FISCAL IMPACT REPORT

SPONSOR Trujillo, J/Herrera **ORIGINAL DATE** 2/6/19 **LAST UPDATED** 3/9/19 **HB** 411

SHORT TITLE Local Gov't Tax Distribution Definitions **SB**

ANALYST Clark

REVENUE (dollars in thousands)

Estimated Revenue*					Recurring or Nonrecurring	Fund Affected
FY19	**FY20**	**FY21**	**FY22**	**FY23**		
$0	($2,000.0) to ($4,000.0)	($2,000.0) to ($4,000.0)	($2,000.0) to ($4,000.0)	($2,000.0) to ($4,000.0)	Recurring	General Fund
$0	$2,000.0 to $4,000.0	$2,000.0 to $4,000.0	$2,000.0 to $4,000.0	$2,000.0 to $4,000.0	Recurring	Local Governments

Parenthesis ( ) indicate revenue decreases

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY19	FY20	FY21	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
Total	$52.5	$0.0	$0	$52.5	Recurring	Taxation and Revenue Department

Parenthesis ( ) indicate expenditure decreases

Duplicates SB 396

SOURCES OF INFORMATION
LFC Files

Responses Received From
Department of Finance and Administration (DFA)
Taxation and Revenue Department (TRD)

SUMMARY

Synopsis of Bill

House Bill 411 amends Section 7-1-6.15 NMSA 1978 to change the calculation of the "average distribution or transfer amount" for local option gross receipts tax (GRT) distribution adjustments to a municipality or county. It changes the distribution from an annual average to an average monthly amount.

The effective date of this bill is July 1, 2019.

FISCAL IMPLICATIONS

The Taxation and Revenue Department (TRD) provided the following fiscal impact analysis for a similar bill from the 2017 session, but additional analysis by TRD and LFC shows the average annual impact would likely be millions of dollars. The estimates shown in the table are in the middle of the range of estimates; it could be less, but it could be significantly greater if large taxpayers make significant amendments to tax filings.

TRD estimated the fiscal impact of the bill using actual distribution amounts of GRT revenue since HB581 (2015) became effective on July 1, 2015. TRD staff created a simulation using the proposed distribution method in the bill by changing the calculation from the annual average to a monthly average and compared the results with the actual amounts seen under current law. The results of the simulation show that, if the proposed bill had been in effect, there would be an increase to 26 cases from three cases under current law. A case is defined as the occurrence in which GRT revenue from all prior periods is less than zero and the absolute value of the negative amount is greater than $100 (see detailed methodology in Other Substantive Issues for further explanation). This means after applying the rules as described in Section 7-1-6.15 NMSA 1978 to the entire universe of accounts since July 1, 2015, the bill would increase the amounts deemed as “unrecoverable” by TRD from $2,931 to $107,097. Unrecoverable amounts are negative amounts that are outside the statute of limitations and any amounts that exceed 50 percent of the average monthly distribution under the proposed bill. However, the proposed bill also would increase the amounts deemed as “repayable” by the local governments from $61,812 to $928,718.

TRD estimated the annual cost to the general fund and the benefit to the local government from the increase in the unrecoverable amount of $69,444. This amount was grown to estimate the impact for fiscal years 2018 through 2021 using the estimated GRT growth rates for those years as published by the consensus revenue estimating group (CREG) in December 2016. The increase in the “repayable” amount is a benefit to the local governments as they are afforded the opportunity to make an agreement with the state to repay the revenue in installments or immediately. This temporarily increases the amount they will receive and affords them more time to repay the debt. This causes a delay in when the state receives the revenue, depending on the agreement made with each local government. This mechanism does not permanently reduce the general fund.

There are two significant items to note with respect to the estimated impact. First, TRD has indicated a “minimum.” Cases since the effective date of HB581 have involved relatively small dollar amounts. Impacts from large tax filers amending returns for prior periods could change the anticipated outcome and fiscal impact significantly and result in much larger general fund losses.

Second, there may be instances in which the impact to the general fund may be positive, depending on the circumstances that result in the prior periods going negative. As noted above, because the bill loosens the threshold for relief, it also loosens the threshold for repayments from local governments. In situations where prior period negatives result from a taxpayer reporting in a city when it should have been reporting in an unincorporated county, there may be positive general fund impacts.

SIGNIFICANT ISSUES

TRD notes this bill makes a further adjustment to Section 7-1-6.15 NMSA 1978 (HB581, 2015), which was enacted in response to a lawsuit filed by Eunice. The statute provides relief to local governments in situations where their GRT revenue distribution is severely impacted due to significant adjustments to taxes owed resulting from multi-year assessments or taxpayer amended returns. Under current law, two things must occur for local governments to qualify for relief. First, the adjustments must cause the aggregate tax amounts from prior periods to go negative. Second, that negative amount must be greater than 20 percent of the local government's annual average distribution.

