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FISCAL IMPACT REPORT

ORIGINAL DATE 2/9/15

SPONSOR Armstrong LAST UPDATED 3/10/15 HB 275

SHORT TITLE Separate Reporting of Tax Expenditures SB _____

ANALYST Graeser

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY15	FY16	FY17	FY18	FY19		
	**	**	**	**	Recurring	General Fund
	**	**	**	**	Recurring	All other State and Local funds

(Parenthesis () indicate revenue decreases)

** While the intent of all separate reporting legislation is to allow the legislature and the public to have the specific information on costs and (with subsequent effort) benefits of – particularly – enacted economic development and other job creation legislation, EDD points out, because of lack of specificity, this bill could impose substantial economic and compliance burden on all taxpayers. There is no direct revenue impact from the provisions of this bill.

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

Estimated Additional Operating Budget Impact*				Recurring or Nonrecurring**	Fund(s) or Agency Affected
FY2015	FY2016	FY2017	FY 15-17		
0	\$500.0	\$500.0	\$1,000.0	Recurring	General Fund (TRD)
0	\$549.0	0	\$549.0	Nonrecurring	General Fund (TRD)

(Parenthesis () indicate expenditure decreases)

Note: this operating budget impact is significantly greater than that reported for HB 18, which required separate reporting for certain Gross Receipts and Compensating Tax deductions and exemptions, but not deductions, exemptions or credits allowed for the Income Tax Act or the Corporate Income Tax Act.

SOURCES OF INFORMATION

LFC Files

Responses Received From

Economic Development Department (EDD)
 Attorney General's Office (AGO)
 Department of Finance and Administration (DFA)
 Taxation and Revenue Department (TRD)

SUMMARY

Synopsis of Bill

House Bill 275 would require all taxpayers who reduce tax liabilities by taking advantage of a tax expenditure to separately report that tax expenditure to the Taxation and Revenue Department. The bill is not specific about what constitutes a tax expenditure. However TRD is instructed in the bill to promulgate regulations as to which tax expenditures would be affected by separate reporting.

FISCAL IMPLICATIONS

EDD notes the following: “Fiscal implications are unknown to EDD. The increased regulatory burden on businesses will reduce profits, thereby reducing revenues to the state both from the business and from its employees, who would be affected as well.”

Implementing this separate reporting for the Gross Receipts and Compensating Tax Act, the Income Tax Act and the Corporate Income and Franchise Tax Act exemptions, deductions and credits would be quite expensive.

SIGNIFICANT ISSUES

DFA notes that, “...the use of the term “tax expenditures” raises several issues that could potentially complicate the usefulness of this legislation. First, philosophical disagreement exists over how taxes ought to be structured and how to define the tax base. For example, an exemption or deduction for construction inputs may be viewed by one individual as an acceptable expenditure to prevent tax pyramiding, while another may view it as an industry subsidy. Defining what does and does not constitute a “tax expenditure” can be quite complicated and may result in costly litigation and compliance issues, as well as raise questions over the quality and accuracy of the reported amounts. Moreover, it is not clear from this legislation which entity would undertake the difficult task of defining which exemptions, deductions, credits and rate differentials constitute tax expenditures, though it would likely be TRD.”

TRD similarly notes, “Tax expenditures are not defined in the bill and can be subject to interpretation. Tax expenditures should be defined to include deductions, exemptions, and credits as defined by the Taxation and Revenue Department “2014 New Mexico Tax Expenditure Report” which is posted on the TRD website at http://realfile.tax.newmexico.gov/Final%20Report%20-%202015%20%2004_Final.pdf. Defining tax expenditure in this manner will increase the burden placed on taxpayers, as taxpayers will need to separately state each exemption, deduction, and credit. In particular with gross receipts and compensating tax, this bill will significantly increase the burden on both the taxpayer and the department as most of the deductions and credits available for these tax programs are not separately stated.”

As to the motivation for this bill, TRD explains it as follows: “This will provide better data for legislative impact reporting, assuming that the taxpayer reports correctly.”

Alternatively, DFA explains it as follows:

“An underlying assumption of a tax expenditure is that if it were to be repealed, all previously untaxed income would become taxed income. Taxpayers however often adjust be-

havior when incentives change and therefore estimates of foregone revenue from tax expenditures may not be accurate.”

All respondents agree that this legislation will substantially increase the burden on taxpayers. Taxpayers may not keep sufficient documentation to be able to report tax expenditures at the time of filing. Taxpayers who are currently exempt from a tax program are not required to file under current law. However, this legislation would require such taxpayers to calculate the tax liability they would have if not for the exemption.

This legislation would create a large administrative burden to TRD. TRD would need to create a form for each tax program listing all those deductions, exemptions, credits, rebates, and rate differentials deemed tax expenditures. The enactment of new tax expenditures would require revisions to forms and additional rulemaking, all adding to the administrative cost of this legislation.

LFC staff similarly note:

“While the ultimate impact of this bill is, presumably, to allow the governor, the Legislature and the general public to have sufficient information from which to judge whether a particular tax expenditure is accomplishing the purpose for which it was enacted, the provisions of this bill will probably cause more confusion than it will generate useful information. The bill uses a phrase that is subject to many differing interpretations:”

“...a person who reduces the person’s tax liability by using a tax expenditure approved by the department, pursuant to any provision of law to which the Tax Administration Act applies...”

