FISCAL IMPACT REPORT

		LAST UPDATED	2/14/23
SPONSOR	Kernan/Brown	**ORIGINAL DATE**	2/8/23
SHORT TITLE	Carlsbad/ Eddy County Gross Receipts	**BILL NUMBER**	CS/Senate Bill 292/STBTCS
		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 analysis of this legislation.

Relates to House Bill 176

Sources of Information

LFC Files

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

No Response Received
New Mexico Municipal League
New Mexico Counties

SUMMARY

Synopsis of STBTC Substitute for Senate Bill 292

The Senate Tax, Business and Transportation Committee substitute for Senate Bill 292 (SB292/STBTCS) 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 changes in tax law.

This bill does not contain an effective date, and as a result, would go into effect June 16, 2023, (90 days after the Legislature adjourns) if signed.

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 bases 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 estimates of the alternative baseline.

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.
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> Furthermore, the city is receiving another source of revenue from the cannabis excise tax, for an annual estimate of $297 [thousand].
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> 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 appropriation proposed by this bill aims 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.
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> 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.

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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