TAXATION & REVENUE
NEW MEXICO

New Mexico Destination-Based Sourcing and the Impact to Local Governments

Presentation to Revenue Stabilization and Tax Policy Committee
December 20, 2022

Mark Chaiken, JD, LLM, Tax Policy Director, Taxation and Revenue Department
Lucinda Sydow, MA, MS, Chief Economist, Taxation and Revenue Department

Tax Policy – Destination-Based Sourcing

- Destination Based – Right tax policy
  - Sourcing used to be relatively simple, because the seller and the purchaser were usually in the same place
  - As economic transactions become more geographically complex and diverse, sourcing rules must evolve
  - The increasing amount of internet-based sales and the use of web-based marketplaces have sped up these changes, and have required responses by all States and by the U.S. Supreme Court.

Tax Policy – Destination-Based Sourcing

- Destination Based – Right tax policy
  - Changes are necessary to adapt to current economic realities, and to ensure that all transactions are taxed fairly and equally.
  - Changes are necessary to protect New Mexico businesses, and even the playing field with out-of-state businesses.
  - Changes benefit state and local revenues on the whole by allowing taxation of internet/marketplace transactions.
  - Changes are necessary to align with other states' tax laws.
  - Changes include changes to "nexus" requirements, as interpreted by the U.S. Supreme Court.

Destination Sourcing – Tax Fairness

- Why is destination sourcing necessary for tax fairness?
  - Old nexus requirements allowed out-of-state businesses to escape state and local gross receipts taxation; since 2018, under the *Wayfair* decision, changed requirements allow New Mexico to tax more out-of-state sellers, including internet sellers.
    - But under origin-based sourcing, this impacted only state gross receipts tax.
    - Out-of-state sellers escaped local option gross receipts taxes; local governments lost revenue, and local business were still at a disadvantage.
  - Destination sourcing closed that gap.
    - Local governments now receive local option GRT revenue by taxing the receipts of out-of-state sellers who sell services or tangible property into their jurisdictions.
    - New Mexico businesses are now on an equal footing with out-of-state businesses.

Tax Policy – Destination-Based Sourcing

- Affects sales of tangible personal property that is delivered, rather than purchased "in store".
  - But impact mitigated because internet sales, which are delivered, are now included in the tax base.
  - May increase complexity for taxpayers who deliver to multiple locations.
  - The Department has created tools to simplify reporting for businesses.
- New Mexico is fairly unique from other states with inclusion of services in Gross Receipts Tax base
  - For applicable services, this method looks to where the <u>product of the service</u> is delivered or initially used.
  - For some taxpayers who deliver their services in multiple locations, this may increase the complexity in billing and applying the correct rates.
  - The regulations allow the use of reasonable estimates, which can simplify reporting requirements for most taxpayers.
  - For some regional governments there may be revenue impacts due to the concentration of certain industries, or from the impact of delivery location differing from business location.

General Impact of Destination Based Sourcing

- Generally positive with inclusion of on-line retail sales and out-of-state now identified in-state
  - Table below demonstrates County GRT tax bases – Matched Taxable Gross Receipts (MTGR)– in FY22, with the implementation of destination-based sourcing , versus FY21
  - Except for four counties all saw strong growth
    - Hidalgo, Luna, Roosevelt and Torrance are unique for having seen the end of major construction projects in FY22

- Local economies with concentrated industry have been impacted by destination-based sourcing in southeast New Mexico

Matched Taxable Gross Receipts by County
FY22 vs FY21

Jurisdiction	Matched Taxable Gross Receipts	Year-over-Year Change	Jurisdiction	Matched Taxable Gross Receipts	Year-over-Year Change
Bernalillo County	$ 23,451,710,527	18.9%	McKinley County	$ 1,374,651,178	19.9%
Catron County	$ 123,977,281	129.9%	Mora County	$ 64,994,201	65.2%
Chaves County	$ 1,602,647,448	23.9%	Otero County	$ 1,777,629,984	62.0%
Cibola County	$ 505,178,249	29.8%	Quay County	$ 194,937,104	21.7%
Colfax County	$ 426,230,901	27.1%	Rio Arriba County	$ 566,960,590	35.8%
Curry County	$ 1,175,021,095	23.0%	Roosevelt County	$ 358,294,500	-32.4%
De Baca County	$ 29,998,475	31.7%	San Juan County	$ 3,537,181,380	29.9%
Dona Ana County	$ 5,695,346,193	38.1%	San Miguel County	$ 445,756,946	12.7%
Eddy County	$ 8,866,668,276	63.6%	Sandoval County	$ 2,847,150,205	51.2%
Grant County	$ 677,829,875	41.2%	Santa Fe County	$ 5,714,971,434	35.0%
Guadalupe Count	$ 141,675,993	7.7%	Sierra County	$ 237,754,939	14.4%
Harding County	$ 19,150,688	31.5%	Socorro County	$ 239,113,187	9.8%
Hidalgo County	$ 127,482,171	-9.1%	Taos County	$ 980,721,192	37.3%
Lea County	$ 9,353,359,109	87.3%	Torrance County	$ 380,987,931	-18.1%
Lincoln County	$ 759,312,348	22.6%	Union County	$ 112,087,382	22.2%
Los Alamos	$ 1,916,917,175	3.9%	Valencia County	$ 1,711,775,980	37.6%
Luna County	$ 476,338,219	-21.2%	Out of State	$ 6,371,870,579	-41.7%

