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

		ORIGINAL DATE	02/03/14		
SPONSOR	Harper	**LAST UPDATED**	02/05/14	**HB**	132/aHTRC
SHORT TITLE	Local Government Hold Harmless Gross Receipts			**SB**	
				ANALYST	van Moorsel

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY14	**FY15**	**FY16**	**FY17**	**FY18**		
		Positive, likely not significant (see Fiscal Implications")			Recurring	General Fund
		Negative, likely not significant (see Fiscal Implications")			Recurring	Local Governments
See "Fiscal Implications"						

(Parenthesis ( ) Indicate Revenue Decreases)

Relates to HB 114, HB 155, SB 87

SOURCES OF INFORMATION
LFC Files

Responses Received From
Taxation and Revenue Department (TRD)
Department of Finance and Administration (DFA)
New Mexico Municipal League (NMML)

SUMMARY

Synopsis of HTRC Amendment

The House Taxation and Revenue Committee amendment addresses a technical issue by clarifying that counties and municipalities subject to the hold harmless phaseout receive a zero distribution on or after July 1, 2029. Prior to the amendment, there was no statutory guidance what these local governments' distribution would be after that date.

Synopsis of Original Bill

House Bill 132 amends the Tax Administration Act and the statute governing local option hold harmless gross receipts taxes to make changes to the phaseout of the food and medical hold harmless distribution and to limit the ability of local governments to impose local option hold harmless gross receipts taxes.

The concept of the legislation is to encourage local governments to impose local option hold harmless GRT taxes only when needed. The bill does so by reducing the state distribution to local governments by taking credit for local government hold harmless GRT revenue above the "pre-phaseout" level. The bill also schedules the local governments' hold harmless GRT rate authority to match closer to the phaseout schedule in an effort to allow impositions when they are needed to keep hold-harmless revenue whole, and not before.
For example, a municipality that would have received a $1.0 million hold harmless distribution would receive only $940 thousand due to the first year, six percent phaseout. If it imposed a 1/8 hold harmless gross receipts tax, it could raise $150 thousand, well in excess of the revenue needed to restore the lost distribution early in the phaseout. Per the provisions of HB132, the state distribution would be calculated as the maximum distribution ($1.0 million) less the local option GRT revenue ($150 thousand). The sum of the distribution and the local option tax revenue would be $1.0 million ($850 thousand state distribution and $150 thousand local revenue).

(Detailed bill synopsis follows, below)

Specifically, the bill creates a "maximum distribution" for municipalities, defined as follows:

- for a municipality with a population less than 10 thousand, total food and medical deductions for the month multiplied by the combined rate of all municipal local option gross receipts taxes for the month plus 1.225 percent; and
- for a municipality with a population 10 thousand or more, total food and medical deductions for the month multiplied by the combined rate of all municipal local option gross receipts taxes in effect in on January 1, 2007 plus 1.225 percent.

Municipalities with populations less than 10 thousand that have not imposed a hold harmless gross receipts tax receive the maximum distribution. For all other municipalities, the maximum distribution is reduced to the lesser of:

- the difference between the maximum distribution and the amount of the a local option hold harmless gross receipts tax, or
- the maximum distribution, phased out according to the schedule by which the food and medical hold harmless distribution would be phased out under current law.

The bill provides that if a municipality's distribution combined with its 3/8 percent local option hold harmless gross receipts tax is less than the maximum distribution, the distribution is increased by the difference.

The bill also creates a "maximum distribution" for counties, defined as follows:

- for a county that with a population less than 48,000, total food and medical deductions for the month multiplied by the combined rate of all county local option gross receipts taxes for the month; and
- for a county with a population 48 thousand or more, total food and medical deductions for the month multiplied by the combined rate of all county local option gross receipts taxes in effect in on January 1, 2007.

A county with a population less than 48 thousand that has not imposed a hold harmless gross receipts tax receives the maximum distribution. For all other counties, the maximum distribution is reduced to the lesser of:

- the difference between the maximum distribution and the amount of the a local option hold harmless gross receipts tax, or
- the maximum distribution, phased out according to the schedule by which the food and medical hold harmless distribution would be phased out under current law.

