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

ORIGINAL DATE 02/10/14
SPONSOR SCORC **LAST UPDATED** **HB**

SHORT TITLE Gross Receipts Deductions Itemization **SB** 29/SCORCS

ANALYST Van Moorsel/Graeser

APPROPRIATION (dollars in thousands)

Appropriation					Recurring or Nonrecurring	Fund Affected
FY14	FY15	FY16	FY17	FY18		
	$500.0				Nonrecurring	General Fund
	$0.0	*	*	*	Recurring	General Fund

(Parenthesis ( ) Indicate Expenditure Decreases)

TRD reports that for the original bill which required monthly reporting, nonrecurring, setup and programming costs would be $250.0 and recurring costs about $200.0. The provisions of this bill would probably be administered with a stand-alone system, not necessarily within the core of the CRS system. The recurring costs are for key entering at least 50,000 reconciliation reports. In any event, the initial appropriation of $500.0 will cover the FY15 anticipated costs and provide some reversion.

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY14	FY15	FY16	FY17	FY18		
	$0.0	***	***	***	Recurring	General Fund

Parenthesis ( ) indicate revenue decreases

*** The bill provides for a civil penalty in the amount of the exemption or deduction not reported "in addition to other penalties provided by law." Since the amount of ***tax*** at issue is the amount of the exemption or deduction times a relevant tax rate, this level of penalty is roughly 14 times a conventional penalty. The first time such a penalty would be imposed would be for the July 2016 report for CY 2015. There is also a difficulty in TRD determining when or if a reconciliation report is required. (See "Significant Issues" below.)

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

Estimated Additional Operating Budget Impact*				Recurring or Nonrecurring	Fund(s) or Agency Affected
FY14	FY15	FY16	FY14-16		
$0.0	$200.0	$200.0	$400.0	Recurring	General Fund (TRD)
$0.0	$250.0<	$0.0	$250.0<	Nonrecurring	General Fund (TRD)

(Parenthesis ( ) Indicate Expenditure Decreases)

Note: TRD would incur substantial systems and forms design costs to implement the provisions of this bill. In addition, data capture, data processing, report generation and other costs would be recurring. See “ADMINISTRATIVE IMPACT” below for an analysis. It appears that the $500.0 appropriation would be sufficient to implement a stand-alone system, linked to CRS to generate penalty notices and process assessments, liens and levies through the CRS system. Note that the appropriation contained in the bill would probably be adequate to deliver the startup phase through FY 2015.

SB 29/SCORCS now conflicts with HB 131, with CS/SB-29 providing a penalty for failure to file a separate report and deleting the sunset provisions of HB-131. SB 29 also relates to bills requiring an annual or biennial tax expenditure report. These include HJR 5, SJR 5 and SB 30.

SOURCES OF INFORMATION
LFC Files

Responses Received From
Taxation and Revenue Department (TRD) (original SB29)
Economic Development Department (EDD)

SUMMARY

Synopsis of Bill

The Senate Corporations and Transportation Substitute to SB 29, Section 1, requires a person that is exempt from or has claimed a deduction against gross receipts tax or compensating tax liability must annually file a reconciliation report to TRD for all exemptions and deductions taken by the person in the previous calendar year. The legislation provides for certain (extensive) exceptions to this requirement (see below) and requires TRD to promulgate rules to enforce this requirement. Section 1 also provides for a penalty for failure to file the reconciliation report equal to the amount of the exemption and/or deduction claimed. TRD is required annually to compile all of the reconciliation reports and present a report detailing all of the exemptions and deductions to the relevant interim committees of the Legislature.

Section 2 provides an appropriation of $500 thousand to TRD to purchase hardware and develop software to process these reconciliation reports.

EFFECTIVE DATE: July 1, 2015

Section 1 provides for substantial exemptions from the general reporting requirements. Remaining after excluding the exemptions is the following list of exemptions and deductions for which the reporting requirement is imposed. In general, these are new deductions or exemptions that have been added to the Gross Receipts and Compensating Tax Act (GR&CTA) since about 2000. Remaining are 47 sections of the GR&CTA subject to the annual reconciliation reporting requirement.

7-9-13.3	Exemption; gross receipts tax and governmental gross receipts tax; stadium surcharge.
7-9-13.4	Exemption; gross receipts tax; sale of textbooks from certain bookstores to enrolled students.
7-9-13.5	Exemption; gross receipts tax and governmental gross receipts tax; event center surcharge.
7-9-20	Exemption; gross receipts tax; certain receipts of homeowners associations.
7-9-26.1	Exemption; gross receipts tax and compensating tax; fuel for space vehicles.
7-9-30	Exemption; compensating tax; railroad equipment, aircraft and space vehicles.