Source: RP500

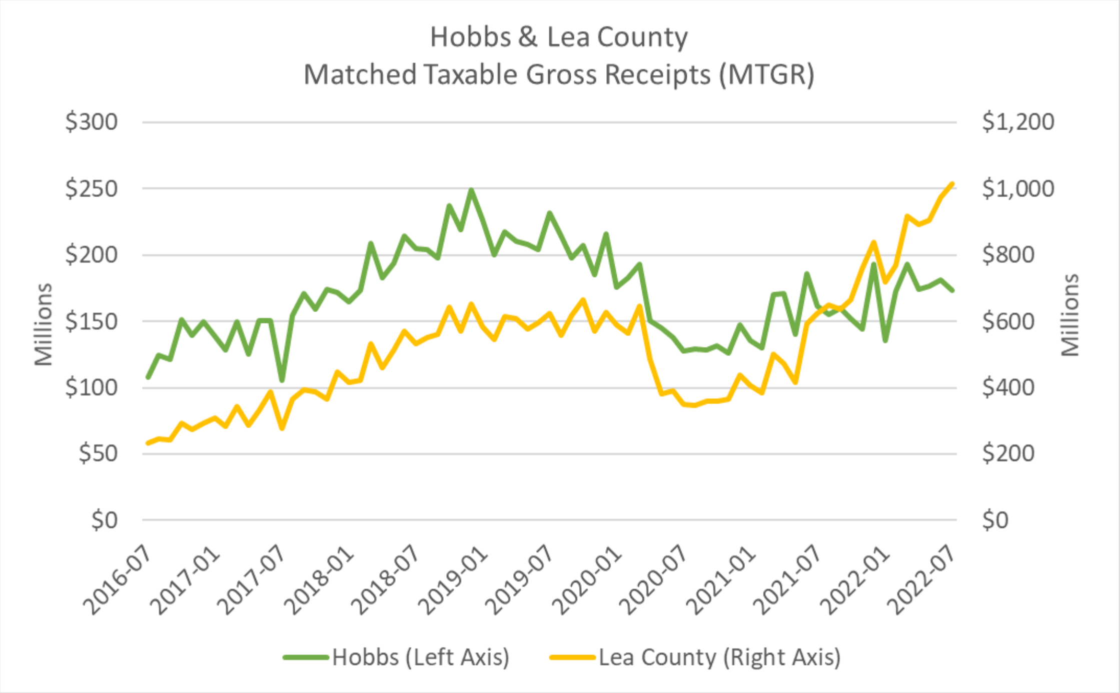
Retail Trade by County – FY22 vs FY21

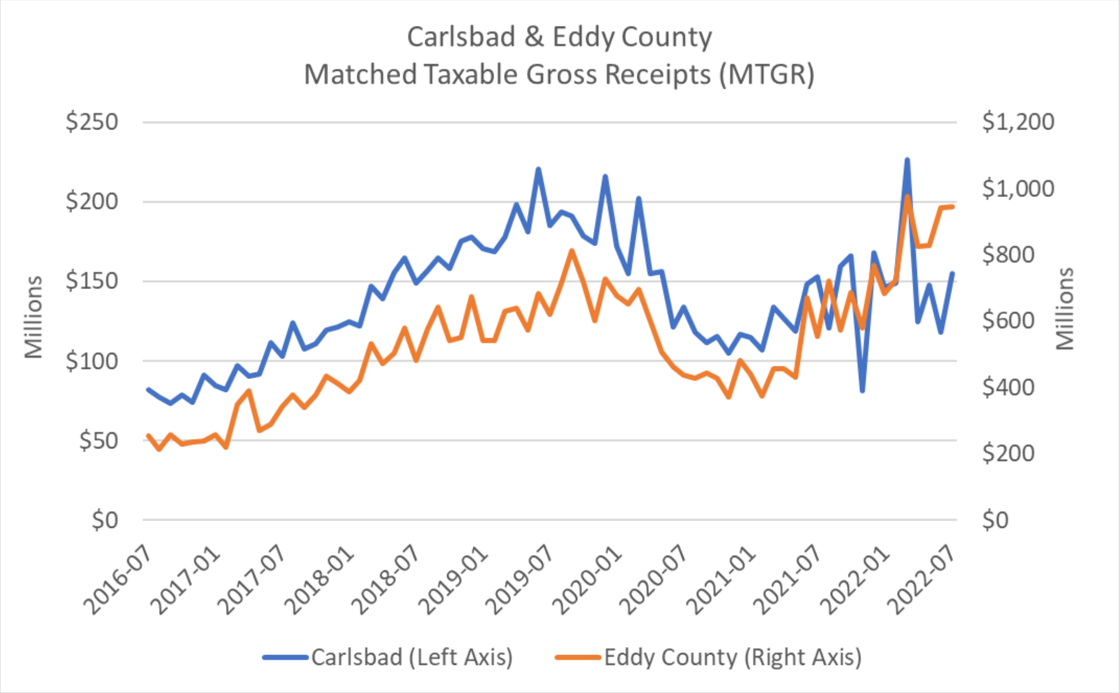
Retail Trade MTGR by County FY22 vs FY21			
County	**FY22 MTGR**	**FY21 MTGR**	**Year-over-Year Change**
Bernalillo County	$ 6,051,104,895	$ 4,949,520,892	22%
Catron County	$ 16,719,752	$ 7,583,259	120%
Chaves County	$ 554,317,305	$ 451,495,795	23%
Cibola County	$ 131,587,836	$ 113,497,154	16%
Colfax County	$ 88,786,247	$ 63,527,645	40%
Curry County	$ 368,731,546	$ 304,395,602	21%
De Baca County	$ 5,964,393	$ 3,980,861	50%
Dona Ana County	$ 1,474,341,189	$ 1,166,966,591	26%
Eddy County	$ 1,054,457,048	$ 682,780,996	54%
Grant County	$ 237,412,875	$ 187,762,861	26%
Guadalupe County	$ 38,391,856	$ 31,749,818	21%
Harding County	$ 1,631,606	$ 1,045,666	56%
Hidalgo County	$ 28,421,210	$ 23,024,218	23%
Lea County	$ 1,035,247,952	$ 695,526,867	49%
Lincoln County	$ 212,121,645	$ 164,263,535	29%
Los Alamos	$ 105,730,032	$ 55,500,994	91%
Luna County	$ 151,804,508	$ 120,365,236	26%
McKinley County	$ 462,355,258	$ 413,886,552	12%
Mora County	$ 14,936,450	$ 9,582,464	56%
Otero County	$ 453,961,574	$ 367,242,930	24%
Quay County	$ 62,515,980	$ 48,000,644	30%
Rio Arriba County	$ 193,049,010	$ 163,295,677	18%
Roosevelt County	$ 112,036,984	$ 88,771,313	26%
San Juan County	$ 1,059,709,990	$ 883,077,679	20%
San Miguel County	$ 146,483,111	$ 124,930,368	17%
Sandoval County	$ 656,873,875	$ 449,920,754	46%
Santa Fe County	$ 1,617,187,863	$ 1,175,855,776	38%
Sierra County	$ 74,976,877	$ 61,170,664	23%
Socorro County	$ 77,255,998	$ 58,685,412	32%
Taos County	$ 278,002,352	$ 204,725,703	36%
Torrance County	$ 89,378,026	$ 69,435,220	29%
Union County	$ 20,764,814	$ 15,916,471	30%
Valencia County	$ 433,553,380	$ 350,165,975	24%
Total	**$ 17,309,813,437**	**$ 13,507,651,592**	**28%**

- When isolating the tax base impact to only receipts reported for Retail Trade, the impact is positive for every county
- Growth in Retail Trade being 11% of total MTGR growth state-wide FY22 versus FY21

Source: Tax & Rev Department, RP500 Report

GRT Tax Bases – Southeast New Mexico





Source: Tax & Rev Department, RP500 Report

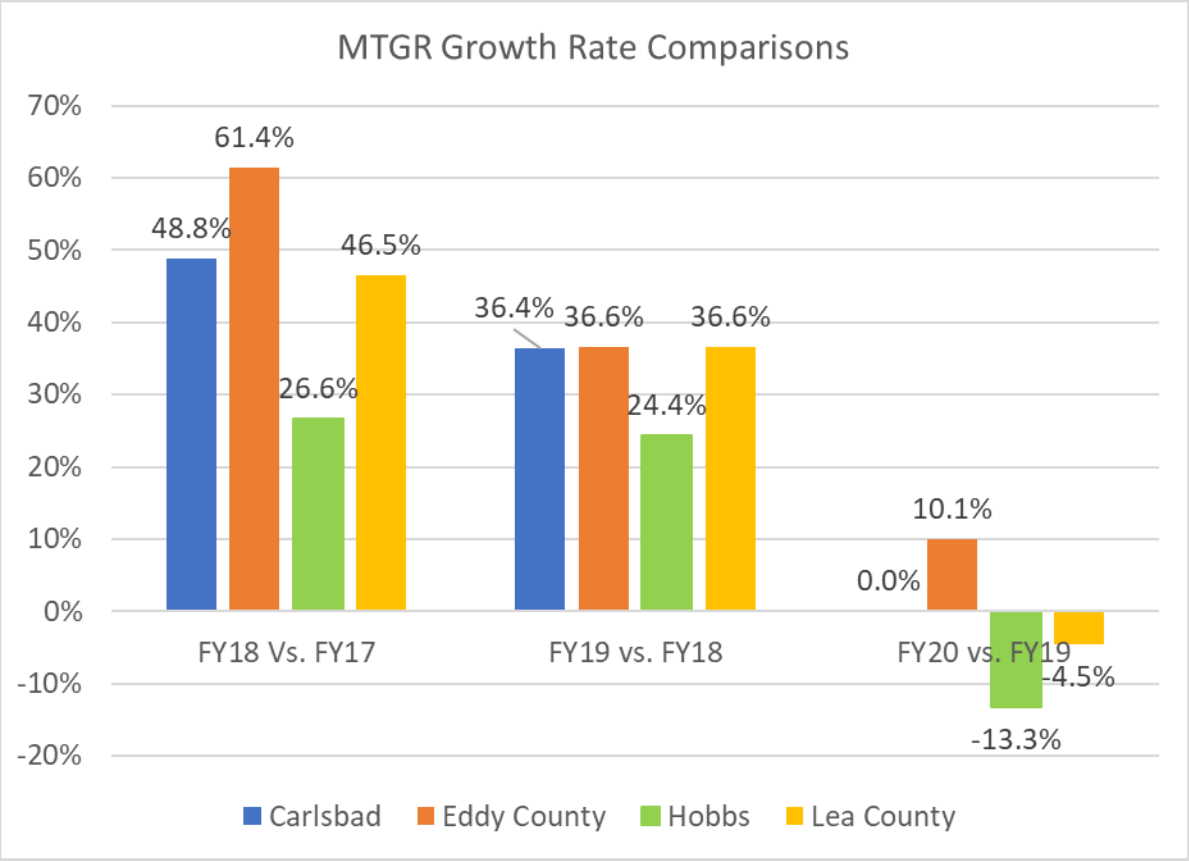
- The south-east region of the state has an economy supported by oil and gas extraction
- Both Lea and Eddy County have seen their GRT tax base – Matched Taxable Gross Receipts – return to pre-pandemic levels and exceed those levels with the recovery of the oil market. Versus Hobbs and Carlsbad not reaching pre-pandemic levels

GRT Tax Bases – Southeast New Mexico

- Destination-based sourcing has pulled GRT activity in the oil and gas industry from out-of-state into both Counties and Municipalities.
  - Prior to destination sourcing, these out-of-state taxpayers would have been taxed solely at the state rate – they would not have been subject to local option gross receipts taxes.
  - Destination sourcing has therefore expanded the tax base of local governments.
  - But municipalities do receive a 1.225% share of state gross receipts tax revenues. 7-1-6.4, NMSA. So even without destination sourcing, municipalities, but not counties, were positively impacted by the changes in nexus rules, which expanded the tax base for the state gross receipts tax.
- High-Level impact of destination-based sourcing has had an impact for the Permian Basin counties - faster growth of County Tax Base versus Municipality Tax Base.
  - In the Permian Basin the impact is magnified for the counties by the large portion of economic activity attributable to mining – which occurs outside of cities.

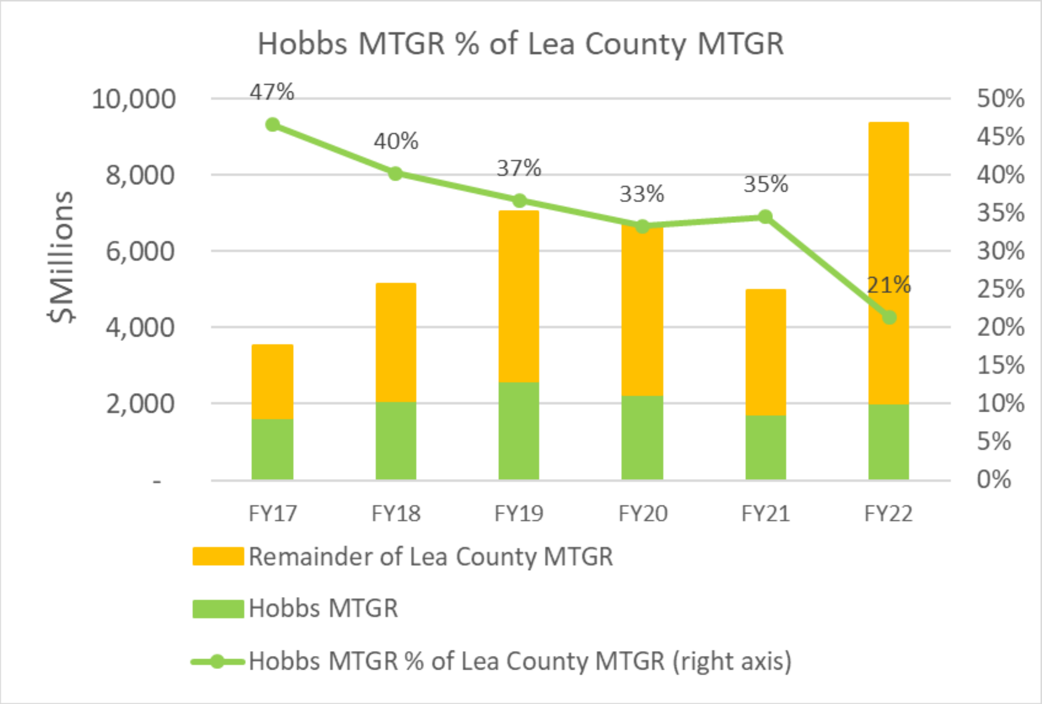
GRT Tax Bases – Southeast New Mexico

- Although destination-based sourcing began July 1, 2021, Lea and Eddy county tax bases had already outperformed Carlsbad and Hobbs for several years

