FISCAL IMPACT REPORT

SPONSOR	Trujillo, JI / Trujillo, CA / Egolf	**ORIGINAL DATE** **LAST UPDATED**	5/24/17	**HB**	2/aHTRC
SHORT TITLE	Reserve fund, internet, hospitals, leg. retirement			**SB**	
				ANALYST	Clark/Iglesias

REVENUE (dollars in thousands)

Total Revenue by Fund: General Fund, County Supported Medicaid, Tax Stabilization Reserve

Estimated Revenue					R or NR **	Fund Affected
FY17	FY18	FY19	FY20	FY21		
$0.0	$117,400.0	$120,900.0	$111,111.9	$92,934.5	R	General Fund*
$0.0	$26,400.0	$26,400.0	$26,400.0	$26,400.0	R	County Supported Medicaid Fund
$0.0	$0.0	$0.0	$14,988.1	$39,465.5	R	Tax Stabilization Reserve

Parenthesis ( ) indicate expenditure decreases. ** R = recurring; NR = non-recurring
* The estimates assume $31.6 million for the internet sales section, which includes nearly $10 million of Amazon.com GRT revenue for the first half of FY18 – this is not a direct impact from the bill but instead represents a change since the consensus forecast directly related to the bill's effects

Total General Fund Revenue Sources by Bill Component

Estimated Revenue					R or NR **	Fund Affected
FY17	FY18	FY19	FY20	FY21		
$0.0	$31,600.0	$44,900.0	$46,700.0	$48,600.0	R	Internet Sales*
$0.0	$111,300.0	$101,500.0	$105,800.0	$110,200.0	R	Hospitals
$0.0	$900.0	$900.0	$900.0	$900.0	N	Legislative Retirement
$0.0	$0.0	$0.0	($14,988.1)	($39,465.5)	R	Rainy Day Fund

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

Internet Sales Gross Receipts Tax

Estimated Revenue					R or NR **	Fund Affected
FY17	FY18	FY19	FY20	FY21		
$0.0	$31,600.0	$44,900.0	$46,700.0	$48,600.0	R	General Fund*
$0.0	$14,400.0	$30,000.0	$31,200.0	$32,400.0	R	Local Governments

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

Hospital Tax Reform

Estimated Revenue					R or NR **	Fund Affected
FY17	FY18	FY19	FY20	FY21		
$0.0	$84,900.0	$75,100.0	$79,400.0	$83,800.0	R	General Fund
$0.0	$26,400.0	$26,400.0	$26,400.0	$26,400.0	R	County Supported Medicaid Fund

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

Legislative Retirement Fund

Estimated Revenue					R or NR **	Fund Affected
FY17	FY18	FY19	FY20	FY21		
$0.0	$900.0	$900.0	$0.0	$0.0	N	General Fund
$0.0	$0.0	$0.0	$900.0	$900.0	N	Judicial Retirement Funds

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

Rainy Day Fund

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY17	FY18	FY19	FY20	FY21		
$0.0	$0.0	$0.0	$14,988.1	$39,465.5	Recurring	Tax Stabilization Reserve
$0.0	$0.0	$0.0	($14,988.1)	($39,465.5)	Recurring	General Fund

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY17	FY18	FY19	3 Year Total Cost	R or NR **	Fund Affected
Total	Moderate Impact	Moderate Impact		Moderate Impact	Mostly Nonrecurring	Taxation and Revenue Department

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

The Taxation and Revenue Department likely will report a moderate impact to implement the hospital and internet tax reform provisions.

SOURCES OF INFORMATION

LFC Files

SUMMARY

Synopsis of HTRC Amendment

The House Taxation and Revenue Committee Amendment makes the five-year suspension of distributions to the legislative retirement fund conditional on determination by the Public Employees Retirement Association that the funded ratio remains at 100 percent or above. If the funded ratio falls below 100 percent, the monthly distribution to the legislative retirement fund would resume until the funded ratio rose to 100 percent.

