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FISCAL IMPACT REPORT

ORIGINAL DATE 3/7/19
SPONSOR Ingle/Smith **LAST UPDATED** **HB**

SHORT TITLE Locomotive Fuel Gross Receipts & Road Fund **SB** 487

ANALYST Graeser

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Non-Rec	Fund Affected
FY19	FY20	FY21	FY22	FY23		
	(46,810.0)	(47,920.0)	(48,910.0)	0.0	NR	General Fund - Motor Vehicle Excise
	46,810.0	47,920.0	48,910.0	0.0	NR	State Road Fund -Motor Vehicle Excise
	18,560.0	19,230.0	19,900.0	20,570.0	Recurring	State Road Fund - GRT & Compensating Tax on Locomotive Fuel
	4,920.0	5,110.0	5,300.0	5,490.0	Recurring	Counties and Municipalities - GRT on Locomotive Fuel*
	(5,500.0)	(5,690.0)	(5,880.0)	(6,100.0)	Recurring	General Fund - GRT & Compensating Tax on Locomotive Fuel*
	1,930.0	1,990.0	2,060.0	2,130.0	Recurring	Small Cities Assistance Fund - Compensating Tax on Locomotive Fuel
	1,280.0	1,330.0	1,370.0	1,420.0	Recurring	Small Counties Assistance Fund - Compensating Tax on Locomotive Fuel
	920.0	950.0	980.0	1,020.0	Recurring	Muni Equivalent -- Comp Tax on Loco Fuel
	22,110.0	22,920.0	23,730.0	24,530.0		**TOTAL IMPACT**

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						

Parenthesis ( ) indicate expenditure decreases

SOURCES OF INFORMATION
LFC Files

Responses Received From
Taxation and Revenue Department (TRD)
Department of Transportation (NMDOT)

SUMMARY

Synopsis of Bill

Senate Bill 487 repeals the Gross Receipts Tax (GRT) and compensating tax deductions for locomotive fuel. Under current law. the deductions apply to all fuel loaded or used by a locomotive carrier that on or after July 1, 2011, made a capital investment of $100 million or more in new construction or renovations at the railroad locomotive refueling facility in which the fuel is loaded or used or on or after July 1, 2012, made a capital investment of $50 million or more in new railroad infrastructure improvements, including railroad facilities, track, signals and supporting railroad network.

The bill distributes the net receipts attributable to the GRT and the compensating tax on the sale of locomotive fuel to the state road fund.

SB487 distributes over a period of three fiscal years 33 percent of the motor vehicle excise tax (MVET) revenue to the state road fund, and the remaining 67 percent to the general fund.

The new MVET distribution to the State Road Fund would start in FY 2020, and would sunset in FY 2023. In FY 2023, the State Road Fund would receive 4.15 percent of the MVET revenue, as under current law, effective July 1, 2019, while the General Fund would receive the remaining amount (95.85 percent).

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

FISCAL IMPLICATIONS

TRD and NMDOT independently estimated the impacts of the provisions of this bill. The impacts reported in the table on page use the DOT methodology and the estimate of locomotive fuel GRT and compensating tax deductions are those from TRD. In both cases, the estimated revenues were slightly adjusted by LFC staff.

Motor Vehicle Excise tax three-year swap:

The December 2018 consensus revenue estimating group (CREG) general fund estimate follows, with the other calculations from LFC staff. Note that pursuant to current law, as of July 1, 2019, the state road fund receives 4.15 percent of MVEX. For FY20, FY21, and FY22, this would increase to 33 percent. It is the difference, or 28.85 percent, that creates the non-recurring impact shown in the table on page 1. :

FY19	FY20	FY21	FY22	FY23	
150,600	155,500	159,200	162,500	165,600	General Fund
157,120	162,230	166,090	169,540	172,770	Total MVEX
6,520	6,730	6,890	7,040	7,170	Road Fund 4.15%
	53,540	54,810	55,950		.33 * Total MVEX
	46,810	47,920	48,910		Net Road Fund Impact

With insignificant differences, this is identical to the impact as published by NMDOT, but is larger by about $2 million from the estimate of TRD. Efforts continue to resolve these differences.

