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

ORIGINAL DATE 02/24/17
SPONSOR Munoz **LAST UPDATED** **HB**

SHORT TITLE Gross Receipts On Sale Of Certain Foods **SB** 416

ANALYST Iglesias

REVENUE (dollars in thousands)

Estimated Revenue					R or NR **	Fund Affected
FY17	FY18	FY19	FY20	FY21		
$0.0	$19,355.0	$38,680.0	$38,690.0	$38,300.0	Recurring	General Fund
$0.0	$1,555.0	$3,400.0	$3,720.0	$4,070.0	Recurring	Counties
$0.0	$1,620.0	$4,190.0	$5,230.0	$6,450.0	Recurring	Municipalities

Parenthesis ( ) indicate expenditure decreases. ** R = recurring; NR = non-recurring

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY17	FY18	FY19	3 Year Total Cost	R or NR **	Fund Affected
Total	$0.0	$75.8	$75.8	$151.5	Recurring	General Fund (TRD)

Parenthesis ( ) indicate expenditure decreases. ** R = recurring; NR = non-recurring

Conflicts with SB441; relates to HB430 and SB5.

SOURCES OF INFORMATION
LFC Files

Responses Received From
Human Services Department (HSD)
Taxation and Revenue Department (TRD)

SUMMARY

Synopsis of Bill

Senate Bill 416 changes the definition of food qualifying for a deduction from gross receipts tax such to exclude foods with minimal-to-no nutritional value. Foods with "minimal-to-no nutritional value" are defined as sweetened beverages and prepackaged and non-prepackaged snacks stripped of essential nutrients and high in salt, saturated fat and sugar, including backed and fried good, candy, frozen desserts, pastries, pudding and gelatin-based desserts, snack chips and crisps, and sweets. Under this bill, the Taxation and Revenue Department will be responsible for promulgating the rule for provisions set forth in the bill. The effective date of this bill is January 1, 2018.

FISCAL IMPLICATIONS

Net effects of the bill are presented in the revenue table on page one. The table below shows gross effects of the changes, as well as changes to hold harmless distributions. The estimate does not assume any changes in consumption.

Estimated Revenue					**R or NR ****	**Fund Affected**
FY17	**FY18**	**FY19**	**FY20**	**FY21**		
$0.0	$10,100.0	$20,800.0	$21,400.0	$21,900.0	Recurring	General Fund (deduction)
$0.0	$3,400.0	$6,970.0	$7,180.0	$7,360.0	Recurring	Counties (deduction)
$0.0	$9,030.0	$18,500.0	$19,060.0	$19,560.0	Recurring	Municipalities (deduction)
$0.0	$9,255.0	$17,880.0	$17,290.0	$16,400.0	Recurring	General Fund (hold harmless)
$0.0	($1,845.0)	($3,570.0)	($3,460.0)	($3,290.0)	Recurring	Counties (hold harmless)
$0.0	($7,410.0)	($14,310.0)	($13,830.0)	($13,110.0)	Recurring	Municipalities (hold harmless)

Parenthesis ( ) indicate expenditure decreases. ** R = recurring; NR = non-recurring

The estimated fiscal impact uses data from a November 2016 report commissioned by the United State Department of Agriculture (USDA) titled, *Foods typically purchased by Supplemental Nutrition Assistance Program (SNAP) households*. The overall study found few significant differences between SNAP and non-SNAP households. Based on this study's findings, about 36 percent of all SNAP household food expenditures fall within the "minimal-to-no nutritional value" items outlined in this bill, and these items account for nearly 32 percent of all non-SNAP household food expenditures (see appendix for details).

Using these percentages, and applying them to NM population-weighted "food-at-home" averages from the Bureau of Labor Statistics, Consumer Expenditure Survey, LFC staff calculate that the average New Mexico household spends $1,275 a year on low-nutritional-value food items as defined by this bill, out of a total food expenditure of $3,836. These are 2015 statistics. FY18 estimates are adjusted to account for implementation mid-fiscal year. Estimates are also adjusted annually based on IHS Global Insight's projections for changes in the consumer price index for food.