Synopsis of Original Bill

House Bill 2 closes tax loopholes, generating revenue, and adds separate reporting requirements in a number of areas. Additionally, the bill transitions the tax stabilization reserve into a true rainy day fund for the state and smoothes out some oil and gas revenues. The bill's components are separated into five areas:

1. Closing the loophole and leveling the playing field to allow collection of gross receipts tax (GRT) on internet sales;
2. Attempting to level the playing field for hospitals by bringing all hospitals into the state GRT base and creating a universal hospital deduction;
3. Suspending monthly distributions to the legislative retirement fund for five years, sending the savings to the general fund for the first two years and to the judicial and magistrate retirement funds for the following three years, and clarifying the distributions are from receipts of oil and gas withholding;
4. Creating a true rainy day fund by distributing revenue in excess of an annual five-year average for the oil and gas emergency school tax to the tax stabilization reserve and repealing the taxpayers dividend fund, such that balances in the tax stabilization reserve may accumulate over time; and
5. Requiring separate reporting for certain GRT deductions, including sale of a service for resale, wind and solar generation equipment, hospital receipts, sale of prescription drugs, and manufacturing services.

The bill contains an emergency clause. The rainy day fund provisions take effect July 1, 2018. All other provisions take effect July 1, 2017 if the bill becomes effective on or before that date; otherwise, these provisions take effect the first day of the month following the effective date of the bill.

Internet Sales Gross Receipts Tax Provisions

- Imposes the regular gross receipts tax, including local option taxes, on remote sellers conducting sales activities via the worldwide web.
    - It does this by changing definitions to exclude any person without physical presence in the state and with less than $100 thousand in average gross receipts during the prior calendar year from gross receipts tax (GRT) and compensating tax liability. By specifically excluding those with less than $100 thousand in receipts, the bill therefore includes larger out-of-state sellers. The intent appears primarily to be to allow for collection of taxes from internet vendors.
    - The bill also includes in the definition of gross receipts third-party sales made over a multi-vendor marketplace platform that acts as the intermediary between the seller and purchaser. This captures third-party sales made through websites such as Amazon.com and eBay.
- Prohibits the Taxation and Revenue Department (TRD) from enforcing the collection of GRT for a tax period prior to July 1, 2017 if the person lacked physical presence in the state and did not report taxable gross receipts for the period.
- Defines out-of-state sales by entities without a physical presence in the state as taking place at the location to which the property or the product of a service is delivered. This would require the seller to collect and remit GRT increments to the local governments.
- Allows the refund of gross receipts tax to be applied against any compensating tax owed by that person's customer as a result of transactions with that person.

Hospital Tax Reform Provisions

- Brings nonprofit hospitals into the state GRT base, increasing state government revenue but minimizing the impact on hospitals by not subjecting them to local GRT rates.
- Brings governmental hospitals into the governmental gross receipts tax (GGRT) base and distributes this additional revenue to the general fund, again minimizing the impact on hospitals by not subjecting them to local GRT rates.
- Allows all hospitals a deduction of 60 percent of gross receipts in FY18 and 65 percent in subsequent years.
- Repeals the for-profit hospital tax credit of Section 7-9-96.1 NMSA 1978.
- Distributes $26.4 million annually to the county supported Medicaid fund to be used for Medicaid reimbursement, generating federal matching funds.

Suspension of Monthly Distributions to the Legislative Retirement Fund

- Identifies distributions to the legislative retirement fund as coming from the Oil and Gas Proceeds and Pass-Through Entity Withholding Tax Act (known colloquially as OGAS Withholding), in keeping with the original intent of the bill that ultimately created the retirement fund.
- Suspends for five years distributions to the fund (in current law of $75 thousand per month, or $900 thousand annually or an amount determined by the PERA actuaries based on the amount necessary to pay out the retirement benefits due under state legislator member coverage). Because the legislative retirement fund is overfunded, no distributions to the fund will be necessary during the forecast period.
- Distributes the suspended amounts to the general fund in FY18 and FY19; in FY20 through FY22, the distributions go to the underfunded judicial and magistrate retirement funds.

