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

		LAST UPDATED	2/28/23
SPONSOR	Harper/Shendo/Hernandez/Block	**ORIGINAL DATE**	2/16/23
SHORT TITLE	Gross Receipts Rates & Professional Svcs.	**BILL NUMBER**	House Bill 367
		ANALYST	Torres, I. /Graeser

REVENUE*
(dollars in thousands)

FY23	FY24	FY25	FY26	FY27	Recurring or Nonrecurring	Fund Affected
	($228,800.0)	($234,980.0)	($242,840.0)	($248,350.0)	Recurring	General Fund – GRT Rate Reduction
	($3,480.0)	($3,570.0)	($3,700.0)	($3,780.0)	Recurring	General Fund – Comp. Tax Rate Reduction
	($73,100 - $109,600)	($75,200 - $112,700)	($77,600 - $116,300)	($79,200 - $118,700)	Recurring	General Fund – Anti-pyramiding
	($305,380 - $341,880)	**($313,750 - $351,250)**	**($324,140 - $362,840)**	**($331,330 - $370,830)**	**Recurring**	**TOTAL GENERAL FUND**
	($17,570 - $26,355)	($18,060 - $27,125)	($18,620 - $28,000)	($19,040 - $28,560)	Recurring	Counties - GRT
	($32,630 - $48,945)	($33,540 - $50,375)	($34,580 - $52,000)	($35,360 - $53,040)	Recurring	Municipalities - GRT
	($50,200 - $75,300)	($51,600 - $77,500)	($53,200 - $80,000)	($54,400 - $81,600)	Recurring	TOTAL Local Governments

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

Sources of Information

LFC Files

Responses Received From
Municipal League
Taxation and Revenue Department (TRD)

SUMMARY

Synopsis of House Bill 367

House Bill 367 (HB367) reduces the state gross receipts and compensating tax rates a quarter of a percent in FY24. The rate will be reduced from 4.875 percent to 4.625 percent.

HB367 also creates a gross receipts tax deduction of receipts for certain business-to-business services, a provision known as “anti-pyramiding.” The deduction is for the receipts from the sale of accounting services, engineering services, architectural services, information technology services, payroll services, and legal services.

HB367 provides definitions for “accounting services,” “engineering services,” “financial management services,” “information technology services,” “human resources services,” “legal services,” and “temporary services.”

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

FISCAL IMPLICATIONS

Estimated fiscal impacts are based on the consensus revenue estimates for gross receipts tax and compensating tax revenues. The baseline effective state gross receipts tax rate was assumed to be 4.155 percent, which was derived from FY23 year-to-date levels and adjusted to account for planned rate reductions. Similarly, the FY22 statewide tax collected indicates a total weighted average rate of 7.13 percent in FY22. Therefore, a local rate of 2.975 percent was used to determine the total loss to all local governments. LFC staff and TRD estimate the county share of the total local cost at 35 percent with the remaining 65 percent impacting municipalities. The cost breakout and total local impact is reflected on page 1.

The anti-pyramiding impacts in the proposed bill are estimated to reduce the general fund between $73 million and $119 million. Anti-pyramiding provisions are based on analysis of data (RP-500 and RP-80) provided by the Taxation and Revenue Department. LFC analyzed FY22 industry data to determine the potential size of the taxable gross receipts base affected. Those industries with gross receipts data appearing to qualify for the relevant deductions were assumed to be 60 percent or 90 percent business-to-business transactions to develop the range and were used to estimate revenue loss. Furthermore, the FY22 taxable base was grown by the December 2022 consensus revenue estimate growth rate for gross receipts taxes. Furthermore, costs reflected on page 1 are the result of a consensus between LFC and TRD economists using differentiated methodologies to arrive at similar results.

For the management, scientific, and technical services NAICS codes (5416..), LFC analyzed the makeup of the six digit sub-codes and determined at least 50 percent of the total is unlikely to qualify for the new deductions. Therefore 50 percent of that tax base was used for this estimate. Appropriately including or excluding certain industry codes is difficult to determine and remains a significant risk to the estimated costs, potentially resulting in large variability from the fiscal impacts table above.

The estimated cost is lower than in previous estimates because of the reductions in GRT implemented in the 2022 regular legislative session and contemplated here. Higher GRT exacerbates anti-pyramiding and as GRT has been lowered the impact of the anti-pyramiding provisions has also lessened.

The estimated cost of reducing the compensating and gross receipts tax rates was calculated using the December 2022 Consensus Revenue Estimate.

This bill creates or expands a tax expenditure with a cost that is difficult to determine but likely significant. Estimating the cost of HB367 is difficult and unclear. More work, data, and agency

analysis is needed. LFC has concerns about the risk to state revenues from tax expenditures and the increase in revenue volatility from erosion of the revenue base.
This bill may be counter to the LFC tax policy principle of adequacy and equity. Due to the increasing cost of tax expenditures, revenues may be insufficient to cover growing recurring appropriations.

