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

SPONSOR Sharer **ORIGINAL DATE** 5/24/17 **LAST UPDATED** **HB**

SHORT TITLE Oil & Gas School Tax to Stabilization Reserve **SB** 7

ANALYST Iglesias

REVENUE (dollars in thousands)

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

Parenthesis ( ) indicate revenue decreases

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY17	FY18	FY19	3 Year Total Cost	Recurring or Nonrecurring	Fund/Agency Affected
Total	$21.0	$0.0	$0.0	$21.0	Nonrecurring	Taxation and Revenue Department (General Fund)

Parenthesis ( ) indicate expenditure decreases

SOURCES OF INFORMATION
LFC Files

SUMMARY

Senate Bill 7 distributes revenue in excess of an annual five-year average for the oil and gas emergency school tax to the tax stabilization reserve. The taxpayers dividend fund is also repealed, such that balances in the tax stabilization reserve may accumulate over time. The effective date of this bill is July 1, 2018, and there is no delayed repeal date.

This bill does not change how funds are appropriated from the tax stabilization reserve and does not change or diminish legislative appropriation authority. The bill still allows for fluctuation and growth in the general fund over time.

The Pew Charitable Trusts, a non-partisan research organization, supports the passage of this legislation and “believes this is a promising bill 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.

FISCAL IMPLICATIONS

It is important to clarify a few things this bill does and does not do:

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

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.

Distributing oil and gas emergency school tax revenues in excess of the previous five-year average would effectively capture revenue windfalls from the oil and gas industry, which has a high degree of variability, and would help to stabilize oil and gas general fund revenues over time.

Currently, the oil and gas emergency school tax is one of New Mexico's four primary severance taxes and accounts for about 90 percent of the severance tax revenue the state general fund receives and about 4 percent of total general fund recurring revenues.

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, this bill assumes the general fund is able to absorb distributions to the tax stabilization reserve without significant negative effects on the state budget.

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 draft legislation, 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.

Table 1. Distrib. to Tax Stabilization Reserve if Enacted in FY19

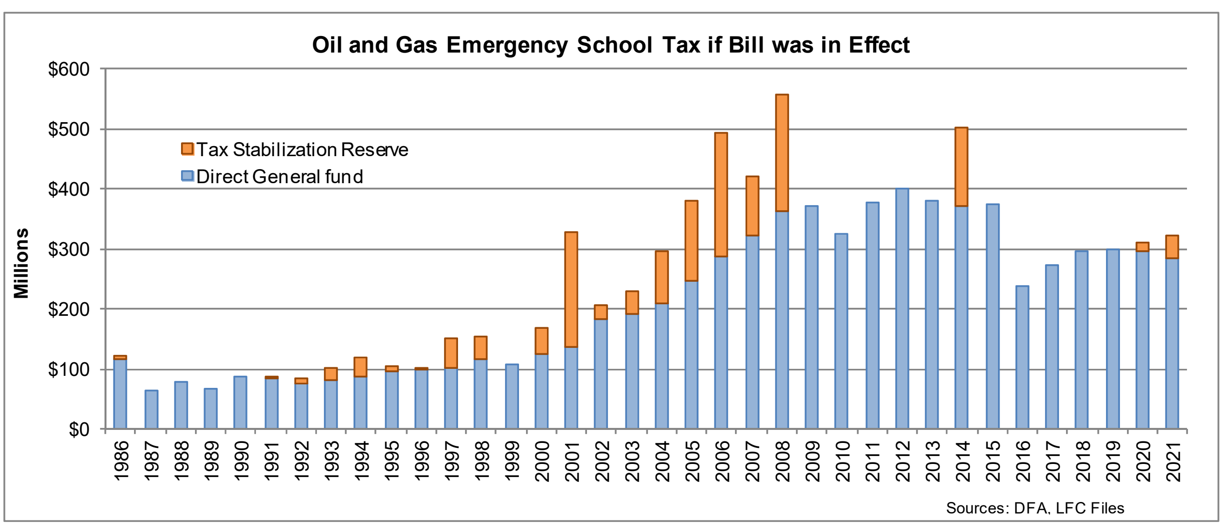
	School Tax (in thousands)		
FY	Revenue (Dec 2016 CREG)	Five-Year Avg.	Excess of Avg.
2019	$299,100.0	$336,414.2	$0
2020	$311,100.0	$296,111.9	$14,988.1
2021	$322,700.0	$283,234.5	$39,465.5
		Total to Tax Stabilization Reserve	$54,453.6

Table 2 below demonstrates 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 from oil and gas emergency school tax revenues in excess of the average of the five previous fiscal years. Assuming no previous withdrawals, the Legislature would have been able to utilize these funds to help address FY16 and FY17 solvency.

Table 2. Distrib. to Tax Stabilization Reserve if Previously Enacted in FY07

	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

To demonstrate the smoothing effect on oil and gas revenues received in state, the graph below illustrates the oil and gas school tax revenue that would have gone to the tax stabilization reserve if this bill had been enacted in 1986. As show below, general fund revenues from this tax would still have been allowed to grow; however, in periods where revenues spiked above the five-year average (e.g. period of high prices), those excess amounts would be transferred to the reserve. Thus, the general fund revenue from this tax, as indicated by the blue lines, reflect less volatility.



SIGNIFICANT ISSUES

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 seeks to repeal the taxpayers dividend fund, which has never been used, and instead allow 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

This bill will have a minimal impact on TRD (40 hours and no additional FTEs). The Financial Distributions Bureau (FDB) will need to verify and test ONGARD system changes and GenTax system changes with planned transition of ONGARD functionalities to GenTax, completing this work by June 15, 2018. FDB will modify SHARE distribution accounts as needed and work with DFA to complete changes in distributions. A further impact may need to be analyzed when the new severance tax functionality is implemented in GenTax. This upgrade is tentatively scheduled around the end of calendar year 2017 followed by a stabilization period of at least 6 months. Implementation requires changes to GenTax revenue processes and configuration.

TECHNICAL ISSUES

Language to consider adding:

> Section 3, (1): Insert "including advance payments" between "net receipts" and "from". This allows consistency with language in Section 7-1-6.20 NMSA 1978 and Section 7-1-6.23 NMSA 1978.

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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