A number of points should be made:

1. The legislature has enacted each tax expenditure, and the governor has signed these tax expenditures into laws that reduce the person’s tax liability. It is uncertain what “approved by the Department” is modifying. Is it the tax expenditure law or the deduction, exemption or credit that is claimed by the taxpayer to reduce liability?
2. What is a tax expenditure? Allowing an executive agency – even one as well-regarded as TRD – to make law in this regard by defining and selecting a list of exemptions, deductions and credits subject to separate reporting is counter to tradition.
3. Many exemptions serve to define the base, not primarily to reduce tax liabilities. For example, the GR&CTA provides exemptions for wages paid and interest received. These exemptions recognize that income of the type noted is properly taxed by the Income Tax Act. Imposing taxes pursuant to both the provisions of the Income Tax Act and GR&CTA would constitute somewhat gratuitous double taxation. This would be economically inefficient.
4. The GR&CTA provides that a person whose only income is covered by an exemption is not required to report that income or the exemption to the Department. Thus, there would be no way of requiring separate reporting of exempt income or the amount of the exemption.
5. Should TRD require personal income tax and corporate income taxpayers to report all of the same information on their state personal income tax and corporate income tax returns that are required on the federal tax returns? There are many passive tax expenditures, such as itemized deductions that are claimed explicitly on the federal return and implicitly on the state tax returns. The bill may allow TRD to require separate reporting of all of the claimed federal deductions on the state tax return. This would be a compliance and processing nightmare.

6. There is no penalty for failure to separately report at all and no penalty for failure to report accurately. The regulatory authority granted to TRD in the bill would not allow the Department to impose a penalty by regulation when that penalty is not explicitly provided in statute.
7. Once the data were obtained, it would only provide an estimate, once compiled, of the revenue costs of various tax expenditures. It would not generate, without subsequent and supplemental effort any idea if the tax expenditure had any benefits in terms of additional jobs or economic opportunities.

The effective date of the act is January 1, 2016.

PERFORMANCE IMPLICATIONS

Ultimately, having good information about the costs and benefits of certain energy and economic development tax incentives would improve the performance of the agencies charged with administering these programs. The agencies could make good recommendations to the Legislature and the governor concerning which tax expenditures to repeal, and which to retain or expand. EDD notes that its performance in recruiting new businesses and retaining existing businesses would improve with better information.

ADMINISTRATIVE IMPLICATIONS

None to EDD.

TRD reports a high administrative & compliance impact, requiring approximately 1,200 hours of reprogramming the various GenTax modules. The bill requires taxpayers who use certain tax expenditures to report them to TRD in a manner that would allow for the required reporting. This would have a very large impact on TRD, both in recurring and non-recurring costs.

The requirement to separately report tax expenditures requires the CRS-1 return to go from a short form to multiple full-page forms. This greatly affects the cost of processing paper returns. The current short form return can be scanned at high speeds at 1000 returns per hour. Moving to a full-page form slows the scanning to approximately 100 returns per hour. Additional lines of data will need to be keyed requiring additional manual intervention to process. Without new equipment purchases and additional FTE to speed processing, these delays will cause further delays in distributions of the gross-receipts, compensating and withholding tax collected to counties and municipalities.

2 to 3 new IBML scanners will be needed at the cost of \$183,000 each, and additional 6 – 10 FTE would be needed at the recurring cost of \$50,000 for each FTE.

The additional reporting requirements would add to the taxpayer's burden of paperwork requirements.

It is highly questionable whether audit and compliance would benefit from the additional information.

Increased e-filing and less paper return filings would mitigate this cost as the Department's equipment needs and FTE needs are significantly decreased with e-filed returns.

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

HB 18 of this session would require separate reporting of any deduction, exemption or credit in the GR&CTA. There are a number of exceptions to this general rule. In general, it is GR&CTA deductions enacted since the year 2000 that are generally selected for separate reporting. HB 18, however, does not required separate reporting of exemptions, deductions or credits applicable to the Income Tax Act or the Corporate Income and Franchise Tax Act or any other act administered under the provisions of the Tax Administration Act.

TECHNICAL ISSUES

The bill uses “person” without defining it. The bill would therefore apply to all taxpayers, pursuant to the Tax Administration Act.

The AGO suggest the following:

It may facilitate reader comprehension to use “its” in substitution for “the person’s” at p.4, line 8 and to insert “tax” before “expenditure” at p. 4, line 11. Providing a definition for “tax expenditure” would likewise facilitate reader comprehension.

EDD points out that the bill fails to define tax expenditure. Many deductions, exemptions or credits that reduce tax liability are not simultaneously considered by experts to be tax expenditures. Some of these provisions are in the code to define the tax base and accomplish other desirable feature of a good tax system, such as removing pyramiding or to avoid double taxation as a structural necessity of any tax system.

LFC staff note that the phrase on page 4, line 9 -- “approved by the Department” – is somewhat is not clear. Is the phrase modifying the tax expenditure law or the deduction, exemption or credit that is claimed by the taxpayer to reduce liability?

LFC staff also note the authority granted in the bill to allow TRD to determine the list of tax expenditures which must be separately stated may be overly broad.

LG/bb