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

SPONSOR Egolf **ORIGINAL DATE** 01/30/12 **LAST UPDATED** **HB** 142

SHORT TITLE Tax Deductions, Rates & Exemptions **SB**

ANALYST Walker-Moran

REVENUE (dollars in thousands)

Estimated Revenue					R or NR**	Fund(s) Affected
FY12	**FY13**	**FY14**	**FY15**	**FY16**		
$0.0	($39,700.0)	($40,500.0)	($41,300.0)	($42,100.0)	Recurring	General Fund (GRT)
$0.0	$4,500.0	$4,200.0	$4,400.0	$4,700.0	Recurring	General Fund (Resource Excise and Processors Tax)
$0.0	$8,100.0	$8,800.0	$9,600.0	$10,400.0	Recurring	General Fund (Coal Surtax)
$0.0	$75,600.0	$74,200.0	$75,000.0	$75,000.0	Recurring	General Fund (School Tax)
$0.0	**$48,100.0**	**$46,600.0**	**$47,700.0**	**$48,000.0**	Recurring	**General Fund Total**
$0.0	$26,900.0	$25,500.0			Recurring	Severance Tax Bonding Fund
$0.0	$30,100.0	$30,900.0	$31,000.0	$31,000.0	Recurring	Severance Tax Bond Capacity
$0.0	$4,100.0	$800.0	$0.0	$0.0	Recurring	General Obligation Bonds
$0.0	***	***	***	***	Recurring	Property tax recipients

(Parenthesis ( ) Indicate Expenditure Decreases)

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY12	FY13	FY14	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
Total	$0.0	$700.0	TBD	$700.0	Recurring	TRD IT (ONGARD)

Relates to HB 174 and HB 189

SOURCES OF INFORMATION
LFC Files

Responses Received From
Taxation and Revenue Department (TRD)
Department of Finance and Administration (DFA)
Economic Development Department (EDD)
Energy, Minerals and Natural Resources Department (EMNRD)

SUMMARY

Synopsis of Bill

New Deduction:
House Bill 142 would allow a new deduction from the gross receipts tax for receipts from the sale of tangible personal property or services by a small business may be deducted by the small business. A small business is one whose gross receipts liability for the month does not to exceed $200.

The purpose of the deduction is to support and encourage the creation and continued success of small businesses in New Mexico.

The new deduction has no sunset date. The LFC recommends adding a sunset date.

Severance and Natural Resource Tax Changes:
The bill also amends several sections of NMSA 1978 for severance and natural resource taxes. Two amendments are to impose the same resource tax rate and processors tax rate of 0.75 percent on all natural resources rather than impose lower rates for potash and molybdenum. The bill also slightly increases the privilege tax or the emergency school tax rate in section 7-31-4 NMSA 1978 to four percent. Three sections are amended to cap the amount TRD can deduct for the oil and gas severance tax, the school tax, and the ad valorem production tax in determining the taxable value of products to 25 percent of the value of transportation or processing of products severed from the production unit.

The effective date of this bill is July 1, 2012. It is unclear if that means on production after that date or any taxes due after that date. The TRD recommends using Sales months after July 1, 2012.

FISCAL IMPLICATIONS

The new small business deduction in this bill may violate the LFC tax policy principle of adequacy. According to the LFC General Fund Recurring Appropriation Outlook for FY14 and FY15 the December 2011 forecasted revenues will be insufficient to cover growing recurring appropriations. Since currently forecasted revenues in FY14 and FY15 may not be adequate to fund government services there is insufficient funds for additional tax cuts.

According to TRD and DFA, Section 1 of this bill proposes a small business GRT deduction for receipts from sales of tangible personal property and services. Small businesses in this range of tax liability average $730 a year in total gross receipts taxes paid. Approximately 54,400 small business taxpayers would initially qualify for the small business GRT deduction. This is expected to increase about 2% per year, representing growth in the number of taxpayers, but not in the average tax deduction per taxpayer. The extract from the CRS system is reported below.

Gross Receipts Tax Due		Number Taxpayers		Gross Receipts		Taxable Gross Receipts		Gross Tax Due		Avg Tax
Over	But not over	#	% of Total	Amt million $	% of Total	Amt million $	% of Total	Amt million $	% of Total	
$0	$0	59,772	38.3%	$9,933.1	9.7%	$0	0.0%	$0	0.0%	$0.00
$0	$2,400	54,438	34.9%	$5,836.2	5.7%	$506.7	1.1%	$39.7	1.2%	$730
$2,400	and over	41,667	26.7%	$86,246.5	84.5%	$46,610.9	98.9%	$3,205.9	98.8%	$76,941
		155,877		$102,015.9		$47,117.7		$3,245.6		$20,822

Section 2 of this bill proposes an increase in resources excise tax rates on potash and molybdenum as follows:

The rate for potash would increase from 0.5% to 0.75%. The rate for molybdenum would increase from 0.125% to 0.75%. Section 3 proposes an increase in companion processors tax rates on potash and molybdenum from 0.125% to 0.75%. Using FY11 data, it is estimated that these rate shifts will increase General Fund revenue by approximately $4.1 million annually.

Sections 4, 6, and 7 of this bill would cap allowable deductions for transportation and processing of product from the taxable value of oil and natural gas severance, school or ad valorem production taxes to no more than 25% of the value of transportation or processing.

Using FY11 data, the estimated impact of decreasing the allowable deductions against these taxes is to reduce the average deduction percentage against the taxable value of natural gas from 12.5% to 12.7%. Since there are very few transportation and processing deductions against the taxable value of oil, the effect of the cap is not expected to have a large impact on oil production revenues.

