FISCAL IMPACT REPORT

SPONSOR	Griggs	**ORIGINAL DATE**	1/31/22
		LAST UPDATED	
		HB	
SHORT TITLE	Local Governments Hold Harmless Deductions	**SB**	27
		ANALYST	Graeser

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY22	**FY23**	**FY24**	**FY25**	**FY26**		
	($2,100.0)	($17.600.0)	($35,000.0)	($56,200.0)	Recurring	General Fund (GRT)
	$2,100.0	$17.600.0	$35,000.0	$56,200.0	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	Nonrecurring	ITD – Contractual Services
$5.7	$1.7	--	$7.4	Nonrecurring	ASD – Staff workload costs

Parenthesis ( ) indicate expenditure decreases

SB27 appears to be in substantial conflict with SB26 Hold Harmless Distributions

SOURCES OF INFORMATION
LFC Files

Responses Received From
Taxation and Revenue Department (TRD)

SUMMARY

Synopsis of Bill

Senate Bill 27 amends Sections 7-1-6.46 and 7-1-6.47 of the Tax Administration Act to freeze the scheduled hold harmless distribution phase-out at either 100 percent or 50 percent for municipalities and counties based on the following table:

Jurisdiction & Qualification	Hold Harmless Freeze Level
Municipality, <10,000 population with no hold harmless GRT local option as of June 30, 2019.	100% of combined current local option rate plus 1.225 percent
Municipality, <10,000 population with a hold harmless GRT local option as of June 30, 2019.	50% of combined current local option rate plus 1.225 percent
Municipality, >10,000 population with no hold harmless GRT local option as of June 30, 2019.	100% of combined local option rate in effect as of January 1, 2007 plus 1.225 percent
Municipality, >10,000 population with a hold harmless GRT	50% of combined local option rate in effect as of January 1,

local option as of June 30, 2019.	2007 plus 1.225 percent
County <48,000 population with no hold harmless GRT local option as of June 30, 2019.	100% of combined current local option rate in effect in municipal areas or county areas (county remainder)
County <48,000 population with a hold harmless GRT local option as of June 30, 2019.	50% of combined current local option rate in effect in municipal areas or county areas (county remainder)
County >48,000 population n with no hold harmless GRT local option as of June 30, 2019.	100% of combined local option rate in effect as of January 1, 2007 in municipal areas or county areas (county remainder)
County >48,000 population with a hold harmless GRT local option as of June 30, 2019.	50% of combined local option rate in effect as of January 1, 2007 in municipal areas or county areas (county remainder)

The effective date of this bill is July 1, 2022. Unlike SB26, the provisions of this bill freeze the hold harmless distributions to both municipalities and counties on a permanent basis with no further contingencies.

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 has provided the fiscal impact of the provisions of this bill:

"The proposed change to the phase-out percentage for impacted local governments is scored against the December 2021 Consensus Revenue Estimating Group (CREG) forecast for food and medical gross receipts tax (GRT) hold harmless distributions to local governments. The FY2023 fiscal impact of $2.1 million is significantly lower than the out-years given the FY2023 phase-out percentage is 49 percent compared to the proposed fixed percentage of 50 percent. The fiscal impact increases significantly given the current phase-out percentages are 42 percent for FY2024, 35 percent for FY2025 and 21 percent for FY2026. The proposed changes impact all municipalities with populations greater than 10,000 and all counties with populations greater than 48,000. There is no change in distributions for municipalities with a population of less than 10,000 or counties with populations less than 48,000."

(LFC staff note: there is a very subtle change proposed in the bill that may not be included in this analysis: counties or municipalities that have imposed a hold harmless gross receipts tax are held to the 100 percent or 50 percent freeze level based on local option rates effective as of January 1, 2007. If counties or municipalities have not imposed a hold harmless gross receipts tax, then the 50 percent or 100 percent standard is applied to current total local option gross receipts taxes.

SIGNIFICANT ISSUES

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.

TRD has provided the following policy analysis:

"The initial phase-out of hold harmless payments began in FY14, at which point local governments could determine whether to enact local GRT hold harmless increments or continue to accept the phased-out distributions. Different municipalities and counties have enacted the GRT hold-harmless increments of 0.125 percent, 0.25 percent and 0.375 percent at different years since then[1]. The proposed changes alter the playing field for local governments that made decisions based on 2013 legislation and had no knowledge of future alterations to the distributions. Changes to distributions may impact budgeting certainty and set 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 Tax & Rev."

"The changes to the hold harmless distributions would increase the future distributions above their current projected levels, as projected levels continue to phase out over the next fiscal years. This increase in distributions provides fiscal relief and may allow local governments to increase services, reduce taxes in other areas, or both. This increase in distributions however comes at a loss to the General Fund and may result in a reduction in government services at the state level, an increase in taxes, or both."

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 the province of experts. TRD annual develops and publishes a Tax Expenditure Report reporting utilization 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 division:

"The Information and Technology Division (ITD) of Tax & Rev will experience a moderate impact, approximately 500 hours or about 3 months and approximately $100,000 of contractual resources to update multiple distributions to counties and municipalities. The Administrative Services Division (ASD) will work with ITD to implement the changes to the GRT hold-harmless distribution. This will involve extensive testing of every GRT location distribution and associated distribution reports. ASD will have $7,400 in associated staff workload costs split between FY22 and FY23."

"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 Tax & Rev faces July 1, 2022 to ensure complete readiness and testing of all processes. Tax & Rev will be in the first months of implementing the new cannabis excise tax program and working through any identified issues with this implementation of a new tax program. Based on this uncertainly there may be additional costs that cannot be estimated at this time."

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

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

The provisions of this bill are in substantial conflict with SB-26 in sections 7-1-6.46 and 7-1-6.47 NMSA 1978. These bills, if both were enacted, could not be construed together.

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 freezes all hold harmless distributions at various levels and therefore reverses the intent of the initial 2004 legislation which provided a gross receipts tax deduction for food and certain medical services and the subsequent imposition of a variable phase-out of the hold harmless distributions.
Targeted		The purpose is implicit. It stabilizes the revenues for larger municipalities and counties at a level that depends on the imposition of a hold harmless gross receipts tax. Certainty in budgeting is also beneficial. This certainty is, in effect, a measureable goal.
Clearly stated purpose	✔	
Long-term goals	✘	
Measurable targets	✔	
Transparent	?	See "Performance Implications" discussion.
Accountable		See "Performance Implications" discussion. The proposed changes would be permanent.
Public analysis	?	
Expiration date	✘	
Effective		
Fulfills stated purpose	✔	
Passes "but for" test	✔	
Efficient	?	This bill somewhat reverses the intent of the initial 2004 legislation to hold harmless the local governments to the food and medical services deduction, but making these distributions permanent may be the most efficient means of stabilizing revenues and retaining the food and medical services deductions. This also ameliorates some of the complexity of these sections of statute.
Key: ✔ Met ✘ Not Met ? Unclear		

LG/acv