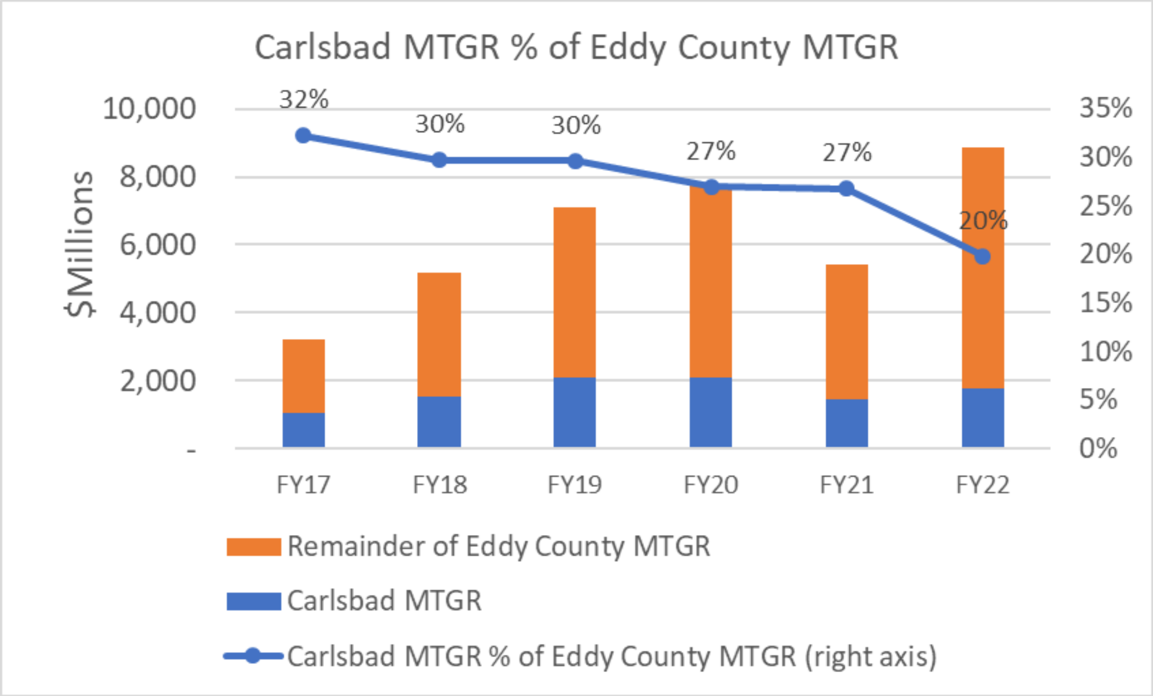


Source: Tax & Rev Department, RP500 Report

GRT Tax Bases – Southeast New Mexico



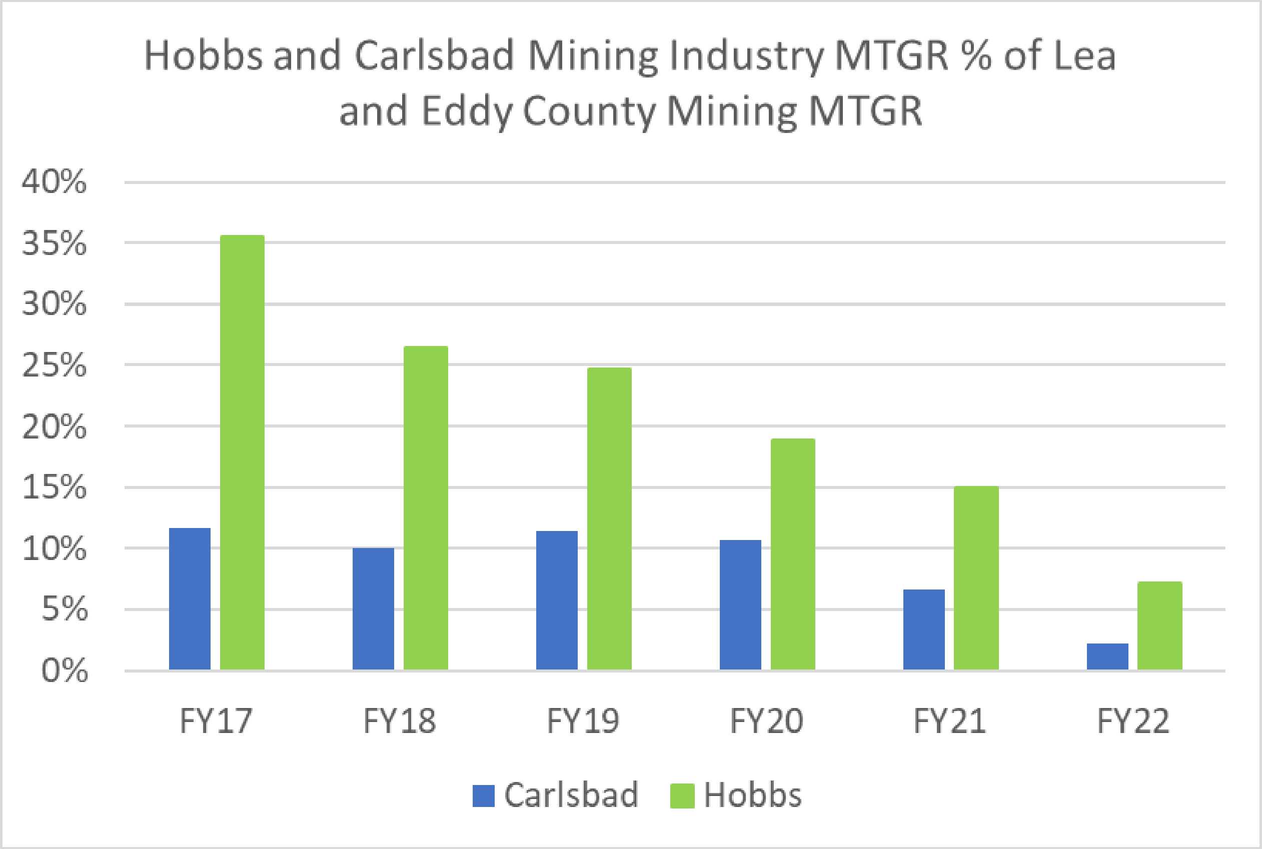
Source: Tax & Rev Department, RP500 Report, Author's Calculation



Source: Tax & Rev Department, RP500 Report, Author's Calculation

- Hobbs and Carlsbad were already declining in proportion to the counties' tax bases prior to destination-based sourcing implementation

