FISCAL IMPACT REPORT

LAST UPDATED 2/3/23
SPONSOR Block/Mirabal Moya **ORIGINAL DATE** 1/31/23
SHORT TITLE 25% GRT Deduction For Small Businesses **BILL NUMBER** House Bill 163

ANALYST Graeser

REVENUE* (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY23	FY24	FY25	FY26	FY27		
	($18,800) to ($86,400.0)	($19,300) to ($88,700.0)	($20,000) to ($91,700.0)	($20,400) to ($93,700.0)	Recurring	General Fund
	($12,500) to ($56,800.0)	($12,900) to ($58,300.0)	($13,300) to ($60,200.0)	($13,600) to ($61,600.0)	Recurring	Counties/Municipalities

Parenthesis ( ) indicate revenue decreases.
*Amounts reflect most recent version of this legislation.
Note: the original review of this bill failed to adjust this fiscal estimate for allowing a deduction of 25 percent of receipts of small businesses. Also, note that this estimate reports TRD's estimate as the lower number and LFC staff's estimate as the higher number.

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT*
(dollars in thousands)

	FY23	FY24	FY25	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
ITD-Staff Workload Cost	$5.5	--	--	$5.5	Nonrecurring	General Fund

Parentheses ( ) indicate expenditure decreases.
*Amounts reflect most recent version of this legislation.

Sources of Information
LFC Files

Responses Received From
Economic Development Department (EDD)
Taxation & Revenue Department (TRD)

SUMMARY

Synopsis of House Bill 163

House Bill 163 would allow small businesses in New Mexico to deduct 25 percent of receipts from the business's gross receipts, effectively giving eligible small businesses a 25 percent decrease in the amount of gross receipts tax they would pay. An eligible small business is a business that employs no more than four full- or part-time employees who are employed by the business for at least 44 weeks in the 12 months prior to the month for which the deduction is claimed.

This bill has an effective date of July 1, 2023.

FISCAL IMPLICATIONS

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.

A sample from the Quarterly Census of Employment and Wages (QCEW) for the first quarter of 2022 for New Mexico indicated that 8.6 percent of covered wages were paid by establishments with fewer than five employees. Assuming that taxable gross receipts are in the same ratio as wages paid, the deduction creates over $2 billion in deductions for FY24. Single proprietors with no employees also would benefit from this deduction but are not included in the simple estimate reported here (see Technical Issues for discussion of this point).

Assume	FY22	FY23	FY24	FY25	FY26	FY27
Gen Fund Rev.	$3,536,374	$3,830,800	$3,802,600	$3,905,300	$4,036,000	$4,127,600
Total MTGR	$82,265,683	$91,783,764	$93,920,974	$96,457,576	$99,685,755	$101,948,196
	4.299%	4.174%	4.049%	4.049%	4.049%	4.049%
Total Deductions			$2,027,140	$2,081,888	$2,151,563	$2,200,395
General Fund			($86,400.0)	($88,700.0)	($91,700.0)	($93,700.0)
Local Gov't			($56,800.0)	($58,300.0)	($60,200.0)	($61,600.0)

This results in a higher estimate than that prepared by TRD. TRD utilized the following methodology:

> "According to the most recent data from the United States Census Bureau, there are 22,440 establishments with fewer than five employees in New Mexico, representing 51 percent of all employer establishments in the state. In the United States, small businesses with less than five employees account for 2.2 percent of general economic activity. Therefore, the Taxation and Revenue Department applied the 2.2 percent to Matched Taxable Gross Receipts reported in the RP-500, which can be interpreted as a measure of the general economic activity in the state, and the 25 percent of the receipts applicable to the Gross Receipts Tax (GRT) deduction to estimate the revenue loss to the general fund and local governments. The fiscal impact used the GRT revenue growth from the December 2022 Consensus Revenue Estimating Group (CREG) forecast."

This methodology results in the following estimate:

Estimated Revenue Impact*					R or NR**	Fund(s) Affected
FY2023	FY2024	FY2025	FY2026	FY2027		
--	($18,800)	($19,300)	($20,000)	($20,400)	R	General Fund
--	($12,500)	($12,900)	($13,300)	($13,600)	R	Local Governments

<u>These two estimates are reported in the Fiscal Impact table as a range, with the TRD estimate the lower general fund and local government revenue loss and the LFC staff estimate the higher.</u>

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.

