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

ORIGINAL DATE 1/25/19
SPONSOR Padilla **LAST UPDATED** ______ **HB** ______

SHORT TITLE Broadband Component Gross Receipts **SB** 208

ANALYST Graeser

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY18	FY19	FY20	FY21	FY22		
	($580.0)	($580.0)	($580.0)	($580.0)	Recurring	Small Cities
	($390.0)	($390.0)	($390.0)	($390.0)	Recurring	Small Counties
	($270.0)	($270.0)	($270.0)	($270.0)	Recurring	Municipal Equivalent
	($2,620.0)	($2,620.0)	($2,620.0)	($2,620.0)	Recurring	General Fund

Parenthesis ( ) indicate revenue decreases

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY18	FY19	FY20	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
Total	*	See note below	See note below	See note below		

Parenthesis ( ) indicate expenditure decreases

*TRD reports moderate operating budget impact, but asserts that the changes can be accommodated in the regular six-month updating cycle.

SOURCES OF INFORMATION
LFC Files

Responses Received From
Taxation and Revenue Department (TRD)
New Mexico Attorney General (NMAG)
Economic Development Department (EDD)
Public Regulation Commission (PRC)

SUMMARY

<u>Synopsis of Bill</u>

Senate Bill 208 proposes a gross receipts tax and compensating tax deduction for the value of broadband telecommunications network facilities components. The purpose of the deduction is to promote the deployment of broadband telecommunications services in the state. The deduction is to be separately stated, but there is no penalty for failure to separately state the value of the deduction. The Department is required to gather the data and report annually to the legislature as to the cost and benefits of the deduction. The technical requirement is that network facilities must meet or exceed the federal communications commission "connect America" standards.

The effective date of this bill is July 1, 2019. The provisions are repealed as of July 1, 2029.

FISCAL IMPLICATIONS

This bill narrows the gross receipts tax (GRT) base. Many of the efforts over the last few years to reform New Mexico's taxes focused on broadening the GRT base and lowering the rates. Narrowing the base leads to continually rising GRT rates, increasing volatility in the state's largest general fund revenue source. Higher rates compound tax pyramiding issues and force consumers and businesses to pay higher taxes on all other purchases without an exemption, deduction, or credit. 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. TRD reports that requiring separate reporting, without providing for a statutory penalty for failure to separately report renders the requirement ineffective in generating useful cost data.

In a similar bill, last year HB-128, PRC provided some useful information regarding a relatively narrow federal funding source known as the "Connect America Fund." Per the PRC FIR:

> The FCC Connect America Fund is a multi-million dollar fund that is being implemented in phases for both wireline and wireless broadband deployment throughout the country, including New Mexico. It is a component of the FCC's Federal Universal Service Fund. Currently the FCC is in the process of implementing the CAF Phase II Funding for Price Cap carriers, including CenturyLink and Frontier Communications. Windstream is also a price cap carrier in New Mexico, but declined the FCC's offer of CAF Phase II Funding in New Mexico. CenturyLink accepted $10,942,748 per year in funding for six years, and Frontier accepted $4,426,327 over the six year period, all in New Mexico. Windstream declined approximately $4 million per year in funding. CAF Phase II Funding is 40 percent completed at this point. However, those areas where a price cap carrier declined funding in a state will become available to prospective bidders in a CAF Phase II reverse auction which should take place in 2018. Also, the FCC will be conducting a Mobility

Fund Phase II Auction which will allocate $4.5 billion over ten years nationwide for wireless 4G LTE broadband access, which will also probably take place in 2018. The FCC usually funds carriers at a 75 percent federal to 25 percent carrier funding match.

Again, per the PRC FIR, "…the language in the bill may be construed to be permissive enough that it could apply to all providers of internet access service that meet either the wireline or wireless FCC CAF funding speed requirements, whether or not they actually receive FCC CAF funding. This may include price cap and rural local exchange carriers, wireless providers, fixed wireless providers, cable providers, and any other provider of internet access services. It may include any funding of any broadband telecommunications network facilities by these providers as long as they meet the FCC's CAF funding transmission speed requirements relevant at the time of investment.

