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

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

SHORT TITLE Gross Receipts Food Definitions **SB** 441

ANALYST Iglesias

REVENUE (dollars in thousands)

Estimated Revenue					R or NR **	Fund Affected
FY17	FY18	FY19	FY20	FY21		
$0.0	$27,195.0	$54,190.0	$54,240.0	$53,670.0	Recurring	General Fund
$0.0	$2,185.0	$4,770.0	$5,210.0	$5,720.0	Recurring	Counties
$0.0	$2,275.0	$5,890.0	$7,330.0	$9,040.0	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	$50.5	$50.5	$101.0	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
Taxation and Revenue Department (TRD)
Human Services Department (HSD)

SUMMARY

Senate Bill 441 limits the definition of food qualifying for a deduction from gross receipts tax to food items approved by the department of health for the federal special supplemental nutrition program for women, infants, and children (WIC), as well as unprocessed meat, poultry and fish, and flour tortillas. [1] The provisions of this bill are effective January 1, 2018.

[1] For a list of WIC-eligible foods, see http://archive.nmwic.org/grocers/approved_grocer_list.php.

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	$14,200.0	$29,100.0	$30,000.0	$30,700.0	Recurring	General Fund (deduction)
$0.0	$4,775.0	$9,780.0	$10,060.0	$10,320.0	Recurring	Counties (deduction)
$0.0	$12,680.0	$25,970.0	$26,720.0	$27,410.0	Recurring	Municipalities (deduction)
$0.0	$12,995.0	$25,090.0	$24,240.0	$22,970.0	Recurring	General Fund (hold harmless)
$0.0	($2,590.0)	($5,010.0)	($4,850.0)	($4,600.0)	Recurring	Counties (hold harmless)
$0.0	($10,405.0)	($20,080.0)	($19,390.0)	($18,370.0)	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 50 percent of all foods purchased would qualify as taxable under this bill.

	SNAP Household Expenditures		Non-SNAP Household Expenditures	
	$ millions	% of total	$ millions	% of total
Meat, Poultry & Seafood	$1,262.9	19.2%	$5,016.3	15.9%
Vegetables	$473.4	7.2%	$2,873.9	9.1%
Cheese	$186.4	2.8%	$948.9	3.0%
Fruits	$308.2	4.7%	$2,271.2	7.2%
Milk	$232.7	3.5%	$1,211.0	3.8%
Baby food	$126.8	1.9%	$198.2	0.6%
Eggs	$73.8	1.1%	$388.2	1.2%
Beans	$38.3	0.6%	$234.5	0.7%
Juice	$43.5	0.7%	$269.0	0.9%
Baked breads	$163.7	2.5%	$874.8	2.8%
Soft Tortillas and Wraps	$23.7	0.4%	$113.1	0.4%
Cereal	$186.9	2.8%	$933.9	3.0%
Yogurt	$59.9	0.9%	$442.3	1.4%
Peanut Butter	$20.4	0.3%	$127.8	0.4%
Non-deductable food	**$ 3,442.6**	**48.6%**	**$ 17,437.1**	**50.5%**

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

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 $1,353 a year on taxable 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.

Notably, the revenue estimate is a conservative one. The USDA report used to gather data for the estimate does not classify some foods to a granular level such that a more accurate revenue estimate can be calculated. For example, the WIC food definition includes whole wheat and whole grain bread, but not other types of breads. The USDA report provides a food expenditure amount for baked breads, but not all variety of breads. Therefore, the estimate assumes all breads are tax deductible, wherein only a portion of those breads will actually qualify for the deduction. Therefore, the revenue estimate is smaller than it would be if only whole wheat and whole grain breads were considered. Such is also the case with estimates of cereal and juices, in which the USDA report data is broader than the WIC definitions, resulting in an underestimate of the potential revenue generated.

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.[2] 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.

The rationale for specifying flour tortillas in this bill is to address the issue that only whole-wheat tortillas are included in the WIC definition of qualifying foods. Thus, flour tortillas will continue to be non-taxed.

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

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, 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.

The responsibility of administering and tracking which foods are deductible from GRT will fall on the Taxation and Revenue Department (TRD) and individual retail stores. According to TRD, the nature of the WIC program and the current structure of retail sales in relationship to the WIC program make this new definition of food under Section 7-9-92 NMSA 1978 administratively difficult for retailers and TRD.

There are several fundamental differences between the SNAP and WIC programs. These factors directly impact the complexity of switching from food as allowed under SNAP to food as allowed under WIC. Due to the broad eligibility of food items under SNAP, this is a more manageable program for retail stores in terms of programming Universal Product Codes (UPC), which retailers uniquely assign to each trade item. However, since WIC serves a narrow population of pregnant or postpartum women, infants, and children up to age 5, the food allowed under this program focuses on the nutritional value of the food to supplement this population's diet. Retail stores have to program their systems to uniquely identify those foods that may be purchased under the WIC benefit.

WIC is a grant program and receives a finite budget each year which is then allocated to states. Because of the budget constraint, the New Mexico WIC program limits the brands and types of food under the major categories. For example, cheese that can only be purchased in block form is further limited by brand. More expensive brands are not approved by the New Mexico WIC program. This added brand restriction makes it challenging for both the WIC participant and the retailer. But for the retailer, this adds another layer of complexity in programming which UPC codes will be accepted by the WIC program. National retailers such as Kroger cannot have a nationwide WIC approved list unlike for SNAP foods, as each state modifies the WIC list to meet their program needs. Added to this complexity is that WIC approved foods may change each year due to federal nutrition and program guidelines and the New Mexico program adjusting to budget constraints.

TRD will need to establish a working relationship with the Department of Health and its WIC program to coordinate and maintain the definition of food for this deduction.

ADMINISTRATIVE IMPLICATIONS

The primary impact to TRD will be taxpayer education. This will be particularly difficult because items not meeting the definition of "food" for the purposes of this bill but paid for with SNAP EBT cards will be largely tax exempt, but all other purchases of these food items will be taxable. 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 one new full-time equivalent (FTE) employee. This FTE is required to work with the Department of Health 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.

CONFLICT AND RELATIONSHIP

This bill conflicts with Senate Bill 416, 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).

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.[3]

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

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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[3] 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.

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. [4] 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

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