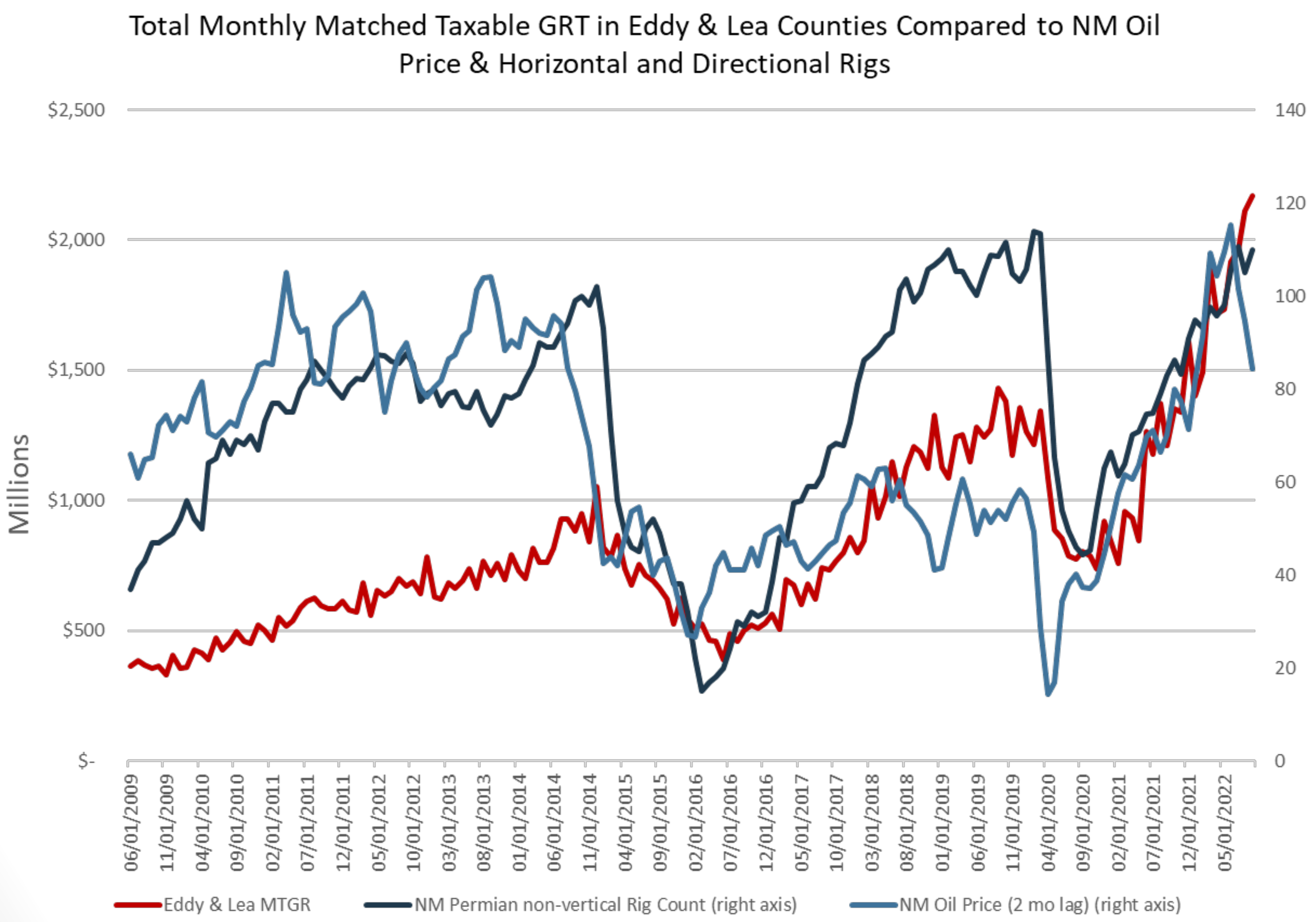
GRT Tax Bases – Southeast New Mexico



Source: Tax & Rev Department, RP500 Report, Author's Calculations

- The relative decline of Carlsbad and Hobbs as a percentage of their counties' tax bases, is seen strongly in the mining industry, even prior to destination-based sourcing.

GRT Tax Bases – Southeast New Mexico



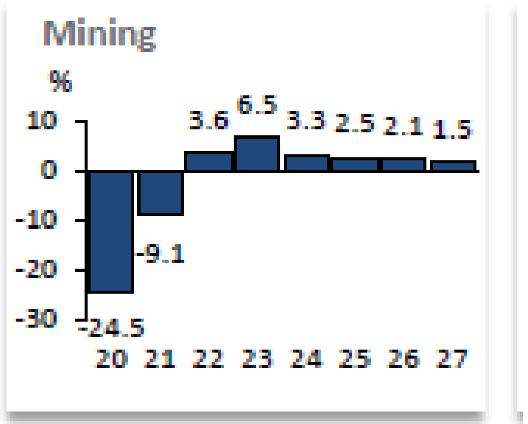
Source: Tax & Rev Department, RP500 Report & County Vol/Value Severance Report; Baker-Hughes; and Author's Calculations

- The county acceleration of growth was occurring with the expansion of oil activity pre-pandemic and pre-destination-sourcing (FY17-FY19)

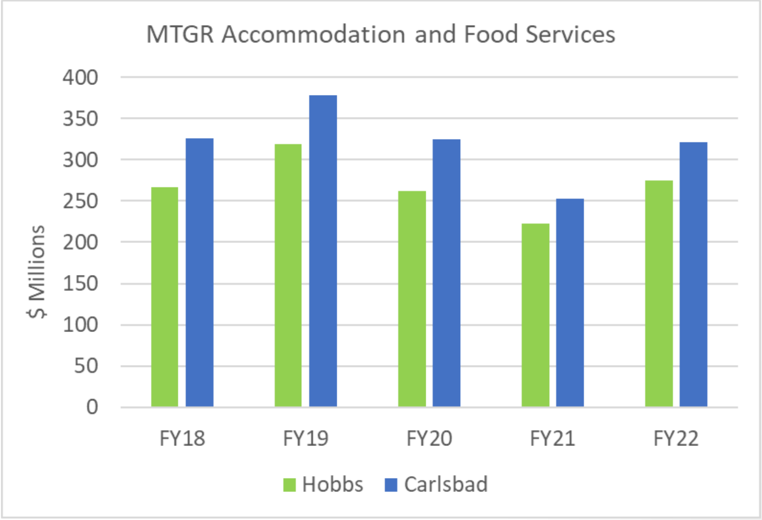
GRT Tax Bases – Southeast New Mexico

- Recovery for Carlsbad and Hobbs has also been slower in Accommodation and Food Services Industry (Sector averages 18% of Carlsbad tax base, 13% for Hobbs, FY18-FY22)
  - FY22 MTGR for Accommodation and Food Services not reaching pre-pandemic levels from FY19 (graph lower right)
  - Associated with labor force not returning to pre-pandemic levels.
    - Lea and Eddy Counties still down about 11,700 jobs (-17.4%) compared to 2 years earlier before the pandemic (Source: UNM BBER November 2022 forecast)
    - In particular, the Mining Labor Force has not recovered and is not forecasted to reach pre-pandemic levels due to new technologies reducing labor-intensive production (Source: UNM BBER November 2022 forecast, forecast graph below left)
  - Consumer spending activity of counties labor force more pronounced in cities.

