FISCAL IMPACT REPORT

		ORIGINAL DATE	1/23/18		
SPONSOR	Gallegos, DY/Neville	**LAST UPDATED**	2/15/18	**HB**	79/aSFC/aSFl#1
SHORT TITLE	Thanksgiving Saturday Gross Receipts			**SB**	
				ANALYST	Graeser/Clark

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY18	**FY19**	**FY20**	**FY21**	**FY22**		
--	($1,700.0)	($1,800.0)	--	--	Recurring	General Fund
--	($1,200.0)	($1,250.0)	--	--	Recurring	Counties and Municipalities

Parenthesis ( ) indicate revenue decreases

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY18	FY19	FY20	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
Total	Moderate	Moderate	Moderate	Moderate	Recurring	TRD Admin

Parenthesis ( ) indicate expenditure decreases

SOURCES OF INFORMATION
LFC Files

Responses Received From (on original bill)
Taxation and Revenue Department (TRD)

SUMMARY

Synopsis of Senate Floor #1 Amendment

The Senate Floor #1 Amendment strikes the SFC amendment and then makes the same changes as the SFC amendment but also narrows the proposed deduction by excluding franchise businesses from eligibility for the deduction and changes the delayed repeal date to July 1, 2020.

Synopsis of SFC Amendment

The Senate Finance Committee amendment narrows the proposed deduction by significantly reducing the possible exploitation of loopholes and specifically targeting the bill to the types of products small, local retail shops are likely to sell to holiday shoppers. The amendment states that sales are only deductible by New Mexico-based businesses with 10 or fewer employees during the previous fiscal year, and it adds a $500 price cap for the sale of each item. It also imposes a delayed repeal date to allow the Legislature the opportunity to evaluate the effectiveness of the deduction.

The eligible items for the deduction include:
(a) clothing and footwear;
(b) accessories, including jewelry, handbags, book bags, backpacks, luggage, wallets, watches and similar items;
(c) sporting goods and camping equipment;
(d) tools used for home improvement, gardening and automotive maintenance and repair;
(e) books, journals, paper, writing instruments, art supplies, greeting cards and postcards;
(f) works of art;
(g) floral arrangements and indoor plants;
(h) cosmetics and personal grooming items;
(i) musical instruments;
(j) cookware and small home appliances for residential use;
(k) bedding, towels and bath accessories;
(l) furniture;
(m) a toy or game intended and designed to be used by children or families;
(n) a video game or video game console and any associated accessories; and
(o) home electronics such as computers, phones, tablets, stereo equipment and related electronics accessories.

Synopsis of Original Bill

House Bill 79 creates a gross receipts tax (GRT) deduction for all retail sales occurring on "Small Business Saturday", which is the Saturday after Thanksgiving each year. All retail sales of tangible personal property made on that day, if sold at an establishment employing fewer than 25 employees, would be deductible. These deductions would be reported separately to TRD and the department would be required to report annually the costs and benefits of the deduction. The stated purpose of the bill is "to increase sales at small local businesses."

The effective date of this bill is July 1, 2018. There is no repeal date. LFC suggests all tax expenditures be reviewed for effectiveness periodically and recommends adding a delayed repeal date.

FISCAL IMPLICATIONS

SFC Amendment
The impact of the amended bill is much smaller, starting at a general fund cost of $1.7 million in FY19 and gradually growing over time, and the benefit is much more likely to be felt by the local shops and customers that appeared to be the intended beneficiaries of the bill. The amended bill also reduces local government revenues by about $1.2 million annually. As with all new tax expenditures, there remains the possibility for future misuse and exploitation of this deduction, but the language in the amendment significantly reduces that possibility. Without aggressive auditing by TRD, probably the greatest chance for exploitation would be shops claiming sales occurred on that day that might have occurred any other day of the month – just as with the back-to-school GRT deduction where the actual cost is unknown.

Original Bill

TRD estimates that the fiscal impact of this bill will be:

Estimated Revenue Impact*					R or NR**	Fund(s) Affected
FY2018	FY2019	FY2020	FY2021	FY2022		
--	($5,000)	($5,500)	($6,000)	($6,600)	R	State General Fund
--	($4,000)	($4,400)	($4,900)	($5,400)	R	Local Governments

The TRD estimate assumes the following:

- Taxable gross receipts in the retail sector were $1 billion in November 2017.
- Half of all retail receipts would be reported by businesses with fewer than 25 employees.
- One third of total monthly receipts are attributable to "Small Business Saturday" sales.
- The share of receipts attributable to tangible property is assumed to be greater than half.
- The impacts are expected to grow rapidly as taxpayers learn to plan around this deduction.

LFC has also built a model of the impact of this bill, assuming the potential loopholes are removed through an amendment. LFC's model assumes the following:

- Total November retail and wholesale taxable sales have averaged about $1.2 billion for the last five years. Largely because of competition from the internet, November sales from 2011 through 2016 fell by 0.6 percent per year. However, November 2017 were 13 percent greater than November 2016 sales. LFC staff use 1.2 billion as the base and hold total sales constant over the five years of the estimate.
- The number of selling days from Thanksgiving Day to the end of the month have traditionally been statistically significant. This effect seems to have moderated. In fact, there is currently no statistical difference between October and November daily sales.
- Despite the lack of statistical evidence of a Black Friday and Small Business Saturday sales bump, LFC staff assume that Small Business Saturday sales have averaged four times the average daily sales in November.
- From a document published by the Department of Workforce Solutions, LFC staff estimate that 33 percent of retail employment is in establishments employing fewer than 25 employees.
- LFC staff also assume a price elasticity of -1 and percentage reductions in price attributable to the deduction of 4.14 percent for the state and 3.3 percent for the local governments.
- Sales and impacts are expected to grow over time at 3.5 percent annually – roughly twice the national inflation rate.