Rainy Day Fund Provisions

- The Pew Charitable Trusts, a nonpartisan research organization, supports the passage of this component of the bill and “believes this is a promising [component] that contains important best practices for rainy day fund saving.” Pew notes if it passed, New Mexico would join 15 states that deposit based off volatility and would become a leader at managing volatile oil and gas taxes.
- Actions the bill does and does not take as a result of these provisions:

DOES

- ✓ Capture windfalls from the oil and gas emergency school tax
- ✓ Create a “smoothing effect” on this revenue source
- ✓ Allow general fund revenue from the oil and gas emergency school tax to fluctuate and grow over time
- ✓ Allow balances to accumulate in the tax stabilization reserve by repealing the taxpayers dividend fund

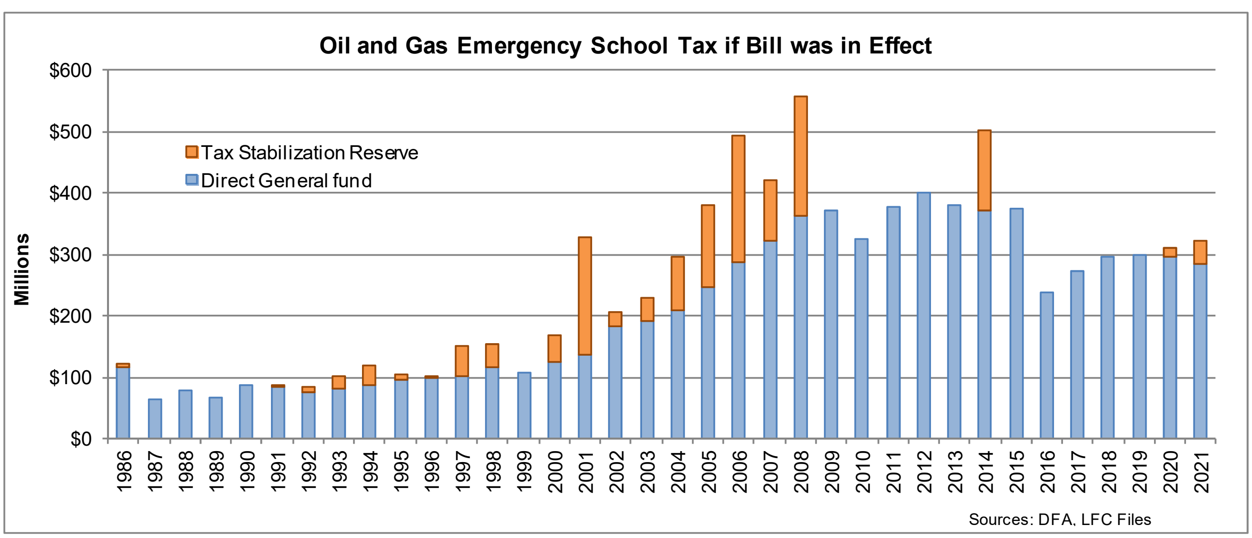
DOES NOT

- ✗ Change how funds are appropriated from the tax stabilization reserve
- ✗ Change or diminish legislative appropriation authority from the tax stabilization reserve
- ✗ Give the governor appropriation authority over these funds
- ✗ Reduce funding for schools
- ✗ Prevent the general fund from fluctuating and/or growing over time

- Does not impact schools -- while originally named the "oil and gas emergency school tax", this revenue source flows directly to the general fund and is not tied to education funding more than any other general fund revenue source.
- Distributes oil and gas emergency school tax revenues in excess of the previous five-year average, effectively capturing revenue windfalls from the oil and gas industry, which has a high degree of variability, and helping to stabilize oil and gas general fund revenues over time.
- Smoothes the oil and gas emergency school tax, currently one of New Mexico's four primary severance taxes, accounting for about 90 percent of the severance tax revenue the state general fund receives and about 4 percent of total general fund recurring revenues.
- Assumes no significant negative effects on the state budget due to the state's high reliance on the oil and gas industry and the tendency for the state's economy and state budget to do well in periods of strong oil and gas industry growth.
- The table and graph below demonstrate if similar legislation had been enacted in fiscal year 2007, about $365 million would have been distributed to the tax stabilization reserve by the end of FY16.