Although roughly 33 percent of all food purchased would qualify as taxable under this bill, the bill does not alter the exemption for food purchased with SNAP EBT cards. Therefore, purchases of food items identified in this bill remain tax deductible when purchased using SNAP benefits. As of January 2017, data from USDA show approximately 25.6 percent of households in New Mexico receive SNAP benefits. The total estimates are adjusted accordingly to account for reduced revenue gains. It should be noted, however, SNAP recipients would still pay the tax on purchases of taxable food items if purchased using means other than a SNAP EBT card.

The total county and municipal tax rates and the hold harmless distribution rates were obtained from an RP500 based spreadsheet, which was built to calculate the impact of adjusting the hold harmless distributions.

SIGNIFICANT ISSUES

Under current law, receipts from qualifying food sales at retail food stores as defined under the federal SNAP program are deductible from gross receipts. Except for clear exclusions – such as alcoholic beverages, tobacco products, vitamins, and food to be eaten in the store – the SNAP approved food list is unrestricted.[1] The original legislation for the GRT food deduction enacted provisions to hold harmless the revenues of municipal and county governments from any lost revenue resulting from the deduction. Therefore, the state effectively has two tax expenditures: the lost revenue from not taxing food products, and the payments to municipalities and counties. The GRT deduction was originally enacted in 2004 and has not been amended. The hold harmless provision was originally enacted in 2004 and was amended in 2013 to phase out the distribution to larger counties and municipalities over a 15-year period.

By reinstating GRT for select food items, this bill would have the effect of generating revenues directly from the tax and indirectly through reduced hold harmless obligations. According to the Taxation and Revenue Department's 2016 Tax Expenditure Report, the GRT food deduction benefits consumers by reducing the costs of food; however, because of the hold harmless provision and the loss of revenue made up through other tax burdens, this reduction has significant cost to both the general fund and the taxpayers it benefits. In FY16, the cost of the GRT food deduction was $133.8 million and the cost of hold harmless payments reached $108.9 million.

As noted above, this bill does not alter the tax exemption for food purchased with SNAP benefits. The federal SNAP regulation, 7 CFR § 272.1, prohibits the taxation of "eligible foods" purchased with SNAP benefits, as defined in 7 CFR §271.2. Based on federal eligibility definitions, the "minimal-to-no nutritional value" food taxable under this bill would remain non-taxable if purchased with SNAP benefits. It does not appear this provision can be bypassed. Federal regulations provide that the United States Department of Agriculture Food and Nutrition Services may terminate the issuance of the SNAP benefits and disallow administrative funds otherwise payable pursuant to part 7 CFR § 277 in any State where such taxes are charged. The New Mexico Human Services Department (HSD) indicates that states across the country have previously submitted waivers to the USDA/FNS to restrict SNAP purchases; however, to date, such waiver applications have been denied.

If this bill were enacted each individual NM food vendor would need to re-program their current point-of-sale (POS) and grocer systems to identify the purchase of certain types and brands of food as taxable. Additionally, POS systems would need the capacity to charge tax on applicable food for non-SNAP customers without taxing customers using SNAP benefits.

TRD states the proposed new definition of food excluding minimal-to-no nutritional value is not tied to a defensible federal or state definition and is thus open to interpretation. Retail stores would need to uniquely identify foods by UPC code that either the store would self-identify or the state would need to provide a list. The dynamic nature of the food industry means that new

[1] List of eligible food items on the SNAP program: https://www.fns.usda.gov/snap/eligible-food-items

foods are constantly introduced to the consumer market thus the list would always be in flux. This leaves concern for how manageable maintenance of such a list would be in practice.

ADMINISTRATIVE IMPLICATIONS

The primary impact to TRD will be taxpayer education. This will be particularly difficult because the identified food items paid for with SNAP EBT cards will be tax exempt, but all other purchases of these food items will be taxable. Additionally, in some cases TRD will be responsible for determining the criteria upon which items do and do not qualify (see technical issues). These will be difficult lines to explain and equally difficult for food markets to program into their cash registers.

