FISCAL IMPACT REPORT

ORIGINAL DATE 02/14/16
SPONSOR Smith **LAST UPDATED** **HB**

SHORT TITLE Fine Art Sales Receipt and Revenue **SB** 226

ANALYST Keyes

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY16	**FY17**	**FY18**	**FY19**	**FY20**		
$0.0	($286.0)	($296.0)	($312.0)	$0.0	Recurring	General Fund
$0.0	($190.0)	($197.0)	($208.0)	$0.0	Recurring	Local Government
$0.0	$476.0	$493.0	$519.0	$0.0	Recurring	Cultural Affairs Department

Parenthesis ( ) indicate revenue decreases

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY16	FY17	FY18	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
Total	$0.0	$36.5	$0.0	$36.5	Nonrecurring	Taxation and Revenue Department

Parenthesis ( ) indicate expenditure decreases

SOURCES OF INFORMATION
LFC Files
City of Santa Fe

Responses Received From
Taxation and Revenue Department (TRD)
Department of Cultural Affairs (DCA)
Economic Development Department (EDD)

SUMMARY

SB 226 amends Section 7-1-14 NMSA 1978 to provide that, for a seller of fine art, the location from which the fine art is sold is considered a place of business, and all receipts from that sale are to be reported to that location. A new section is also added to the Tax Administration Act to provide a distribution, prior to July 1, 2019, to the Cultural Affairs Department in an amount equal to three and nine-tenths percent of the taxable gross receipts attributable to the sale of fine art by a person engaged in the business of selling fine art. SB 226 would become effective July 1, 2016. The sunset is stated for July 1, 2019.

FISCAL IMPLICATIONS

TRD has provided the following description of the methodology used for estimating the revenue impact:

This bill codifies, in statute, TRD's longstanding regulation of sourcing receipts from sales of tangible personal property to the seller's business location. (See: NMAC 3.1.4.13(A)(6).) This bill also creates a new distribution to the Cultural Affairs Department directly from the gross receipts tax. TRD does not track the sale of "fine art". In order to make a distribution as proposed, a specific reporting code will be needed to identify the receipts associated with the sale of fine art. In the absence of this information TRD used data from the NAICS code 45392 for Art Dealers to estimate the revenue impact. The average tax receipts from NAICS 45392 in 2014 and 2015 were about $752,000. The average state gross receipts tax (GRT) rate is 6.87%. The distribution to the Cultural Affairs Department of 3.9% of the taxable gross receipts is 57% of this average tax rate. The GRT growth rates from the January 2016 consensus revenue estimate were applied to estimate a distribution close to $500,000.

This bill may be counter to the LFC tax policy principle of adequacy, efficiency and equity. Due to the increasing cost of tax expenditures revenues may be insufficient to cover growing recurring appropriations.

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 economy of arts and culture in New Mexico is unique and large in comparison with other sectors of employment in the state. Broadly defined, artisan crafts, art purveyors, museums, and other arts businesses are larger than construction or manufacturing. Employment in arts and culture is prominent feature for New Mexico, employing one out of every 18 jobs. The University of New Mexico's Bureau of Business and Economic Research has provided an in-depth study of the economic impact of the arts on New Mexico: http://bber.unm.edu/media/publications/NM_CreativeEconomy_report_0814.pdf

The study has noted "the arts and cultural industries generate $137.1 million in revenues for state and local governments in New Mexico. Approximately two-thirds of the total is received by the state government as gross receipts taxes. …The total cost of cultural services to public agencies in New Mexico is $168 million. Most of the costs are borne by local/municipal governments... New Mexicans are, to a much greater extent than residents of other states, employed professionally as artists and artisans in galleries and museums, and in other activities and industries most closely associated with the creative aspects of arts and culture. Moreover, there are specific regions within New Mexico where the association with specific activities is truly extraordinary, such as galleries in Santa Fe and artisanship among the Native Nations."

SIGNIFICANT ISSUES

DCA has noted that existing law for most sales of goods, including art, applies gross receipts taxes at the point of sale.

They continue to state that this bill does not modify NMSA 1978, Section 7-9-55, which allows for deductions for transactions in interstate commerce from gross receipts to the extent that the imposition of the tax would be unlawful under the U.S. Constitution. It also does not modify Section 7-9-3, which defines "buying" and "selling" as "a transfer of property for consideration of the performance of service for consideration."

DCA has pointed out that as the bill does not specify a certain purpose for the use of the funds, they would likely be placed in the DCA Enterprise fund, which holds non-specified revenues in addition to admission fees, etc.

TRD has noted that this bill does not raise significant policy issues. It confirms a longstanding sourcing rule used by TRD for sales of tangible personal property and makes it apply directly to sales of fine art. The bill then directs that GRT earned by fine arts vendors be distributed directly to the Cultural Affairs Department, instead of the local jurisdiction or jurisdictions in which the seller's business is located.

Two technical issues with this bill that mostly effect administration and compliance – i.e. simplicity. First, and due to the complication of what would need to occur to implement this bill, significant taxpayer non-compliance could occur. This bill will require taxpayers to report a location code (the business premises) and designate specific gross receipts as sales of "fine art" because, unlike the vast majority of taxable transactions, these transactions will have to be reported based on the type of property sold.

Finally, the bill does not specify the pool of revenue from which the distribution to the Cultural Affairs Department is paid. The bill prescribes that 3.9 percent of the gross receipts is to be paid to the Cultural Affairs Department. However, the bill does not indicate whether the percentage is to come from the state portion of the combined rate, the local government portions of the combined rate, or a portion from both. The 3.9 percent rate strongly implies that the distribution would be made from the state revenues, but it is not clear on the face of the bill.

PERFORMANCE IMPLICATIONS

EDD has commented that while SB226 directs the distribution of revenues to the Cultural Affairs Department, the bill does not outline how the funds may be utilized. Questions raised include whether the funds will be in addition to the department's operating budget? EDD points out that the sponsor may consider requiring reporting on the utilization of the additional funds to determine impact and effectiveness.

The LFC tax policy of accountability is <u>not</u> met since TRD is <u>not</u> required in the bill to report annually to an interim legislative committee regarding the data compiled from the reports from taxpayers taking the deduction and other information to determine whether the deduction is meeting its purpose.

ADMINISTRATIVE IMPLICATIONS

TRD has stated that a new distribution to the Cultural Affairs Department will need to be setup. This requires changes to revenue distribution configuration and business objects. Additional reports may need to be changed to reflect this change. The Financial Distributions Bureau (FDB) staff will need to verify GenTax system changes by performing selected tests of data, functionality and reporting, prior to authorizing GenTax to move changes into production.

TRD would modify forms, instructions, and publications at no cost, as part of the semi-annual renewal of the tax program. Regulations will need to be promulgated and education for taxpayers and TRD personnel will need to occur.

This bill has a moderate impact on financial distribution business processes. Within the state's central accounting system (SHARE) a new accounts would need to be created by FDB staff to record the distribution of the Cultural Affairs Department. Total FDB administrative impact would be 40 hours or less.

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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