Distributions to Tax Stabilization Reserve if Previously Enacted

	School Tax (in thousands)		
FY	Revenue	Five-Year Average	Excess of Average
2007	$420,254.3	$341,317.3	$78,937.0
2008	$557,668.1	$397,718.1	$159,950.0
2009	$370,354.0	$446,151.4	$0.0
2010	$324,544.0	$437,680.7	$0.0
2011	$376,104.5	$417,315.6	$0.0
2012	$399,588.9	$408,845.1	$0.0
2013	$379,899.0	$390,490.0	$0.0
2014	$500,658.6	$374,780.8	$125,877.8
2015	$375,423.4	$406,660.1	$0.0
2016	$236,817.6	$394,226.8	$0.0
		Total to Tax Stabilization Reserve	$364,764.8



FISCAL IMPLICATIONS

Internet Sales Gross Receipts Tax Provisions

The estimated fiscal impact is particularly uncertain. These are highly imprecise figures and represent a conservative estimate of lost GRT revenues through such sales to compensate for the bill's exclusion of vendors who sell less than $100 thousand within the state each year. It is important to note there is not universal agreement this bill would not violate the U.S Supreme Court Quill decision (see "Significant Issues" for a detailed discussion), potentially placing these revenues in jeopardy if courts order the taxes refunded to taxpayers. LFC staff economists used a slightly different method from TRD economists to estimate the loss of GRT revenues through internet sales, taking the per capita amount of the national losses and then adjusting based on the state's population and differential in average real disposable income. TRD's methodology is presented below.

> Accurately estimating GRT revenue collections from sales by any internet-based retailer is extremely difficult, as there is a dearth of information that would allow for estimates without the application of numerous assumptions. For this estimate, the base was calculated using information from a representative sample of "internet-based retailers". TRD used publically available data from these companies' U.S. Securities and Exchange Commission (SEC) filings for 2015, which in turn, contained data on the entities' net sales and operating expenses in the U.S., North America, and other regions. Based on our analysis, gross sales in the U.S. were estimated at about $130 billion. TRD does not know which component of that base would be taxable or exempt under New Mexico's laws.
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> The gross U.S. sales estimate of $130 billion was then divided by the U.S. population (318.9 million) to come up with a "gross sales per capita" amount of $407. This amount is used as a proxy of the average annual dollar amount spent on purchases fulfilled by "internet-based retailers". Using New Mexico's estimated actual average GRT rate in FY2016 of 6.93 percent, a sale of $407 would generate a combined GRT revenue of $28.19 for the state and local governments. This amount is multiplied by a hypothetical percent of the population[1]. In this case, TRD assumed 25 percent of the population, or approximately 520,254 individuals in the state, would engage in such practice, henceforth producing an estimated $14.7 million of "internet-based retailer" GRT revenue.

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[1] New Mexico's population as of July 1, 2016 was estimated at 2,081,015 inhabitants, according to the U.S. Census Bureau's website located at http://www.census.gov/quickfacts/table/PST045216/35

Hospital Tax Reform Provisions

The table below shows the methodology used to estimate the fiscal impact of bringing all hospitals into the GRT base and applying the new universal hospital deduction.

