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

**SPONSOR** Keller & Cote  **ORIGINAL DATE** 02/03/14  **LAST UPDATED**  **HB**

**SHORT TITLE** State Tax Expenditure Reporting, CA  **SJR** 5

**ANALYST** Graeser

## REVENUE (dollars in thousands)

| Estimated Revenue | | | | | Recurring or Nonrecurring | Fund Affected |
|---|---|---|---|---|---|---|
| FY14 | FY15 | FY16 | FY17 | FY18 | | |
| | NFI ** | NFI ** | NFI ** | NFI ** | | All |

(Parenthesis ( ) Indicate Revenue Decreases)

** Although this is not directly a revenue bill, the intention is clearly that with accurate and timely tax expenditure reporting, the State will have the information necessary to expand useful tax expenditures, curtailing or eliminating those that are not meeting stated goals and modifying those in-between tax expenditures to improve the effectiveness and equity of the State's many tax exemptions, deductions and credits. If this effort is successful, it could mean more, less or the same revenue impact, but substantially greater economic impact on the state than we experience with the hodge-podge of uncoordinated tax expenditures we now have.

## ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

| | FY14 | FY15 | FY16 | 3 Year Total Cost | Recurring or Nonrecurring | Fund Affected |
|---|---|---|---|---|---|---|
| **Total** | | >$ 46.0 | | >$ 46.0 | Nonrecurring | Election Fund |

Under Section 1-16-13 NMSA 1978 and the NM Constitution, the Secretary of State (SOS) is required to print samples of the text of each constitutional amendment, in both Spanish and English, in an amount equal to ten percent of the registered voters in the state. The SOS is also required to publish them once a week for four weeks preceding the election in newspapers in every county in the state. In 2012, the cost for the 2012 General Election ballots was $46,000 per constitutional amendment. However, if the ballot size is greater than one page, front and back, it would increase the cost of conductins the general election. In addition to the cost of the ballot, there will be added time for processing voters to vote and would mean additional ballot printing systems would be required to avoid having lines at voting convenience centers.

**SOURCES OF INFORMATION**
LFC Files

Responses Received From
Department of Transportation (DOT)
Department of Finance and Administration (DFA)
Taxation and Revenue Department (TRD)

## SUMMARY

Synopsis of Bill

Senate Joint Resolution 5 proposes an amendment to Article 8 of the Constitution of New Mexico by adding a new section that would require the consensus revenue estimating group (CREG) comprising professional economists of DFA, DOT, TRD, and the LFC, in cooperation with other appropriate state or local government agencies, to compile and present a tax expenditure report to the governor and the appropriate legislative committees that consider tax or budget issues no later than October 15 of each odd-numbered year. In the compilation and presentation of a tax expenditure report, the consensus revenue estimating group must comply with the federal Internal Revenue Code of 1986, as amended, although it is not clear if this requirement means that the CREG is required to estimate the State-level impact of the even more numerous tax expenditures included in the Internal Revenue Code.

The proposed amendment provides that the tax expenditure report must include:

- the identification of each tax expenditure and the tax expenditure's statutory basis, the tax liabilities against which the tax expenditure can be applied, the purpose of the tax expenditure, if any, the year of enactment and the date of repeal, if any.
- for at least the previous five fiscal years, the aggregate cost in foregone revenue of each tax expenditure; and the number of taxpayers that used each tax expenditure.
- a description and quantification of benefits that each tax expenditure provides to the state.
- the cost expended by the state to administer each tax expenditure.
- any significant unexpected effects of a tax expenditure;
- the projected cost in foregone revenue of each tax expenditure for, at a minimum, the current and following fiscal year. And
- identification of deviations from the state's tax structure determined not to be tax expenditures.

The proposed amendment would also require a taxpayer that claims or otherwise uses a tax expenditure to report the tax expenditure in a manner necessary to facilitate the tax expenditure report required by this section. The proposed amendment defines tax expenditure as a credit, deduction, exclusion, exemption, offset, rebate, rate differential or other deviation from the state's baseline tax structure that reduces a taxpayer's tax liability, as determined by the consensus revenue estimating group.