"Those providers who will be accepting FCC CAF Funding in New Mexico are required to deploy internet access services as required by the FCC, so the tax breaks should not affect those carriers deployments under that program since they are required to do so anyway. It is those broadband investments outside of CAF funding which may increase due to the tax savings to internet access providers under this bill. Most new broadband investment by internet access providers of all types exceeds CAF funding transmission speed requirements of the FCC."

(LFC) Accepting CAF funding will not affect the rapidity of deployment of broadband telecommunications/internet services to customers. However, it will affect both state and local revenues for any equipment purchased and installed after July 1, 2019. The financial benefits of this bill will probably not be experienced by customers, but by the internet service providers. However, the internet service providers will likely reinvest at least half of the funds derived from this deduction in expanding access.

($ in thousands)						
	FY 17 Total	100% to Internet	15% to Small Cities	10% to Small Counties	7% Muni Equivalent	Residual to Gen Fund
Information	$5,511					
Telecomms	$3,858	($3,858)	($579)	($386)	($270)	($2,623)
	FY 16 Total					
Information	$4,221					
Telecomms	$2,954	($2,954)	($443)	($295)	($207)	($2,009)
	FY 15 Total					
Information	$3,629					
Telecomms	$2,541	($2,541)	($381)	($254)	($178)	($1,728)

Industry sources indicate that there are no manufacturers of equipment in New Mexico, so that all of the equipment is subject to the compensating tax and not the gross receipts tax. We can look up the history of compensating tax as follows:

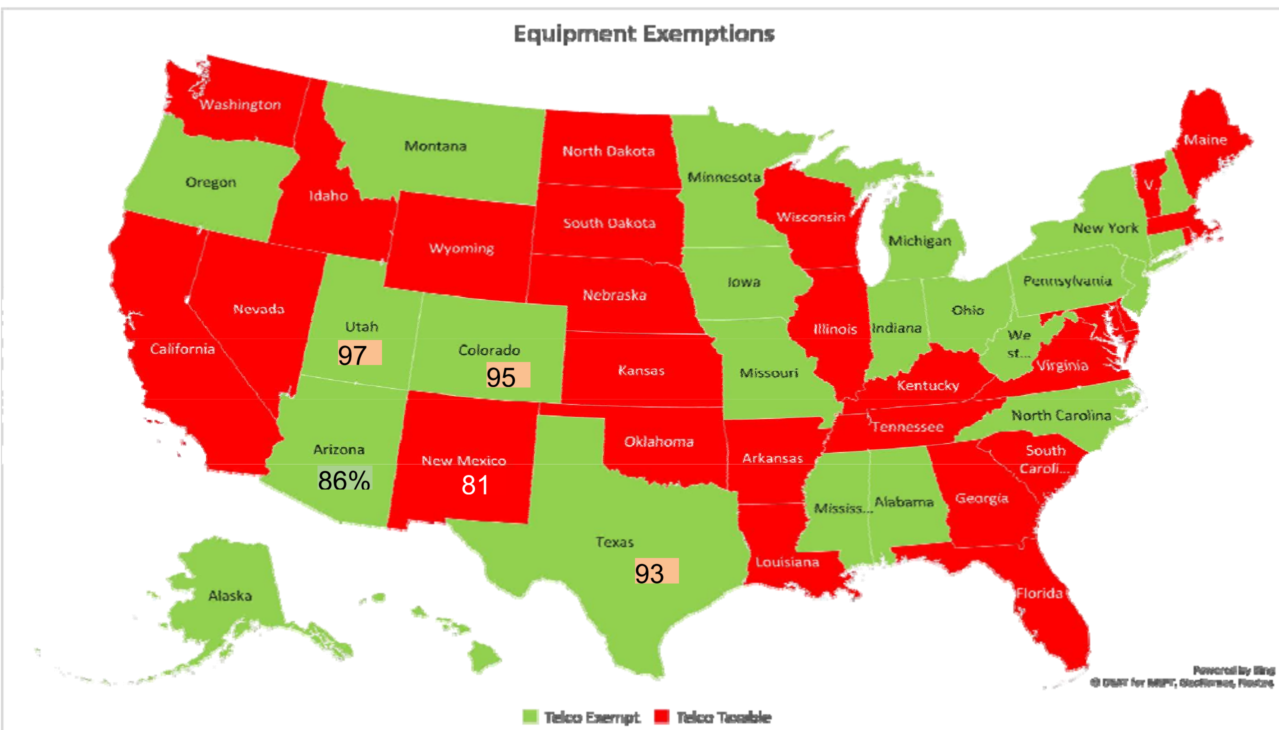
These estimates approximately confirm the Connect America funding estimates provided by PRC. FY 2017 estimates are used for the purposes of this FIR. TRD estimated the costs the same as did the LFC, which are reported in the Revenue Tables. Industry sources have accepted as plausible the LFC estimates.

