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

SPONSOR Kernan/Ingle **ORIGINAL DATE** 2/4/22 **LAST UPDATED** **HB**

SHORT TITLE Exclude Oil & Gas Services From DBS Rules **SB** 136/ec

ANALYST Torres

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY22	**FY23**	**FY24**	**FY25**	**FY26**		
	($25,000.0-$31,200.0)	($25,900.0 - $32,300.0)	($26,600.0 - $33,200.0)	($27,600.0-$34,500.0)	Recurring	General Fund
	More than ($9,500.0)	More than ($9,900.0)	More than ($10,100.0)	More than ($10,500.0)	Recurring	Counties
	Less than $31,200.0	Less Than $32,300.0	Less Than $33,200.0	Less Than $34,500.0	Recurring	Municipalities

Parenthesis ( ) indicate revenue decreases

Relates to SB137

SOURCES OF INFORMATION
LFC Files

Responses Received From
Taxation and Revenue Department (TRD)

SUMMARY

Synopsis of Bill

Senate Bill 136 (SB136) provides an exception to the destination-based sourcing rules for reporting gross receipts tax (GRT) under Section 7-1-14 NMSA 1978 for oil and gas production services performed in New Mexico. This exception reverts those services to origin-based sourcing for gross receipts. In other words, the business location of the service provider will be used to determine gross receipts tax liability rather than the location of where the service is performed. The bill also defines oil and gas production services.

This bill contains an emergency clause and would become effective immediately upon signature by the governor.

FISCAL IMPLICATIONS

Gross receipts tax data for the first five months of destination-based sourcing show an increase in remainder-of-county matched taxable gross receipts associated with oil and gas services and the change in sourcing. Using only those counties with a large presence of oil and gas activity (Eddy, Lea, and San Juan), the state would lose an estimated $25 million to $34.5 million in gross receipts tax revenue as proposed in SB136.

If all of the increase in remainder-of-county oil and gas related services were attributed back to a municipality in the same county, counties would lose $9.5 million to $10.5 million in county specific increment revenues. However, a significant portion of the increase may be attributed to out-of-state service providers who have grown the tax base. By excluding oil and gas services from destination based sourcing, the entirety of the out-of-state tax base would be lost to the counties and would result in the entire county increment lost. It is not possible to discern how much of the increase is related to out-of-state activity, but if the increase is out-of-state, counties could lose up to $40 million.

If municipalities received all of the observed remainder-of-county increases in oil and gas related services, municipalities could gain up to $34.5 million. However, a significant portion of the observed increase may be attributed to out-of-state service providers who would not be attributed back to municipalities. It is not possible to discern how much of the increase is related to out-of-state activity, but if half of the increase is out-of-state, municipalities would gain only up to $17.25 million.

Estimating the impacts is highly difficult and unclear. More work, data, and agency analysis is needed. This bill has a cost that is difficult to determine. The committee recommends bills adhere to the LFC tax expenditure policy principles for vetting, targeting, and reporting or be held for future consideration. 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.

Administrative Impact: The transition from origin to destination based sourcing rules that went into effect July 1, 2021 has proven difficult. The Tax Information and Policy Office of TRD has experienced a high-volume of requests for clarification and assistance to understand the new law. The allowance of a further exception to the rules would add another layer of complexity to an already complicated set of reporting requirements and require further customer service resources and time.

This change would require TRD to update current forms, publications, and media to work on getting the information out to the public on this additional change to destination-based sourcing. As part of forms, GRT Filers Kits are printed and mailed bi-annually to align with potential rate changes on July 1 and January 1. The Tax Information and Policy Office estimates making the required changes would take 80 hours of employee time.

The emergency clause adds to the complexity and resource needs to ensure complete readiness for TRD and taxpayers. TRD recommends an effective date of July 1, 2022 or January 1, 2023 to align with GRT rate changes and ensure proper implementation of the legislation.

SIGNIFICANT ISSUES

Beginning in FY22, the administration of gross receipts taxes changed from origin-based sourcing to destination-based sourcing. In general, this change requires tax to be determined by the location of the destination of the good or service rather than the previous method of determination at the location of the seller. This change allows local gross receipts taxes to be applied to out-of-state providers, leveling the playing field for New Mexico businesses. It also allows municipal and county governments to receive revenue from out-of-state sellers. In southern New Mexico, for example, oil and gas service companies compete across state lines with differing GRT rates. SB136 would place New Mexico oil and gas service businesses at a disadvantage with out-of-state businesses who would pay a lower GRT rate.

The Taxation and Revenue Department noted in other destination based sourcing legislation:

> The exclusion of [oil and gas] services from destination-based sourcing may be viewed as preferential treatment of a specific industry. The exclusion may also set precedent in the tax code for other professions with a similar reporting structure … This may cause concerns over favoritism and lead to other industries requesting a similar allowance, potentially resulting in more complex tax code as industries shift between sourcing rules….
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> In the 2021 Tax Expenditure Report, TRD summarizes 'Principles of Good Tax Policy.'[1] The proposed exceptions to the destination-based statutes challenge the concepts of equity and simplicity among GRT taxpayers. Regarding equity, this exception erodes horizontal equity where similarly-situated taxpayers face similar tax burdens. Regarding simplicity, taxpayers incur compliance burdens as they prepare, submit, and keep records about tax returns. Likewise, TRD incurs administrative costs to collect taxes, review the accuracy of tax returns and tax payments, and bring taxpayers into compliance. The exception to the destination-based sourcing as noted above further complicates the tax code for both taxpayers and TRD. The more complicated the code, the higher the cost everyone must bear to ensure compliance.

ADMINISTRATIVE IMPLICATIONS

TRD may be unable to make the appropriate change by statutory enactment.

TECHNICAL ISSUES

On page 4, lines 10 and 11, the bill states that, the reporting location is the "location of the performer of the service or seller of the product of the service." These can be two different locations. The performer of the services may be an individual working for a company that is performing these services at the service site, but the seller of the services is the location of the company. The likely intent of this bill is to report the location at the seller of services, or in other words, wherever the business is located. The language currently does not do this (nor does the language of the current statute do this for 'professional services'). To meet the assumed intent of the exception language, TRD suggests that this language be revised to specify that the location of

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[1] 2021 New Mexico Tax Expenditure Report, New Mexico Taxation and Revenue Department, https://www.tax.newmexico.gov/forms-publications/

the services is the location where the business resides or is located.

TRD recommends an effective date of July 1, 2022 or January 1, 2023 to align with GRT rate changes and ensure proper implementation of the legislation.

ALTERNATIVES

If the intent of the bill is to support municipalities negatively impacted by destination based sourcing specifically in oil and gas areas, a fund could be created that allows municipalities to receive support based on need. This mechanism would allow for better targeting. Furthermore, reporting could be considered so the costs of making changes considered in SB136 could be better determined. This is currently considered in STBTC substitute for SB137.

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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