Lea & Eddy Employment - Mining Sector Forecast



Source: UNM BBER, November 2022 Forecast, Lea & Eddy County Review and Outlook

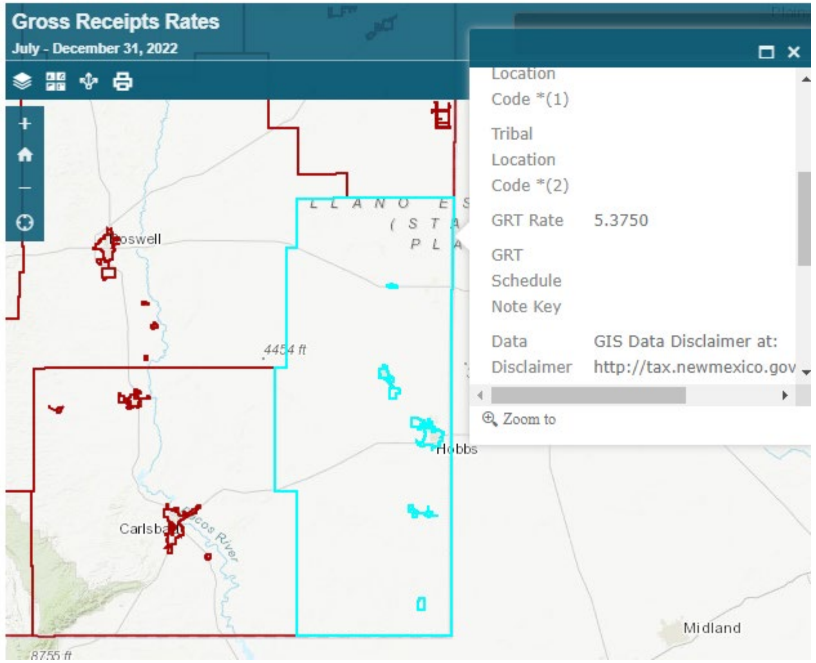


Source: Tax & Rev Department, RP500 Report, Author's Calculations

Current GRT Tax Rates

Lea County

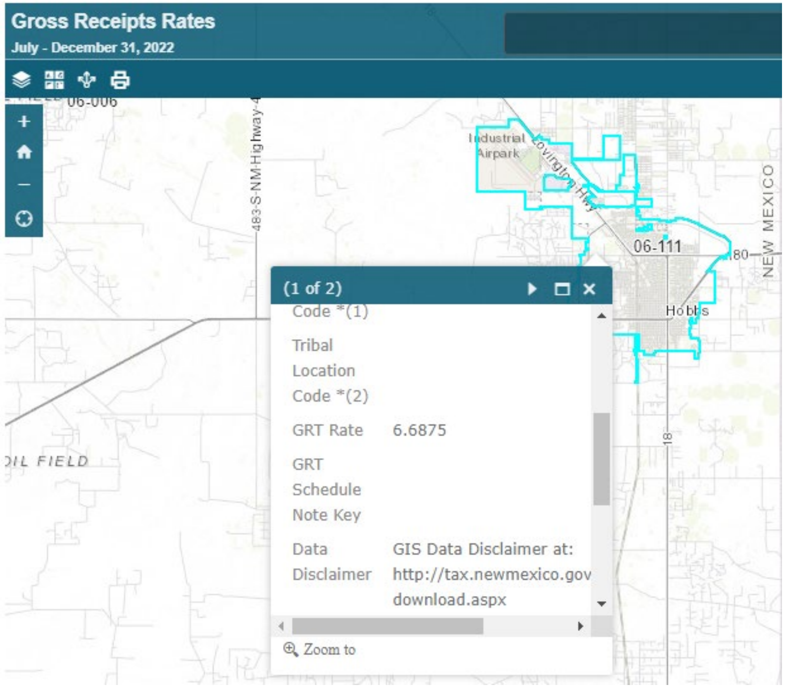
GRT Rate – 5.375 %



- Lea County second lowest county rate behind Lincoln County

Hobbs

GRT Rate – 6.6875 %

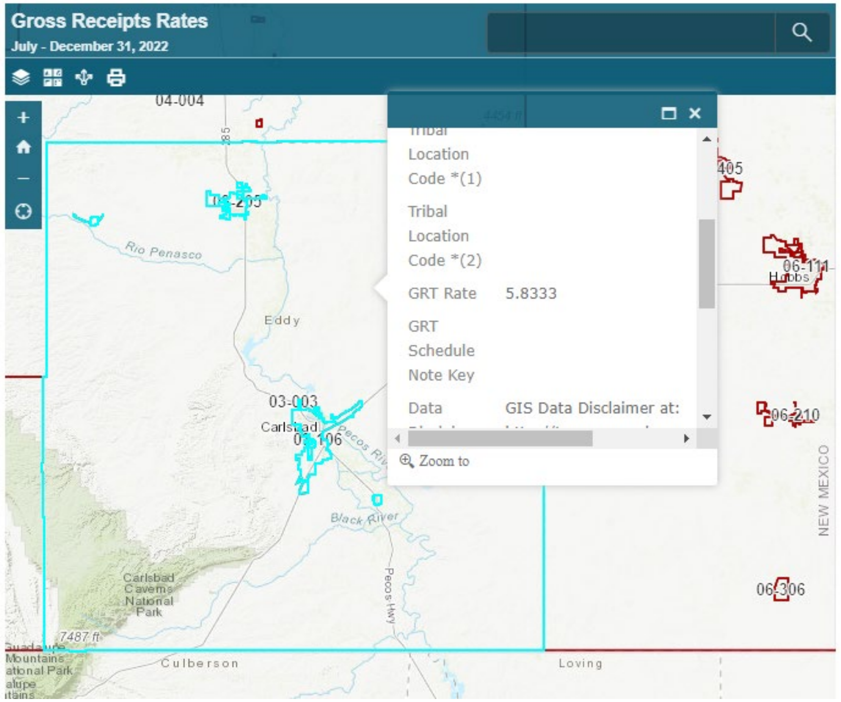


- Hobbs remaining GRT authority– 0.6125 %
- Second lowest municipal rate behind Virden in Hidalgo County (does not include special tax districts)
- Eunice, Jal, Lovington and Tatum in Lea County have higher rates

Current GRT Tax Rates

Eddy County

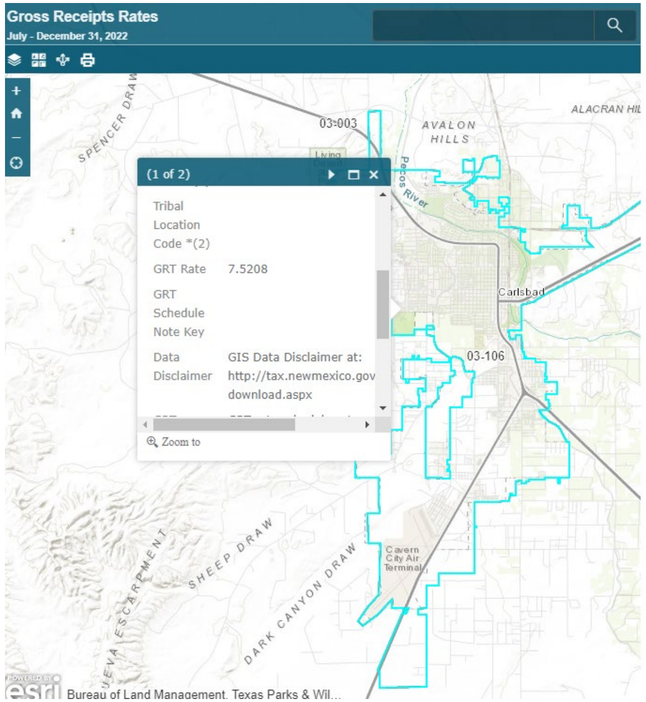
GRT Rate – 5.8333 %



- Eddy County third lowest county rate behind Lincoln and Lea Counties

Carlsbad

GRT Rate – 7.5208 %



- Carlsbad remaining GRT authority– 0.3625 %
- Carlsbad's municipal rate in the lower third quartile of rates for municipalities
- In Eddy County, Artesia has a higher rate at 7.7708% and Loving has the same rate as Carlsbad. Hope has the lowest rate in Eddy County at 6.7083%

Recommendations

- Tax & Rev recommends leaving the tax code generally unchanged with regard to destination-based sourcing
- GRT filers statewide in all industries should not face higher burden to restore diminished revenues to a handful of municipalities
- Tax & Rev's Gentax system is not an efficient vehicle to address the issue
- Example: In 2022, SB137 proposed distributions to municipalities based on the gross receipts of sellers performing services including if the service is delivered outside the municipality.
  - The bill added significant taxpayer reporting/compliance burden, challenging the tax policy principle of simplicity. The more complicated the tax code, the higher the cost everyone must bear.
  - The bill added complexity for Tax & Rev's Gentax system. The proposed changes under SB137 were estimated to cost $3.9 million to implement.

Recommendations

- Could increase municipal local option gross receipts tax rates.
- Local Compensating Tax, GRT from internet sales, and Cannabis Excise Tax Revenue are increasing municipal revenues.
- Food & Medical Hold Harmless changes – effective for Hobbs in FY23 and Carlsbad in FY26 freezing of percentage and maintaining hold harmless distributions.
- As compliance increases from out-of-state taxpayers, revenues may increase further from internet sales.

Department / Audit response to individual taxpayer information

- Not appropriate or ethical for Department to examine individual taxpayer filings – for the purpose of demonstrating the revenue impact to local governments, especially in the fact taxpayers are filing correctly
  - Taxpayer Bill of Rights: 7-1-4.1 (A) NMSA 1978 ensures 'taxpayers are adequately safeguarded and protected during the assessment, collection and enforcement of any tax administered by the department' and 7-1-4.2 (H) NMSA 1978 ensures 'the right to have the taxpayer's tax information kept confidential unless otherwise specified by law.'
- Department employees need an official reason to search taxpayer accounts.
  - Section 7-1-8(A) NMSA 1978 makes it 'unlawful for any person . . . to reveal to any other person return information', except for, among several exceptions, for statistical purposes, such that the information revealed is not identifiable as applicable to an individual taxpayer.
  - The Department researches data in the aggregate. When there are no anomalies, the Department does not perform further research.

Tax Administration – Destination-Based Sourcing

- The department will continue to assist taxpayers who may not be filing correctly
- To aid taxpayers – certainty in tax code is needed for tax compliance and business planning
- Economic growth – uncertainty in the tax code may restrict business investment
- Tax & Rev managing a fund for revenue reduction due to destination-based sourcing
  - Any adjustment to revenue distributions is administratively burdensome and potentially costly to implement
  - How to determine what is economic down-turn in economy versus the result of destination-based sourcing is subjective and again administratively burdensome

Questions?