TRD states the department will need to hire 1.5 new full-time equivalent (FTE) employees. These FTEs are required for work to maintain the definition of food, update TRD publications and system processes, and maintain customer support for taxpayers.

Taxpayers will need assistance from TRD to clearly understand what may be taken as a deduction and to update their systems and business processes to properly meet the definition by January 1, 2018. The scope of what is required for taxpayers will need further research and understanding.

Since this bill creates specific types of taxable foods, it would create a burden on TRD concerning audits. The food categories are specific and would require auditors to gather extensive documentation to determine taxability. The specificity of the categories could require the auditors to audit down to specific ingredients of types of food. Without a defensible definition of taxable foods (see technical issues), auditors' reviews would be difficult.

CONFLICT AND RELATIONSHIP

This bill conflicts with Senate Bill 441, which also seeks to change the definition of food for the purposes of the gross receipts tax deduction.

House Bill 430 prohibits municipalities from imposing an excise tax on food. Senate Bill 5 restricts purchases under the federal supplemental nutrition assistance program (SNAP) to purchases of meat and qualifying foods under the special supplemental nutrition program for women, infants and children (WIC).

TECHNICAL ISSUES

On Page 2, lines 7-8, the bill defines "baked and fried goods" to include identified products that are "high in saturated fat or sugar." On Page 4, line 23, the bill defines "snack chips and crisps" to include identified items that are "high in sodium and fat." However, the bill does not define what "high" means. Since the bill designates TRD to promulgate the rules of this section, what then qualifies as high in saturated fat, sugar, and/or sodium would ultimately be up to TRD to determine.

Page 2, lines 5-8, defines "baked and fried goods" as "baked or fried dough, batter, mixes and decoration products such as cakes, cookies and pastries that are high in saturated fat or sugar." It is unclear whether this bill intends to remove only items that are already baked or fried from the tax deduction, or whether it also includes items that are made or packaged for the purpose of baking or frying (e.g. cake mixes, cookie dough, etc.). For the purpose of the revenue estimate above, LFC staff assume the definition covers only items that are already baked or fried.

Pages 3, lines 23-25, and page 4, lines 1-2, define "pastries" for the purpose of its inclusion as a food not eligible for the GRT deduction. This definition reads, *"<u>any mixed, baked or fried products made primarily but not exclusively from any form of flour</u>, sugar, artificial sweeteners, dairy, shortening, oil, butter, baking powder, nuts, fruits, eggs, jelly and other filling ingredients."* [emphasis added]. This language could mean all breads and tortillas qualify as pastries and as such would no longer qualify for the GRT deduction. Unless that is the bill's intent, consideration should be given to revising the definition of a pastry.

There is a typo on Page 3, line 3, in which it should be revised to read "…snack chips and <u>crisps</u>,…". On this same line, the word "sweetened beverages" is duplicated from Page 3, line 6, above.

According to TRD, the definitions included in the bill are ambiguous and unenforceable. For example, the verb "stripped" on page 3, line 7, suggests foods must have had nutrition that is taken away. Not all food has intrinsic nutrition, such as tapioca. There is also a subjective measure of foods high in salt, saturated fat and sugar. Litigation would result by food manufacturers concerning whether a product is a "snack," whether nutrition has been "stripped," what is "high in salt, saturated fat and sugar" and whether nutrients are "essential," for example.

OTHER SUBSTANTIVE ISSUES

The revenue estimates for this bill assume no changes in consumption due to the tax. However, impact of taxes on the prices consumers pay can affect what consumers eat and drink. Nevertheless, the size of this response varies. For example, consumers may find it easier to switch away from sugary drinks, which may have alternatives, than from other foods and drinks. Thus, taxes are an imprecise way to address many nutritional concerns. More research is needed to determine how taxes affect entire diets, how diets change over prolonged periods, and how responses vary across different groups of people. While taxing unhealthy food choices may narrow the price gap between healthy and unhealthy foods, in which unhealthy foods tend to be less expensive, imposing such a tax might affect the people less able to afford it. Although the SNAP benefit tax exemption might mitigate the impact on the poor, it limits the potential impact of higher sales taxes for these products on reductions in consumption.[2]

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

APPENDIX

[2] Chriqui et al., 2007, State Sales Tax Rates for Soft Drinks and Snacks Sold Through Grocery Stores and Vending Machines, *Journal of Public Health Policy, 29*(2), 226-249.