Using December 2011 consensus revenue and the severance tax bond (STB) capacity estimates, it is expected that this reduction in allowable deductions will generate an additional $26.9 million in severance tax revenue in FY13, which will increase total STB capacity by $30.1 million in FY13.

Based on the December 2011 general obligation bond (GOB) capacity estimate, the reduction in allowable deductions will increase ad valorem production taxable value by $406 million in PTY13, which will lead to an increase in GOB capacity of $4 million in PTY14. The estimate suggests no significant impact to GOB capacity in later years. The increase in the property tax base due to this proposal would cause tax rates to fall, where not already limited by caps or by yield control, to compensate for the growth in the base.

Section 5 of this bill proposes increasing the emergency school tax rate on oil, carbon dioxide, helium and non-hydrocarbon gases from 3.15% to 4%. The proposal would also remove the lower rates allowed through certain price contingencies. The removal of provisions allowing a lower tax rate in instances in which the price of oil or gas falls below a certain threshold would not likely impact revenue. The price thresholds set by these provisions are much lower than current forecasts of oil and gas price, and prices are not likely to fall to these levels in the foreseeable future.

Combined with the deduction limitations noted in Sections 4, 6, and 7, the increased school tax rate on oil production is estimated to increase general fund revenue by $74.7 million in FY13. The December 2011 consensus revenue forecast was used to calculate this impact.

Using ONGARD data for FY11, it is estimated an additional $930 thousand in school tax revenue will result from the increase in the tax rate on carbon dioxide.

Section 8 of this bill proposes an increase in tax revenue through the elimination of certain surtax exemptions on qualifying purchases of coal. As of FY11, virtually all of the coal contracts in the state had been renegotiated and, pursuant to the provisions of Section 7-29C-2 have become surtax exempt. The surtax is calculated based on the producer price index (PPI) for coal. This has

been averaging slightly less than 9% for the decade. The following uses 8.6% growth rate in PPI and no change in production. It is uncertain how the Intergovernmental Tax Credit would work in these circumstances. Section 7-29C-2 (D) NMSA 1978 provides that any increase in tax rate imposed by a Tribe or Nation after March 1, 2001 would not increase the amount of the intergovernmental tax credit. However, Section 7-29C-2 (D) did not anticipate what would happen to the calculation if the State increases the coal surtax. For the purposes of this bill, it is assumed that the State would receive all of the proceeds from the surtax exemption repeal.

The fiscal impact of this portion of the bill is:

	FY12	FY13	FY14	FY15	FY16
Coal Surtax Exemption Repeal	$0	$8,108	$8,799	$9,554	$10,371

SIGNIFICANT ISSUES

According to EDD, raising taxes on these businesses will increase their costs and inevitably slow their production, which will decrease state revenue via the severance tax as well as revenues from other taxes that will drop due to the decreased production.

EMNRD points out that the increase in certain taxes on high-value resources would negatively impact the affected industries and may lend competitive economic advantage to surrounding states.

PERFORMANCE IMPLICATIONS

The LFC tax policy of accountability is met when TRD is required to report annually to the interim legislative revenue stabilization and tax policy committee regarding the data compiled from the reports from taxpayers taking the deduction and other information to determine whether the deduction is meeting its purpose.

ADMINISTRATIVE IMPLICATIONS

Per TRD, the change to the ONGARD system would be required at a time when there are major changes underway with the DoIT mainframe computing system that supports the majority of ONGARD functionality. Based on current data, they estimate that the earliest that this bill could be implemented in ONGARD would be July 1, 2013. For further detail about the ONGARD issues refer to TRD's FIR.

Per TRD, this bill will have a moderate impact on ITD/GenTax; approximately 600 hours to implement. To implement the deduction on CRS, a new version of the CRS-1 Form will be required. Changes to forms, configuration, calculations, databases, EDCR, CRSNet and the extract process will also be required. To implement the rate changes on Resource Tax and Processors Tax code changes will be required for multiple returns.

This bill has low impact on TRD's distribution process.

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

The bill relates to HB 189 for small business gross receipts and HB 174 which amends other sections of the Severance tax laws.

TECHNICAL ISSUES

According to TRD and DFA, under Section 1, Part B, the deduction is not necessarily limited to small businesses in New Mexico. They suggest changing Part B to read: The Purpose of the deduction ... of small businesses engaging in business in New Mexico.

Similarly, the definition of "small business" is confusing and must be determined on a month by month basis. Based on the definition, it appears that once the monthly gross receipts tax liability exceeds the $200 threshold a taxpayer would no longer qualify for the deduction, causing very erratic reporting. Taxpayers could manipulate receipts to qualify every month. The definition should state that it is a $200/month average without other deductions and use the preceding year as the qualifying period. In addition, the bill only addresses tangibles and services and not leases of property or intangible property. See Technical Issues – Detailed Discussion on TRD's FIR for additional technical concerns.

OTHER SUBSTANTIVE ISSUES

The TRD suggests that the current taxable value can be determined under two separate sections of law for purposes of the monthly oil and gas taxes. Absent an audit, it will be difficult for TRD to determine which value is used and if the allowable deductions are being overstated.

Currently the treatment of deductions is identical in the four monthly oil and gas taxes – severance, school, conservation and ad valorem production. The proposal changes the treatment of three of these but excludes conservation. For purposes of reporting and processing payments, the current system enables all four taxes to be processed together. To maintain this simplicity, it would be highly recommended to extend the revisions to the conservation tax.

The proposed limitation on deductions uses the word "or" between transportation and processing. Use of the word "or" in this context creates uncertainty. Although the intention appears to be to limit deductions for processing and transportation to no more than 25 percent of the otherwise allowable amount, the way the language reads it would limit total deductions to 25 percent of processing or transportation. Thus, 100 percent of one category of deductions would be eliminated.

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

EWM/svb