7-9-40	Exemption; gross receipts tax; purses and jockey remuneration at New Mexico racetracks; receipts from gross amounts wagered.
7-9-41.1	Exemption; gross receipts tax and governmental gross receipts tax; athletic facility surcharge.
7-9-41.2	Exemption; compensating tax; locomotive engine fuel. (Contingent effective date. See note.)
7-9-46	Deduction; gross receipts tax; governmental gross receipts; sales to manufacturers.
7-9-54.2	Gross receipts; deduction; spaceport operation; space operations; launching, operating and recovering space vehicles or payloads; payload services; operationally responsive space program services.
7-9-54.3	Deduction; gross receipts tax; wind and solar generation equipment; sales to governments.
7-9-54.4	Deduction; compensating tax; space-related test articles.
7-9-54.5	Deduction; compensating tax; test articles.
7-9-56.3	Deduction; gross receipts; trade-support company in a border zone.
7-9-57.2	Deduction; gross receipts tax; sale of software development services.
7-9-61.2	Deduction; receipts from sales to state-chartered credit unions.
7-9-73	Deduction; gross receipts tax; governmental gross receipts; sale of prosthetic devices.
7-9-73.1	Deduction; gross receipts; hospitals.
7-9-73.2	Deduction; gross receipts tax and governmental gross receipts tax; prescription drugs; oxygen.
7-9-77.1	Deduction; gross receipts tax; certain medical and health care services.
7-9-83	Deduction; gross receipts tax; jet fuel.
7-9-84	Deduction; compensating tax; jet fuel.
7-9-86	Deduction; gross receipts tax; sales to qualified film production company.
7-9-90	Deductions; gross receipts tax; sales of uranium hexafluoride and enrichment of uranium.
7-9-92	Deduction; gross receipts; sale of food at retail food store.
7-9-93	Deduction; gross receipts; certain receipts for services provided by health care practitioner.
7-9-94	Deduction; gross receipts; military transformational acquisition programs.
7-9-95	Deduction; gross receipts tax; sales of certain tangible personal property; limited period.
7-9-97	Deduction; gross receipts tax; receipts from certain purchases by or on behalf of the state.
7-9-98	Deduction; compensating tax; biomass-related equipment; biomass materials.
7-9-99	Deduction; gross receipts tax; sale of engineering, architectural and new facility construction services used in construction of certain public health care facilities.
7-9-100	Deduction; gross receipts tax; sale of construction equipment and construction materials used in new facility construction of a sole community provider hospital that is located in a federally designated health professional shortage area.
7-9-101	Deduction; gross receipts; equipment for certain electric transmission or storage facilities.
7-9-102	Deduction; compensating tax; equipment for certain electric transmission or storage facilities.
7-9-103	Deduction; gross receipts; services provided for certain electric transmission and storage facilities.
7-9-103.1	Deduction; gross receipts tax; converting electricity.
7-9-103.2	Deduction; gross receipts; electricity exchange.
7-9-104	Deduction; gross receipts; nonathletic special event at post-secondary educational institution.
7-9-105	Credit for penalty pursuant to Section 7-1-71.2 NMSA 1978.
7-9-106	Deduction; military construction services.
7-9-107	Deduction; gross receipts tax; production or staging of professional contests.
7-9-110.1	Deduction; gross receipts tax; locomotive engine fuel.
7-9-110.2	Deduction; compensating tax; locomotive engine fuel.
7-9-111	Deduction; gross receipts; hearing aids and vision aids and related services.
7-9-112	Deduction; gross receipts; solar energy systems.
7-9-114	Advanced energy deduction; gross receipts and compensating taxes.

FISCAL IMPLICATIONS

There may be no direct fiscal impact of the provisions of this bill. The bill provides for a civil penalty in the amount of the exemption or deduction not reported "in addition to other penalties provided by law." Since the amount of ***tax*** at issue is the amount of the exemption or deduction times a relevant tax rate, this level of penalty is roughly 14 times a conventional penalty. The first time such a penalty would be imposed would be for the July 2016 report for CY 2015. Experience with other civil penalties tied to an amount of deduction, not tax, indicate that these penalties are vigorously protested and generally reduced or abated after hearing. Some detail concerning administrative and compliance costs are discussed below.

SIGNIFICANT ISSUES

The approach to this complicated issue in the original SB 29 imposed substantial costs on the taxpaying public. In past years, the compliance costs to taxpayers reporting to New Mexico Taxation and Revenue Department (TRD) on the CRS-1 form were estimated at less than 2 percent of the taxes paid. Conventional accounting systems and programs can easily track gross receipts by location. However, conventional accounting systems are not easily adapted to track the multitudinous GRT deductions that are currently available. Compliance costs for the original bill could easily exceed 10 percent of taxes paid for small to medium-sized businesses with significant levels of deductions.

