02/22/13
SPONSOR Trujillo, J. **LAST UPDATED** 03/01/13 **HB** 612/aHHGAC

SHORT TITLE Lower Gross Receipts & Phase Out Deductions **SB**

ANALYST Walker-Moran

REVENUE (dollars in thousands)

Estimated Revenue					**Recurring or Nonrecurring**	**Fund Affected**
FY13	**FY14**	**FY15**	**FY16**	**FY17**		
5-year phase-in beginning FY16 ending FY20						
$0.0	$0.0	$0.0	$35,460.0	$72,720.0	Recurring	General Fund
$0.0	$0.0	$0.0	$22,800.0	$46,800.0	Recurring	Local Governments
$0.0	$0.0	$0.0	$270.0	$540.0	Recurring	Small City Assistance Fund
$0.0	$0.0	$0.0	$180.0	$360.0	Recurring	Small County Assistance Fund
$0.0	$0.0	$0.0	$90.0	$180.0	Recurring	Muni. Equiv. Distribution
$0.0	**$0.0**	**$0.0**	**$58,800.0**	**$120,600.0**	**Recurring**	**Total**

(Parenthesis ( ) Indicate Revenue Decreases)

SOURCES OF INFORMATION
LFC Files

Responses Received From
Taxation and Revenue Department (TRD)
Human Services Department (HSD)
Economic Development Department (EDD)

SUMMARY

Synopsis of HHGAC Amendment

The House Health, Government and Indian Affairs Committee amendment to House Bill 612 corrects the technical error in the bill regarding dates. The date now reads July 1, 2019 (not July 1, 2020).

Synopsis of Original Bill

GRT and Compensating Tax Rate Reduction (5-year Phase-In):
House Bill 612 (HB 612) amends sections 7-9-4 and 7-9-7 NMSA 1978 to reduce the gross receipts tax rate and the compensating tax rate by 1/8 percent per year for five years beginning in FY16. By FY20 the gross receipts tax rate and the compensating tax rate will be 4.5 percent (it is currently 5 1/8 percent).

HB 612 amends section 7-1-6.4 NMSA 1978, municipality gross receipts tax distribution to reflect the new gross receipts tax rate.

Tax Expenditures (5-year Phase-Out):
Section 7-9-16, certain nonprofit facilities, and section 7-9-29, 501(C)(3) organizations are converted from exemptions to deductions and then phased out over five years beginning in FY16.

Several credits and deductions are phased out over five years starting in FY16:
- Section 7-9-73 – Sales of prosthetic devices deduction
- Section 7-9-73.1 – 50 percent hospital deduction
- Section 7-9-73.2 – Sales of prescription drugs; oxygen deduction
- Section 7-9-77.1 – Certain medical and health care services deduction
- Section 7-9-93 – Health care practitioner deduction
- Section 7-9-96.1 – Receipts of certain hospitals credit
- Section 7-9-96.2 – Unpaid charges for services provided in a hospital credit
- Section 7-9-99 – New facility construction service for certain public health care facilities deduction
- Section 7-9-100 – Sole community provider hospital deduction

The effective date of this bill is July 1, 2013. The applicability date applies to gross receipts received on or after July 1, 2013.

FISCAL IMPLICATIONS

This bill reduces the gross receipts tax rate and the compensating tax rate from 5.125 percent to 4.5 percent. The rate is reduced 0.125 percent per year beginning in FY16 and fully phased in by FY20. The intent of the bill is to pay for the tax reductions by eliminating several health care credits and deductions. Lowering the GRT rate and eliminating reliance on tax expenditures is efficient tax policy as it broadens the base.

GRT and Compensating Tax Rate Reduction (5-year Phase-In), TRD:
The state GRT rate is reduced by .125 percent steps over five years beginning July 1, 2015, to a final rate of 4.5 percent. The compensating tax rate is reduced in the same way over the same time period, from 5.125 percent to 4.5 percent. The estimated impacts from reducing the rates, based on the February 2013 consensus revenue forecast of gross receipts and compensating tax levels are shown in the table below.

Cost of GRT & Compensating Tax Rate Reduction (in thousands of dollars)					
	FY13	**FY14**	**FY15**	**FY16**	**FY17**
Impact on GRT	0	0	0	(40,000)	(83,000)
Impact on Compensating Tax	0	0	0	(1,650)	(3,360)

The impacts arise from a decrease from 6.84 percent to 6.72 percent in FY16 to 6.59 percent in FY17 in the effective statewide average GRT, and decreases in the compensating tax rate from 5.125 percent to 5 percent in FY16 and 4.875 percent in FY17. Applying the reduced rate, in percentage terms to the forecast levels of GRT and compensating tax gives the impacts.

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.

<u>Tax Expenditures (5-year Phase-Out), TRD</u>:
Offsetting the revenue reductions due to reducing the tax rates, several large tax expenditures are phased-out over the same five-year period. In fact, the positive effect of the expenditure phase-out is expected to be much larger than the negative effect of the rate reductions. The table below is an itemized list of the estimated magnitude of the listed expenditures at the current tax rates.