This bill creates significant tax planning opportunities. As drafted, companies could exploit potential loopholes involving the requirement for 25 or fewer employees and types of transactions that were not seemingly intended by the bill. Because of these loopholes, the deduction could end up reducing general fund revenues by significant amounts.

LFC staff recommend placing a cap of $500 or less on each qualifying item and specifically identifying the types of items that may qualify – the list of items currently deductible under the back-to-school GRT deduction could be useful, either to replicate or to use as a starting point. Setting types of qualifying products would help substantially in preventing possible exploitation of this deduction by companies in a variety of industries. In addition, many retail stores already have systems in place to account for sales of items deductible under the back-to-school deduction, so using the same list or with very minor changes could make administering this at the retail shop level much easier.

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

SIGNIFICANT ISSUES

The purpose of the deduction provided by this section is to increase sales at small local retail businesses. Perhaps a more effective means of stimulating sales at bricks and mortar retail stores may be to impose and collect gross receipts taxes from competing Internet retailers, as this could encourage more local shopping year-round.

The New Mexico Tax Research Institute reports, "Tax holidays in general tend to represent exceptionally poor tax policy, in that they rarely further the espoused purpose, add complication, and cost money."

<u>Original Bill</u>
The Taxation and Revenue Department (TRD) points out that the bill creates numerous tax planning opportunities because of the somewhat arbitrary parameters for the eligible sellers and the timing of the sales. For example, it would be possible for a taxpayer to split their operations in order for the separate entities to be eligible. Also, the lack of definition of "sale at retail" creates planning opportunities. Such planning increases the likelihood that the tax expenditure would not achieve its intended purpose, or would do so at a higher-than desirable cost to the state.

PERFORMANCE IMPLICATIONS

The LFC tax policy of accountability may be met since TRD is 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. However, in the 2016 edition of the TRD Tax Expenditure Report, the Department reports that there is no penalty in statute for not separately reporting deductions, such as the back-to-school deduction. Thus, the information provided to the department is underreported and the costs reported in the tax expenditure report are considered at the lowest level of reliability. This deduction would probably face the same reporting unreliability problem.

ADMINISTRATIVE IMPLICATIONS

TRD notes a moderate administrative impact. "Because of the relatively large number of potential claimants of the deduction, and the need to monitor eligibility of the seller and the timing of the sales, the proposal would impose moderate administrative costs on the Department's Audit and Compliance and Revenue Processing Divisions. The bill imposes reporting requirements on the Department for which the Department has no available resources. The bill would also have a moderate impact on the Information Technology Division because a new code would need to be created and tested to accommodate the required separate reporting."

TECHNICAL ISSUES

Original Bill
TRD points out two technical issues, "…a definition of "sale at retail" should be added to the legislation. The definition should clarify whether the term refers to "brick & mortar" stores only, or if it also refers to online sales." (See note below on constitutional commerce clause issues.) Also, "… the Department also recommends that the term "fiscal year" be defined in order to avoid confusion by taxpayers that report on a calendar year-basis. Additionally, the Department recommends that the term "employees" be defined to specify whether part-time employees and/or contractors are considered under the definition. Small businesses that use the accrual accounting method may choose to invoice most sales on the first Saturday after Thanksgiving. If the intent of the law is to allow the deduction for sales that occur during this Saturday only, then the Department recommends that sales be defined as sales of tangible personal property where payment is received on the first Saturday after Thanksgiving."

This bill does not contain a delayed repeal date. LFC recommends adding a delayed repeal date.

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

This bill does not appear to meet any of the five core LFC tax policy principles.

Does the bill meet the Legislative Finance Committee tax expenditure policy principles?
1. **Vetted**: The proposed new or expanded tax expenditure was vetted through interim legislative committees, such as LFC and the Revenue Stabilization and Tax Policy Committee, to review fiscal, legal, and general policy parameters.
2. **Targeted**: The tax expenditure has a clearly stated purpose, long-term goals, and measurable annual targets designed to mark progress toward the goals.
3. **Transparent**: The tax expenditure requires at least annual reporting by the recipients, the Taxation and Revenue Department, and other relevant agencies.
4. **Accountable**: The required reporting allows for analysis by members of the public to determine progress toward annual targets and determination of effectiveness and efficiency. The tax expenditure is set to expire unless legislative action is taken to review the tax expenditure and extend the expiration date.
5. **Effective**: The tax expenditure fulfills the stated purpose. If the tax expenditure is designed to alter behavior – for example, economic development incentives intended to increase economic growth – there are indicators the recipients would not have performed the desired actions "but for" the existence of the tax expenditure.
6. **Efficient:** The tax expenditure is the most cost-effective way to achieve the desired results.

This bill does not appear to meet any of the core LFC tax expenditure policy principles except transparency, since separate reporting is required.

LG/sb/al/JC/