This substitute bill, however, provides for an ***annual*** reconciliation report. This will cut down on the costs to both taxpayers and TRD significantly, and improve the quality of the information substantially.

The reporting requirements in this legislation may provide better information regarding the cost of tax expenditures. Without reporting on the use of exemptions and deductions, estimates of the impacts of many tax expenditures retain a high level of uncertainty. Estimating the cost of tax expenditures is difficult. Confidentiality requirements surrounding certain taxpayer information create uncertainty, and analysts must frequently interpret third-party data sources. The statutory criteria for a tax expenditure may be ambiguous, further complicating the initial cost estimate of the expenditure's fiscal impact. Once a tax expenditure has been approved, information constraints continue to create challenges in tracking the real costs (and benefits) of tax expenditures.

The apparent reason for including some deductions and exemptions in the list and not including others is to require reporting for deductions and exemptions that were enacted after 2000. Also not requiring specific declaration of type 2 (resale of tangibles) Non-Taxable Transaction Certificates (NTTCs) will cut down the number of hand-entered deductions data by a factor of two. However, in general, complexity discourages compliance. Although complexity -- selecting 47 exemptions and deductions that will require reconciliation reporting -- generally degrades compliance, the judicious selection of exemptions and deductions requiring reconciliation reporting and the quite high level of civil penalty for non-filing, it is likely that the data when collected will be useful. The classic avoidance behavior for this type of requirement is for the taxpayer to make up data. The bill does not provide a penalty for inaccurate reporting, only non-filing.

Because the majority of deductions (primarily type-2 NTTCs) are not required to be reported and reconciled, TRD will have a difficult time determining non-filing and imposing the civil penalty. It will only be when a taxpayer is audited and the auditor determines that a deduction reconciliation report should have been filed that a penalty will be imposed.

Overall, this approach appears to have merit, but because of the difficulties noted in the previous two paragraphs, the data when obtained will be better than the current situation where virtually no data is obtained directly, but the data may not be sufficiently accurate to base conclusions and recommendations for retention, modification or repeal.

EDD discusses the costs and complexity of this bill:

> Provided that the process to require companies to separately state and itemize certain gross receipts and compensating tax deductions is streamlined sufficiently for the taxpayer, the annual reconciliation report template should allow for that data to roll up. The record keeping and reporting tasks by the taxpayer may raise costs to businesses, which leads to a creating a difficult climate in which to recruit and/or retain businesses to New Mexico. In addition, the legislature has provided for certain exemptions to Gross Receipts and Compensating Tax as incentives to attract and grow businesses in our targeted industry sectors. This will detract somewhat from those incentives as the additional costs by the taxpayer may somewhat offset the value of certain incentives.
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> Very few of the targeted industry sectors are exempted from this bill, which will make business recruitment more difficult when comparing New Mexico tax incentives to the other regional states offerings. Ultimately, a more comprehensive approach to reviewing and updating the entire tax structure for long term economic development improvement is preferably to a "patch quilt" approach to individual rule adjustments.

ADMINISTRATIVE IMPLICATIONS

TRD reports a moderate impact to implement this bill. The bill requires taxpayers who use certain tax expenditures to report them to TRD in a manner that would allow for the required reporting. Since this is an annual reporting requirement, this would have a moderate impact on TRD, both in recurring and non-recurring costs, whereas the original monthly filing requirement would impose a very high impact on TRD.

PERFORMANCE IMPLICATIONS

The apparent purpose of this bill is to fully support implementation of the Legislative Finance Committee's tax policy principles, with the exception of simplicity. However, the substitute bill seems to balance the legislature's valid need for information against costs imposed on TRD and on taxpayers.

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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Appendix A

The following are exemptions from the reporting requirement, including for **deductions** of receipts from:

