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

		ORIGINAL DATE	1/26/18		
SPONSOR	HTRC	**LAST UPDATED**	2/01/18	**HB**	CS/194/HTRC
SHORT TITLE	Alternative Evidence for Tax Deductions			**SB**	
				ANALYST	Clark

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY18	**FY19**	**FY20**	**FY21**	**FY22**		
No Impact	Unknown, Possibly Minimal Impact				Recurring	General Fund
No Impact	Unknown, Possibly Minimal Impact				Recurring	Local Governments

Parenthesis ( ) indicate revenue decreases

SOURCES OF INFORMATION
LFC Files

Responses Received From
None

SUMMARY

Synopsis of Bill

The House Taxation and Revenue Committee Substitute for House Bill 194 significantly changes requirements to take deductions currently permitted through use of nontaxable transaction certificates (NTTCs), allowing alternative evidence to be presented by the taxpayer in situations where there is no NTTC available. Alternative evidence includes:

(1) invoices or contracts that identify the nature of the transaction;

(2) documentation as to the purchaser's use or disposition of the property or service;

(3) a statement from the purchaser indicating that the purchaser sold or intends to resell the property or service purchased from the seller, either by itself or in combination with other property or services, in the ordinary course of business. The statement from the purchaser shall include:

(a) the seller's name;
(b) the date of the invoice or date of the transaction;
(c) the invoice number or a copy of the invoice;
(d) a copy of the purchase order, if available;
(e) the amount of purchase; and
(f) a description of the property or service purchased or leased; or

(4) other evidence that demonstrates the facts necessary to establish entitlement to the deduction or specified by department rule or instruction.

This bill contains an emergency clause and would become effective immediately upon signature by the governor.

FISCAL IMPLICATIONS

In response to a similar bill, the Taxation and Revenue Department (TRD) reported, "The bill would make significant changes affecting the department's process for validating claims for deduction under the gross receipts tax (GRT). However, TRD will still be able to require that taxpayers provide adequate evidence to justify a deduction, so the net impact on revenues may be small."

Additionally, Richard Anklam, director of the New Mexico Tax Research Institute (NMTRI), provided the following fiscal impact analysis.

> So, as you know I'm no real economist and don't want to pretend to be real revenue estimator. I'm also not naïve enough to believe that just because NTTC money is "dirty", that it isn't real. The short answer to the question as to why I think any workable elimination of the form over substance "gotcha" provisions would result in negative fiscal impacts is that this is simply a resource reallocation issue.
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> First, the proposal at hand is not retroactive, meaning existing matters in dispute are un-impacted.
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> Second, going forward, the audit resources currently used on gotcha audits will simply be redeployed on other productive audits. And now, I really am speaking from my own experience. I outperformed the "gotcha" auditors every year, without doing gotcha audits. Others did also. So, rather than having auditors do less productive gotcha audits, we could simply have them do more productive audits that grow the compliance base.
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> But I think the fiscal impact could even be positive. How could the fiscal impact be positive? Two ways (direct and indirect). First, if properly redeployed, audits can improve voluntary compliance through taxpayer education. If I audit, assess, and bring into compliance a Texas-based oil service provider, New Mexico contractor, out of state R&D service provider, etc., we get money on the collected tax. We also typically get ongoing compliance, and not just from that taxpayer, but others related too. With gotcha audits you're assessing stuff that isn't in your tax base to begin with, so there is no future growth, education, etc. You're profiting on someone's inability to deal with your bureaucracy and red tape 100 percent effectively (since we designed it that way, it will stay that way).

> Second and more indirectly, there's a long held tenant of tax policy administration that suggests in a voluntary system, compliance is maximized through not just ease of administration and education, but it's also predicated on confidence in the system. Gotcha audits on top of aggressive position reversals and other features of bad administration only reinforce the notion that one should not hand over their money – at least not a penny more than you have to – for fear of never getting it back. This actually reduces collections, and makes administration more expensive. That's becoming a bigger problem. It's not easy to quantify, but simply directing existing audit resources from activities that improve real compliance to those that rely on taxpayer mistake and don't otherwise improve or expand the base of compliant taxpayers.

SIGNIFICANT ISSUES

The concept presented in this bill can be considered good tax policy, because tax professionals report New Mexico currently has the most stringent NTTC laws in the country. The statute can result in unexpected tax liabilities for taxpayers in cases where the legislative intent would otherwise seem to clearly indicate the transaction should be nontaxable. Issues such as this with a state's tax code can create hardships when money was not budgeted or available to pay this unexpected tax. Additionally, this hardship can occur through no fault of the taxpayer, such as the inability to get a promised NTTC from a company that closes, leaves the state, or for other reasons does not prepare and send the NTTC within the timeframe required for the taxpayer.

As a result of the potential for these unexpected hardships and the strict NTTC requirements, the existing law might act as an impediment to business and be viewed as over-regulation, in addition to the compliance issue discussed in Fiscal Implications. This could have the effect of reducing to some degree business done in New Mexico, acting as a slight drag on general fund revenues. The opposing fiscal impact from existing law is that the unexpected tax liabilities if an NTTC cannot be produced would generate more revenue if the liabilities are able to be paid. However, this would conflict with the LFC tax policy principles of equity and simplicity. This bill would ease the regulatory burden and better align with LFC tax policy principles.

In response to a similar bill, TRD provided the following analysis.

> This bill addresses a longstanding area of dispute between TRD and certain taxpayers. Current law generally requires a taxpayer to possess an appropriate NTTC to be eligible for a deduction. A taxpayer who is not in possession of an NTTC when audited is not eligible for a deduction even if the economic substance of the transaction suggests that it may be eligible. Some taxpayers argue that the NTTC requirements are a triumph of "form over substance," resulting in punitive assessments. On the other hand, when a taxpayer qualifies for the NTTC, the audit process is streamlined significantly, which can reduce recordkeeping and other burdens of audits. In addition, the requirement to apply to TRD for eligibility to issue NTTCs has been a strong incentive for taxpayers to register and become compliant with the tax system. TRD views the NTTC system as a critical component of its processes for insuring compliance with the Gross Receipts Tax.

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

JC/jle