EDD notes that: "…small businesses make up the majority of business within the state of New Mexico and employ a large portion of the state's workforce. Allowing a 25 percent deduction on receipts could help struggling small businesses stay in business or help small businesses expand and hire more employees faster. Both cases could promote additional economic activity within the state."

TRD also notes positive and negative effects from this proposal:

> "Small businesses are an economically important component of the state economy and a key driver of production, employment, and growth. As such, tax policies aimed at alleviating the tax burden of these small businesses may foster job growth and the production of a very dynamic sector of the economy. Even so, the bill goes against the principle of equity, which ensures that all businesses face the same tax regime. Apart from treating businesses differently, establishments that meet the bill's small business criteria might benefit differently. For instance, the bill will benefit equally a restaurant that hires unskilled workers and a tech startup that employs skilled workers. However, these two establishments might differ significantly regarding their taxable activity. It is not clear from the bill proposal what is the purpose behind this new tax incentive and Tax and Rev suggest including a purpose statement in the bill to make the goal more transparent."
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> "The recent GRT state rate reduction to 5.00 percent and the additional rate drop to 4.875 percent on July 1, 2023 are aimed to benefit all taxpayers and support fewer tax incentives. While tax incentives may support particular industries or encourage specific social and economic behaviors, the proliferation of such incentives complicates the tax code. Adding more tax incentives: (1) creates special treatment and exceptions to the code, growing tax expenditures and/or narrowing the tax base, with a negative impact on the general fund; and, (2) increases the burden of compliance on both taxpayers and TRD. Adding complexity and exceptions to the tax code does not comport generally with the best tax policy."
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> "This bill may unintentionally hinder employment growth by creating a cliff effect. A small business that might be poised to grow to more than four employees may opt not to hire because doing so will increase their effective GRT rate by 25 percent."

PERFORMANCE IMPLICATIONS

The LFC tax policy of accountability is met with the bill's requirement for separate reporting and the requirement that TRD 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. This reporting would be accomplished by inclusion in TRD's annual Tax Expenditure Report.

ADMINISTRATIVE IMPLICATIONS

Administrative & Compliance Impact: TRD will need to make information system changes and update forms, instructions and publications. These changes will be incorporated into annual tax year implementation and cost $5,554 in workload costs for the Information Technology Division (ITD) of approximately 100 hours or about one month

TECHNICAL ISSUES

TRD notes the following technical issue:

> "The bill defines "small business" as a business with not more than four employees, leaving open the possibility that it applies to a business with no employees other than the owner, such as sole proprietorships. It is therefore unclear whether the bill attempts to target only employer establishments, as they are directly involved in the creation of jobs, or also is supposed to cover non-employer, self-employed individuals or unincorporated businesses. Tax and Rev assumes the bill targets employer establishments in estimating the fiscal impact above but suggests the bill clarify the definition of 'small-business'."

OTHER SIGNIFICANT ISSUES

The Quarterly Census of Employment and Wages (QCEW) program publishes a quarterly count of employment and wages reported by employers covering more than 95 percent of U.S. jobs available at the county, Metropolitan Statistical Area (MSA), state and national levels by detailed industry.

> **Employment**
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> QCEW monthly employment data represent the number of covered workers who worked during, or received pay for, the pay period that included the 12th day of the month. Covered employees in the private-sector and in the state and local government include most corporate officials, all executives, all supervisory personnel, all professionals, all clerical workers, many farmworkers, all wage earners, all piece workers, and all part-time workers. Workers on paid sick leave, paid holiday, paid vacation, and the like are also covered.
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> **Employment Exclusions**
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> …QCEW excludes proprietors, the unincorporated self-employed, unpaid family members, certain farm and domestic workers from having to report employment data, and railroad workers covered by the railroad unemployment insurance system. Excluded as well are workers who earned no wages during the entire applicable pay period because of work stoppages, temporary layoffs, illness, or unpaid vacations.

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	✘	
Targeted		
Clearly stated purpose	✘	Not stated
Long-term goals	✘	
Measurable targets	✘	
Transparent	✓	Separate reporting
Accountable		
Public analysis	✘	
Expiration date	✘	
Effective		
Fulfills stated purpose	✘	
Passes “but for” test	✘	
Efficient	✘	
Key: ✓ Met ✘ Not Met ? Unclear		

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