The amendment proposed by this resolution shall be submitted to the people for their approval or rejection at the next general election or at any special election prior to that date that may be called for that purpose.

## FISCAL IMPLICATIONS

None.

## SIGNIFICANT ISSUES

DOT comments, "… many states currently prepare tax expenditure budgets as a means of tracking the impacts of special tax provisions that reduce state revenue in order to target certain populations or activities. As directed by Governor Martinez's executive order 2011-071, a tax expenditure budget was produced and first presented in 2012 by the Taxation and Revenue Department:

http://old.tax.newmexico.gov/SiteCollectionDocuments/2012%20Tax%20Expend%20Report%20Final.pdf

It was updated in 2013:
http://old.tax.newmexico.gov/SiteCollectionDocuments/2013%20Tax%20Expenditure%20Report%20TRD%202013-11-12%20final.pdf

Several major challenges limit the usefulness of these reports such as proprietary or confidential information required for analysis and reliability of estimates of the full economic impacts of tax preferences."

Last year, the legislature overwhelmingly passed[1] SB 7/SFCS/aSFl. On April 5, 2013, however, Governor Martinez vetoed the bill and sent Senate Executive Message #47 to the President Pro Tempore and the members of the Senate. The relevant portions of this veto message are below:

"Senate Bill 7 requires the Consensus Revenue Estimating Group (CREG) to compile a tax expenditure budget for the next fiscal year and provide a mandatory reporting of that tax expenditure analysis and budget to the governor, the Legislative Interim Revenue Stabilization and Tax Policy Committee, and the Legislative Finance Committee no later than October 15th of each year."

"The bill is problematic for several reasons. First, it is unnecessary. New Mexico already has a Tax Expenditure Report. As a result of my 2011 executive order on this matter, the Taxation and Revenue Department (TRD) compile a thorough report in 2012. TRD will continue to update that report as needed."

"I am also concerned about the potential violation of confidentiality of taxpayer information created by the bill. It would require TRD to share with the CREG any information necessary to compile the report. Although taxpayer names, addresses and IDs are specifically excluded in the bill, in instances in which one large firm dominates an industry or region, it can be fairly easy to determine the identity of a taxpayer from information about a tax expenditure. Thus, publishing financial information about a tax expenditure can effectively release proprietary information of the affected taxpayer. Under current law, TRD is prohibited from publishing such information and therefore it is generally redacted in their reports."

"The purpose of a tax expenditure report is to re-examine past legislative decisions to identify policies in need of reform. During my administration, we have accomplished exactly that with regard to some of our largest tax expenditures, by reforming the Film Production Tax Credit, the High-Wage Jobs Tax Credit and the Rural Jobs Tax Credit. These changes illustrate that this administration takes seriously the need to monitor tax expenditures and to reform them when necessary to improve their effectiveness."

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[1] SPREF [1] SPAC/SFC-SPAC [4] DNP-CS/DP-SFC [18] DNP-CS/DP [21] fl/a- PASSED/S (37-0) [30] HCPAC/HTRC-HCPAC [39] DP-HTRC [50] DP - PASSED/H (58-10) VETO.

"Finally, I find it troubling that the Legislature would choose the CREG to compile this report, while simultaneously disregarding their revenue estimates during the legislative session. In the past, New Mexico's reliance on the CREG to prepare unbiased forecasts has been identified as a best practice that preserves the separation between fact-based analysis and political judgments. I hope that in the future, the Legislature will reverse its recent actions and return to the use of the consensus process."

A major difference between last year's CS SB-7 and this House Joint Resolution 7 is that the Constitutional Amendment proposed in this joint resolution, if enacted by the vote of the people, would embed the Consensus Revenue Estimating Group (CREG) in the State Constitution and would similarly place a purely administrative function in a document intended to detail basic rights and responsibilities of citizenship. The CREG has been functioning in New Mexico at least since 1978.

