FISCAL IMPACT REPORT

		LAST UPDATED	2/8/23
SPONSOR	Brown/Kernan	**ORIGINAL DATE**	2/6/23
SHORT TITLE	Carlsbad Gross Receipts Distribution	**BILL NUMBER**	House Bill 176
		ANALYST	I. Torres

APPROPRIATION*
(dollars in thousands)

Appropriation		Recurring or Nonrecurring	Fund Affected
FY23	**FY24**		
$25,000.0		Nonrecurring	General Fund

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

REVENUE* (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY23	**FY24**	**FY25**	**FY26**	**FY27**		
	($24,000.0)	($24,000.0)	($24,000.0)	($24,000.0)	Recurring	General Fund
	$24,000.0	$24,000.0	$24,000.0	$24,000.0	Recurring	City of Carlsbad

Parenthesis ( ) indicate revenue decreases
*Amounts reflect most recent version of this legislation.

Duplicates Senate Bill 292

Sources of Information

LFC Files

<u>Responses Received From</u>
Taxation and Revenue Department (TRD)
Department of Finance and Administration (DFA)
New Mexico Attorney General (NMAG)

<u>No Response Received</u>
New Mexico Municipal League
New Mexico Counties

SUMMARY

Synopsis of House Bill 176

House Bill 176 (HB176) appropriates $25 million from the general fund to the Local Government Division of the Department of Finance and Administration for the benefit of the city of Carlsbad for expenditure in FY23 and subsequent years to compensate the municipality for the loss of gross receipts tax revenue due to tax laws changes. Further, $24 million of gross receipts tax revenue would be earmarked and transferred from the general fund to the city of Carlsbad in FY24 and subsequent years.

The effective date of this bill is July 1, 2023.

FISCAL IMPLICATIONS

The appropriation of $25 million contained in this bill is a nonrecurring expense to the general fund. Any unexpended or unencumbered balance remaining at the end of FY23 shall not revert to the general fund.

In analysis of the transition to destination-based sourcing of the gross receipts tax—an approach that basis the tax on the rates of the location where the good or service is used rather than on the rates of the location of its source—LFC staff found nearly all municipalities have seen growth in gross receipts tax revenues. However, for Carlsbad, the tax on services from companies based in the city but delivered to other locations has exceeded the gain from the sale of goods purchased remotely and delivered to Carlsbad purchasers, resulting in a net loss in tax revenue. In the case of Carlsbad, the current estimated monthly decrease is about $1.57 million. These estimates change based on taxpayer behavior, reporting, and in estimating the alternative baseline.

This bill creates a new earmark. LFC has concerns with including continuing distributions language in statute because earmarking reduces the ability of the Legislature to establish spending priorities.

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.

SIGNIFICANT ISSUES

Noted by the Department of Finance and Administration:

> There will be no consequences of not enacting this bill. The City of Carlsbad's gross receipts revenue trend has increased by 16 percent FY22 in comparison to FY21. In addition, general fund ending cash balance increased by 41 percent from FY21 to FY23, as per their 1st quarter financial report (actuals) submitted to the Department of Finance, Local Government, Budget and Finance Bureau, on October 31, 2022.
>
> Furthermore, the city is receiving another source of revenue from the cannabis excise tax, for an annual estimate of $297 [thousand].
>
> If exceptions are made for destination-based sourcing this will start a trend for all locations to request additional funds from the general fund.

As noted by the Taxation and Revenue Department:

The new distribution and appropriation proposed by this bill aim at balancing the fiscal revenue of the city of Carlsbad, which claims it has lost revenue due to the tax policy change of destination-sourcing at the state level. That change has affected the city of Carlsbad due to the region's unique reliance on the oil and natural gas industry. More specifically, oil and natural gas GRT receipts that were originally sourced to the city under origin-based sourcing rules have now been sourced to Eddy County and other area counties, and the city of Carlsbad has seen its revenues grow more slowly than would be anticipated in a moment in which the municipal sector has experienced decreased revenues, increased services demand, and general budgetary constraints due to the Covid-19 pandemic. Thus, the bill seeks to secure resources for the city of Carlsbad to continue its programs and initiatives, and to grant revenue to the city that it claims it would have received, but for the change to destination sourcing.

However, it is still too soon to anticipate how the city of Carlsbad and, in general, the municipal sector will perform after the pandemic, the broadening of the tax base to include internet sales, and continued growth of the oil and natural gas industry. Fiscal revenues will stabilize as the pandemic and the programs created to control it recede. Also, it takes time for the municipalities' unique service and structure characteristics to respond to the new incentives promoted by the changes in GRT rules. This tax policy change will bring alterations in tax efficiency and effectiveness that require time to be assessed.

In addition, tax policies in the state are built on the principle of equity, which tries to ensure that all local governments face the same tax regime. Compensating cities for losses based on particular circumstances could set a negative precedent that could be used in many other cases. The bill makes permanent the distribution to the City of Carlsbad by not including a sunset date. This would establish a consistent future balance for budgeting by the city especially when there is a downturn in the oil and natural gas industry but would permanently divert GRT revenue from the general fund. Again, this would place the city in a unique category of being supported in economic downturns, while no other cities would be as equally compensated.

New Mexico's tax code is out of line with most states in that more complex distributions are made through the tax code. As an alternate to this proposal, the city could be provided for through regular distributions through the Local Government Division of DFA as proposed in Section 2. The more complex the tax code's distributions, the costlier it is for TRD to maintain the GenTax system and the more risk is involved in programming changes. By employing both TRD and DFA to make financial distributions to the city, both agencies face added administrative burdens and an inefficiency is created across executive agencies.

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.

ADMINISTRATIVE IMPLICATIONS

Updates to distributions in GenTax, the tax system of record, will have a cost in contractual services for TRD's Information Technology Division (ITD). This bill implementation will entail approximately 100 hours or approximately one month of $21 thousand in contractual costs.

If several bills with similar effective dates become law there will be a greater impact on TRD and additional staff workload costs or contract resources may be needed to complete the changes specified by the effective date of each bill.

ALTERNATIVES

TRD proposes an alternative to the Section 7-1-6.1 NMSA 1978 recurring distribution. This would be to require Carlsbad and any other municipalities to justify on an annual basis any amount of net GRT revenue decreases and to make this hold-harmless an annual appropriation. This would counter the argument against earmarking and would allow the Legislature to approve this hold-harmless every year.

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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