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

ORIGINAL DATE 2/1/2016
SPONSOR Maestas Barnes **LAST UPDATED** **HB** 152

SHORT TITLE Water Conservation Product Gross Receipts **SB**

ANALYST Graeser

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY16	FY17	FY18	FY19	FY20		
	($1,300)	($1,300)	($1,300)	($1,300)	Recurring	General Fund
	(0)	(0)	(0)	(0)	Recurring	Counties and Municipalities

Parenthesis ( ) indicate revenue decreases

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY16	FY17	FY18	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
Total	$14	$14	0	$28	NR	TRD operating

Parenthesis ( ) indicate expenditure decreases

Relates to HB 163

SOURCES OF INFORMATION
LFC Files

Responses Received From
Taxation and Revenue Department (TRD)
Energy, Minerals and Natural Resources Department
New Mexico Department of Agriculture

SUMMARY

House bill 152 adds new section of the Gross Receipts and Compensation Tax Act to allow a deduction for receipts derived from sales of water-saving tangible personal property during a one-week time period each year. The deduction is available for sales made from midnight on the third Sunday of March until midnight on Saturday of that week. The proposed deduction must be reported separately by the taxpayer and has a delayed repeal of 2027.

Examples of water-saving tangible personal property include:

- Drought tolerant live plants, turf and grass;
- Drip irrigation hose and drippers;
- Mulch;
- Rain barrels; and
- Coated plant and grass seeds.

The bill also provides that the Taxation and Revenue Department (TRD) compile an annual report to the Revenue Stabilization and Tax Policy Committee and the Legislative Finance Committee analyzing the cost benefit of the deduction.

The purpose of the deduction provided is to mitigate the effects of drought in New Mexico by creating an incentive for private property owners to reduce their outdoor water consumption through the use of products designed to decrease water waste.

There is no effective date of this bill. It is assumed that the new effective date is 90 days after this session ends (May 18, 2016). This means that the de facto effective date would be the one-week period from March 19, 2017 to March 25, 2017.

FISCAL IMPLICATIONS

"TRD collected data on tax paid by the retail industry during the months of March in the last three years. The amounts were averaged and divided by four as this deduction is only applicable for one out of four weeks of the month. This amount was then multiplied by a ratio which was calculated by dividing the total expenditures in outdoor gardening equipment by households into the total expenditures in retail by households. The impact could potentially be higher if households decide to make all their purchases the first week of March because of this deduction."

"The average household expenditures data was found in the 2012 National Gardening Association Report. The household expenditures data was estimated using U.S. Census figures and data provided by statista.com."

LFC staff notes that many other gardening items are purchased besides specific water saving equipment. The revenue estimate may include other equipment and tools.

This bill may be counter to the LFC tax policy principle of adequacy, efficiency and equity. Due to the increasing cost of tax expenditures revenues may be insufficient to cover growing recurring appropriations.

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. Estimating the cost of gross receipts tax expenditures is, in general, particularly difficult, since deductions are not separately reported. This proposed deduction, however, must be separately stated and will render the cost estimate accurate.

SIGNIFICANT ISSUES

This bill implicates policy principles of efficiency, in terms of incentivizing consumer behavior, and accountability. With respect to accountability, TRD will be unable to evaluate the effectiveness of this bill vis-à-vis its stated purpose because TRD has no means and no expertise in determining the amount of water savings that result from the deduction. TRD will be able to quantify the utilization of this separately stated deduction.

PERFORMANCE IMPLICATIONS

The LFC tax policy of accountability 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. Since the bill requires separate reporting of the deduction, TRD will have no difficulty accurately analyzing the cost of this proposed deduction. However, as noted above, TRD has no means or expertise in determining the amount of water savings that result.

ADMINISTRATIVE IMPLICATIONS

TRD notes the following administrative impacts:

Moderate IT impact (400 Hours). The bill would require a new location code for distribution involving changes to configurations and CRS return documentation in GenTax and Taxpayer Access Point. Along the same lines, the department will need to establish a "Special Code" on the CRS-1 report to track sales of the water saving tangible personal property. An annual report would need to be developed to analyze the cost/benefit of the deduction.

TRD will need to adopt regulations to implement this deduction. Absent a provision in the proposed bill that would require the use of nontaxable transaction certificates, TRD will need to audit and obtain evidence to support these deductions such as copies of invoices or detailed receipts that list the water saving tangible personal property sold, copies of checks or some sort of documentation to support the deduction taken.

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

HB 152 serves the same purpose as other existing and proposed tax credits. The new sustainable building tax credit, Section 7-2-18.29 NMSA 1978, now requires sustainable residential buildings to have drip irrigation systems in landscaped areas. HB 163 proposes a tax credit for water efficiency improvements at residences.

TECHNICAL ISSUES

TRD has a number of technical concerns with this bill.

"There are several technical concerns with the proposed bill. First, as alluded to above, it will be difficult for TRD to ensure compliance, as there is no way to know whether the purchased materials will be used on eligible properties for water-saving purposes. In short, there is potential for abuse. An additional requirement of Non-Taxable Transaction Certificates, containing purchaser statements of verification, would at least give some protection to the vendors that claim the deduction from their gross receipts. However, verifying that the purchaser used the materials on eligible property would be impracticable. Additionally, the products included in the deduction are sometimes described in a very generic fashion (e.g. "mulches and soils"); it may be hard for sellers to reasonably judge whether a particular purchase is intended for private use, or whether the size of the purchase indicates intended business use. This risk is mitigated to some degree because the majority of purchasers that are not end users, such as landscapers and contractors, could normally purchase these types of materials without gross receipts tax under the standard sale-for-resale deduction if the materials were to be used in taxable construction projects."

"Second, practical realities complicate the timing and the limited window in which the deduction applies. The types of property that are deductible are often installed for end users by landscapers and contractors that issue progress billings or invoices at certain times during the overall project. In this context, it may be very difficult to determine when a "sale" occurred if the property is both provided and installed by a contractor. Also, in situations where the property is provided and installed by a contractor, only the property component may qualify for the deduction, whereas the labor to install the property would not. While contractors are fully capable of itemizing the costs of the property, inaccurate allocations between property and installation costs might result in an effort to decrease tax burdens."

"The bill requires the implementation of a public information campaign to encourage consumption of water-saving tangible personal property. However, there are no specific guidelines for the campaign, and despite joint agency best efforts, there will likely be consumers and sellers that are unaware of the deduction and its limited window."

"TRD also has the following specific technical comments:

Page 1, line 25 – Adding the language "on the following Saturday" would increase specificity.

Page 3, line 3 – The use of the words "Business use" causes confusion. Does it mean the products cannot be used at a business location, or in an apartment complex?

Page 3, Line 11 – The definition or list of drought-tolerant live plants may cause subjective interpretations."

OTHER SUBSTANTIVE ISSUES

This would be the second limited period deduction in the Gross Receipts & Compensating Tax Act. The first was enacted in 2005 and allows a tax free week for purchasing school supplies and clothing. The 2014 TRD Tax Expenditure report estimates that one-week tax loss for this purpose has ranged from $3.3 million to $4.1 million in general fund loss and an additional $1.5 to $2.0 million loss to the local governments.

EMMRD notes that the Office of the State Engineer should be consulted to establish acceptable water conservation practices that are allowed under their best practices guidelines and to help develop guidelines and/or regulations for this legislation.

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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