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

ORIGINAL DATE 2/28/19
SPONSOR Munoz **LAST UPDATED** 3/12/19 **HB**

SHORT TITLE Dept. of Defense Satellite Gross Receipts **SB** 425

ANALYST Clark

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY19	FY20	FY21	FY22	FY23		
NFI	NFI	($1,000.0) to ($1,750.0)	($2,000.0) to ($3,500.0)	($2,000.0) to ($3,500.0)	Recurring	General Fund
NFI	NFI	($1,000.0) to ($1,750.0)	($2,000.0) to ($3,500.0)	($2,000.0) to ($3,500.0)	Recurring	Local Governments

Parenthesis ( ) indicate revenue decreases

SOURCES OF INFORMATION
LFC Files

Responses Received From
Economic Development Department (EDD)
Taxation and Revenue Department (TRD)

SUMMARY

Synopsis of Bill

Senate Bill 425 extends the year through which the existing gross receipts tax (GRT) deduction is effective for certain directed energy and satellite receipts. Currently, the deduction may be taken prior to January 1, 2021, and this bill extends that to January 1, 2031. The bill makes no other changes.

This deduction allows a qualified contractor to deduct from GRT receipts from the sale of qualified research and development services and qualified directed energy and satellite-related inputs when sold pursuant to a contract with the United States Department of Defense.

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

FISCAL IMPLICATIONS

No data from the Taxation and Revenue Department (TRD) is available to estimate the cost of this deduction because fewer than three taxpayers took the credit in FY16, the latest data shown in reports from TRD, and in most cases the agency cannot release data unless aggregated to at least three taxpayers. Absent direct reporting of the gross receipts tax amounts deducted by the two taxpayers involved, estimates must be used based on imperfect, available data.

LFC staff estimated the fiscal impacts using data available on operations and employment related to directed energy and satellite research by federal contractors in New Mexico along with data supplied to staff when the bill that created the deduction in 2015 was being considered. That analysis noted the following:

> EDD reports in its analysis of the bill that the Air Force Research Laboratory at Kirtland Air Force Base is the primary purchaser of directed energy and satellite research and development services with a procurement budget of approximately $700 million, approximately 65 percent of which is currently spent out of state. EDD notes that of the $245 million spent in New Mexico, approximately 70 percent ($171.5 million) would qualify for the deduction.

The estimates for FY21 are half the value of the estimates shown for subsequent fiscal years because the deduction is currently scheduled to sunset halfway through FY21, and the impacts shown represent the cost of extending the sunset.

This bill may be counter to the LFC tax policy principles 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 benefits) of tax expenditures.

SIGNIFICANT ISSUES

EDD reports the bill would have a significant impact in retaining existing businesses and recruiting new ones in the field, as well as retaining the existing workforce in the field that is exiting employment with the federal government or government contractors due to spending cuts.

This bill narrows the gross receipts tax (GRT) base. Many of the efforts over the last few years to reform New Mexico's taxes focused on broadening the GRT base and lowering the rates. Narrowing the base leads to continually rising GRT rates, increasing volatility in the state's largest general fund revenue source. Higher rates compound tax pyramiding issues and force consumers and businesses to pay higher taxes on all other purchases without an exemption, deduction, or credit.

PERFORMANCE IMPLICATIONS

EDD reports the deduction would have a substantial impact on EDD's and the New Mexico Partnership's retention and recruiting performance.

The LFC tax policy of accountability is met on paper with the existing statutory requirement for TRD and EDD to report annually to LFC on this deduction and its effectiveness; however, *accountability is not met* due to no reporting on the cost of the deduction, the effectiveness, and whether it is meeting its intended purpose. The only reporting provided by TRD in the most recent annual tax expenditure report was that fewer than three taxpayers claimed it in FY16.

OTHER SUBSTANTIVE ISSUES

EDD provided the following analysis.

> By extending the deadline and continuing a more competitive environment for government contracts in directed energy and satellite technology, the deduction will continue to boost employment and allow for recruiting for foreign firms in the field. This increase will continue to have a substantial positive revenue impact, the exact amount of which EDD is unable to accurately estimate. What is clear is that the positive revenue impact from increased employment in the absence of the deduction would more than offset the fiscal impact of gross receipts tax revenue over the last decade. In 2004, Boeing moved its Airborne Laser Program Integration and Test activity from New Mexico to California. The activity lasted for six years and cost $1.36 billion in labor, goods, and services. Boeing made $668 million in purchases in California rather than New Mexico. In other words, the gross receipts tax revenue from Boeing's purchases of goods for this program alone would have more than offset the revenue loss to the general fund had the deduction been in law in 2004.
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> In addition, Boeing spent $689 million on labor for 230 jobs in the program relocated from New Mexico. Boeing moved its Advanced Tactical Laser program integration and testing facility from New Mexico to Florida in 2008. Seventeen high-technology jobs, equal to $5 million in labor costs, and $600,000 in material purchases and subcontracts were expended in Florida over a year, rather than New Mexico. In 2010, Boeing relocated its High Energy Laser Technology Demonstrator program integration and testing from New Mexico to Alabama. Eighteen high-technology jobs, equal to $5.5 million in labor costs, and $1.4 million in material purchases and subcontracts were expended in Alabama over two years, rather than New Mexico.

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

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.

LFC Tax Expenditure Policy Principle	Met?	Comments
Vetted	✘	
Targeted		
Clearly stated purpose	✓	
Long-term goals	✘	
Measurable targets	✘	
Transparent	✘	
Accountable		
Public analysis	✘	
Expiration date	✓	
Effective		
Fulfills stated purpose	?	
Passes "but for" test	?	
Efficient	?	
Key: ✓ Met ✘ Not Met ? Unclear		

JC/al