Mark Chaiken, Tax Policy Director

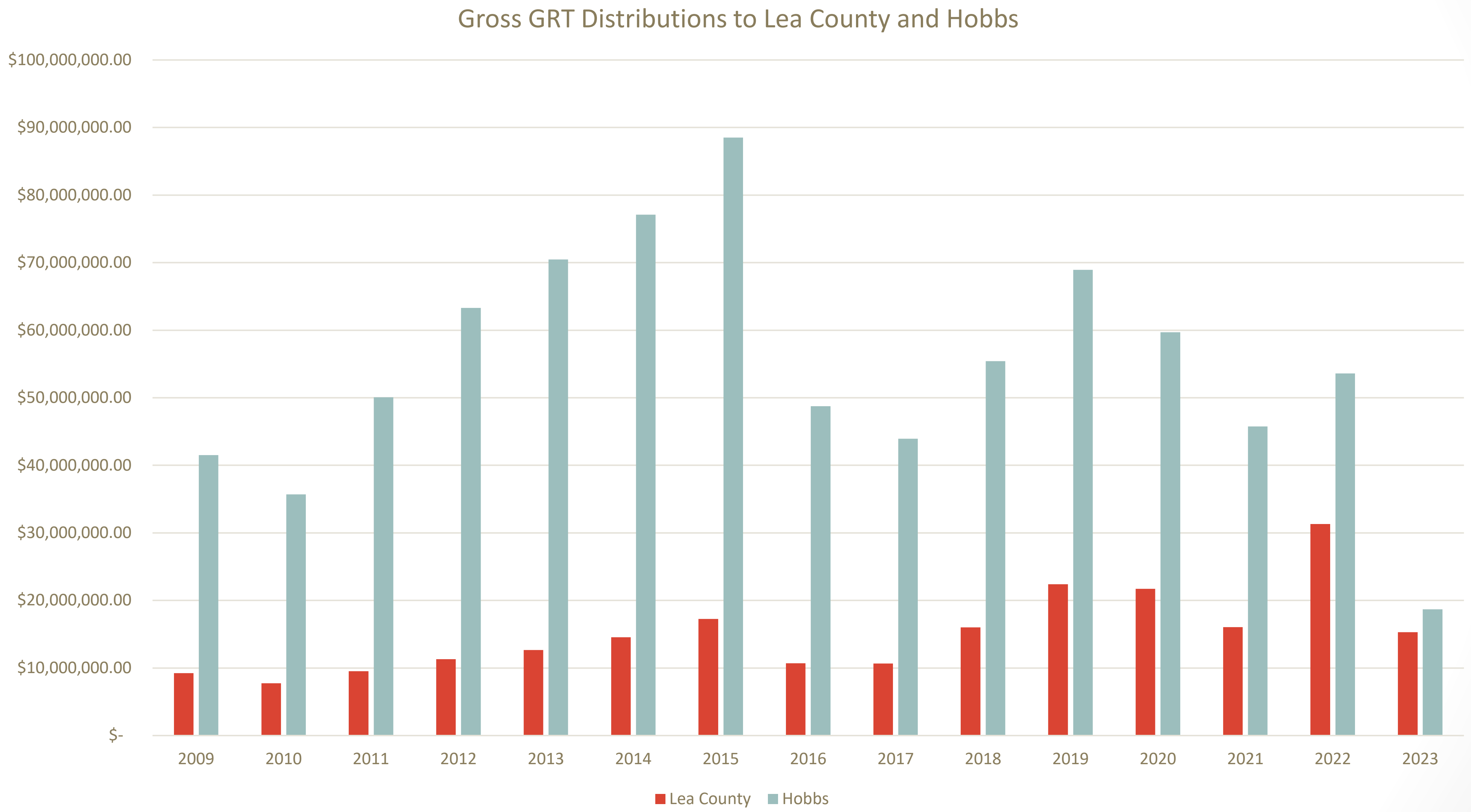
Mark.Chaiken@tax.nm.gov

Lucinda Sydow, Chief Economist

Lucinda.Sydow2@tax.nm.gov

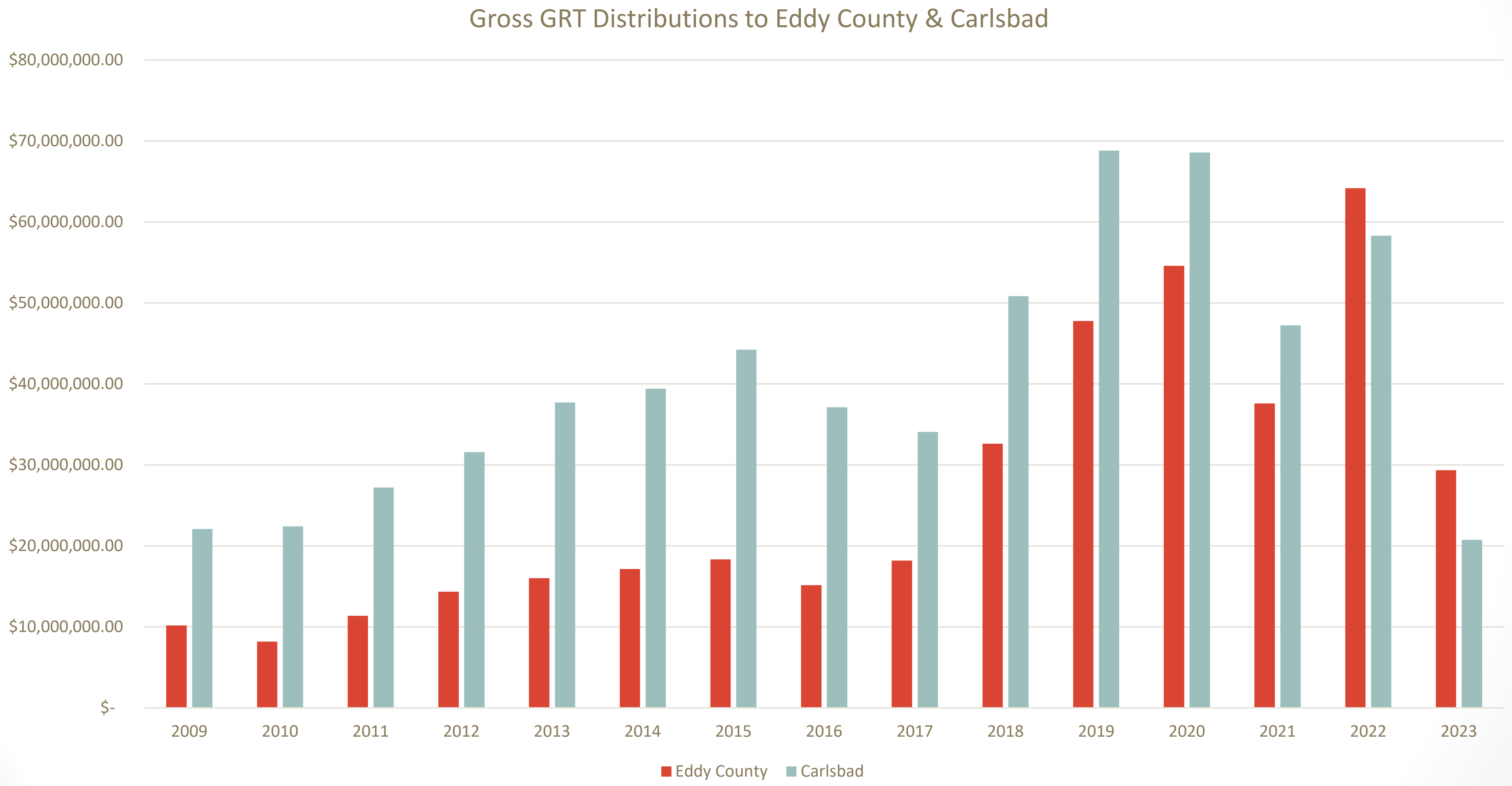
Appendix – Gross Receipts Distribution Data

Appendix – Lea County & Hobbs Gross GRT Distributions



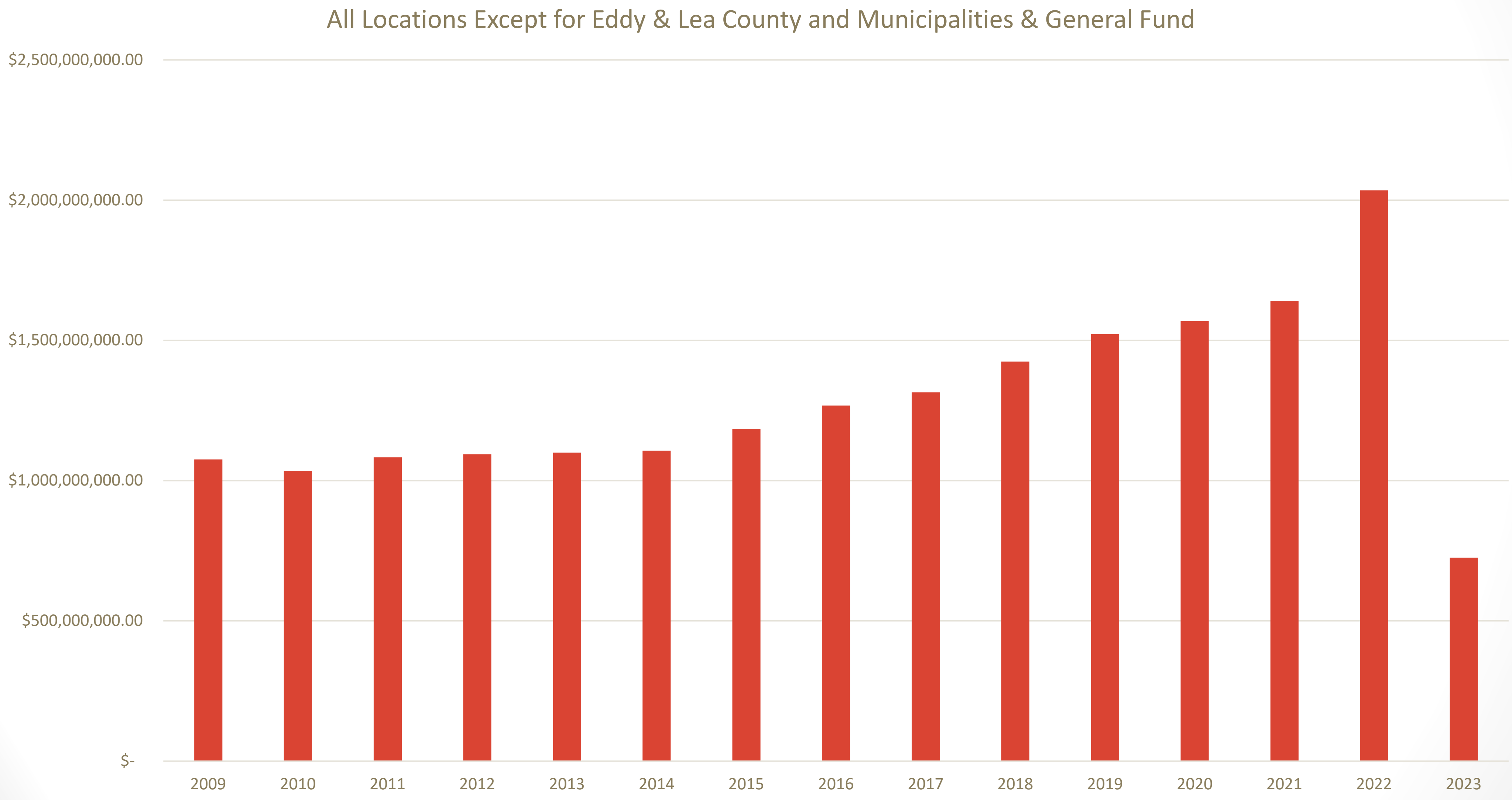
Source: Tax & Rev Department, RP500 Report
NOTES 1) Does not include Hold Harmless Distributions, admin fees, penalty & interest 2) FY2023 – Year-to-date

