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

		ORIGINAL DATE	1/31/22		
SPONSOR	Shendo/Johnson	**LAST UPDATED**		**HB**	
SHORT TITLE	Hold Harmless Distributions			**SB**	26
				ANALYST	Graeser

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY22	FY23	FY24	FY25	FY26		
	($2,061.0)	($3,476.0)	($4,974.0)	($7,123.0)	Recurring	General Fund (GRT)
	$2,061.0	$3,476.0	$4,974.0	$7,123.0	Recurring	Local Governments (GRT

Parenthesis ( ) indicate revenue decreases

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

FY22	FY23	FY24	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
$100.0	--	--	$100.0	Non-recurring	ITD – Contractual Services
$5.7	$1.7	--	$7.4	Non-recurring	ASD – Staff workload costs

Parenthesis ( ) indicate expenditure decreases

SB26 appears to be a near duplicate of SB27 Local Governments Hold Harmless Deductions

SOURCES OF INFORMATION
LFC Files

Responses Received From
Taxation and Revenue Department (TRD)
Attorney General's Office (NMAG)

SUMMARY

Synopsis of Bill

Senate Bill 26 amends Sections 7-1-6.46 and 7-1-6.47 of the Tax Administration Act to exempt certain municipalities and counties from the hold harmless distribution phase-out if they did not have a hold harmless gross receipts tax in effect on June 30, 2019. The amendment also allows municipalities with a population of at least 10 thousand to retain a percentage of the hold harmless distribution based on their poverty level.

The Attorney General's Office states these tax distributions to municipalities and counties are offsets for food and health care practitioners services deductions. SB26 would update and simplify the formula for revenues distribution to municipalities and counties and tie some to the poverty level for municipalities.

In section 1, SB26 would modify municipality distribution amounts and rates by

A. Making it applicable to municipalities that did not have a municipal hold harmless gross receipts tax through an ordinance in effect on June 30, 2019 and simplifying the formula for determining the distribution for municipalities that meet the date criteria and have populations less than 10 thousand by making the distribution the applicable maximum distribution for the municipality;
B. Making it applicable to municipalities that did not have a municipal hold harmless gross receipts tax through an ordinance in effect on June 30, 2019 and simplifying the formula for determining the distribution for municipalities that meet the date criteria and have populations more than 10 thousand by making the distribution specific percentages of the applicable maximum distribution for the municipality depending on the poverty level of the municipality, with the distribution decreasing as the poverty level decreases and decreasing each year for municipalities with poverty levels two percentage points or more below the state poverty level;
C. Changing the distribution for municipalities not described in A or B, to delete prior years and update the maximum distribution going forward multiplied by percentages that start at 49 percent and decrease by 7 percent each year until being phased out entirely on July 1, 2029;
D. Eliminating a July 1, 2029 phase out of distributions to municipalities not described in Subsection A or to municipalities that imposed a GRT through an ordinance that does not provide a deduction contained in the Gross Receipts and Compensating Tax Act;
E. Updating the dates in this Subsection of the Act to reflect the changes proposed; and
F. Adding new definitions of “maximum distribution” and “poverty level”.

In section 2, the Bill would modify county distribution amounts and rates by

A. Making it applicable to counties that did not have a county hold harmless gross receipts tax through an ordinance in effect on June 30, 2019 and simplifying the formula for determining the distribution for counties that meet the date criteria and have populations less than 48 thousand by making the distribution the applicable maximum distribution for the municipality rather than tying it to deductions and rates;
B. For counties not described in A, the SB26 would change the distribution to delete prior years and update the maximum distribution going forward multiplied by percentages that start at 56 percent and decrease by 7 percent each year until being phased out entirely on July 1, 2029;
C. Eliminating a July 1, 2029 phase out of distributions to counties not described in Subsection A or to counties that imposed a GRT through an ordinance that does not provide a deduction contained in the Gross Receipts and Compensating Tax Act;
D. Updating the dates in this Subsection of the Act to reflect the changes proposed; and
E. Adding a new definition of “maximum distribution”.