The following pages present information on other state's sales tax treatment of various food items, as well as relevant data from the USDA household food expenditure report referenced in the body above.

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Sales Tax Treatment of Groceries, Candy and Soda, As of January 1, 2012

State	State General Sales Tax	Grocery Treatment	Candy Treated as Groceries?	Soda Treated as Groceries?
Ala.	4.00%	Included in Base	Yes	Yes
Alaska	-	-	-	-
Ariz.	6.60%	Exempt	Yes	Yes
Ark.	6.00%	2.00%	Yes	Yes
Calif.	7.25%	Exempt	Yes	No
Colo.	2.90%	Exempt	No	No
Conn.	6.00%	Exempt	No	No
Del.	-	-	-	-
Fla.	6.00%	Exempt	No	No
Ga.	4.00%	Exempt	Yes	Yes
Hawaii	4.00%	Included in Base	Yes	Yes
Idaho	6.25%	Included in Base	Yes	Yes
Ill.	6.25%	1.00%	No	No
Ind.	7.00%	Exempt	No	No
Iowa	6.00%	Exempt	No	No
Kans.	6.30%	Included in Base	Yes	Yes
Ky.	6.00%	Exempt	No	No
La.	4.00%	Exempt	Yes	Yes
Maine	5.00%	Exempt	No	No
Md.	6.00%	Exempt	No	No
Mass.	6.25%	Exempt	Yes	Yes
Mich.	6.00%	Exempt	Yes	Yes
Minn.	6.875%	Exempt	No	No
Miss.	7.00%	Included in Base	Yes	Yes
Mo.	4.225%	1.23%	Yes	Yes
Mont.	-	-	-	-
Nebr.	5.50%	Exempt	Yes	Yes
Nev.	6.85%	Exempt	Yes	Yes
N.H.	-	-	-	-
N.J.	7.00%	Exempt	No	No
N.M.	5.13%	Exempt	Yes	Yes
N.Y.	4.00%	Exempt	No	No
N.C.	5.75%	Exempt	No	No
N.D.	5.00%	Exempt	No	No
Ohio	5.50%	Exempt	Yes	No
Okla.	4.50%	Included in Base	Yes	Yes
Ore.	-	-	-	-
Pa.	6.00%	Exempt	Yes	No
R.I.	7.00%	Exempt	No	No
S.C.	6.00%	Exempt	Yes	Yes
S.D.	4.00%	Included in Base	Yes	Yes
Tenn.	7.00%	5.50%	Yes	Yes
Tex.	6.25%	Exempt	No	No
Utah	5.95%	1.75%	Yes	Yes
Vt.	6.00%	Exempt	Yes	Yes
Va.	5.00%	2.50%	Yes	Yes
Wash.	6.50%	Exempt	Yes	No
W.Va.	6.00%	3.00%	Yes	No
Wis.	5.00%	Exempt	No	No
Wyo.	4.00%	Exempt	Yes	Yes
D.C.	6.00%	Exempt	Yes	No

Source: Tax Foundation, *Overreaching on Obesity: Governments Consider New Taxes on Soda and Candy* (Oct. 2011).