60% Deduction FY18 Then 65% Deduction; No Local Change; Medicaid Match (in millions)								
		FY18		FY19		FY20		FY21
Non-Profit								
Gross Receipts*	$	2,128.8	$	2,218.3	$	2,311.4	$	2,408.5
Taxable Base After Deduction	$	851.5	$	776.4	$	809.0	$	843.0
State Impact (5.125%)	$	43.6	$	39.8	$	41.5	$	43.2
Government								
Gross Receipts*	$	2,493.0	$	2,597.7	$	2,706.8	$	2,820.5
Taxable Base After Deduction	$	997.2	$	909.2	$	947.4	$	987.2
State Impact (5%)	$	49.9	$	45.5	$	47.4	$	49.4
For-Profit								
Gross Receipts*	$	1,100.8	$	1,147.1	$	1,195.3	$	1,245.5
Taxable Base After Deduction	$	440.3	$	401.5	$	418.3	$	435.9
State Impact (4.05%)	$	17.8	$	16.3	$	16.9	$	17.7
New State Revenues	**$**	**111.3**	**$**	**101.5**	**$**	**105.8**	**$**	**110.2**
Medicaid Appropriation	$	26.4	$	26.4	$	26.4	$	26.4
Total General Fund Impact	**$**	**84.9**	**$**	**75.1**	**$**	**79.4**	**$**	**83.8**

* 2015-2016 cost report data plus 4.2% - 5% trend per year (minus 1.5% due to prior Medicaid rate cuts)

The net impact on hospitals should remain positive in the aggregate due to the federal match for Medicaid funds if the appropriation in the companion General Appropriation Act to use the $26.4 million for Medicaid reimbursement (contingent on passage of this bill) is enacted.

Suspension of Monthly Distributions to the Legislative Retirement Fund

Monthly distributions to the legislative retirement fund total $900 thousand per year ($75 thousand per month) or the amount necessary to make the required payment distributions. The bill suspends for five years distributions to the fund because the legislative retirement fund is overfunded, and no distributions to the fund will be necessary during the forecast period. The bill distributes the suspended amounts to the general fund in FY18 and FY19; in FY20 through FY22, the distributions go to the underfunded judicial and magistrate retirement funds in the respective amounts of $661.5 thousand and $238.5 thousand annually.

Rainy Day Fund Provisions

Using December 2016 consensus revenue estimates for the oil and gas emergency school tax revenues, if the Legislature were to establish this distribution effective the beginning of FY19 as proposed in the bill, the fund would build a balance of $54.5 million by the end of FY21. Due to current low oil and gas prices following previous periods of significant strength in the oil and gas industries, revenues are not expected to exceed the five-year average until FY20. This bill allows the tax stabilization reserve fund to further capture any significant future increases in the oil and gas industry in future years and would assist the state in shoring up deficits in periods of high need.

Distributions to Tax Stabilization Reserve if Enacted in FY19

	School Tax (in thousands)		
FY	Revenue (Dec 2016 CREG)	Five-Year Avg.	Excess of Avg.
2019	$299,100.0	$336,414.2	$0
2020	$311,100.0	$296,111.9	$14,988.1
2021	$322,700.0	$283,234.5	$39,465.5
	Total to Tax Stabilization Reserve		$54,453.6

All Provisions

This bill addresses the LFC tax policy principles of adequacy, efficiency, and equity. The increasing cost of tax expenditures has contributed to revenue problems, and the provisions of this bill may partially reduce some revenue leakage attributed either to loopholes or to shifts in commercial patterns.

SIGNIFICANT ISSUES

Internet Sales Gross Receipts Tax Provisions

The Association of Counties previously reported, "NMAC has a policy to support any legislation and tax reform efforts that improve economic efficiency, economic development, ease of administration, and overall fairness of the state and local tax system. It is essential that NMAC fully participates in legislative and executive efforts to restructure and reform the state and local tax system. Therefore, NMAC would support this bill to broaden the tax base and level the playing field with our local small businesses. We do have concerns as to how the tax would flow to local tax districts."

TRD previously provided the following analysis.

