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

SPONSOR HGUAC **DATE TYPED** 3/12/2005 **HB** 581/HGUACS/aHTRC /aSCORC

SHORT TITLE Local Option Compensating Taxes **SB**

ANALYST Taylor

REVENUE

Estimated Revenue		**Subsequent Years Impact**	**Recurring or Non-Rec**	**Fund Affected**
FY06	**FY07**			
	$6,500.0	Similar	Recurring	Municipalities
	$2,400.0	Similar	Recurring	Counties
	$250.0	Similar	Recurring	TRD Administration
	$190.0	Similar	Recurring	General Fund
	$40	Similar	Recurring	Small Counties/Cities Assistance

(Parenthesis ( ) Indicate Revenue Decreases)

Duplicates SB118

SOURCES OF INFORMATION
LFC Files

Responses Received From
Taxation and Revenue Department (TRD)

SUMMARY

Synopsis of SCORC Amendments

The SCORC amendments make the following changes to the bill:

1. Section 6, which would have allowed the Taxation and Revenue Department to take action to enforce local option gross receipts tax obligation due on purchases from individuals for non-business transaction, is struck from the bill;
2. The credit provided against the state compensating tax is deleted.
3. An additional exemption to the local option compensating tax is provided for property used by the railroad, airline and cable industries.

Fiscal Impact of SCORC Amendments

The amendment regarding enforcement of individual purchases slightly increases revenues to the state general fund and the small cities and small counties assistance fund. TRD estimates that the General Fund impact from this provision is a positive $190 thousand; small cites and small counties revenues increase by about $20 thousand each.

The additional exemptions provided to the railroad, airline and cable industries would reduce the fiscal impacts of the bill by about 20 percent, according to TRD.

Eliminating the credit against the state compensating tax effectively eliminates the general fund impact, other than the small gain that results from striking the section 6 amendment.

Synopsis of HTRC Amendments

1. The HTRC amendment changes the effective date of the bill from July 1, 2005 to July 1, 2006.

Fiscal Impact of HTRC Amendments

The change in the effective date, delays the fiscal impact by one year, and provides TRD more time to implement the administrative issues.

Synopsis of Substitute Bill

The House Government and Urban Affairs Committee (HGUAC) substitute for House Bill 581 allows county and municipal governments to impose a local option compensating tax. The local option compensating tax is imposed pursuant to current local option gross receipts taxes. Local option compensating tax rates mirror local option gross receipts tax rates. A 0.5 percent credit against the state compensating tax is provided. The bill requires TRD to administer the tax and transfer payments to local governments in the same way it does the state compensating tax.

The substitute bill also provides an exemption to the local option compensating tax for property used by the mining, oil and natural gas, electric and gas utilities or telecommunications industries. (This exemption is how the substitute differs from the original bill).

The bill has an effective date of July 1, 2005.

FISCAL IMPLICATIONS

TRD estimates that the HGUAC substitute for HB 581 as amended by House Taxation and Revenue Committee, which enacts a local government compensating tax in FY06 would increase local government recurring revenues by a little less than $11 million ($7.9 million for municipalities; $2.90 million for counties).

TRD's analysis reports that the FY06 compensating tax base is $925 million, and the statewide weighted average local option tax rate is 1.4 percent. . However, the exemption provided to the mining and utility industries reduces the tax base. TRD reports that 29 percent of the compensating tax is paid by industries eligible for the exemption. They are uncertain as to how much of this would ultimately be exempted because of not being available from New Mexico suppliers. They assume that half of the 29 percent is exempted. This implies the compensating tax base will be about $786 million (85 percent of $925 million). Multiplying the $786 million tax base by the 1.4 percent average rate yields $11 million in additional local government revenues. The $11 million is divided between municipalities and counties based on where taxpayers report.

The general fund and small counties/cities assistance fund revenue losses result from 0.5 percent credit provided against the state compensating tax. This has the effect of reducing the state compensating tax in municipal areas from 5.0 percent to 4.5 percent.

ADMINISTRATIVE IMPLICATIONS

TRD reports that this bill would have major administrative impacts. Their analysis is repeated here:

> The exemption for some equipment for purposes of the local option compensating tax causes a significant increase in the complexity of administering the proposal. Providing this exemption will require the Department to change the Combined Revenue System ("CRS") reporting forms significantly. Determining whether equipment was available from local sources on audit will be extremely difficult.
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> The provisions in this bill would have a major administrative impact on the department. In order to capture the data necessary to distribute revenue from the new local option taxes, larger CRS reporting forms would be required. This, in turn would require at least four full-page scanners at a cost of about $550 thousand apiece. Five additional FTE would be required to enter the additional data and verify distribution amounts. Absent full-page scanners and additional resources, there is a high likelihood of late revenue distributions to local governments resulting from increased time for processing tax returns.
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> Major computer systems changes would be necessary to make the appropriate local revenue distributions. Reprogramming the system is possible. ***However, the effective date of July 1, 2005, does not allow the department enough time to implement the changes by the effective date. An effective date of January 1, 2006, would give the department enough time to incorporate the changes.***

TECHNICAL ISSUES

TRD's analysis of technical issues is replicated here:

> This substitute bill allows the mining, oil and natural gas, electric and gas utilities and telecommunications industry to exempt tangible personal property from local option compensating taxes if that property is not available from New Mexico sources. The term "not available" is not defined, nor is it clear who will determine whether the property is available from New Mexico sources. If the aforementioned industries are to determine the availability of property, then it is possible that property that is not available within budget limitations or within a certain time frame would be exempt. The term "not available" should be strictly defined. The bill should also explain how property will be deemed "not available."

The industries eligible to exempt personal property from the local option compensating taxes—mining, oil and natural gas, electric and gas utilities and telecommunications industry—also need to be defined.

Section 9, page 17, lines 7-19. The local option compensating tax is imposed on the use of property, not the use of services. This makes the reference to "use or service" on lines 9-10 confusing. Suggested correction: Delete the term "or service" after the word "use" on line 9.

Section 9, p. 17, lines 14-19; Section 15, p. 25, lines 7-15; Section 18, p. 28, lines 15-19; Section 21, p. 31, lines 11-21; Section 24, p. 34, lines 11-23. These provisions, as amended, provide that where a local gross receipts tax is in effect on the effective date of the law enacted by the bill, the corresponding local compensating tax is automatically imposed at the same rate. If the original local gross receipts tax was adopted by vote of qualified electors, the subsequent automatic addition of the compensating tax may result in arguments that the compensating tax is improper because it falls outside the scope of the ballot questions submitted to the voters.

Section 8, beginning on page 16, refers to the "municipal compensating tax." The bill, however, provides for a "supplemental municipal compensating tax" and a "municipal local option compensating tax" but not a "municipal compensating tax." The term "municipal compensating tax" is not mentioned nor defined in any other section of the bill.

Numerous tax laws may have to change to make sure that local option compensation taxes are referred to and defined.

OTHER SUBSTANTIVE ISSUES

TRD notes a policy advantage to making the compensating tax equivalent to the gross receipts tax rate is that it would eliminate a tax induced incentive for buyers to purchase from out of state vendors.

BT/lg:yr