The Municipal League notes:

> The costs of proposed GRT deductions will be significant for local governments and are also uncertain. The fiscal impact report for House Bill 207 in 2022 (a similar bill) included a first-year cost to local governments of $50 million to $109 million, and initial comments on HB367 suggest a local fiscal impact of approximately $70 million. This level of revenue loss would seriously undermine local revenue stability, affecting cities' ability to provide essential city services, public safety, and employee wage increases, among other needs.
>
> Additionally, the proposed deductions could negatively impact municipal debt service coverage ratios, in turn impacting municipal bond ratings. Bond ratings could be affected by both a reduction in revenue, as well as the negative impact the revenue reduction would have on city budgets.
>
> Municipalities would not see a fiscal impact from the GRT rate reduction provision in HB367, as a reduction to the state GRT rate would not affect the 1.225 percent local share of state GRT.

SIGNIFICANT ISSUES

Tax pyramiding occurs when the GRT is applied to business-to-business purchases of goods and services, creating an extra layer of taxation at each stage of production. The burden of pyramiding is then exacerbated by rising GRT rates.

New Mexico currently has anti-pyramiding provisions for many goods-based inputs, but service-based inputs are still largely taxed. Because smaller businesses are unable to incorporate many professional resources in their operations, tax pyramiding for services may disproportionately harm small businesses.

Though, larger businesses in New Mexico will have less of an incentive to move services in-house. By not having an incentive to hire employees, some of the enumerated services could be contracted to out-of-state or New Mexico businesses. The net employment impact is unclear from the incentive changes.

In a previous analysis for HB207 of the 2022 regular legislative session, the Economic Development Department noted:

> This bill attempts to level the tax environment between small and large businesses. Most small businesses must outsource the specific types of work outlined in the bill, while larger businesses often have those services in house. This deduction would reduce tax pyramiding on businesses in the state, which has become an increasing problem as GRT rates have risen over the years. The state has a large percentage of businesses (64%) that have fewer than 5 employees, and it is likely these businesses are the ones that would benefit the most from the deduction in the bill.

According to the Bureau of Labor Statistics (BLS) Quarterly Census of Employment and Wages (QCEW), the preliminary data for the first quarter of 2021 for the number of establishments or businesses in New Mexico according to size are as follows:

Size of Business by Number of Employees	Number of Businesses	% of Businesses
Fewer than 5 employees	37,798	64.36%
5-9 employees	8,656	14.74%
10-19 employees	6,115	10.41%
20-49 employees	4,220	7.19%
50-99 employees	1,109	1.89%
100-249 employees	632	1.08%
250-499 employees	157	0.27%
500-999 employees	30	0.05%
1000 or more employees	12	0.02%
Total Number of Establishments	**58,729**	

It is worthwhile to note that while small businesses are most likely to benefit from the deduction in this bill, many film production companies also contract out many of these services. This could create confusion and potential for film production companies to assume the transaction was taxable and thus eligible for the film production tax credit when those transactions would not be eligible if the deduction were applied by the seller of the services to the production company. The result would pose significant accounting and auditing challenges for film production companies and TRD, necessitating increased costs to ensure proper compliance. The film production companies would need to ensure they continue to pay the GRT and their contractors do not take this optional deduction.

Section 7-2F-13(B)(1)(b) NMSA 1978 of the film production tax credit states that for direct production expenditures to be includable in the calculation of the credit, they have to be "subject to taxation by the state of New Mexico." That would mean that if the expenditures are not taxable because they are deductible, then they could not be included in the film credit calculation. This is also stated in the TRD's FYI-370.

The Municipal League adds:

The magnitude of potential revenue loss is uncertain. Fiscal impact estimates are based on industry NAICS codes, which are unreliable because they are self-reported by taxpayers. Further, taxpayers outside the identified NAICS codes may legitimately claim the deductions, increasing the cost. In addition, estimating the share of B2B transactions within affected industries is challenging, with no reliable data source for this information.

TECHNICAL ISSUES

Language concerning the deduction in Section 3, Paragraphs 1 through 3, may provide unintended loopholes for deduction applicability and unintended consequences. For clarity, the paragraphs may be combined and simplified.

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	✗	
Long-term goals	✗	
Measurable targets	✗	
Transparent	✓	
Accountable		
Public analysis	✓	
Expiration date	✗	
Effective		
Fulfills stated purpose	?	
Passes "but for" test	?	
Efficient	?	
Key: ✓ Met ✗ Not Met ? Unclear		

IT/mg/hg/mg/hg/mg/rl/ne/rl/ne/mg