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

SPONSOR Sharer **ORIGINAL DATE** 03/04/13 **LAST UPDATED** **HB**

SHORT TITLE Evaluate SB 368 As Tax Policy **SJM** 39

ANALYST Walker-Moran

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY13	FY14	FY15	FY16	FY17		
	NFI	NFI	NFI	NFI		

(Parenthesis ( ) Indicate Revenue Decreases)

Relates to HB 369 and SB 368

SOURCES OF INFORMATION
LFC Files

SUMMARY

Synopsis of Bill

Senate Joint Memorial 39 requests the Legislative Finance Committee (LFC) and the Revenue Stabilization and Tax Policy Committee (RSTP) to evaluate the extent to which Senate Bill 368 meets the criteria of good tax policy.

Copies of this memorial are to be transmitted to the members of the LFC and RSTP.

Summary of Senate Bill 368 (SB 368)

Personal Income, Corporate Income Tax, Franchise Tax, Estate Tax

SB 368 amends several sections of the tax code. References to income tax, income tax returns, Income Tax Act, corporate income, franchise tax, and estate tax have been deleted.

Section 7-1-12, NMSA 1978, the applicability of the tax administration act, is amended to repeal: 1. The Income Tax Act; 2. The Venture Capital Investment Act; 3. The Estate Tax Act; 4. The Railroad Car Company Tax Act; and 5. The Corporate Income and Franchise Tax Act.

The bill also repeals the Motor vehicle excise tax and leased vehicle gross receipts tax.

Gross Receipts

A new section of the Gross Receipts and Compensating Tax Act is enacted. The gross receipts tax rate is reduced but expanded.

Section 7-1-6.4 is amended to reduce the municipality gross receipts tax distribution. The quotient is reduced to 0.508 percent (currently 1.225 percent). Sections 7-1-6.16 and 7-1-6.55, county equalization distribution and distribution to municipality equalization, are similarly amended.

This bill also amends the authority of counties and municipalities to impose certain local option gross receipts tax rates.

Section 7-1-8 amends the confidentiality requirements to clarify that the release of information should not violate an agreement between the state and the federal IRS per the Internal Revenue Code.

Section 7-1-14, the taxable gross receipts act, adds all wages, receipts from dividends or interest earned, and all receipts from the sale or lease of oil, gas or mineral interest subject to the gross receipts tax.

The gross receipts tax is reduced to 2.125 percent (currently 5.125 percent) of gross receipts.

The governmental gross receipts tax is reduced to 2.125 percent (currently 5 percent) of gross receipts. An entity licensed by the DOH that is principally engaged in providing health care services is now subject to the governmental gross receipts tax.

The compensating tax is reduced to 2.125 percent (currently 5.125 percent) of the value of tangible property and the value of the services at the time they were rendered.

Unless explicitly stated the following are no longer exempt from the GRT or the compensating tax: governmental agencies, services performed outside the state, certain organizations, certain nonprofit facilities, wages, agricultural products, food stamps, livestock feeding, vehicles, boats, and insurance companies.

In computing the GRT or government GRT due all deductible receipts whether specified as deductible once or several times in the gross receipts and compensating tax act may be deducted only once from the gross receipts or governmental gross receipts. Currently only selected deductions apply.

Municipal GRT

After July 1, 2013 the municipality may no longer impose the supplemental municipal gross receipts tax.

A new section is introduced to limit the rate imposed by all ordinances enacted pursuant to the municipal local option gross receipts not to exceed 0.5 percent. The municipal gross receipts tax is reduced to 0.5 percent (currently 1.5 percent).

Several of the municipal gross receipts taxes are reduced to 0.05 percent (currently 0.0625 percent).

Tax Expenditures: Exemptions, Deductions and Credits
Several exemptions, deductions and credits are being repealed in this bill (identified on page 7).

Other repeals
This bill also repeals the minor league baseball stadium funding act, the municipal event center funding act, the venture capital investment act, and the university athletic facility funding act.

Debt Service
Bonds issued per section 7-19-17 NMSA 1978 will no longer be issued after July 1, 2014. This bill provides for continued repayment of existing debt service obligations.

