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

SPONSOR: Russell   DATE TYPED: 02/21/01   HB 737

SHORT TITLE: Reallocate Tax Revenue To Municipalities   SB

ANALYST: Williams

REVENUE

Estimated Revenue		Subsequent Years Impact	Recurring or Non-Rec	Fund Affected
FY01	**FY02**			
	$ (2,720.0)	$ (6,520.0)	Recurring	General Fund
	$ 2,720.0	$ 6,520.0	Recurring	Local Gov't.

(Parenthesis ( ) Indicate Revenue Decreases)

SOURCES OF INFORMATION

LFC Files
Taxation and Revenue Department (TRD)

SUMMARY

Synopsis of Bill

The gross receipts tax distribution to municipalities is reduced from 1.225% to 1%.

In exchange, the state would make a monthly distribution to the municipalities in the following amount, whichever is greater:

- the municipal gross receipts tax deduction at .225% or
- an amount equal to .275 of the adjusted gross income of residents in that municipality

Effectively, this language holds the municipal government harmless from any potential reduction in the revenue distribution.

The new distribution would be calculated using adjusted gross income from two tax years prior to the distribution year. For example, distributions to municipalities beginning February 1, 2002 would be based on tax returns for the 2000 tax year, filed in the spring, summer and fall of 2001. The cut-off date for the determination of the location of the adjusted gross income totals is specified as November 30th.

This distribution may be used to meet principal and interest payment obligation for revenue bonds outstanding prior to January 1, 2002 for which the repayment revenue stream is the municipalities gross receipts distribution.

For calendar year 2000, the secretary of TRD is directed to accurately determine the site of residence of New Mexico taxpayers.

The interim Revenue Stabilization and Tax Policy Committee would receive an annual report on distribution made to the municipalities and recommendations for changes in the distribution formulas or revenue sources from the secretaries of Taxation and Revenue Department and Department of Finance and Administration and executive director of Municipal League. The bill would be effective beginning January 1, 2002.

Significant Issues

This policy approach sets a significant precedent for New Mexico in that the state would implement a new revenue sharing mechanism based on personal. The new mechanism would only be implemented for municipalities. See Other Substantive Issues below.

The first warrant to reflect the change would be February collections distributed to local governments on March 15, 2002.

FISCAL IMPLICATIONS

The bill is estimated by the Taxation and Revenue Department to reduce general fund revenue by a minimum base amount of $2,020.0 in FY02 and by $4,840.0 in FY03. Due to processing and calendar filing variations from month-to-month and year-to-year, TRD estimates potential additional loss of general fund revenues of up to $1,400.0 in FY02 and $3,360.0 in FY03. The revenue gains to local governments would be in corresponding amounts. This analysis is based on the latest gross receipts tax revenue projections for FY02 and FY03, income tax data from 1998 tax returns with amounts inflated to tax year 2000 and tax year 2002, and historical data on each municipality's share of monthly distributions.

The LFC analysis assumes the base recurring impact as noted above and fifty percent of the potential additional impact to develop a point estimate of the total fiscal impact. Thus, the total general fund revenue loss is estimated at $2,720.0 in FY02 and $6,520.0 in FY03. The revenue gains to local governments would be in corresponding amounts.

The TRD analysis outlines these issues and estimates two potential impacts for each municipality in the state **(see Attachment A).**

ADMINISTRATIVE IMPLICATIONS

TRD notes this proposal would have minimal administrative impacts. The new CRS TRIMS systems will not be online until June 2001 and will require corrections and additions through December 2001; therefore, this program would be implemented using a PC approach. As a result, TRD cautions distributions to local governments could be delayed by up to 3 days through June 2003.

TECHNICAL ISSUES

TRD poses a number of technical issues; **see Attachment A.**

OTHER SUBSTANTIVE ISSUES

TRD notes a potential range of impacts for all municipalities in their analysis **(Attachment A).**

In "State Fiscal Issues and Risks at the Start of a New Century" published by The Nelson A. Rockefeller Institute of Government" in June 2000, the following were noted:

<u>Sales Taxes/Gross Receipts Taxes</u>

- Sales taxes are typically less volatile than the income tax, and can grow slightly slower than the state's economy.

- The short-run elasticity of New Mexico's gross receipts taxes was estimated at 0.98 (**see Attachment B).**

- Over the business cycle, consumer behavior changes which can impact gross receipts tax collections. People postpone nonessential purchases during recessions so sales-type taxes tend to fall off more sharply than income. During economic recoveries, consumers have pent-up demand and increase consumption, and associated tax revenues, typically more than income. In sum the gross receipts tax can be somewhat volatile.

- The sales tax base throughout the nation has eroded due to 3 major factors: 1) Shifting consumption toward services which may not be taxed (not a significant issue for New Mexico); 2) Growth of "remote sales" **(see Attachment C)**; and 3) Narrowing of the tax base through new exemptions. The erosion of the base due to these three factors is projected to continue by most tax experts.

POSSIBLE QUESTIONS

1. Would the distributions exactly match for each municipality?

2. Who would be the winners under this policy change?

3. Who would be the losers under this policy change?

4. What would be the impacts on municipalities with significantly large tourism sectors?

5. What would be the fiscal impact for a municipality with a rapidly growing population? a declining population?

6. How would impacts differ for different suburban communities such as Edgewood, Belen and Rio Rancho?

7. How would impacts differ for urban versus rural municipalities?

8. How many municipalities have imposed the maximum gross receipts tax levy? Which communities are currently not using all available capacity?

9. What would be the long-term effects of this policy change?

AW/ar
Attachments