It should be noted that the costs associated with installation of the equipment is not deductible pursuant to the provisions of this bill.

From HB-128 (2016) analysis and information provided by PRC, the Connect America grants to Century Link and Frontier totaled about $15,000,000 and the promise was to extend fast internet service to 25,000 New Mexico customers. This was a grant of an average of $600 per customer. It is unknown how much total equipment costs are per customer.

Also of note, is that in 2018, the Oil and Gas sector contributed an estimated $8 billion to the state's GDP of 98.4 billion, while the utility industry, including natural gas, water and electricity contributed an estimated $1.9 billion. An unknown portion of the total utility contribution was from telecommunications and broadband. All utilities together were .48 percent of the US GDP contribution from utilities. The state's population ratio to US population is about .65 percent.

SIGNIFICANT ISSUES



The map above explains part of the problem that this bill is attempting to solve. Arizona, Utah, Colorado and Texas do not tax telecommunications equipment. The average broadband coverage for those states is 93 percent. New Mexico which does tax telecommunications equipment has a 81 percent broadband coverage.

However, the map to the left indicates that coverage is by no means uniform throughout the state. The problem in New Mexico is, significantly, rural access. LFC, in March 2018 published an analysis entitled: ***Broadband Deployment in New Mexico***.[1]

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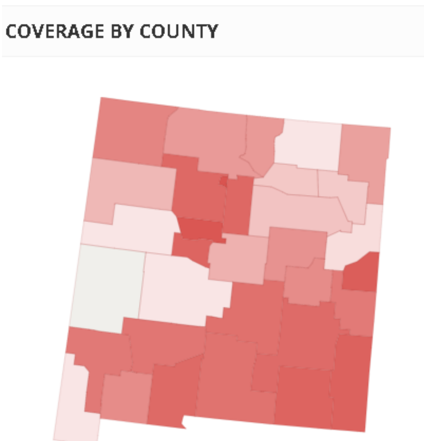
1 https://www.nmlegis.gov/Entity/LFC/Documents/Program_Evaluation_Reports/Broadband%20Deployment%20in%20New%20Mexico.pdf

In Summary, this report indicated the following:



In New Mexico, access to the World Wide Web largely occurs at whole sale prices in Albuquerque and is distributed at retail prices throughout the state. There is a robust fiber backbone throughout the state but not to the "last mile" to homes and businesses, and the expensive electronics required to drive data content have not largely been invested in outside Albuquerque. The reason why is because there is not enough demand to attract investment in the last mile or in electronics in rural areas. The state can solve this problem by aggregating demand among public institutions, which currently procure internet independent of each other. If multiple institutions in a geographical region agree to purchase internet at one location, they can get access at significantly higher speeds and share the costs by sharing the access across a wide area network, similar to how coworkers in an office share one internet connection. To compete for the procurement of much higher speeds, providers will need to install the expensive electronics in the region to deliver the content and can then more cost effectively deliver higher speeds to other customers in the area as well. The evidence of the effectiveness of this in states that have aggregated demand among their institutions is clear, as is the evidence that no improvement will be made in New Mexico broadband deployment relative to the nation with the status quo.

This LFC report did not suggest that a GRT deduction would solve the rural access problem, but that an institutional solution might. The problem is, of course, that it is far easier to provide incentives to private providers than to implement a massive cooperation scheme.

In its analysis of last year's HB-128, TRD noted the following concern:

> The bill would effectively make the components of nearly all telecommunications facilities, including some used for cable television, exempt from all gross receipts and compensating tax. According to information from Broadbandnow.com, New Mexico ranks 37th among the states for connectivity. Notably, however, 75 percent of all New Mexicans already have broadband access at speeds higher than indicated in the proposed bill. Fiber optic wired coverage remains low at 7.5 percent, however, New Mexicans' access to wired connections at speeds of at least 10 mbps has improved from 72.8% to 83.5 percent since 2011. See http://broadbandnow.com/New-Mexico.