The effective date of this bill is July 1, 2013 for sections 37, 48 and 68 of the bill. The effective date of this bill is July 1, 2014 for sections 36, 38 through 47, 49 through 67 and 69 through 82.

FISCAL IMPLICATIONS

The LFC and the RSTP with the assistance of staff will dedicate time and resources to the study of SB 368 and whether it meets the LFC tax policy principles listed below.

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

More time is needed to determine the fiscal impact of SB 368. The Taxation and Revenue Department (TRD) reports that they cannot estimate the impact of the SB 368 due to complexity of changes and timing constraints.

SIGNIFICANT ISSUES

A massive overhaul of the state's tax code may require significant changes in reporting and monitoring software by government agencies and in the private sector.

Summary of SB 368 by the TRD:

The SB 368 provides for the comprehensive repeal and replacement of numerous, but not all tax programs. The bill is structured around the re-writing of the Gross Receipts & Compensating Tax Act, and eliminates corporate and personal income taxes. As a result, significant modifications of existing statutory language and references are required to implement the intent of the legislation. As an initial observation, it is probably preferable that a comprehensive repeal of the Gross Receipts & Compensating Tax Act be adopted, with a "re-write from scratch" of the intended tax provisions to avoid inconsistencies and unintended consequences. That said, the value of the draft in its current form is to provide a very explicit identification of the intents and purposes of the tax code modifications.

Several summary tax policy observations are important. First, the most fundamental trade-off in scrapping the existing GRT/CIT/PIT tax structure is to substantially lower tax rates and apply that lower rate to a broader tax base. As a result, tax policy issues characterized at tax rates of 5 percent to 8 percent may be fundamentally reshaped at a 2 percent to 2.5 percent tax rate. By example, a 7 percent to 8 percent GRT rate on sales of food is made substantially less regressive at a 2 percent tax rate. Similarly, the economic effects of tax pyramiding are profoundly different at substantially lower tax rates.

Second, the proposal addresses taxation principles designed to replace state revenue requirements, but does not repeal county and municipal local option GRT tax programs. This will have an important impact to decouple state tax revenue requirements from the independent authority of individual political subdivisions to choose specific tax programs to meet local needs. Such local taxes would build on the state tax revenues streams restated at much lower tax rates.

In retaining a "gross receipts and compensating tax" foundation, an important fact regarding New Mexico is recognized. The magnitude of non-taxable federal and Indian land holdings in the state virtually precludes imposition of property tax as an adequate foundation of governmental revenues. New Mexico is different from most states in this singular attribute.

Finally, the intent of the proposal is to reset the complex social policies that have evolved through individual tax expenditures — eliminating virtually all of the credits, exemptions and deductions that now burden any fairness or equity analysis of state tax policy. In such broad and fundamental tax reform there will be many "winners" as well as "losers." The foundation of such comprehensive reform must be the recognition, acceptance and commitment to a new tax policy that is required to move New Mexico to a re-visioned economic future.

<u>Tax Reform Proposal</u> — SB 368 is structured around re-writing the Gross Receipts & Compensation Tax Act to broaden the base of economic transactions subject to taxation. The broader tax base allows the lowering of the GRT tax rates to produce equivalent revenues to the state. Implementing this revised tax policy, the reform also eliminates and modifies a number of other tax programs, while retaining a number of existing tax programs.

This bill proposes specific tax rates, but it is understood (from the sponsors) that these are estimated rates that will need to be verified by economic analysis and testing.

<u>Tax Expenditures</u> — Among of the most vexing and challenging components of assessing the current GRT act is evaluating the benefits obtained and costs incurred as a result of the several hundred credits, exemptions and deductions provided by statute and regulatory policies. It is believed that the intent of the bill is to remove (nearly) all tax expenditures.

ADMINISTRATIVE IMPLICATIONS

This memorial requires that the LFC and RSTP analyze the impact of the bill. Analyzing the impact of this bill will also require assistance from the TRD and some other state agencies.

EWM/svb