The effective date of this bill is July 1, 2022. Portions of the bill establish contingent changes in hold harmless distributions at various times in the future.

FISCAL IMPLICATIONS

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. Because a portion of the bill’s provisions are contingent on municipalities or counties achieving poverty levels below state average, this makes estimating the fiscal effects of this bill in out years difficult.

TRD provided the fiscal impact of the provisions of this bill, stating: municipalities with populations of 10 thousand or more based on census data and without a gross receipts tax (GRT) hold harmless increment imposed on June 30th, 2019 were identified and categorized by poverty level. An estimated 10 municipalities would be impacted by this legislation, with three frozen at 80 percent and three at 50 percent of their applicable maximum distribution. The remaining four municipalities continue the phase-out until FY26 at which point their distribution is frozen at 30 percent.

Table 1 - Revenue Impact by Municipality ($ thousands of dollars)

Municipality	Hold-Harmless Increment	% - per Poverty Level	FY2023	FY2024	FY2025	FY2026
Santa Fe	N	30%	$0	$0	$0	$365.0
Roswell	N	50%	$58.6	$482.6	$932.1	$1,408.1
Hobbs	N	50%	$30.1	$248.0	$479.0	$723.5
Carlsbad	N	30%	$0	$0	$0	$75.9
Alamogordo	N	50%	$36.6	$301.6	$582.6	$880.1
Gallup	N	80%	$1,156.0	$1,459.6	$1,780.3	$2,118.9
Los Alamos[1]	N	30%	$0	$0	$0	$66.7
Los Lunas	N	30%	$0	$0	$0	$55.7
Las Vegas	N	80%	$475.9	$600.9	$732.9	$872.3
Portales	N	80%	$303.6	$383.3	$467.5	$556.5

Note: The difference between the current phase-out schedule for these municipalities is compared to the proposed phase-out schedules to determine the fiscal impact. FY2021 hold harmless distribution data was used in the estimate.

The changes to the hold harmless distributions would increase future distributions above current projected levels for the 10 municipalities that have not imposed a hold harmless gross receipts tax. This increase in distributions provides fiscal relief and may allow local governments to increase services, reduce taxes in other areas, or both. The increase in distributions, however comes at a loss to the general fund and may result in a future reduction in state government services, an increase in taxes, or both.

County GRT hold harmless distributions remain unimpacted by the proposed legislation.

SIGNIFICANT ISSUES

This bill narrows the 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 and increased 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.

TRD provided the following policy analysis: "The proposed changes to the municipal hold harmless distributions would create three categories of treatment for local governments. The initial phase-out of hold harmless payments began in FY14, when local governments could determine whether to enact local hold harmless increments. Different municipalities and counties enacted the GRT hold-harmless increments of 0.125 percent, 0.25 percent and 0.375 percent at different years since then[2]. The original legislation created two types of municipalities; (1)

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[1] Los Alamos is both a municipality and a class-H county and is classified as a municipality for tax statutes

[2] Current and prior local GRT enactment date tables , https://www.tax.newmexico.gov/all-nm-taxes/current-historic-enactment-date-tables/

municipalities with a population less than 10 thousand that had not imposed a hold harmless tax, and (2) all others. The bill creates a new third category: municipalities with a population of 10 thousand or more that had not imposed the hold harmless tax as of June 30, 2019. This new third category represents a large carve-out from the prior "all others" category. Table 2 below compares the municipalities with a population above 10,000 with the additional third category.

SB26 alters the playing field for local governments that made decisions based on 2013 legislation and had no knowledge of future alterations to the distributions or treatments of different local governments. Changes to distributions may impact budgeting certainty and sets precedent for the possibility of further adjustments of the hold harmless distributions to local governments adding additional uncertainty for planning purposes, and a related administrative burden for TRD."

