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

SPONSOR HTRC **ORIGINAL DATE** 2/13/2020 **LAST UPDATED** ______ **HB** 308/HTRCS

SHORT TITLE Define "Average Distribution Transfer Amount" **SB** ______

ANALYST Iglesias

REVENUE (dollars in thousands)

Estimated Revenue*					Recurring or Nonrecurring	Fund Affected
FY20	FY21	FY22	FY23	FY24		
-	-	($0.5-$5,000)	($0.5-$5,000)	($0.5-$5,000)	Recurring	General Fund
-	-	$0.5-$5,000	$0.5-$5,000	$0.5-$5,000	Recurring	Local Governments

Parenthesis ( ) indicate revenue decreases

*Note: Analysis from the Taxation and Revenue Department is necessary to determine the fiscal impacts of this committee substitute. The cost estimates provided reflect TRD's analysis of the original bill prior to substitution – the department has indicated this substitute could reduce the potential costs to the general fund but no updated analysis was provided.

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

FY20	FY21	FY22	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
$63.1	-	-	$63.1	Nonrecurring	TRD Operating Budget

Parenthesis ( ) indicate expenditure decreases

SOURCES OF INFORMATION

LFC Files

No Response Received From
Taxation and Revenue Department (TRD)
New Mexico Municipal League

SUMMARY

Synopsis of Bill

The House Taxation and Revenue Committee substitute for House Bill 308 amends Section 7-1-6.15 NMSA 1978 to changes the way the Taxation and Revenue Department (TRD) can reduce distributions to municipalities based on taxpayer amendments. It changes the threshold for determining when a correction to a local distribution is recovered over multiple years, or whether general fund or road fund revenue is used so the correction does not reduce local distributions. The effective date of this bill is January 1, 2022.

This distribution adjustment procedure applies to distributions made each month by TRD to local governments of the:

- State gross receipts taxes to municipalities (Section 7-1-6.4 NMSA 1978)
- Any municipal or county local option gross receipts tax (Section 7-1-6.15. A(2)&(3) NMSA 1978)
- Food hold harmless distributions (Section 7-1-6.46 NMSA 1978)
- Medical hold harmless distributions Section 7-1-6.47 NMSA 1978)
- Gasoline taxes to municipalities (Section 7-1-6.9 NMSA 1978 and 7-1-6.27 NMSA 1978)
- Gasoline taxes to counties (Section 7-1-6.26 NMSA 1978)
- Compensating taxes to municipalities (Section 7-1-6.55 NMSA 1978)
- Interstate telecommunications gross receipts taxes (Section 7-1-6.36 NMSA 1978)
- County equalization distribution from the General Fund (Section 7-1-6.16 NMSA 1978) and
- Local liquor excise taxes (Section 7-24-8 to 7-24-16 NMSA 1978)

TRD previously provided the following description of current law:

> "Under current law, if a local government has a prior period distribution that is negative and the absolute value exceeds the greater of $100 or 20 percent of that local government's 'average annual distribution or transfer amount', the negative amounts net of the positive amounts for that same period are excluded from the distribution from TRD to the local government and only the current month period will be distributed. TRD gives notice to the local government of the negative amount and offers the opportunity to enter into a payment agreement to repay the negative amount, typically over a 72-month period. If the local government does not enter into a repayment agreement, TRD reduces the distribution to the local government over the next six monthly distribution periods to make the general fund whole for the negative prior period amount. The TRD Secretary may also choose to waive 'any portion of the recoverable amount' if they choose to seek and are granted State Board of Finance approval.
>
> Under current law, if the prior period amount is negative and in excess of 50 percent of the local government's 'annual average distribution or transfer amount', the amount in excess of 50 percent is automatically deemed unrecoverable and a claw back of this amount from the local government is waived. The current law also allows the Secretary of TRD, with the approval of the State Board of Finance, to waive recoverable amounts under the 50 percent threshold."

The proposed legislation would change the 20 percent annual threshold that triggers a repayment plan to 2 percent. The bill also strikes the provision in current law that determined negative amounts in excess of 50 percent to be unrecoverable. Presumably, the combined effect would be that any negative amounts with a local impact of greater than 2 percent of the local government's average annual distribution or transfer amount would trigger a repayment plan up to the full amount. The TRD secretary retains the ability to waive any portion of the recoverable amount, pending Board of Finance approval.