The bill provides that if a county's distribution combined with its 1/8 percent local option hold harmless gross receipts tax is less than the maximum distribution, the distribution is increased by the difference.

The bill allows municipalities (excluding an H class county) to impose up to a 3/8 percent hold harmless gross receipts tax, implemented in 1/8 increments. The first increment may be imposed on or after July 1, 2015, the second on or after July 1, 2018, and the third on or after July 1, 2020. The imposition of these tax increments is not subject to referendum.

Counties may impose up to a 1/8 percent hold harmless gross receipts tax, implemented in 1/8 increments. The first increment may be imposed on or after July 1, 2015, and the second on or after July 1, 2022. The imposition of these tax increments is not subject to referendum.

The bill includes a temporary provision providing that a municipality or a county that has imposed a hold harmless gross receipts tax or prior to the effective date of the bill must conform to its provisions, requiring a municipality or county that imposed the hold harmless gross receipts tax that does not conform to the provisions of the bill to repeal such taxes on or before July 1, 2014.

HB132 contains an emergency clause, and would become effective immediately upon signature by the governor.

FISCAL IMPLICATIONS

NOTE: The fiscal impact of HB 132, both to the general fund and to local governments is highly uncertain (see below).

1) HB 132 could have a potentially significant positive impact on the general fund, and a negative impact on local governments as compared with the status quo. However, the impact is a potential one, and in LFC's estimation is likely not significant, because very few local governments have enacted a hold harmless tax, and some (including Albuquerque) have stated an intent not to. LFC estimates there is little will at the local level to increase taxes only to have the state reduce its distribution to local governments accordingly.

2) HB 132 takes credit for local government hold harmless GRT revenue in excess of the maximum distribution. The LFC analysis assumes this deters small cities and counties (not subject to the phaseout) from implementing the local option hold harmless GRT, and therefore the bill has no impact on these small local governments.

3) LFC and TRD used similar approaches to arrive at estimated impacts, but the large number of variables in the analyses creates a high degree of uncertainty. In particular, the assumptions concerning local government enactment of hold harmless gross receipts taxes both under current law[1] and under the provisions proposed in HB132 have a significant impact on the magnitude of both the general fund and the local government impact. As such, LFC's and TRD's estimates vary, and both are described below.

LFC Analysis

The LFC analysis was based on actual FY12 hold harmless distributions, grown for the forecast period at the rate assumed in the analysis of HB 641 in 2013. The GRT increments were also based on FY12 matched taxable gross receipts grown at the LFC estimate for growth in taxable gross receipts.

As noted above, the LFC analysis centered on the "large local governments[2]," municipalities and counties with sufficient populations to make them subject to the hold-harmless phaseout. For these local governments, the scenario estimated assumed each local government would impose the hold harmless GRT increments as soon as the provisions of the bill allow. This accelerates the reduction in general fund distribution to the governments, as the distribution is decreased by the hold harmless GRT revenue.

Assuming all local governments (including Albuquerque) impose the 1/8 percent GRT increment in FY16, the general fund distribution to large municipalities and counties would be reduced by $56 million in FY16, by $50.7 million in FY17, and by $44.8 million in FY18. The general fund distribution would continue to diminish in out years as the phaseout of the maximum distribution progresses, and as local governments are authorized to impose additional hold harmless GRT increments.

However, the likelihood that Albuquerque and other local governments would not impose additional hold harmless GRT increments is noteworthy. Albuquerque's decision not to impose the 1/8th increment in FY16 would decrease the positive impact to the general fund to $41.1 million in FY16, $37.3 million in FY17, and $33.4 million in FY18. If other large local governments opt not to exercise their hold harmless GRT rate authority, the general fund impact would diminish further. The analysis assumes the positive gain to the general fund is equivalent to the negative impact to the local governments, although scenarios exist where this is not the case.