This year, TRD notes the following:

> The bill may incentivize broadband expansion in the state and reduce the tax burden on taxpayers. Deductions narrow the base however, and result in an increase in other taxes, a reduction in government services, or both. To the extent that broadband services may be

subject to the gross receipts tax, eliminating the tax on equipment used to deliver that service would reduce the pyramiding of that tax. However, Internet access and related services that would be provided using this equipment, are not subject to gross receipts. Instead, those receipts are preempted from state taxation under the federal Internet Tax Freedom Act, as amended, Sec. 1101-1109, 47 U.S.C. 151 note. Therefore, taxing this equipment will not lead to pyramiding in the same way as taxing other business inputs might.

PERFORMANCE IMPLICATIONS

The LFC tax policy of accountability may be met since TRD is required in the bill 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. However, in the 2016 edition of the TRD Tax Expenditure Report, the Department reports that there is no penalty in statute for not separately reporting deductions, such as the Back-to-School deduction. Thus, the information provided to the Department is underreported and the costs reported in the Tax Expenditure Report are considered at the lowest level of reliability. This deduction would probably face the same reporting unreliability problem. As noted below at “Administrative Implications,” TRD does not have any means of determining benefits from this tax expenditure.

ADMINISTRATIVE IMPLICATIONS

The bill would have a moderate impact on TRD’s Information Technology Division of approximately 200 hours, or about $14,000 in employee time and effort, as the new deduction would require a new location code and changes to configurations, documents and reports in GenTax and TAP. The combined reporting system program documentation will need to be updated. However, the costs associated with the change can be absorbed with semi-annual review of the tax program documentation.

TRD points out that the does not have resources or expertise to collect information necessary to evaluate the effectiveness of this deduction. They will be able to implement the separate reporting requirement of this bill and collect utilization and cost statistics.

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

HB-176 is similar, but with a slightly shortened sunset date.

TECHNICAL ISSUES

TRD points out the following technical issues:

> This section sets out two separate deductions, one for calculating compensating tax and one for gross receipts tax. This is unnecessary since Section 7-9-7 NMSA 1978 effectively limits the imposition of the compensating tax to those items of tangible property, the receipts from the sale of which would be subject to, and not exempt or deductible from, the gross receipts tax. Therefore, if a deduction is provided for gross receipts tax, it applies to compensating tax as well. Also, the bill requires taxpayers to separately report both the compensating tax and the gross receipts tax deduction, as appropriate, when reporting their taxes. This complicates

the reporting of taxes and creates additional burdens on taxpayers. Without a penalty for mis-reporting, the information will also be unreliable. Further, the bill requires TRD to compile and present an annual report on the cost and effectiveness of the bill, but the standard for that analysis is not clear.

ALTERNATIVES

A perusal of the "CITIES" table below, provided by broadbandnow.com, somewhat confirms that the problem may be rural high speed access. Industry sources, however, indicate that there are some areas of Albuquerque that are not adequately served.

That said, there may be a mechanism to provide incentives for improving rural access by creating an income tax credit that would be allowed for 5 percent of the equipment and installation costs of providing access in an underserved area. It might be difficult, but not impossible, to identify underserved areas, but this approach would carefully target the incentives to areas that might not be otherwise profitable for the companies to install equipment.

OTHER SUBSTANTIVE ISSUES

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

The provisions of this bill seems to violate four of the five tax policy principles, and accountability is of a concern to TRD.

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.

Arguably, this bill has ineffective reporting requirements and does not establish annual goals in terms of improvements in coverage, hence it cannot meet the LFC tax expenditure policy guidelines.

ADDITIONAL INFORMATION

The following data were copied from https://broadbandnow.com/New-Mexico

BROADBAND SPEEDS

82.5% of New Mexicans have access to wired broadband 25mbps or faster.
76.7% of New Mexicans have access to broadband 100mbps or faster.
10.2% of New Mexicans have access to 1 gigabit broadband.