FISCAL IMPLICATIONS

An updated analysis from TRD is necessary to determine the fiscal implications of this bill.

TRD's previous analysis of a proposal to change the calculation from an average annual amount to an average monthly amount using the following methodology:

> "Data from GenTax was used to determine actual unrecoverable amounts from the current definition of "average distribution transfer amount" as an annual calculation, as well as the occurrences of a repayment agreement. From FY16 through FY19, there were three instances that resulted in the 50 percent threshold for unrecoverable amounts being triggered for a total of $2.93 million. The change in the definition of average distribution or transfer amount to monthly would have resulted in an additional 18 unrecoverable instances over this period and resulted in an additional loss to the general fund of $4.85 million.
>
> It is possible that this impact could be even higher than $5 million in a given fiscal year, however as it is based on unpredictable taxpayer behavior, this amount is not quantifiable, but the range is reasonable given historical figures."

For reference, the cost estimate table reflects the analysis above. The department has informally stated the methodology used in this committee substitute would reduce the potential costs to the general fund; however, no updated analysis has been received.

SIGNIFICANT ISSUES

TRD previously provided the following policy discussion:

> "The most recent amendments to Section 7-1-6.15 were made in 2015 following the New Mexico Court of Appeals' decision in the *City of Eunice vs. State of New Mexico* case. To summarize, a large taxpayer that had been paying gross receipts tax in the City of Eunice determined that it was not located in Eunice, and that instead it was located in the unincorporated county area outside of the City of Eunice. The taxpayer requested refunds on overpaid City taxes paid and, in response, TRD planned to claw back over $2 million from the City of Eunice. The version of Section 7-1-6.15 prior to 2015 amendments stated that TRD could only claw back for up to 23 months in a distribution that had been [determined] was "erroneous." TRD argued that "erroneous" only meant that TRD had made an error, which it had not done in this instance. The Court of Appeals found that "erroneous" meant any type of error, including an error made by a taxpayer.
>
> The changes to Section 7-1-6.15 signed into law in 2015 following the Eunice decision were one of the few times when the legislature delegated its authority over both future general fund and road fund revenues to a combination of a complex formula and to the discretion of a department cabinet secretary….
>
> In 2015, a section of law was added that allowed "in the [TRD] secretary's discretion, [to] waive recovery of any portion of the recoverable amount." If the Secretary makes the choice to exercise this discretion, they are directed to seek State Board of Finance approval; however, the Secretary may choose unilaterally not to exercise this "discretion." Either choice does not need any further legislative oversight. In other circumstances, subject to the

formula, no discretion is allowed by the legislature, the Secretary, or the State Board of Finance, but the formula takes over to reduce road fund or general fund revenues and redirect them to certain local governments….

By definition, any time a local government is spared from having a negative distribution clawed back, the state general fund absorbs the associated revenue loss. There have been instances in which a large amendment on taxpayer filing location risked significantly impairing a local government's ability to fulfill financial obligations while remaining solvent. Fiscally robust local governments are in the best interest of the members of their community, the local governments themselves, and the state….