Appendix – Eddy County & Carlsbad Gross GRT Distributions



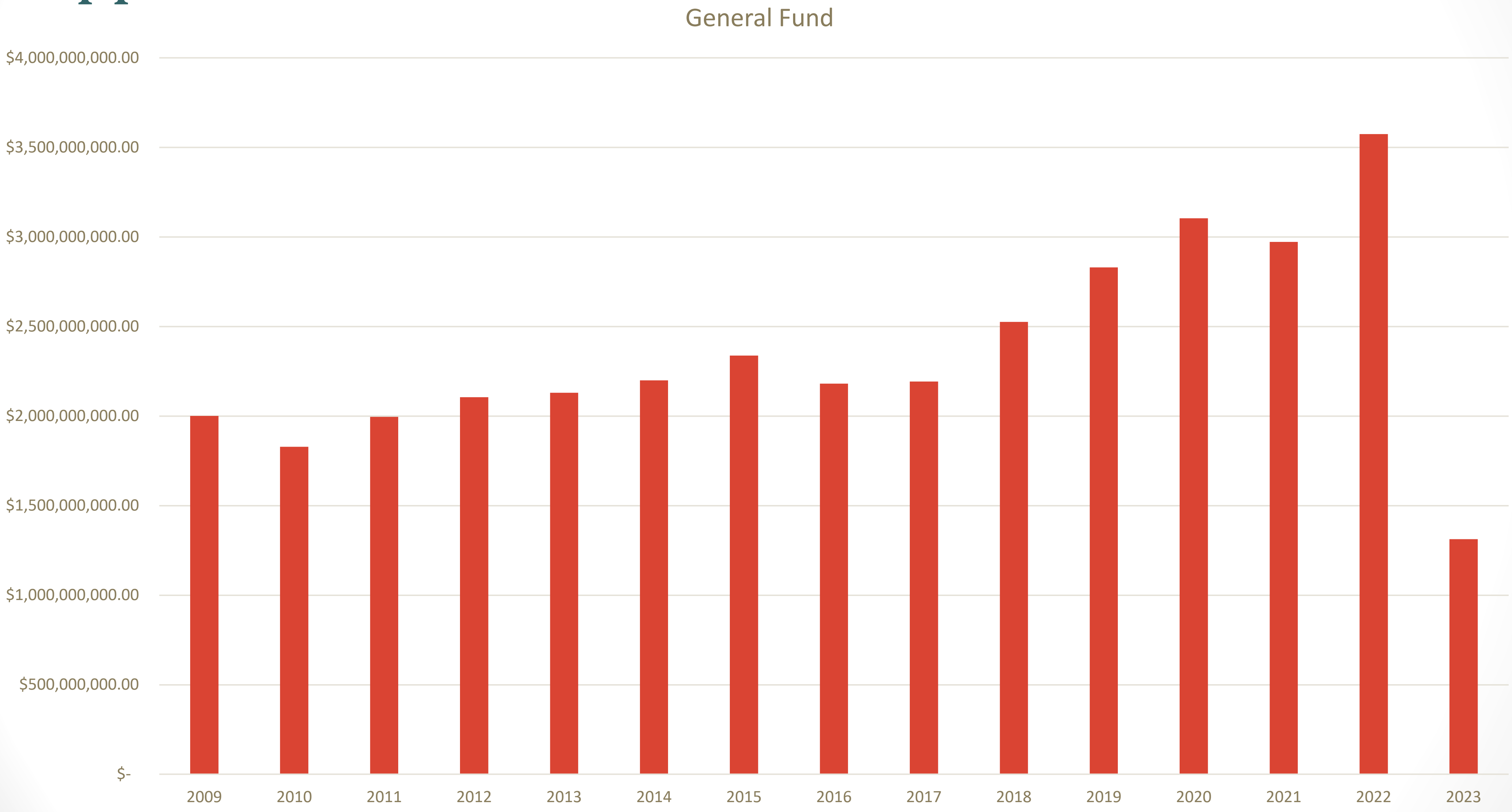
Source: Tax & Rev Department, RP500 Report
NOTES 1) Does not include Hold Harmless Distributions, admin fees, penalty & interest 2) FY2023 – Year-to-date

Appendix – All of NM Except SE NM and Gen Fund GRT



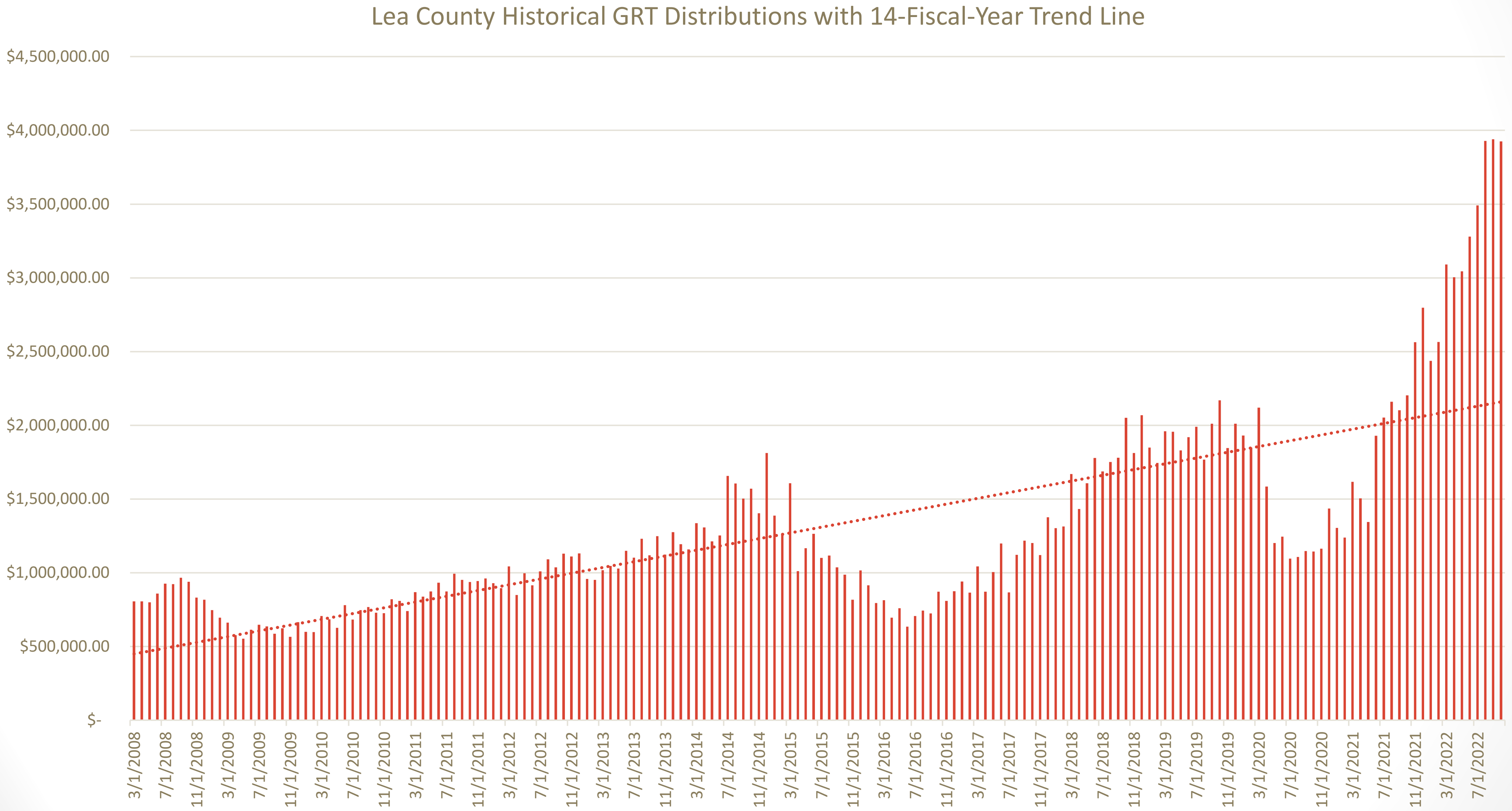
Source: Tax & Rev Department, RP500 Report
NOTES 1) Does not include Hold Harmless Distributions, admin fees, penalty & interest 2) FY2023 – Year-to-date

Appendix – General Fund Gross GRT Distributions



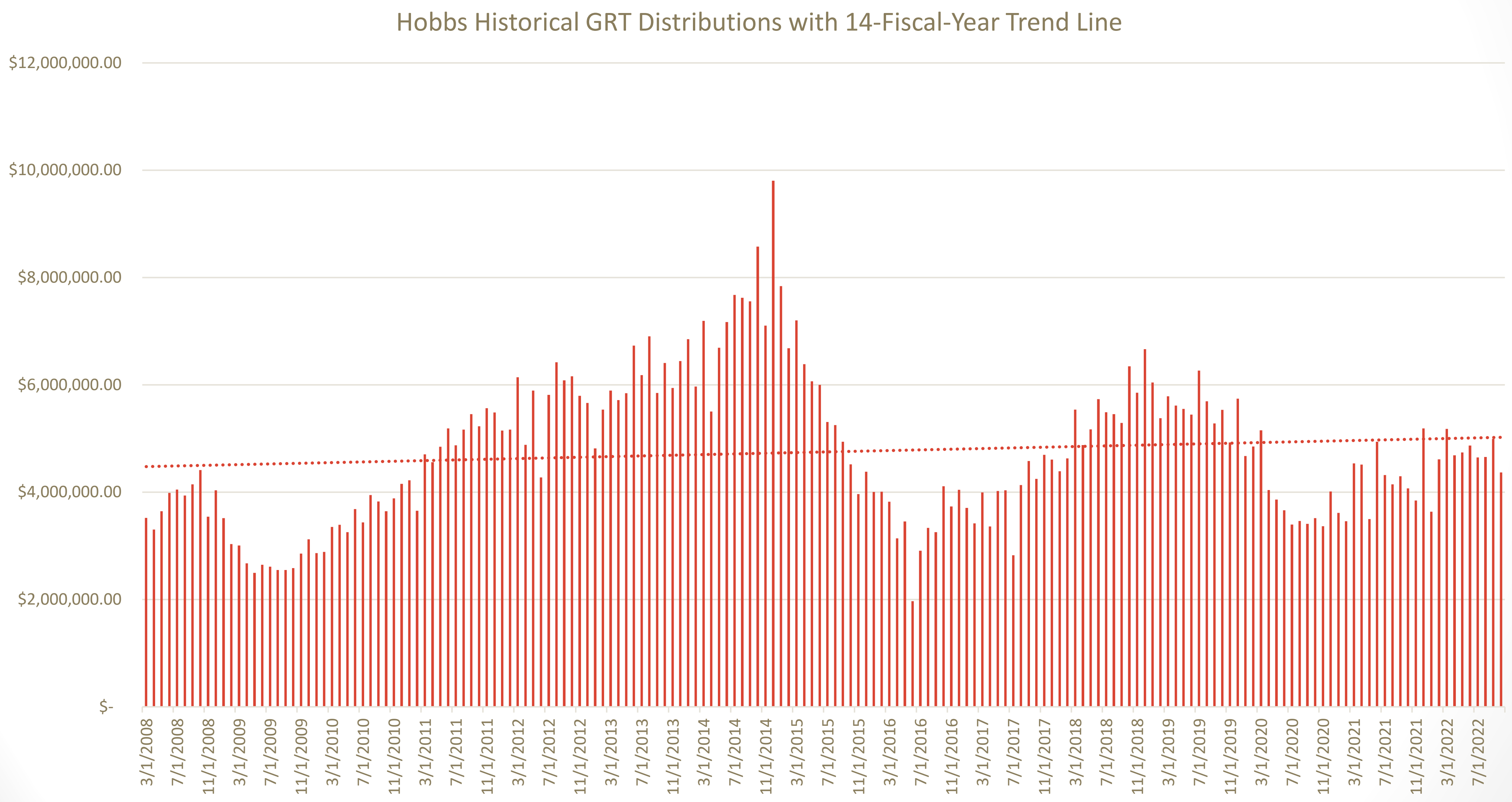
Source: Tax & Rev Department, RP500 Report
NOTES 1) Does not include Hold Harmless Distributions, other misc. distributions, admin fees, penalty & interest 2) FY2023 – Year-to-date