LFC estimates the likelihood that local governments increase local option GRT rates increases as the proportion of the additional revenue that the state would take credit for decreases. That is, the local governments are more likely to impose a local option tax if it raises just enough revenue to hold the revenue flat, and does not exceed the maximum distribution. This would have the effect of diminishing any impact to the general fund. The bill could be amended to allow municipalities to impose the hold armless GRT in 1/16 (rather than 1/8) percent increments, allowing the local governments to better structure their rate imposition to match the phaseout schedule of the hold harmless distribution.

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[1] Laws 2013, Ch. 160.

[2] Alamogordo, Albuquerque, Artesia, Carlsbad, Clovis, Deming, Espanola, Farmington, Gallup, Hobbs, Las Cruces, Las Vegas, Los Alamos, Los Lunas, Lovington, Portales, Rio Rancho, Roswell, Santa Fe, Silver City, Sunland Park, Bernalillo County, Chaves County, Curry County, Dona Ana County, Eddy County, Lea County, McKinley County, Otero County, San Juan County, Sandoval County, Santa Fe County, Valencia County.

TRD Analysis:

TRD made several general assumptions, applying them across the potential scenarios analyzed. Food and medical hold harmless payments were forecast separately, with a baseline of FY2013, using forecasts by IHS Global Insight[3], for percentage changes in real consumer spending on food for off premises consumption and health care, respectively. Taxable gross receipts, which was used to calculate the potential revenue from the hold harmless gross receipts tax increments was forecast from a FY2013 matched taxable gross receipts baseline using the UNM Bureau of Business and Economic Research forecast for percentage change in New Mexico real disposable income.

Counties over 48,000 population, municipalities over 10,000 population, and counties and municipalities under the population threshold that choose to enact a hold harmless gross receipts tax will receive the lesser of the applicable maximum distribution less tax receipts, or a distribution equivalent to the status quo, phased out hold harmless distribution. Counties under 48,000 and municipalities under 10,000 that do not enact a hold harmless gross receipts tax will continue to receive the full amount of the gross receipts distribution indefinitely.

The general fund impact is estimated as the amount of current law hold harmless distributions less the amount of distributions made under this proposed statute. The impact to local governments is much harder to quantify. The largest possible negative impact would be to a local government that would otherwise have implemented the full three eighths percent hold harmless tax immediately, and now would only be allowed to implement one eighth percent and would also receive an offsetting decrease in hold harmless distribution. Assuming this for every local government would result in an aggregate negative impact to local governments exceeding -$200 million in the first year. However, given that only a few local governments have enacted the tax or begun the process of enacting the tax, and that Albuquerque, accounting for almost 28 percent of total hold harmless distributions, has strongly indicated that it will not implement the tax, this is a gross overstatement of the actual impact to local governments.

TRD evaluated several scenarios involving varying groups of counties and municipalities choosing to enact the tax to arrive at a range of likely outcomes. Because different local governments will have different priorities when evaluating whether to enact a new tax or not, the revenue impact given must be recognized for what it is: a range of potential impacts. To avoid the increasing complexity of evaluating every possible combination of potential local government impacts, the negative impact shown for local governments corresponds with the maximum positive impact to the General Fund. Based on these assumptions, TRD reported a potential general fund impact ranging from $18.7 million to $38.1 million in FY16, and diminishing in out years.

SIGNIFICANT ISSUES

In October 2013, staff of the Legislative Council Service, the LFC, the Department of Finance and Administration, the Taxation and Revenue Department, and the New Mexico Tax Research Institute met with representatives of the New Mexico Municipal League (NMML) and the New Mexico Association of Counties (NMAC) to discuss issues related to the phase-out of the food

[3] IHS Global Insight is the economic forecasting service used by TRD, DOT, and LFC.

and medical hold-harmless distribution and the local option hold harmless GRT rate authority created in Laws 2013, chapter 160. The group discussed issues with the implementation of that legislation and policy options to address them. The main issues and respective options were:

- "Stacking" county and municipal 3/8 percent GRT authority as authorized under current statute could result in a 3/4 percent GRT rate increase in municipalities.

