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

ORIGINAL DATE 02/07/12
SPONSOR Garcia, T. **LAST UPDATED** **HB** 223

SHORT TITLE Manufacturing Equipment Gross Receipts **SB**

ANALYST Walker-Moran

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY12	**FY13**	**FY14**	**FY15**	**FY16**		
	(10,800)	(14,200)	(15,800)	(16,700)	Recurring	General Fund
	(1,900)	(1,900)	(1,900)	(1,900)	Recurring	Local Governments
	(1,600)	(2,100)	(2,300)	(2,500)	Recurring	Small Counties Assistance
	(1,600)	(2,100)	(2,300)	(2,500)	Recurring	Small Cities Assistance
	(1,200)	(1,500)	(1,700)	(1,800)	Recurring	Muni Equivalent Distribution

(Parenthesis ( ) Indicate Revenue Decreases)

Relates to HB 256, HB 184

SOURCES OF INFORMATION
LFC Files

Responses Received From
Economic Development Department (EDD)
Taxation and Revenue Department (TRD)

SUMMARY

Synopsis of Bill

House Bill 223 amends the Gross Receipts and Compensating Tax Act. The bill adds a new deduction from the gross receipts tax for the sales of manufacturing equipment.

The purpose of this deduction is to encourage the growth of manufacturing in New Mexico, improve the competitive position of New Mexico with other states and encourage a manufacturing operation to update and improve the manufacturing operation's equipment to enable greater and more efficient production of manufactured goods.

The bill also defines "manufacturing equipment" as an essential machine, mechanism or tool or a component of such used directly and exclusively in a taxpayer's manufacturing operation and subject to depreciation. This definition excludes any vehicle that leaves the site of the manufacturing operation for purposed of transporting persons or property.

The effective date of this bill is July 1, 2012. There is no sunset date. The LFC recommends adding a sunset date.

FISCAL IMPLICATIONS

This bill may be counter to the LFC tax policy principle of adequacy. According to the LFC staff General Fund Recurring Appropriation Outlook for FY14 and FY15, December 2011 forecasted revenues will be insufficient to cover growing recurring appropriations.

The TRD provided the following: The estimate assumes that the main impact of the new deduction will be on compensating tax liabilities rather than on GRT liabilities, which means the local government share of the impact is lower. This assumes that most manufacturing equipment is purchased from out of state vendors. To estimate the tax base for the proposed deduction, the estimate relies on estimates of New Mexico capital expenditures from the 2007 Economic Census and 2010 Annual Manufacturers Survey. The estimate reduces the tax base by excluding equipment purchased with industrial revenue bonds and investment tax credits. According to the Tax Department’s RP-90 report, $7.46 million in compensating tax revenue was paid by taxpayers in the manufacturing sector. A portion of the total is assumed to represent tools and supplies consumed in the manufacturing process but not physically included in the finished goods. The consensus revenue estimate growth rate for compensating tax revenue is used for out years.

SIGNIFICANT ISSUES

According to the TRD, the proposed deduction would address a problem with the structure of the GRT that economists have criticized for many years. By imposing tax on manufacturers’ purchases of equipment, which is not imposed in most states, the GRT creates higher operating costs and reduces manufacturing investment in New Mexico. The proposal would help to reduce this competitive disadvantage.

According to the EDD, the GRT raises the effective tax rates on job creators discouraging hiring. The tax forces small firms to hire expensive accountants as a result of the GRTs complicated compliance process. GRT relief for manufacturing entities encourages greater capital investment and employment growth in New Mexico.

PERFORMANCE IMPLICATIONS

The LFC tax policy of accountability is not met since TRD is not required in the bill to report annually to an interim legislative 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

The TRD will need to develop a new series of NTTC for this deduction. Overall there is a minimal impact. The changes to the instructions and publications can be made with the semi-annual review of the CRS tax program documentation. High taxpayer and department employee needs.

Audit and compliance personnel and vendors should be made aware that when the equipment is self-constructed, then purchases qualifying as equipment can include all sorts of miscellaneous items including construction materials, nuts and bolts, and more obscure purchases. This can be difficult to audit.

TECHNICAL ISSUES

The TRD may have to develop regulations identifying which types of equipment purchases are eligible for the deduction.

OTHER SUBSTANTIVE ISSUES

Per the TRD, the taxpayer would still be eligible for the Investment Tax Credit for the same equipment purchases that are eligible for this deduction. This could create a "double-dip", i.e. investment credit being paid even though no tax was paid on the equipment purchase.

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

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