> The bill implicates several principles of tax policy. It addresses revenue adequacy by increasing revenues to the state and local governments. It addresses equity and "main street" fairness issues by eliminating the competitive tax disadvantage borne by local, in-state vendors. The bill would however, increase tax burdens borne by New Mexico citizens on purchases from certain remote vendors. In the current landscape, and because constitutional principles of "nexus" (physical presence) have expanded and loosened in the last five to 10 years, especially through judicial decisions, some internet or remote vendors are already subject to GRT. Others, however, are not.
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> As written, the bill facially challenges the US Supreme Court's decision in *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992). It begs resolution to two questions: (1) does the constitutional physical presence requirement apply to New Mexico's GRT; and (2) if so, whether the *Quill* decision should be reversed. The New Mexico Supreme Court applied the *Quill* decision in their decision in *N.M. Taxation & Revenue Dep't v. Barnesandnoble.com LLC* (2014). Once the department identifies a taxpayer as having no physical presence in the state, the department cannot tax that person. Other states do tax internet retail companies that do not have a traditional nexus with the taxing state, but their statutes do not use the term "without a physical presence." If the bill's purpose of amending the statute is to collect gross receipts taxes from persons that make a threshold amount of internet sales to New Mexico buyers, that goal can be accomplished by redefining what it means to engage in business in New Mexico, without using the term

"no physical presence". For example, "engaging in business in New Mexico includes out-of-state retailers who make more than X amount of sales to purchasers in New Mexico."

Section 7-1-29(C) NMSA 1978 is problematic because of a potential violation of confidentiality laws. The practical application of this is the bill would allow TRD to offset a refund of gross receipts tax paid from one taxpayer against the compensating tax liability of a different taxpayer. Unlike offsetting credits within the same tax program for the same taxpayer, the proposed amendment allows TRD to offset a refund of gross receipts taxes from one taxpayer against another taxpayer's compensating tax liability based only on a purchase which would have to be shared with the department by the seller in order to locate the correct account(s), at a minimum this would violate the confidentiality of both taxpayers.

The following analysis contains historical and technical details from the New Mexico Tax Research Institute related to internet taxation issues.

In 1992, the U.S. Supreme Court in the Quill case said that some physical presence was necessary for a state to assert a sales tax collection obligation on a person selling to purchasers in a state. There was no internet retail commerce in 1992. Fast forward, and the volume of dollars at issue is huge and growing. Budget woes and fairness concerns have focused attention on overturning Quill, which was the genesis of the Streamlined Sales and Use Tax Agreement and proposed federal legislation including the Marketplace Fairness Act.

Alabama, South Dakota and others have now enacted legislation designed to provide the basis for a challenge to Quill. Large internet sellers are responding, in many cases, by simply agreeing to begin paying tax.

One important development in the Direct Marketing Association (DMA) case affects New Mexico directly. In that case, the 10th Circuit Court of Appeals (our federal circuit) held that Quill was limited to sales and use tax reporting obligations exclusively. DMA filed a petition with the Supreme Court on another issue but chose not to appeal the question of whether Quill's physical presence limit applies to anything other than sales and use tax collection requirements. So in this circuit, at least, the issue is settled. Additionally, the Supreme Court recently declined to hear the DMA appeal. There is no longer any reason to assume that Quill applies to our gross receipts tax – which is substantially different from a sales tax collection obligation.

The legislative intent behind our gross receipts tax "engaging in business" statute has long been much broader than the physical presence requirement of Quill, but enforcement of the tax was constrained on the assumption that Quill applied. The Legislature can now provide clarification that, given all these developments, there is no longer any reason to make that assumption.

The approach in the proposed legislation amending the engaging in business statute could prove the fastest approach at improving voluntary compliance by remote sellers. It simply clarifies that it is now clear that Quill's limitation does not apply to the tax and, at the same time, provides an exception for a small business that has limited receipts and no physical presence. It further ensures that there will be no looking backward on unsuspecting taxpayers who may have assumed that Quill applied to the gross receipts tax.

