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

SPONSOR: Tripp DATE TYPED: 02/06/02 HB 318

SHORT TITLE: Phased in Gross Receipts Tax Credit SB

ANALYST: Smith

REVENUE

Estimated Revenue		Subsequent Years Impact	Recurring or Non-Rec	Fund Affected
FY02	**FY03**			
	($17,700.0)	See Narrative	Recurring	General Fund (GRT)
	$17,900.0		Recurring	General Fund (Cigarettes)

(Parenthesis ( ) Indicate Revenue Decreases)

SOURCES OF INFORMATION

Taxation and Revenue Department (TRD)

SUMMARY

Synopsis of Bill

SB 148 provides a credit against the State share of gross receipts tax on receipts from sales of food for home consumption. The credit is conditionally phased-in over three and one-half years—one-third of the full credit amount in FY 2003, two-thirds in FY 2004, with the full credit scheduled for January 2005. The last third of the credit only takes effect if certain conditions are met, which are described below. The full amount of the credit is equal to 5% for transactions occurring outside municipalities and 3.275% for transactions occurring within municipal boundaries. When the credit is fully phased-in, the gross receipts tax on food will be limited to the local government portion, which varies from as little as 0.125% in some unincorporated areas to as much as 3.725% in some municipalities, depending on the local options imposed.

Sections 7-1-6.4 NMSA 1978 (1.225% state-shared gross receipts tax receipts to municipalities) and 7-1-6.16 NMSA 1978 (county equalization distributions) are amended to maintain local government revenues at the same level as under present law.

The third phase of the credit takes effect only if the actual distributions of cigarette tax revenue from August 1, 2003 to July 31, 2004 less the amount distributed to the general fund from August 1, 2001 to July 31, 2002 is equal to or greater than 150% of the amount of the food credit claimed and allowed for fiscal year 2004.

For the purposes of the bill, "food" and "retail food store" are defined by reference to the federal food stamp program. According to program definitions, "food" includes most staple grocery food items and cold prepared foods packaged for home consumption. Specifically excluded from the definition of food for home consumption are alcoholic beverages, tobacco, and prepared hot foods sold for immediate consumption. Retail food stores must meet one of two criteria specified in the federal act. Under the first criterion, a retail food store must stock and offer for sale a variety of foods on a continuous basis in each of the four defined staple food categories, with perishable foods in a least two of those categories. Under the second criterion, more than 50 percent of a retail food store's total gross retail sales must be in staple foods. The purpose of the second criterion is to encompass legitimate food retailers that may specialize in specific types of food, such as fish, meat, poultry or produce.

The bill contains a provision that stops the last 1/3rd phase in of the credit if the growth in FY04 cigarette tax revenue (compared to the revenue from FY02) is greater than or equal to 150 percent of the food tax credit claimed in FY04. Distribution rates of cigarette taxes to non-general fund beneficiaries are modified to maintain their revenues at the same levels as under present law. Notwithstanding the new rates, section 3(E) of the bill provides a hold harmless provision for the non-general fund beneficiaries of the cigarette tax so that their distribution in any future year will not fall below the amount they receive in FY 2002.

Section 5 of the bill amends the definition section of the gross receipts and compensating tax act to exclude from tax those call centers that *provide services* (e.g. technical support) primarily to non-New Mexico customers. This provision was passed by the Legislature during the 2001 session, and signed by the Governor, but did not become law because the same section of statute was amended by another bill that was signed later. The measure is included in the current bill to avoid the same problem, since other sections of this bill amend the same section of statute.

FISCAL IMPLICATIONS

The bill is revenue neutral for FY03 and FY04. However, this bill is not neutral over time. Cigarettes are taxed on quantity and food is taxed on price and quantity. Over the last ten years, gross receipts tax collections on food have grown at a 1.7% compound rate per year. In contrast, taxable cigarette sales volume has decreased at a compound rate of 0.9 percent over this period.

The long run estimate hinges on assumptions about cigarette consumers' sensitivity to price. TRD assumes that the elasticity of demand is –0.7 and then calculates that the last third of the credit will not be imposed. However, elasticities have historically been calculated over relatively small changes and where consumers' other alternative was to reduce their consumption. In New Mexico, consumers have the option of purchasing cigarettes from Native American retail outlets. Further, cigarettes are easily transported and store indefinitely. If TRD's assumptions about tribal sales are overly optimistic, then the credit is not repealed; it merely remains at the FY04 rate. The state would then again be confronted with a revenue gap.

On the positive side, there would probably be a small revenue increase due to an improvement of

New Mexico grocers versus their interstate competitors. For example, people in Hobbs would have less incentive to shop in Texas.

The call center provision by itself would cause an uncertain but probably small loss of general fund revenue.

TECHNICAL ISSUES

TRD notes the following technical issues:

1. The language in Section 6 of the bill modifying cigarette tax rates specifies the rates that will apply up to July 1, 2004. The bill is silent on what rate would apply after that date. This language should be amended to make the tax rate increase permanent. The revenue estimate assumes that this change will be made.

2. As drafted, the bill does not explain when and how the food gross receipts credit can be claimed. The simplest approach would be to allow it to be claimed on the CRS-1 form, on which gross receipts, compensating and withholding tax liability are reported. The simplest approach would be to disallow carryforward of the credits, since this substantially complicates administration of the credit.

OTHER SUBSTANTIVE ISSUES

There has been much debate about whether taxes on cigarettes impact the poor greater than taxes on food. The evidence is conflicting and further research needs to be conducted.

A reduction in smoking may cause an improvement in public health and a commensurate decrease in public health expenditures.

SS/ar