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

SPONSOR Trujillo, J / Gonzales / Egolf **ORIGINAL DATE** 2/2/18 **LAST UPDATED** 2/8/18 **HB** 4

SHORT TITLE Tax Changes **SB**

ANALYST Clark

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY18	**FY19**	**FY20**	**FY21**	**FY22**		
NFI	**$97,380.0**	**$34,600.0**	**$41,300.0**	**$48,100.0**	**Recurring**	**General Fund (total)***
NFI	$136,700.0	$142,400.0	$148,400.0	$154,600.0	Recurring	General Fund (hospitals)
NFI	($39,320.0)	($96,600.0)	($94,700.0)	($93,300.0)	Recurring	General Fund (personal income tax changes)
NFI	NFI	$19,800.0	$18,600.0	$17,800.0	Recurring	General Fund (Internet)
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

*A portion of the 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

Partially Duplicates SB175 & SB62 (hospitals and remote sellers)

SOURCES OF INFORMATION
LFC Files

Responses Received From (on similar bills)
New Mexico Municipal League
Department of Health (DOH)
Taxation and Revenue Department (TRD)

SUMMARY

Synopsis of Bill

House Bill 4 makes changes to gross receipts tax (GRT) and personal income tax (PIT) revenue streams. 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. It repeals two statutes in doing this (the hospital credit and related distribution language). Second, it repeals an expired section of PIT statute, strikes all existing language for current PIT brackets and rates, and creates new brackets and rates. 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.

The effective date for the hospital provisions is July 1, 2018; for the income tax changes January 1, 2019; and for the remote seller provisions is July 1, 2019.

FISCAL IMPLICATIONS

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)

Personal Income Tax
The fiscal impact is based on analysis from the Taxation and Revenue Department (TRD), but it assumes less than a full-year impact in FY19 (40 percent of the impact) due to the income tax changes beginning for the 2019 tax year, and therefore only partially affecting that first fiscal year. TRD notes that although the top rate is increased, the expansion of the tax brackets means taxes are reduced for many more households than those facing an increase. Thus, the net impacts on revenue are negative.

Note that any estimates at this point may not fully reflect impacts from the 2017 Tax Cuts and Jobs Act (federal tax reform). Analysis is underway by TRD, but there is a strong chance the 2018 legislative session may end before the full impacts are estimated.

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).

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.

Personal Income Tax
The current PIT rate schedule is shown below.

Filing Status	Income Range	Tax Rate
Married Filing Separate	Not over $4,000	1.7% of taxable income
	$4,000 to $8,000	$68 plus 3.2% of excess over $4,000
	$8,000 to $12,000	$196 plus 4.7% of excess over $8,000
	Over $12,000	$384 plus 4.9% of excess over $12,000
Head of Household; Surviving Spouse; Married Filing Joint	Not over $8,000	1.7% of taxable income
	$8,000 to $16,000	$136 plus 3.2% of excess over $8,000
	$16,000 to $24,000	$392 plus 4.7% of excess over $16,000
	Over $24,000	$768 plus 4.9% of excess over $24,000
Single Individuals; Estates and Trusts	Not over $5,500	1.7% of taxable income
	$5,500 to $11,000	$93.50 plus 3.2% of excess over $5,500
	$11,000 to $16,000	$269.50 plus 4.7% of excess over $11,000
	Over $16,000	$504.50 plus 4.9% of excess over $16,000

The bill creates the following rate schedule, which adds a bracket, broadens brackets into much larger wage ranges, reduces the tax rate at the lowest end, and increases the tax rate at the high end.

Filing Status	Income Range	Tax Rate
Married Filing Separate	Not over $8,000	1.5% of taxable income
	$8,000 to $16,000	$120 plus 3.0% of excess over $8,000
	$16,000 to $24,000	$360 plus 4.5% of excess over $16,000
	$24,000 to $75,000	$720 plus 5.2% of excess over $24,000
	Over $75,000	$3,372 plus 5.9% of excess over $75,000
Head of Household; Surviving Spouse; Married Filing Joint	Not over $16,000	1.5% of taxable income
	$16,000 to $32,000	$240 plus 3.0% of excess over $16,000
	$32,000 to $64,000	$720 plus 4.5% of excess over $32,000
	$64,000 to $150,000	$2,160 plus 5.2% of excess over $64,000
	Over $150,000	$6,632 plus 5.9% of excess over $150,000
Single Individuals; Estates and Trusts	Not over $11,000	1.5% of taxable income
	$11,000 to $22,000	$165 plus 3.0% of excess over $11,000
	$22,000 to $32,000	$495 plus 4.5% of excess over $22,000
	$32,000 to $100,000	$945 plus 5.2% of excess over $32,000
	Over $100,000	$4,481 plus 5.9% of excess over $100,000

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.

The New Mexico Municipal League provided the following analysis on a similar bill.

(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.

The bill 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, and the bill ensures that local option tax rates should apply.

The bill also bars TRD from going after remote sellers and marketplace facilitators prior to July 1, 2019, the effective date of these provisions.

(2) Treatment of hospitals
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.

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.

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 on a similar bill.

> 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.
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> 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.
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> DOH suggests a possible amendment could exclude hospitals managed by DOH from the tax.

DUPLICATION, RELATIONSHIP

Partially duplicates SB162 and SB175 with identical hospital and remote seller provisions.

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.

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/jle