Appendix – Lea County GRT Distributions



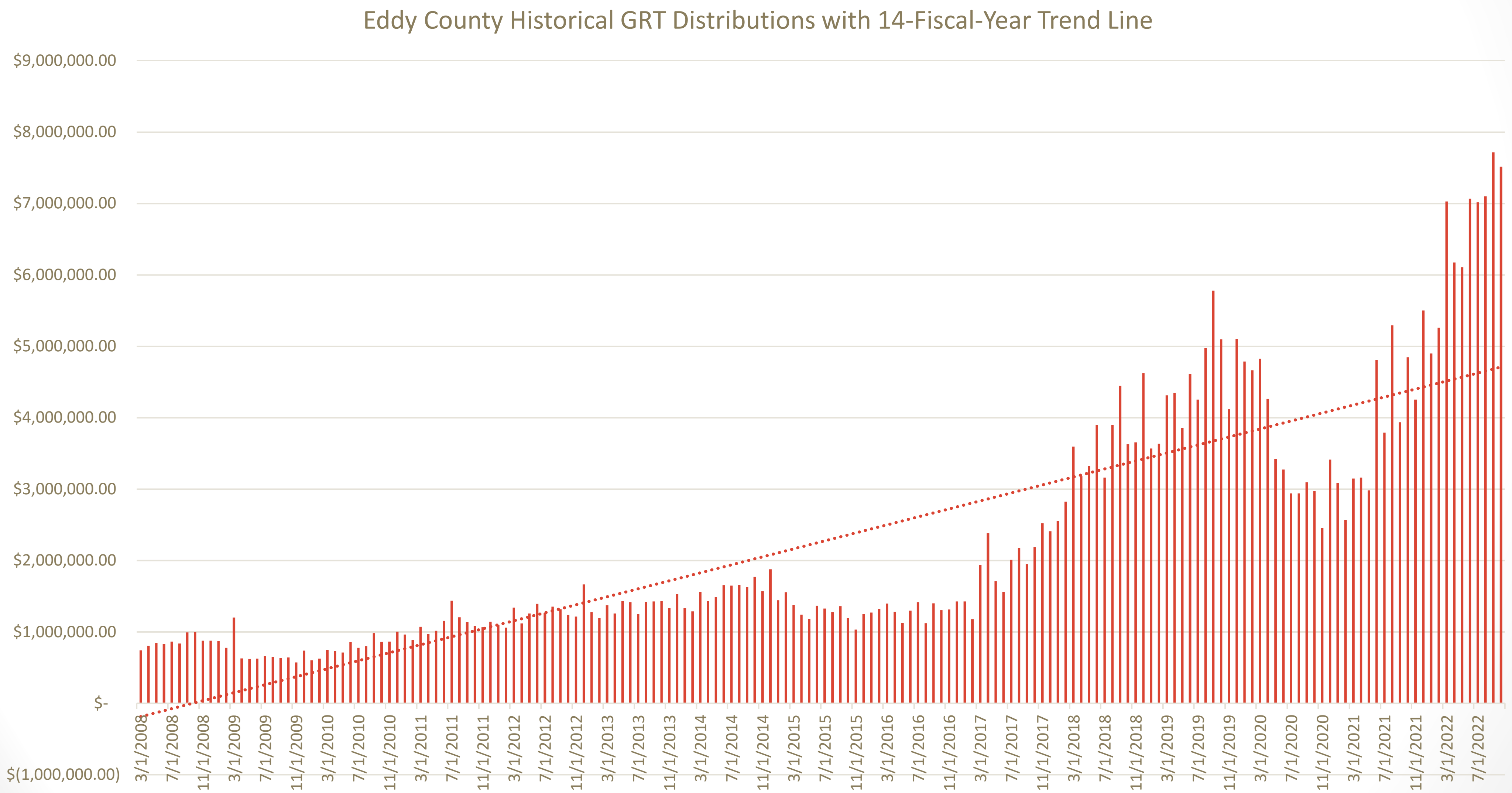
Source: Tax & Rev Department, RP500 Report, Author's Calculations

Appendix – Hobbs GRT Distributions



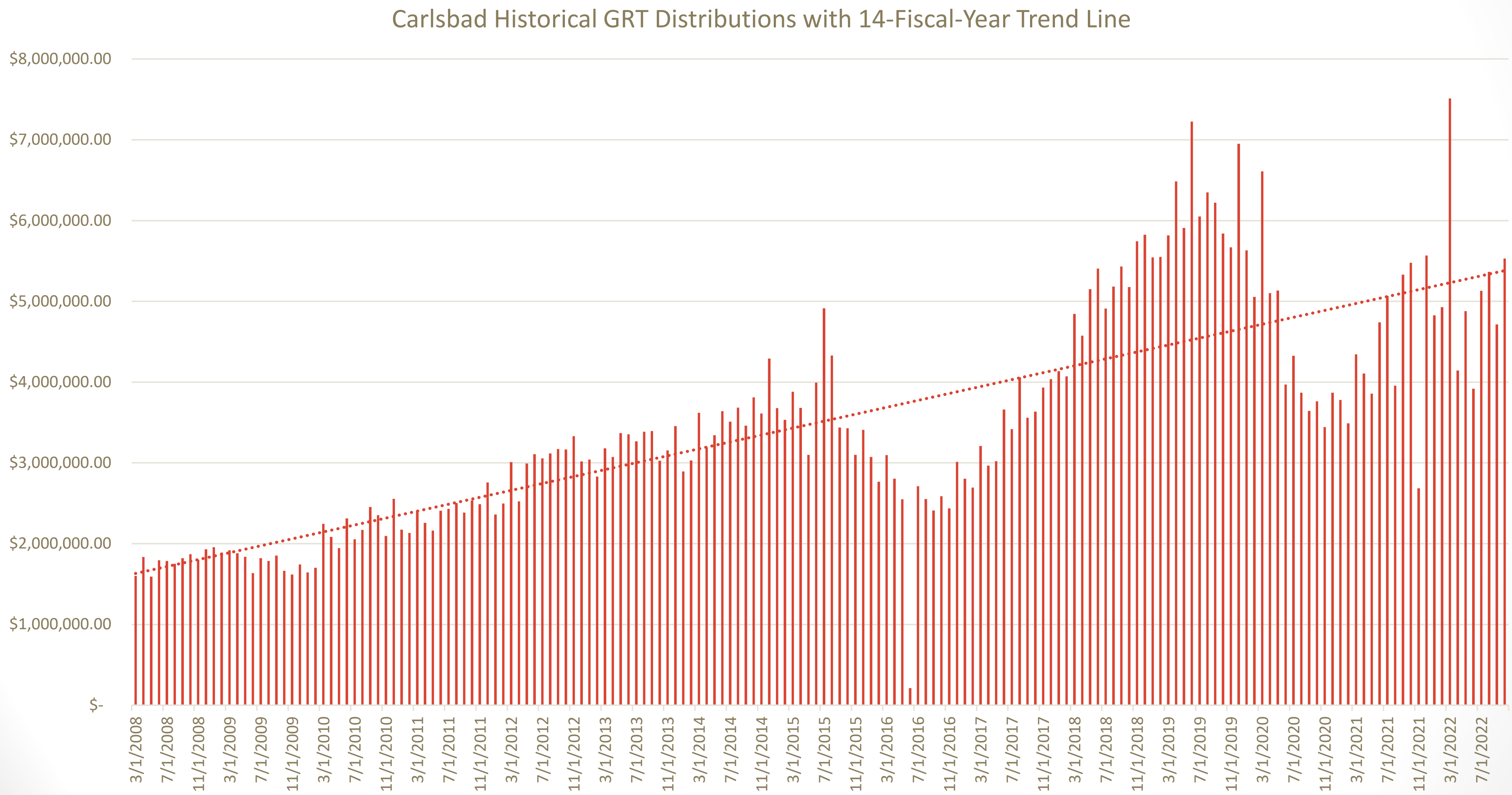
Source: Tax & Rev Department, RP500 Report, Author's Calculations

Appendix – Eddy County GRT



Source: Tax & Rev Department, RP500 Report, Author's Calculations

Appendix – Carlsbad GRT Distributions



Source: Tax & Rev Department, RP500 Report, Author's Calculations