Gross Receipts Tax Deduction for Locomotive Fuel

Pursuant to Section 1 of the bill, all of the compensating tax and gross receipts tax collected from the repeal of the two deductions would be distributed to the state road fund. With the repeal of the GRT deduction, the local option rates would apply. No special provision is proposed with respect to the municipal state share 1.225 percent. Therefore, the two entities that would lose the benefit of the deduction would bear the additional burden of the state 5.125 percent rate, plus the local option in the jurisdiction of sale. The muni state share would apply. This creates a loss to the general fund, since, in a sense, the 1.225 percent is double counted – once in distributing the 5.125 percent state rate to the road fund and a second time as municipal state share to the municipal location of the gross receipts. For the purpose of illustration, this municipal impact is shown for the Belen location in Valencia County.

The projection for the amount of gross receipts that would become taxable is derived from the 2017 TRD *Tax Expenditure Report* presented to the Legislature on October 31, 2018.

NMDOT explains these somewhat complicated calculations as follows, although the numbers have updated to conform to the revenue table on page 1:

> SB 487 would distribute an average of $67 million to the State Road Fund in FY 2020 through FY 2022, and about $21 million in FY 2023, and thereafter. About $47-$49 million would come from the increased Motor Vehicle Excise distribution, which would sunset in FY 2023, while the remaining revenue would come from the repealing of the GRT and compensating tax deductions for locomotive fuel.
>
> Local governments, and in particular the city of Belen and the county of Valencia would benefit from the repealing of the GRT deduction for locomotive fuel. The estimate shows a revenue gain of about $5 million per fiscal year. This impact is based on the assumption that all the GRT deductions reported by BNSF Railway Company (BNSF) for FY 2017 were from their fueling facility located in Belen (see table below for additional information).
>
> The Small Counties Assistance Fund and the Small Cities Assistance Fund would both benefit from the repealing of the compensating tax deduction for locomotive fuel, and would receive about $2 million and $1.4 million per year, respectively.

The General Fund would be negatively affected by the MVET change in distribution in FY 2020 through FY 2022, which would translate in a $46-$48 million losses per fiscal year. Moreover, because the State Road Fund would be entitled to receive the net receipts attributable to the GRT and the compensating tax on the sale of locomotive fuel, presumably the General Fund would still be responsible for distributing 15 percent and 10 percent of the compensating tax revenue to the Small Cities Assistance Fund and the Small Counties Assistance Fund, and for distributing 1.125 percent of the state GRT share portion to the city of Belen.

The repeal of the compensating tax and the GRT deductions on locomotive fuel, would cost the General Fund about $4.5 million and $1.3 million per fiscal year, respectively.

In order to estimate the effect of repealing GRT and compensating tax deductions on locomotive fuel, this analysis refers to the numbers published by the Taxation and Revenue Department on the "New Mexico Tax Expenditure Report - 2017" for FY 2017, and presented to the Revenue Stabilization and Tax Policy Committee on October 31, 2017 (https://www.nmlegis.gov/handouts/RSTP%20103017%20Item%206%20Locomotive%20Fuel%20Deduction%20Report.pdf).

This analysis assumes that BNSF and Union Pacific are the only taxpayers subject to GRT and compensating tax who use locomotive fuel. [LFC staff note: 7-9-110.3 NMSA 1978 requires these companies to fully disclose to the legislature the value of the 7-9-110.1 and 7-9-110.2 NMSA 1978 deductions to the legislature, as well as construction and permanent jobs created. Both railroad companies have conformed to these disclosure requirements. Without this specific requirement, the information obtained from tax returns would be confidential pursuant to 7-1-8 NMSA 1978).

The MVET impact is based on the December 2018 Consensus General Fund Forecast and on the January 2019 State Road Fund estimates.

Total Deductions on locomotive fuel by tax payer, values in million.

	Tax Program		
	Compensating Tax	**GRT**	**Total**
BNSF	2.9	6.1	9
Union Pacific	7.9	0	7.9
Total	**10.8**	**6.1**	**16.9**

Source:
https://www.nmlegis.gov/handouts/RSTP%20103017%20Item%206%20Locomotive%20Fuel%20Deduction%20Report.pdf

This bill substantially narrows a tax expenditure with a cost relatively easy to determine. Thus, the provisions of this bill would bring this tax expenditure into conformance with LFC tax policy principles of adequacy, efficiency, and equity.