  The increase in the GRT could result in high rates in some municipalities. One option to address this issue is to amend statute to limit the imposition of the county option GRT to "rest of county." However, this could result in county hold harmless local option GRT revenue being insufficient to make up for lost hold harmless revenue. TRD analysis shows that, under this option, seven counties would not generate sufficient revenue to replace their hold harmless distributions, including four counties large enough to be automatically phased out. This option could be fine tuned to limit one or two of the authorized 1/8 percent increments imposed by counties to "rest of county" areas.

- Timing differences between the GRT imposition and the hold-harmless phase-out could result in local governments receiving a windfall during the phase-out period.

  Amending statute to "offset" the windfall could provide an incentive to impose a lower rate or to defer tax impositions until the additional money is needed to meet the loss from the hold harmless phase-out. This could be accomplished by accelerating the phase-out of hold harmless distributions to local governments in the event that the local option GRT revenue would exceed the hold harmless payments. Another option is to limit the imposition of local option GRT to the increment necessary to make up for lost hold harmless revenue.

- For some municipalities a 3/8 percent rate increase is not sufficient to make up for lost hold harmless revenue

  Per TRD's analysis during the interim, several municipalities would face a net revenue loss after the hold harmless phase-out, even after imposing the maximum 3/8 percent GRT. Revenue shortfalls would not occur until later in the phase-out of the hold harmless distribution, and municipalities could generate excess revenue early in the phase-out by imposing the local option GRT increase. The timing of the phase-out could give local governments time to adjust budget priorities to prepare for an eventual reduction in revenue.

- Referendum vs. no referendum for imposition of local option GRT. Should the imposition be subject to referendum either by request of the local governing body or by petition of the voters?

  Statute changes to allow the imposition of any local option GRT increase to be subject to local referendum could be implemented in several ways. One option is to make any local option GRT imposition subject to referendum, while another option is to allow referendum on GRT increments that would generate revenue in excess of the reduction in the hold harmless distribution.

HB 132 aims to address these three issues:

1) limiting local rate authority to an aggregate 3/8 percent (as opposed to 6/8 percent) will reduce the potential for rate increases, and allowing counties to implement in 1/16 percent increments

2) limiting the timing of the impositions to match closer with the hold harmless distribution phaseout schedule will reduce local revenue windfalls;
3) providing for an additional distribution to local governments whose distribution and whose local option tax combine to be less than the maximum distribution, and
4) clarifying that the impositions are not subject to referendum.

TECHNICAL ISSUES

Page 6, line 25 through page 7, line 5 and page 17, lines 1-6 remove sections that cease distributions to certain local governments after July 1, 2029. Without these sections, the Taxation and Revenue Department (TRD) does not have direction on what the distributions will be after July 1, 2029. The sponsor may wish to amend this strike-through.

ALTERNATIVES

The bill could be amended to allow municipalities to impose the hold armless GRT in 1/16 (rather than 1/8) percent increments, allowing the local governments to better structure their rate imposition to match the phaseout schedule of the hold harmless distribution. This would also diminish the likelihood that local option revenue exceeds the maximum distribution, thus placing downward pressure on any potential revenue impact to the general fund.

The New Mexico Municipal League suggests an alternative to HB 132. From its analysis of the bill:

> "The rationality of the whole hold harmless scheme, as well as HB 132's modification of it, rests on the soundness of deducting retail food and many medical services from the gross receipts tax base. An alternative, far less complicated administratively, is to reverse the 2004 enactment of 7-9-92 and 7-9-93. The General Fund gains a mountain of money instantly and all municipalities and counties would be left exactly in the same fiscal position as they are today. As a second alternative, the state could continue not taxing retail food and medical services while allowing municipalities and counties to do so through a credit device, like 7-9-96.1."

WHAT WILL BE THE CONSEQUENCES OF NOT ENACTING THIS BILL

The hold-harmless phaseout and hold harmless GRT rate authority provisions in current law (Laws 2013, Ch. 160) will remain in effect.

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

PvM/ds:jl