HB 581 established procedures that allow TRD to adjust local government distributions under most circumstances but protect municipalities and counties from fiscally catastrophic adjustments. In situations where TRD proposes major changes to prior distributions, the unadjusted distribution would be transferred immediately (but temporarily) with a notice that the municipality or county must contact the department and negotiate how repayment of the over-distribution would be made.

TRD also notes current law provides relief in the types of situations contemplated in the original Eunice lawsuit where taxpayer amendments severely impacted expected revenues. This proposed bill, by switching from 20 percent of the average annual distribution to 20 percent of the average monthly distribution, expands the burden on the general fund to reimburse local governments that meet the requirements for marginal changes in expected revenues. In short, it acts as another form of hold harmless, by which the general fund indemnifies local governments in cases of much more moderate misreporting. TRD acknowledges the bill could have a marginal but positive effect on the general fund if the reason for taxpayers to amend their returns is to correct the application of an erroneous "location code". In other words, if the taxpayer inadvertently filed their returns for a location within city boundaries, but the business is located outside of city boundaries, the amended returns would likely have a positive fiscal impact on the general fund via the GRT rate differential between the city rate and the remainder of county rate.

ADMINISTRATIVE IMPLICATIONS

TRD reports the bill would have a moderate impact on the department's Financial Distribution Bureau (FDB) as it would require changes in the GenTax software system. FDB will need to verify GenTax system changes by performing selected tests of data, functionality, reporting, and especially of the operating transfer to the Department of Finance and Administration. To ensure accuracy that updates in GenTax have been performed satisfactorily before the changes are made permanent, FDB would need to do a distribution simulation. No additional FTE are required.

The bill would also have a moderate impact on the Information Technology Department (ITD) of approximately 400 work-hours with a one-time estimated cost of $128 thousand ($28 thousand for state resources and $100 thousand for contractual services of FAST Enterprises as the service provider of GenTax).

Considering the effort that would be required if the proposed legislation becomes law, ITD reports it would need an estimated 2.5 months to implement and the effective date of the bill does not provide enough time for ITD to perform the implementation. ITD recommends amending the bill to include an effective date of January 1, 2018. As written, if the bill is passed and signed within 30 days, that would leave two months before the presumed effective date.

DUPLICATION

This bill duplicates SB396.

OTHER SUBSTANTIVE ISSUES

TRD provided the following explanation of current eligibility for relief under Section 7-1-6.15 NMSA 1978.

Two predicate requirements must be satisfied before a municipality or county is entitled to relief. First, the returns processed for the current month's distribution must result in the amounts reported for all tax periods prior to the current month going negative. This would happen, for example, if taxpayers amended returns to claim additional deductions or received refunds based on over-reporting for prior tax periods.

Second, the dollar amount (absolute value) of the negative amount from the prior periods has to exceed the greater of either $100 or 20 percent over the distribution. Under statute, the average distribution is an annual average, not a monthly average. Section 7-1-6.15(J)(3). If, for example, the local government received distributions of $10 thousand each month, the average distribution is $120 thousand and relief would not be triggered unless the negative amount from the prior periods exceeded $24 thousand.

When these two predicate requirements for relief are satisfied, HB581 provides very specific forms of relief. First, any negative amounts from prior periods that are older than three calendar years prior to the current calendar year are not recoverable by TRD (Section 7-1-6.15(B)(1) NMSA 1978). Second, TRD then evaluates the remaining negative amounts, once those unrecoverable amounts are eliminated.

If the dollar value (absolute value) of the remaining negative prior period amount does not exceed the greater of $100 or 20 percent of the city's/county's average distribution, the remaining negative amount is used to offset the current month's distribution (Section 7-1-6.15(B)(1) & (2) NMSA 1978). If, in contrast, the remaining negative amount exceeds the greater of $100 or 20 percent of the average distribution, TRD is required to notify the city or county, allow the city 90 days to enter a payment agreement, and may recover the negative amounts from the city or county (Section 7-16.15(B)(2) & (E) NMSA 1978). However, TRD may not recover any negative amounts that exceed 50 percent of the city's average distribution (Section 7-1-6.15(E)(2)(a) NMSA 1978). Additionally, the TRD secretary may waive portions of the amount TRD may recover with State Board of Finance approval (Section 7-1-6.15(E)(2)(b) 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

JC/sb