Tax Foundation
www.TaxFoundation.org

As of January 1, 2017, the Federation of Tax Administrators (FTA) reported 13 states that apply the state's sales tax to food, some of which apply a reduced sales tax rate, and some of which allow a rebate or income tax credit to compensate low-income households.[3] Only two of these states tax food at the full state sales tax rate with no rebate or income tax credit for low-income households. However, it appears 23 states put limitations on their tax exemptions for food:

State	**Items excluded from the state food tax exemption:**
Arizona	hot, cold, and frozen sandwiches
Colorado	carbonated water, chewing gum, candy, soft drinks, food to be eaten in the store, hot foods ready to eat, and hot/cold beverages served in unsealed cups through a vending machine
Connecticut	soft drinks, candy and confectionery, and food prepared or packaged for immediate consumption (most individual, single-serving packages of snacks including chips, pretzels, or cookies, are considered "meals" and are therefore subject to sales tax)
Florida	soft drinks and candy
Illinois	while grocery items are taxed at a reduced rate, the reduced rate does not apply to candy, soft drinks, carbonated water, mineral water, chewing gum, ice, and food prepared for immediate consumption
Indiana	soft drinks and candy
Iowa	soft drinks and candy
Kentucky	candy, soft drinks, carbonated water, mineral water, ice, chewing gum, prepared food, and food sole through vending machines
Maine	soft drinks, iced tea, water (includes mineral, bottled, and carbonated), ice, candy, and confectionery
Maryland	soft drinks and candy
Minnesota	soft drinks, candy, and food sold through vending machines
New Jersey	candy, confectionery, and carbonated soft drinks
New York	candy, confectionery, fruit drinks containing less than 70 percent natural fruit juice, soft drinks, and soda
North Carolina	soft drinks and candy
North Dakota	candy, gum, carbonated beverages, soft drinks containing less than 70 percent fruit juice, powdered drink mixes, coffee and coffee substitutes, tea, cocoa and cocoa products
Ohio	soft drinks
Rhode Island	soft drinks and candy
South Carolina	prepared food
Texas	carbonated and noncarbonated packaged soft drinks, diluted juices, ice, and candy
Washington	carbonated beverages, ice, bottled water, and savory bakery items (pizzas, quiche, sandwiches, etc.)
West Virginia	soft drinks
Wisconsin	soda and some snack foods
District of Columbia	soft drinks

[3] http://www.taxadmin.org/assets/docs/Research/Rates/sales.pdf

	SNAP Household Expenditures		Non-SNAP Household Expenditures	
	$ millions	% of total	$ millions	% of total
Sweetened Beverages				
Sweetened Beverages	$608.7	9.3%	$2,238.8	7.1%
Juices	$110.4	1.7%	$605.4	1.9%
Powder and crystal drink mix	$21.6	0.3%	$75.2	0.2%
Baked or Fried Goods/Pastries				
Toaster Pastries	$14.0	1.8%	$47.6	1.2%
Cereal Bars	$10.9	1.4%	$78.4	1.9%
Waffles/Pancakes/French Toast	$17.3	2.2%	$77.4	1.9%
Prepared desserts	$453.8	6.9%	$2,021.2	6.4%
Cookies	$78.2	1.2%	$408.3	1.3%
Cakes	$68.2	1.0%	$240.9	0.8%
Baked sweet goods	$57.5	0.9%	$159.6	0.5%
Candy/Sweets/Sugar/Sweetener				
Sugars/Sweeteners	$60.9	0.9%	$260.3	0.8%
Candy	$138.2	2.1%	$701.4	2.2%
Sweet goods	$32.5	0.5%	$152.9	0.5%
Frozen/Gelatin-Based Desserts				
Jams, jellies, preserves and other sweets	$29.1	0.4%	$117.5	0.4%
Ice cream, ice milk, sherbets	$86.0	1.3%	$481.8	1.5%
Snack Chips & Crisps				
Potato Chips	$64.4	1.0%	$253.2	0.8%
Tortilla/Nacho Chips	$47.4	0.7%	$209.0	0.7%
Multi-Pack Bag Snacks	$21.6	0.3%	$43.4	0.1%
Corn Chips	$9.1	1.2%	$45.6	1.1%
Crackers and misc baked food	$50.9	0.8%	$323.7	1.0%
Non-deductable food	**$1,980.7**	**35.8%**	**$8,541.6**	**32.3%**

Source: U.S. Department of Agriculture, *Foods Typically Purchased by Supplemental Nutrition Assistance Program (SNAP) Households,* November 2016.