- sale of tangible property or services for resale;
- sale of tangible property for leasing;
- lease for subsequent lease;
- sale of construction material and services to persons engaged in the construction business;
- lease of construction equipment to persons engaged in the construction business;
- sale or lease of real property and lease of manufactured homes;
- sale of tangible personal property to governmental agencies;
- sale of aerospace services for resale to the United States Air Force;
- transactions in interstate commerce;
- intrastate transportation and services in interstate commerce;
- internet services and hosting world wide web sites;
- sale of certain services to an out-of-state buyer;
- sales through world-wide-web sites;
- sales of livestock feed and fertilizers;
- warehousing, threshing, cleaning, growing, cultivating or harvesting agricultural products;
- selling tangible personal property to 501(c)(3) organizations;
- charges made in connection with the origination, making, or assumption of a loan or for handling loan payments;
- fifty percent of the receipts from selling agricultural implements, farm tractors, aircraft or vehicles that are not required to be registered under the Motor Vehicle Code;
- maintaining, refurbishing, remodeling or otherwise modifying a commercial or military carrier over ten thousand pounds gross landing weight;
- publishing newspapers or magazines;
- selling newspapers;
- selling chemicals or reagents;
- commissions on sales of tangible personal property which are not subject to the GRT;
- real estate commissions on that portion of the transaction subject to GRT;
- refunds and allowances made to buyers or amounts written off as an uncollectible debt;
- furnishing goods or services to the purchaser of tangible personal property to fulfill a warranty obligation;
- administrative, managerial, accounting and customer services performed by a business entity for an affiliate on a nonprofit or cost basis;
- rental or leasing of vehicles used in the transportation of passengers or property for hire in interstate commerce;
- the portion of a seller’s receipts represented by a trade-in of tangible personal property of the same type being sold;
- sale of property used in the manufacture of jewelry;
- selling the service of combining or processing components or materials to a person engaged in the manufacturing;
- travel agents’ receipts from commissions paid by maritime transportation companies and interstate airlines, railroads and passenger buses;
- resale of a manufactured home;
- leasing or licensing of theatrical and television films and tapes;
- 50 percent of the value of agricultural implements, farm tractors, aircraft (comp tax);
- receipts from payments by the US government for provision of medical and other health ser-

vices;
- use of tangible personal property for leasing;
- equipment and replacement parts to used enrich uranium in a uranium enrichment plant;
- up to two fundraising events annually by a 501(c) other than a 501(c)(3) organization;
- lottery retailer receipts;
- sales to certain accredited diplomats and missions;
- contributions of inventory to certain organizations and governmental agencies;
- receipts from performing management or investment advisory services for mutual funds, hedge funds or real estate investment trusts;
- veterinary medical services, medicine or medical supplies used in medical treatment of cattle;

The bill provides for exemptions from this reporting requirement, including for **exemptions** from GRT of receipts from:

- having a worldwide web site as a third-party content provider on a computer physically located in New Mexico but owned by another nonaffiliated person; and using a nonaffiliated third-party call center to accept and process telephone or electronic orders from out-of-state buyers;
- cash discounts allowed and taken;
- New Mexico GRT, GGRT, and leased vehicle GRT payable on transactions;
- taxes imposed pursuant to the provisions of any local option GRT payable on transactions;
- gross receipts or sales taxes imposed by an Indian nation, tribe or pueblo;
- any type of time-price differential;
- amounts received solely on behalf of another in a disclosed agency capacity;
- amounts received by a New Mexico florist from the sale of flowers, plants or other products made pursuant to orders placed with an out-of-state florist for filling and delivery in New Mexico by a New Mexico florist;
- sales by government agencies;
- services performed outside the state, the product of which is initially used in New Mexico;
- sales subject to GRT or other taxes (exempt from GGRT);
- use of property by government agencies and Indian nations (exempt from comp tax);
- use of property by organizations have been granted exemption from the federal income tax (exempt from comp tax);
- operation by nonprofit entities of facilities providing accommodations for retired elderly persons;
- wages, salaries, commissions or from any other form of remuneration for personal services;
- selling livestock and other agricultural products;
- food stamps;
- feeding or pasturing livestock;
- selling vehicles and boats subject to other tax;
- use of vehicles and boats subject to other tax (exempt from compensating tax);
- insurance premiums and earnings of bondsmen;
- dividends or interest from or sale of stocks, bonds or securities;
- selling using use gasoline, special fuel or alternative fuel;
- use by an individual of personal or household effects brought into the state (exempt from com tax);
- isolated or occasional sale of or leasing of property;
- organizations that have been granted exemption from the federal income tax;
- carrying on chamber of commerce, visitor bureau and convention bureau functions;
- resale activities of an armed forces instrumentality;

- sale of or leasing of oil, natural gas or mineral interests;
- products subject to Oil and Gas Emergency School Tax Act;
- refiners and persons subject to Natural Gas Processors Tax Act;
- natural resources subject to Resources Excise Tax Act;
- oil and gas consumed in the pipeline transportation of oil and gas products;
- use of oil and gas in the pipeline transportation of oil and gas products;
- use of electricity in the production, conversion and transmission of electricity;
- interstate and certain other telecommunications services;
- fees from social organizations;
- religious activities;
- sales by disabled street vendors; and
- officiating at New Mexico activities association-sanctioned school events.