Initial membership of the CREG was composed of the professional economists from the legislative finance committee (LFC), the department of finance (DFA) and the taxation and revenue department (TRD). Over the years, there have been various attempts to put the function and membership of the CREG in the budget act 6-3-1 et seq, NMSA 1978. None of these efforts have been brought to fruition. Although there have been ups and downs in the independence and competence of the process, the CREG has served the State well for over 35 years, despite not being backed by enabling statute. Since the CREG is not in statute, it may not be a particularly good idea to embed this process in the State Constitution, which should contain general principles concerning the ways we govern ourselves and detail rights and obligations of the citizens. The CREG is purely an administrative and staff function and does not represent any basic rights or principles.

**PERFORMANCE IMPLICATIONS**

The entire focus of this joint resolution is to implement a basic LFC tax policy. That is the policy of accountability which is met with the bill's requirement to report annually to an interim legislative committee regarding the data compiled from the reports from taxpayers taking the deduction and other information to determine whether the deduction is meeting its purpose.

**ADMINISTRATIVE & COMPLIANCE IMPACT**

TRD reports that, although the constitutional amendment taking this concept to the voters has no direct administrative or compliance impact on TRD, if the voters approve the CA and mandate an annual or biennial Tax Expenditure Report including both revenue foregone costs and estimated benefits, the impact will be very high on all four agencies required to prepare the report: TRD, DFA, DOT and LFC. Estimating the impact of compliance with enabling legislation that would follow voter approval of this CA, "… is based on TRD's experience in preparation of the 2012 and 2013 Tax Expenditure Reports. There are more than four hundred known potential tax expenditures that must be analyzed separately (i.e., many tax expenditures may be applicable to as many as five different tax programs or taxpayer refund revenue tracking systems). If all of these individual tax programs must be investigated biennially by TRD Tax Analysis, Research and Statistics staff, it is anticipated that 3.0 FTEs effort is required to extract, estimate, and compile the foregone tax revenue data and to forecast future foregone revenue. It must be noted that there is no general agreement on the definition of every tax expenditure, and wide variety of "reasonable interpretations" among well informed analysts of tax expenditures will produce significant debate on these issues."

TRD's analysis continues:

> This effort is independent of the Consensus Revenue Estimating Group's (CREGs) efforts to identify, define and characterize the required statutory and substantive descriptions of all tax expenditures, or the time required to create a balanced, logical five year plan to comprehensively investigate the benefits and other details of the identified tax expenditures. Prior to October 15, 2015, this initial structuring of the first year CREG Tax Expenditure Report can be reasonably anticipated to require TRD, DFA, LFC and DOT representatives to meet at least monthly (approximately 4 hour meetings), and each representative would need at least one day preparation time before the meeting (NOTE: the CREG's membership constitutes approximately 11 individuals). This would constitute an additional burden of an estimated 110 staff-days, with approximately 50% of those hours from TRD resources, 20 percent each from LFC and DFA resources, and 10 percent from DOT resources.
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> The existing staff resources required to complete this CREG Tax Expenditure Report are otherwise committed throughout the six months prior to the October 15, 2015, due date. Importantly, these are staff resources that are otherwise currently fully occupied with interim research and analysis assignments, and such work will necessarily suffer as a result of this expansive CREG analytical responsibility.
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> The bill also contains a provision that requires taxpayers that use any tax expenditures to report them to TRD in a manner that would allow for the required reporting. This would have a very large impact on the Department, both in recurring and non-recurring costs.
>
> Department IT staff estimates that the reprogramming of the GenTax system would cost approximately $250,000, as a one-time expense. TRD is currently in the process of several significant IT projects, and existing staff is insufficient to accomplish another large scale project simultaneously. In order to complete the programming would require the hiring of several contract developers over the course of a six month development cycle, as well as diverting the few available staff from other responsibilities. As with the actual compilation of the report, these are staff resources that are currently dedicated to other important duties.
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> The Revenue Processing Division (RPD) of TRD would also be heavily impacted. In calendar year 2013, between 4,500 and 23,000 paper CRS returns were processed in a given month, with an average of more than 9,000. The differences in the number of returns reflects seasonal variation and annual, quarterly, semi-annual and monthly filing patterns. Currently, the vast majority of these paper forms are submitted on the short-form CRS return. The short form is very quick to process. If a check is received with the return, the check and short form can be scanned in a specialized scanner that processes the check at the same time that it images the return at a rate of about 1,000 returns per hour. The return acts as a voucher, so that a separate voucher is not needed.
>
> The itemization of all CRS tax expenditures would necessitate the move from the short form to the long form CRS return for any tax payer claiming deductions – the short form lacks the physical space for itemized deductions. To process a long form return, staff creates a voucher, sends the newly created voucher through the scanner with any included check for processing, and then scans the return on a larger, slower scanner. The whole