WIRED COVERAGE

93.6% of New Mexicans have access to wireline service.
8.4% of New Mexicans have access to fiber-opticservice.
75.3% of New Mexicans have access to cable service.
90.8% of New Mexicans have access to DSL service.

WIRELESS COVERAGE

99.6% of New Mexicans have access to mobile broadband service.
83.2% of New Mexicans have access to fixed wireless service.

TOP 5 FASTEST CITIES IN NEW MEXICO

City	Avg. Download Speed	No. of Providers
1. Clovis	71.1 MBPS	9 Providers
2. Fairacres	62.8 MBPS	7 Providers
3. Cedar Crest	59.2 MBPS	15 Providers
4. Farmington	58.2 MBPS	13 Providers
5. Bernalillo	57.9 MBPS	15 Providers

SPEEDS FOR MAJOR PROVIDERS IN NEW MEXICO

Provider	Avg. Download Speed
Cable ONE	43.9 MBPS
XFINITY from Comcast	42.9 MBPS
Windstream	10.5 MBPS
CenturyLink	10.3 MBPS
Wi-Power	2.8 MBPS

GOV'T FUNDING

- Since 2010, New Mexico Broadband Program has been awarded $4,762,287 in federal grants for New Mexico's Broadband Initiative.
- Another $76,978,670, accounting for 2.2% of all federal infrastructure grants, was awarded to broadband infrastructure projects in New Mexico.

- Since 2011, access to a wired connection of at least 10mbps has improved from 72.8% to 89.3% of New Mexicans.
-

QUICK STATS

- In total there are 121 internet providers in New Mexico.
- There are 379,000 people in New Mexico without access to a wired connection capable of 25mbps download speeds.
- There are 395,000 people in New Mexico that have access to only one wired provider, leaving them no options to switch.
- Another 138,000 people in New Mexico don't have any wired internet providers available where they live.

Sources: Data collected via the FCC, NTIA, and other sources. For a full list of data sources please visit our data page.

NEW MEXICO CITIES

City	Broadband Coverage	# of Providers
Alamogordo	98.4%	13 providers
Albuquerque	98.3%	25 providers
Anthony	83.7%	12 providers
Artesia	87.7%	10 providers
Aztec	80.6%	9 providers
Belen	86.6%	14 providers
Bernalillo	87.0%	15 providers
Bloomfield	82.4%	11 providers
Bosque Farms	88.8%	12 providers
Carlsbad	94.0%	13 providers
Chaparral	31.8%	10 providers
Church Rock	7.9%	9 providers
Clovis	94.8%	9 providers
Corrales	99.0%	15 providers
Crownpoint	0.0%	6 providers
Cuba	6.6%	9 providers
Deming	68.6%	11 providers
Dexter	47.9%	13 providers
Edgewood	77.0%	14 providers
Espanola	51.7%	12 providers
Farmington	92.2%	13 providers
Fruitland	28.7%	10 providers
Gallup	80.9%	12 providers
Grants	6.9%	9 providers
Hobbs	94.4%	15 providers
Kirtland	98.8%	11 providers
La Mesa	37.3%	10 providers
Laguna	12.0%	10 providers

City	Broadband Coverage	# of Providers
Las Cruces	92.8%	15 providers
Las Vegas	40.1%	10 providers
Los Alamos	99.1%	15 providers
Los Lunas	87.2%	13 providers
Lovington	88.5%	11 providers
Mesquite	72.5%	10 providers
Moriarty	53.9%	14 providers
Placitas	96.0%	15 providers
Portales	80.9%	9 providers
Ranchos De Taos	86.1%	9 providers
Raton	14.8%	7 providers
Rio Rancho	98.7%	18 providers
Roswell	94.6%	12 providers
Ruidoso	92.3%	10 providers
Sandia Park	87.0%	15 providers
Santa Fe	90.7%	21 providers
Santa Teresa	99.3%	10 providers
Shiprock	0.0%	6 providers
Silver City	87.3%	12 providers
Socorro	0.4%	10 providers
Sunland Park	99.0%	9 providers
Taos	78.1%	10 providers
Thoreau	10.5%	8 providers
Tijeras	74.8%	16 providers
T or C	93.3%	8 providers
Tucumcari	7.1%	7 providers
Tularosa	99.1%	9 providers
Zuni	58.9%	4 providers

LG/al