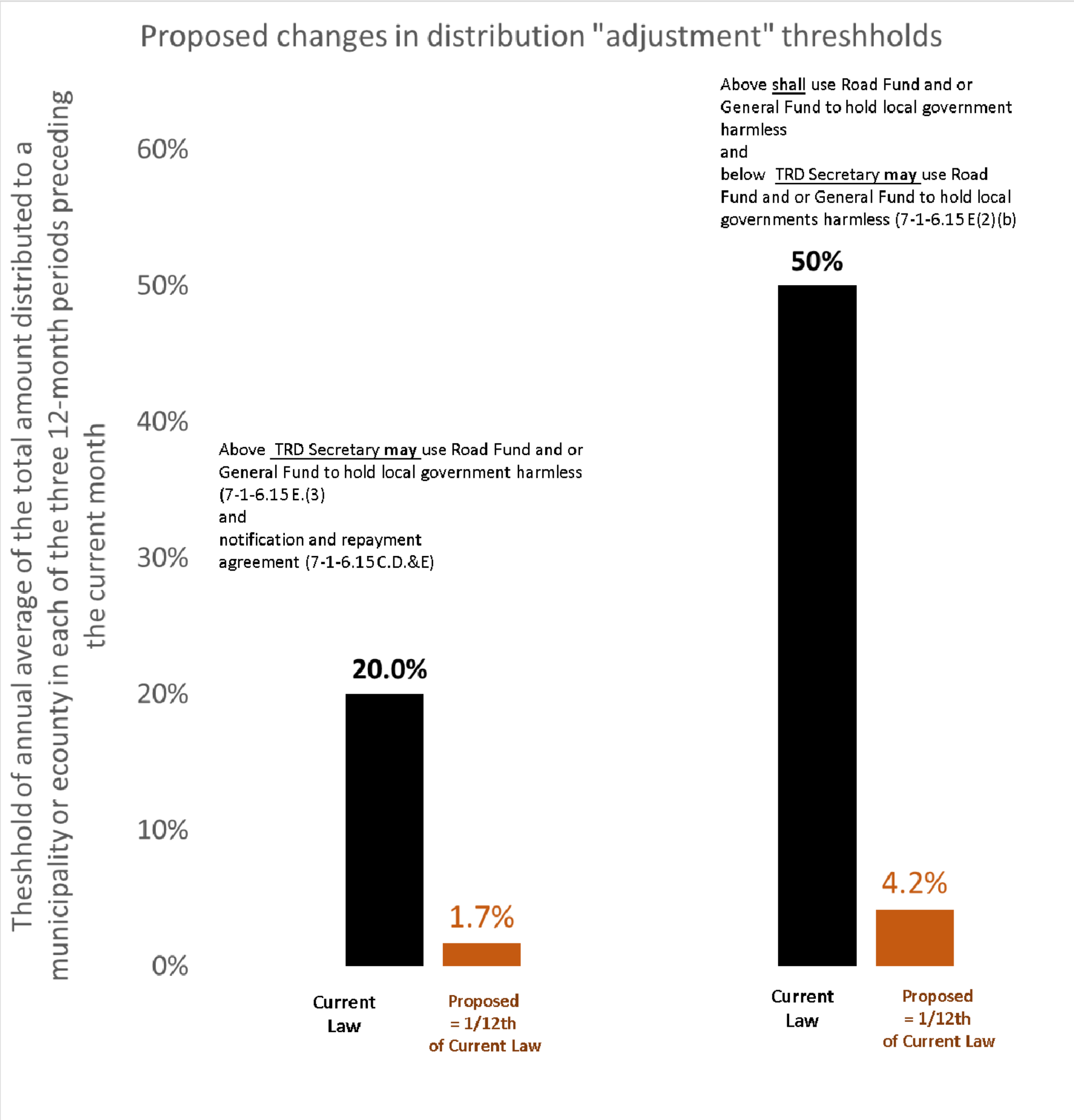
Under current law, a claw back that costs a local government 20 percent of its average annual distribution, the local government is offered a payment plan to gradually repay the amount; if the claw back costs the local government 50 percent of its average annual distribution, the repayment in excess of 50 percent is automatically waived and the Secretary may seek State Board of Finance approval to waive a portion under 50 percent. Under additional authority in current law if the repayment amount is less than 50 percent but over 20 percent the Secretary may seek approval to waive any portion of the recoverable amount. One can imagine that a 20 percent to 50 percent revenue shock could be devastating to a local government. However, this bill proposes to reduce the size of shocks local governments are to withstand to [2 percent]. Revenue shocks this small should, arguably, be managed through local government reserve levels. Due to their dependence on property tax, which is received intermittently, counties are required to keep at least 25 percent (3/12th) general fund reserves, while municipalities, which tend to benefit more from regular monthly gross receipts tax cash flow, are required to keep at least an 8 percent (1/12th) general fund reserve."

ADMINISTRATIVE IMPLICATIONS

Implementing this would likely have a moderate impact on its Information Technology Department.

DI/sb

ATTACHMENT



Source: Taxation and Revenue Department