process takes several times as long as it takes to process a short form return. The scanner used for the long form is limited to 450 sheets per hour, but as long form CRS returns are multiple pages, the rate is an average of 225 returns per hour. RPD estimates that it would require 8,000 additional personnel hours a year, at a cost of about $200,000, recurring, to maintain current timelines with regard to processing CRS returns. Some of this could be mitigated, but it would necessitate delayed CRS closing dates, which would have the effect of delaying distributions to local governments.

Regardless of which form is used, short or long, all of the information on the forms is manually key entered by RPD staff. Increasing the amount of information on the forms necessarily increases data entry time. This is accounted for in RPD's estimate of additional staffing requirements. It also bears noting that increased data entry requirements can also lead to increased error rates.

The following table summarizes the anticipated impact on the operating budgets of the three executive agencies (TRD, DFA and DOT) as well as the one legislative agency (LFC) if the proposal is added to the Constitution.

**ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)**

| FY14 | FY15 | FY16 | 3 Year Total Cost | Recurring or Nonrecurring | Fund Affected |
|---|---|---|---|---|---|
| $0.0 | $354.0 | $355.0 | $709.0 | Recurring | General Fund (TRD) |
| $0.0 | $250.0 | $0.0 | $250.0 | Nonrecurring | General Fund (TRD) |
| $0.0 | $21.0 | $21.0 | $42.0 | Recurring | General Fund (DFA) |
| $0.0 | $10.0 | $10.0 | $20.0 | Recurring | General Fund (DOT) |
| $0.0 | $21.0 | $21.0 | $42.0 | Recurring | General Fund (LFC) |

**DUPLICATION**

Duplicates HJR 5.

**OTHER SUBSTANTIVE ISSUES**

If this Constitutional Amendment is passed by the voters, an enabling act, similar to last year's SB7/SFCS/aSFl would be needed to provide concrete guidelines for the CREG to prepare the tax expenditure document.

Without exception, short-term and long-term staff who have experienced the joys of preparing any part of a tax expenditure report will testify that the effort is: (1) extremely difficult; (2) extremely time-consuming; and (3) extremely expensive, whether done by in-house staff as proposed in this joint resolution or put out as a contract. The two editions of the New Mexico Tax Expenditure Report (2012 and 2013) have been extremely well-done, but have consumed enormous amounts of resource. These reports have not essayed into the areas of impact on jobs and other benefits as required by the joint resolution.

TRD also comments that it is important to note the differences between tax expenditures as they relate to the tax programs against which they are taken. Income tax expenditures, for instance are already reported separately on various PIT forms (PIT-ADJ, PIT-RC, PIT-CR.), including exemptions and deductions. This is information that the Taxation and Revenue Department

(TRD) already routinely collects on income tax returns. CRS filing - gross receipts tax, compensating tax and withholding, is very different in nature. Currently, only a few deductions are reported separately, including food and some medical deductions. All other deductions are reported in a single lump sum. CRS exemptions are not reported at all, and some for good reason. The exemption of wages from gross receipts tax, for instance, if separately reported would require all wage earners in New Mexico to become CRS filers. Rebuilding the CRS reporting system would entail significant cost as discussed above in the "administrative and compliance Issues."

**ALTERNATIVES**

EDD suggests that an alternative to including a purely staff function in the Constitution is to require legislative economists to perform the analysis. The executive agencies could continue to perform the biennial updating of the current Tax Expenditure Report. This version of the report does a good job of determining the revenue impacts of various tax expenditures, but does not attempt to determine any corresponding benefits. The legislative economists, if properly supported, could build IMPLAN or PI+ models to determine plausible levels of direct, indirect and induced economic effects and measure the plausible levels of revenue feedback.

LG/jl:ds