Hospital Tax Reform Provisions

In 2004 and subsequent years, the Richardson administration enacted health care industry tax expenditures in excess of $80 million; however, the health care landscape changed significantly in the intervening years. The industry is one of a few bright spots in New Mexico for job growth, yet it remains largely untaxed, and hospitals remain completely untaxed at the state level. Fueled by the Affordable Care Act and Medicaid expansion, the industry would likely grow regardless of the tax expenditures in place, resulting in significant and perhaps unnecessary costs to the state. The revenue issue is exacerbated by the growing cost of the state's Medicaid payments. The changes proposed in these sections of the bill would generate about $111 million in new revenue for FY18 (with a July 1, 2017 effective date), all of the revenue going to the general fund except the $26.4 million annual distribution to the county supported Medicaid fund.

The bill would correct a decades-old inequity in which differing levels of tax are imposed for the same services delivered depending on the legal status of the hospital. The bill would subject 40 percent (35 percent after FY18) of gross receipts of for-profit, nonprofit, and government general hospitals and specialty hospitals to the gross receipts tax. Currently, the law only applies to for-profit facilities. Taxing nonprofit and government facilities would be a major step in applying the tax in an equitable manner.

Suspension of Monthly Distributions to the Legislative Retirement Fund

The only policy implication here is to clarify that distributions to the legislative retirement fund are from receipts from oil and gas withholding, which was the original intent when legislation was first drafted to create the retirement fund.

Rainy Day Fund Provisions

It should be noted this bill does not change how funds are appropriated from the tax stabilization reserve and does not change or diminish legislative appropriation authority. Under current law, money in the tax stabilization reserve may only be appropriated if (1) the governor declares it "necessary for the public peace, health and safety" and the legislature approves appropriation from the fund with a vote of two-thirds of both the House and Senate; or (2) if revenues are determined by the governor to be insufficient to meet authorized appropriations for the current and next fiscal year and the House and Senate approve a transfer to the general fund with a majority vote to cover the projected insufficiency for either or both fiscal years.

This bill repeals the taxpayers dividend fund, which has never been used, and instead allows balances to accumulate in the tax stabilization reserve. Under current law, it is difficult to use the tax stabilization reserve as a "rainy day fund". When the tax stabilization reserve balance reaches 6 percent of the previous fiscal year's recurring appropriations, state law requires the transfer of the excess funds to the taxpayers dividend fund.

ADMINISTRATIVE IMPLICATIONS

The Taxation and Revenue Department likely will report a moderate impact to implement the hospital and internet tax reform provisions.

TECHNICAL ISSUES

With regard to internet sales, TRD notes, "The proposed refund of GRT being applied to a compensating tax liability could lead to a significant decrease of GRT revenue distributions to local governments. Compensating tax only applies to the state jurisdiction (5 percent for services and 5.125 percent for sale of tangible personal property) and not the local government jurisdiction. The potential decrease in GRT revenue would affect distributions and could be severe enough as to cause an adverse event for small cities and counties that would prompt them to seek relief under Section 7-1-6.15 NMSA 1978 (HB-581 2015 Session).

Under current law, buyers of goods and services using the Internet from out-of-state vendors without a physical presence are subject to the corresponding compensating tax rate. If the bill becomes law, the state and local GRT assessed would exceed the equivalent compensating tax portion that would only have been assessed from the state jurisdiction for the same period. If the department refunds the GRT back to the seller once they prove they have no nexus in the state based on the $100 thousand gross receipts threshold, the seller would benefit from the total GRT rate differential when the buyer is subject to the compensating tax. For this reason, TRD proposes the bill is amended to deposit into an escrow account the proceeds of the difference between the GRT rate and the compensating tax rate differentials, until they are refunded to the taxpayer who is the buyer."

JC & DI/jle/al