Current Cost of Tax Expenditures at Current Tax Rate (in thousands of dollars)					
	FY13	**FY14**	**FY15**	**FY16**	**FY17**
7-9-16	(953)	(964)	(975)	(985)	(996)
7-9-29	(198,955)	(202,933)	(206,990)	(211,129)	(215,351)
7-9-73	**	**	**	**	**
7-9-73.1	(42,678)	(43,397)	(44,128)	(44,871)	(45,626)
7-9-73.2	(67,530)	(70,872)	(74,379)	(78,061)	(81,924)
7-9-77.1	(53,225)	(56,576)	(60,137)	(63,923)	(67,947)
7-9-93	(79,992)	(85,261)	(90,878)	(96,865)	(103,245)
7-9-96.1	(10,323)	(10,511)	(10,703)	(10,898)	(11,096)
7-9-96.2	(1,536)	(1,621)	(1,710)	(1,805)	(1,904)
7-9-99	**	**	**	**	**
7-9-100	**	**	**	**	**
Total	**(455,192)**	**(472,135)**	**(489,900)**	**(508,536)**	**(528,090)**

**Adequate information does not exist to estimate the magnitude of these expenditures.

Under the proposed legislation, all of the listed tax expenditures would be phased-out in 20 percent increments. The positive impact also needs to be adjusted to reflect the tax rates proposed in the legislation. At the lower rate, the impact of a deduction or credit is smaller, since it is applied to a smaller base rate. This would have a positive revenue effect itemized in the table below.

Savings from Eliminating Tax Expenditures at Proposed Tax Rate in HB 612 (in thousands of dollars)					
	FY13	**FY14**	**FY15**	**FY16**	**FY17**
7-9-16	0	0	0	193	384
7-9-29	0	0	0	41,449	82,970
7-9-73	0	0	0	**	**
7-9-73.1	0	0	0	8,809	17,579
7-9-73.2	0	0	0	15,325	31,564
7-9-77.1	0	0	0	12,549	26,178
7-9-93	0	0	0	19,016	39,778
7-9-96.1	0	0	0	2,139	4,275
7-9-96.2	0	0	0	354	734
7-9-99	0	0	0	**	**
7-9-100	0	0	0	**	**
Total	**0**	**0**	**0**	**99,835**	**203,461**

The impact reflects a 20 percent reduction in the adjusted expenditures in FY2016 and a 40 percent reduction in FY2017. Because of the very large size of the tax expenditure, even at the 20 percent reduction level the positive impact outweighs the negative impact from the rate reduction.

Change in the municipal share quotient formula: This change has no fiscal impact. To determine the municipal share of the state GRT rate, a quotient is calculated as a given percentage divided by the state GRT rate. As the state rate is lowered, the numerator is lowered correspondingly to keep the quotient at a constant 0.239.

Net Impacts: The two impacts are added together to get the net, positive impact on revenues, given in the revenues table on page 1. The impacts from the phase-out of the credits and deductions are total impacts. Some of the credits and deductions apply across multiple tax programs. It is difficult to attribute such broad changes to particular tax programs, so the impacts are split between GRT and compensating tax based on relative proportions: 97 percent to GRT and 3 percent to compensating tax.

As reported by the Human Services Department (HSD):

HB 612 would create no immediate impact on the Medicaid program because the changes do not start until July 1, 2015, which is state fiscal year 2016.

However, as the provisions of the bill are implemented, the Medicaid program would reduce the amount that is paid to providers to cover gross receipts taxes.

For calendar year 2014, the Medicaid program is estimating the amount of tax that will be paid to providers that will eventually be affected by this bill, as follows;

$16,500,000 for hospitals and other facilities (hospitals are currently paid at 50 percent of their tax rate because of their current exemptions, which is accounted for in this estimate)
$1,000,000 for home health agencies, and other non-hospital outpatient services
$55,000,000 for practitioners, hospice, and nursing home facilities

TOTAL: The Medicaid program and the Medicaid managed care organizations currently pay these providers approximately $72,500,000 annually in gross receipts tax that would start to be reduced on July 1, 2015 until gradually phased out.

SIGNIFICANT ISSUES

As reported by the HSD:

Medicaid for-profit providers receive additional payment (over and above the fee schedule) to cover GRT on services paid by the Medicaid Fee for Service Program.

Managed care organizations typically pay for-profit providers additional payments (over and above the fee schedule) to cover GRT at negotiated amounts as part of their contracts with the providers.

When the Medicaid program negotiates and establishes capitation payment amounts, the necessary amount to allow a managed care organization to appropriately reimburse providers for GRT is included in those amounts.

Payments by both the Medicaid Fee for Service program and the Medicaid managed care organizations would affected by the bill.

GRT amounts paid to providers are matched with federal Medicaid matching funds, which account for approximately 70 percent of the tax amounts paid. If providers are not required to pay GRT to the TRD, it would not be permissible to continue to pay for-profit providers for the tax.

As the gross receipts taxes for the providers affected in this bill decreases, provider payments by the Medicaid program and Medicare manage care contractors would be similarly reduced. The capitation amounts that the HSD pays to managed care organizations should drop similarly.

ADMINISTRATIVE IMPLICATIONS

The TRD reports a moderate impact. Distribution changes will need to be made each fiscal year through July 1, 2019. This also changes the rates used in the Investment Credit Act as the credit is computed at the compensating tax rate. Transition rules will need to be made to the Investment Credit Act to determine the credit amount to be applied to an application.

Low IT impact (200Hours). The form instructions and publications and the rate schedules for the CRS tax program will need to be revised each year. This can be done with existing resources.

CONFLICT

Conflicts (overlaps) with HB 99 regarding tax related to medical supplies, HB 153 and SB 4 regarding tax related to dialysis, HB 375 regarding expanding tax deductions, HB 406 regarding tax related to Medicare and Medicaid payments, HB 427 regarding tax related to rural health, SB 267 regarding tax related to prosthetics and orthotics, and SB 269 regarding tax related to medical supplies.

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

EWM/blm:svb