Table 2 – Comparison of Municipalities population > 10,000

Municipality	Population	Hold Harmless GRT Increment- (Y/N)	Increment	Enactment Date
Albuquerque	564,559	Y	0.375%	July, 2018
Las Cruces	111,385	Y	0.375%	July, 2014
Rio Rancho	104,026	Y	0.125%	January, 2019
Santa Fe	87,505	N		
Roswell	48,422	N		
Farmington	46,624	Y	0.375%	January, 2019
Hobbs	40,508	N		
Clovis	38,567	Y	0.125%	July, 2017
Carlsbad	32,238	N		
Alamogordo	30,898	N		
Gallup	21,899	N		
Los Alamos	19,419	N		
Los Lunas	17,242	N		
Sunland Park	16,702	Y	0.375%	July, 2015
Deming	14,758	Y	0.375%	July, 2017
Las Vegas	13,166	N		
Artesia	12,875	Y	0.25%	July, 2015
Portales	12,137	N		
Lovington	11,668	Y	0.375%	January, 2015
Espanola	10,526	Y	0.375%	July, 2014

PERFORMANCE IMPLICATIONS

The LFC tax policy of accountability may not be met. The impacts are available monthly to the municipalities, counties and the public in TRD's RP-500. Extracting summary information from this report is can be difficult. TRD annually develops and publishes a Tax Expenditure Report reporting use of various tax expenditures. However, summary analysis similar to that provided in this FIR is not made available to the Legislature.

ADMINISTRATIVE IMPLICATIONS

TRD notes a moderate impact on its information and the administrative services divisions: "SB26 will have a moderate impact on the Information and Technology Division (ITD) of approximately 500 hours or about three months and approximately $100 thousand of contractual resources to update multiple distributions to counties and municipalities to account for different poverty levels. The Administrative Services Division (ASD) will work in partnership with ITD to implement new distribution changes and incur an estimated $7.4 thousand in staff workload resources."

"Due to the effective date of July 1, 2022 for this bill and other proposed bills, any changes to rates, deductions and distributions adds to the complexity and risk TRD faces July 1, 2022 to ensure complete readiness and testing of all processes. TRD will be in the first months of implementing the new cannabis excise tax program and working through any issues with this implementation. ASD reports the proposed implementation date of July 1, 2022 will be very difficult to achieve given resources are already dedicated to the implementation of the new cannabis excise tax distributions. Based on this, there may be additional costs that cannot be estimated currently, and TRD recommends the effective date be delayed to January 1, 2023."

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

SB26 appears to be a near duplicate of SB27 Local Governments Hold Harmless Deductions.

TECHNICAL ISSUES

This provisions of this bill modify the 2029 phase-out dates for some municipalities.

POSSIBLE QUESTIONS

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.

LFC Tax Expenditure Policy Principle	Met?	Comments
Vetted	✓	This proposal was introduced most recently by Sen. Munoz as SB226 in 2021. The issue was debated in committee.
Targeted		The purpose is implicit. Larger municipalities that did not avail themselves of the opportunity to impose a hold harmless gross receipts tax may now be experiencing revenue shortfalls. A stated purpose is to allow these larger municipalities additional revenue to assist in addressing persistent poverty issues. A measureable goal is provided.
Clearly stated purpose	✓	
Long-term goals	✗	
Measurable targets	✓	
Transparent	?	See "Performance Implications" discussion.
Accountable		See "Performance Implications" discussion. Modifies the 2029 cutoff date for the hold harmless distributions to larger municipalities.
Public analysis	?	
Expiration date	?	
Effective		If poverty remediation is the principal purpose of this bill, it will be quite difficult to determine if additional revenue will help in the effort.
Fulfills stated purpose	?	
Passes "but for" test	?	
Efficient	?	Poverty remediation is a controversial subject and there are no simple solutions. Additional municipal revenue, however, may assist the effort.

Key:	✓ Met	× Not Met	? Unclear

LG/al/acv