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FISCAL IMPACT REPORT

ORIGINAL DATE 2/20/15

SPONSOR Harper LAST UPDATED 3/11/15 HB 421

SHORT TITLE Local Gov't Gross Receipts & Hold Harmless SB _____

ANALYST van Moorsel

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY15	FY16	FY17	FY18	FY19		
	Positive, potentially not significant.				Recurring	General Fund
	Negative, potentially not significant.				Recurring	Local Governments
See "Fiscal Implications"						

Parenthesis () indicate revenue decreases

Relates to SB 101, SB 266, SB 274, SB 555, SB 621, SB 633,

SOURCES OF INFORMATION

LFC Files

Responses Received From

Taxation and Revenue Department (TRD)

New Mexico Municipal League (NMML)

Department of Finance and Administration (DFA)

SUMMARY

Synopsis of Bill

House Bill 421 amends the provisions governing the phaseout of hold harmless payments to municipalities and counties and the local option hold harmless gross receipts tax rate authority. The bill defines a maximum distribution for municipalities and counties and adjusts this distribution based on either the local government's local option hold harmless GRT imposition or the hold harmless phaseout schedule in current law.

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

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- 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, imposed according to the allowable schedule (see below), 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. To be eligible for an excess distribution if its distribution plus the revenue pursuant to the 3/8 percent GRT increment falls short of the maximum distribution, the first increment must be imposed on or after July 1, 2013, 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.

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, imposed according to the allowable schedule (see below), is less than the maximum distribution, the distribution is increased by the difference.

The bill reduces the hold harmless GRT rate that counties may impose to 1/8 percent, implemented in 1/16th percent increments. To be eligible for an excess distribution if the county's distribution plus revenue pursuant to the 1/8th percent GRT increment falls short of the maximum distribution, the first increment must be imposed on or after July 1, 2013, and the second on or after July 1, 2022. The imposition of these tax increments is not subject to referendum.

The bill creates new sections of the Municipal Local Option Gross Receipts Taxes Act and the County Local Option Gross Receipts Taxes Act to prohibit local governments from pledging hold harmless GRT revenue for the payment of bonds. Revenue pledged prior to the effective date of this section is not affected.

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. The section provides that an ordinance not in compliance with this bill on or after January 1, 2016 is not valid. One exception is that if prior to the effective date of the sections prohibiting pledging the revenue to a bond a local government has issued a revenue bond and pledged hold harmless GRT revenue, the ordinance imposing the tax shall remain in effect until the ordinance expires or the revenue bond has been discharged.

The effective date of the sections governing the municipal and county distributions and their local option hold harmless GRT authority is January 1, 2016. The sections limiting the pledge of local option hold harmless GRT revenue to bonds is effective upon enactment of the legislation

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

FISCAL IMPLICATIONS

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

- 1) The bill 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 staff estimation is likely not significant, because very few local governments have enacted a hold harmless tax, and some have stated an intent not to. LFC staff estimate there is little will at the local level to increase taxes only to have the state take credit for the marginal revenue through a reduced distribution.
- 2) The bill takes credit for local government hold harmless GRT revenue in excess of the maximum distribution. The LFC staff 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 staff 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 law¹ and under the provisions proposed in the bill have a significant impact on the magnitude of both the general fund and the local government impact.

- 4) It is uncertain to what extent the provision prohibiting local governments from pledging local option hold harmless GRT revenue toward financing revenue bonds will influence local decision making prior to that section.

The LFC staff analysis was based on actual FY14 hold harmless distributions, grown for the forecast period at the rate of food and medical distributions assumed in the February consensus revenue estimate. The GRT increments were based on FY14 matched taxable gross receipts grown at the LFC staff estimate for growth in taxable gross receipts.

As noted above, the LFC staff analysis centered on the “large local governments²,” 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.

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.

Assuming all local governments (including Albuquerque) impose the first 1/8 percent GRT increment in FY16, the general fund distribution to large municipalities and counties would be reduced by \$51 million in FY16, by \$46 million in FY17, by \$37 million in FY18, and by \$28 million in FY19. 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.

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.

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 would decrease the positive impact to the general fund to \$37 million in FY16, \$34 million in FY17, \$28 million in FY18, and \$22 million in FY19. 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 staff estimate 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 harmless 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.

Finally, although the bill attempts to address some significant issues remaining from the 2013 legislation while maintaining a phaseout of the bulk of hold harmless payments, the bill would create a permanent distribution to local governments whose full hold harmless GRT imposition would fall short of the local government's maximum distribution. In 2013 the following local governments were estimated to meet these criteria: Silver City, Alamogordo, Espanola, Santa Fe, Roswell, Clovis, Gallup, Portales, Las Vegas, Las Cruces, Los Lunas, Deming, and McKinley County.

SIGNIFICANT ISSUES

The New Mexico Municipal League reports it supports the concept of the bill, adding that the bill would keep whole (compared with estimates of the pre-phaseout hold harmless distribution) those local governments who would not generate enough revenue with local option hold harmless GRT impositions.

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 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.

This bill aims to address these four issues:

- 1) limiting local rate authority to an aggregate 4/8 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.

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. Several other bills introduced in the 2015 session attempt to amend the hold harmless phaseout provisions imposed in Laws 2013, Ch. 160.

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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