SIGNIFICANT ISSUES

From TRD's 2017 Tax Expenditure Report:

> Construction of the Union Pacific ("UP") intermodal ramp and refueling facility in Santa Teresa was completed in December 2014. According to UP's annual report, the company has invested $400 million in the 2,200-acre facility between 2011 and 2014 and $153 million in its rail infrastructure in the State. The company reports they have created about 1,375 construction jobs over the 3.5 years construction period. As of June 30, 2017, UP reported creating 433 new permanent jobs (303 UP employees and 130 contractors). Burlington Northern Santa Fe ("BNSF") reports New Mexico operating revenue of $1.4 billion for the period ending June 30, 2017 as it represents one of the largest private sector employers in the cities of Clovis, Belen, and Gallup. BNSF reports they have created 1,032 permanent jobs since the beginning of operations. According to the Border Industrial Association, Santa Teresa continues to show robust economic growth thanks to the ripple effect associated with increase in economic activity in the region.

This bill broadens the gross receipts and compensating tax base 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. The base broadening implicit in this bill might serve to reverse some of the bad effects of tax expenditures.

It is very hard to determine the consequences if this bill were to pass in terms of continued growth of the rail refueling and multimodal transportation hub activity. The aggressive expansion of jobs and economic activity would certainly slow, but it is unlikely to cease. On the other hand, TRD suggests some accommodation might be in order:

> The locomotive fuel deduction can likely be tied directly to a significant investment in the state – the large rail depot that was built near Santa Teresa soon after the deduction took effect. This rail depot has helped grow activity at the Santa Teresa border crossing. TRD recommends considering whether to sunset the deduction via a phase-out of the percentage allowed.
>
> The use of MVX in the state road fund adheres to the policies of adequacy and simplicity, as it amounts to a use tax for maintenance of the roads.

PERFORMANCE IMPLICATIONS

The tax expenditure proposed for repeal in this bill have fully conformed to the disclosure ideals implicit in the LFC tax policy of accountability. Both companies have provided full information to the Legislature as to whether the deductions are meeting the purpose as stated in 7-1-110.3 NMSA 1978.

> "The purpose of the deduction on fuel loaded or used by a common carrier in a locomotive engine from gross receipts and from compensating tax is to encourage the

construction, renovation, maintenance and operation of railroad locomotive refueling facilities and other railroad capital investments in New Mexico."

ADMINISTRATIVE IMPLICATIONS

TRD notes the provisions of the bill have a moderate impact on the Information Technology Division, requiring only soft costs. The effective date is achievable with strong stakeholder participation.

OTHER SUBSTANTIVE ISSUES

The back story of this deduction is quite interesting. In 2011, the multimodal transportation facility in Santa Teresa was gearing up. An essential part of the design of the facility was to be able to break bulk from rail trans-shipment to trucks to serve both sides of the border and the maquiladora factories on the Mexican side of the border. In the FIR for HB583 of the 2011 regular session, the analyst discussed a now abandoned tax policy criterion that economists call the "but for" test. It was not certain if the railroad portion of the Santa Teresa multimodal transportation facility would be built without the tax incentive. If it would have been built without the tax incentive, the original FY14 FY15 estimate peaked at about $8 million total revenue cost. The low estimate assumed that the railroad portion would not have been built without the tax incentive, and that total cost was under $2 million. In 2013, the refueling facility in Belen was added to the deductions laws 2013, chapter 123 and was scored at about $3 million. Currently, the value of the two deductions are estimated in this review at about $20 million, with substantial portion attributed to growth in the two years. This means the original estimates were pretty accurate but also means the industry probably achieved the growth expected pursuant to the necessity of the deductions in stimulating railroad investment in the state.

Another interesting back story is that this may be the first attempt in New Mexico to provide a five-year incubator tax regime, but impose that regime ex-post. In international economic development, it is almost certain that large projects involving direct foreign investment (DFI) are granted a five-year tax holiday – at least in terms of first-round taxes, such as value-added taxes, property taxes, and income taxes, and, in some countries, withholding (pay-as-you-earn) taxes remitted on behalf of employees. After the five-year tax holiday, the projects are expected to begin paying taxes similar to indigenous firms. This form of incubator tax regimes has apparently been successful in many countries.

ALTERNATIVES

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