FISCAL IMPACT REPORT

		LAST UPDATED	
SPONSOR	Harper	**ORIGINAL DATE**	1/29/24
SHORT TITLE	Reduce Gross Receipts Tax Rate	**BILL NUMBER**	House Bill 219
		ANALYST	Graeser

REVENUE*
(dollars in thousands)

Type	FY24	FY25	FY26	FY27	FY28	Recurring or Nonrecurring	Fund Affected
TRD/GRT Rate Reduction	$0	($234,000.0)	($246,200.0)	($262,200.0)	($276,400.0)	Recurring	General Fund
TRD/Comp Rate Reduction	$0	($3,600.0)	($3,700.0)	($4,000.0)	($4,200.0)	Recurring	General Fund
TRD/GRT Anti-pyramiding	$0	($66,400.0 to ($88,900.0)	($69,900.0 to ($93,500.0)	($74,400.0 to ($99,600.0)	($78,400 to ($105,000.0)	Recurring	General Fund
Total General Fund	$0	($304,000.0 to ($326,500.0)	($319,800.0) to ($343,400.0)	($340,600.0) to ($365,800.0)	($359,000.0) to ($385,600.0)	Recurring	Total General Fund
TRD/Comp	$0	($480.00)	($490.00)	($530.00)	($560.00)	Recurring	Small Counties
TRD/Comp	$0	($720.00)	($740.00)	($800.00)	($840.00)	Recurring	Small Cities
TRD/GRT Anti-pyramiding	$0	($16,000.0 to ($21,400.0)	($16,800.0) to ($22,500.0)	($17,900.0 to ($24,000.0)	($18,900.0) to ($25,300.0)	Recurring	Counties
TRD/GRT Anti-pyramiding	$0	($29,600.0) to ($39,700.0)	($31,100.0) to ($41,800.0)	($33,100.0) to ($44,500.0)	($34,900 to ($46,900.0)	Recurring	Municipalities
Total Local Governments	$0	($46,800.0) to ($61,100.0)	($49,130.0) to ($64,300.0)	($52,330.0) to ($68,500.0)	($55,200.0) to ($72,200.0)	Recurring	Total Local Government

Parentheses ( ) indicate revenue decreases.
*Amounts reflect most recent analysis of this legislation.

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT*
(dollars in thousands)

Agency/Program	FY24	FY25	FY26	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
TRD	$26.2	$0	$0	$26.2	Nonrecurring	General Fund

Parentheses ( ) indicate expenditure decreases.
*Amounts reflect most recent analysis of this legislation.

Conflict and companion bills this session:

HB 219	REDUCE GROSS RECEIPTS TAX RATE	Jason C. Harper
HB 257	CONVENIENCE STORE FOOD GROSS RECEIPTS	Jenifer Jones
SB 36	HEALTH CARE SERVICES GROSS RECEIPTS	Mark Moores
SB 54	SCHOOL GROSS RECEIPTS WEEKEND DATES	Harold Pope
SB 174	CALF CANYON FIRE LEGAL SVCS. GROSS RECEIPTS	Leo Jaramillo

Sources of Information
LFC Files

Agency Analysis Received From
Economic Development Department (EDD)
New Mexico Municipal League (NMML)
Taxation and Revenue Department (TRD) on 2023's HB367.

Agency Analysis was Solicited but Not Received From
New Mexico Counties (NMC)

SUMMARY

Synopsis of House Bill 219

House Bill 219 (HB219) reduces the state gross receipts and compensating tax rates a quarter of a percent in FY25 and subsequent years. The rate will be reduced from 4.875 percent to 4.625 percent. Section 7-9-46.1 NMSA 1978 retains current language that would restore the lower rate to the 4.875 percent rate if gross receipts tax revenues in any year were less than 95 percent of the revenues the previous year.

HB219 also creates a gross receipts tax deduction of receipts for certain business-to-business services, a provision known as "anti-pyramiding." The deduction is for the receipts from the sale of accounting services, engineering services, architectural services, information technology services, payroll services, and legal services. The bill provides definitions for "accounting services," "engineering services," "financial management services," "information technology services," "human resources services," and "legal services." In some cases, the definitions reinforce the restriction of the provisions of the bill to business-to-business services.

The effective date of this bill is July 1, 2024.

The effective date of this bill is July 1, 2024. No sunset date is provided for the professional services deduction.

FISCAL IMPLICATIONS

Estimated fiscal impacts are based on the consensus revenue estimates for gross receipts tax and compensating tax revenues. The baseline effective state gross receipts tax rate was assumed to be 4.312 percent for the professional services category, which was derived from FY24 year-to-date levels. Similarly, the FY24 year-to-date statewide tax collected indicates a total weighted average rate of 6.60 percent in FY24. Therefore, a local rate of 2.348 percent was used to determine the total loss to all local governments. LFC staff and TRD estimate the county share of the total local cost at 35 percent with the remaining 65 percent impacting municipalities. The cost breakout and total local impact is reflected in the table on page 1.

The anti-pyramiding impacts in the proposed bill are estimated to reduce the general fund between $66 million and $105 million. Anti-pyramiding provisions are based on analysis of data (RP-500 and RP-80) provided by the Taxation and Revenue Department. LFC analyzed

FY21 through FY24 industry data to determine the potential size of the taxable gross receipts base affected. These RP80/RP500 data were compared with 2017 Economic Census data available from the U.S. Bureau of Census and update to 2023 levels using RP500 data for the entire NAICS 54 category. Those industries with gross receipts data appearing to qualify for the relevant deductions were assumed to be 60 percent or 90 percent business-to-business transactions to develop the range and were used to estimate revenue loss. Furthermore, the FY22 taxable base was grown by the December 2022 consensus revenue estimate growth rate for gross receipts taxes.

FY24	FY25	FY26	FY27	FY28	Recurring or Nonrecurring	Fund Affected
	($234,000.0)	($246,200.0)	($262,200.0)	($276,400.0)	Recurring	General Fund –GRT Rate Reduction
	($3,600.0)	($3,700.0)	($4,000.0)	($4,200.0)	Recurring	General Fund –Comp. Tax Rate Reduction
	($66,400) to ($88,900)	($69,900.0) to ($93,500.0)	($74,400.0) to ($99,600.0)	($78,400.0) to ($105,000.0)	Recurring	General Fund – Anti-pyramiding
	($304,000.0) to ($326,500.0)	($319,800.0) to ($343,400.0)	($340,600.0) to ($365,800.0)	($359,000.0) to ($385,600.0)	**Recurring**	**TOTAL GENERAL FUND**
	($480.0)	($490.0)	($530.0)	($560.0)	Recurring	Small Counties –Comp. Tax Rate Reduction
	($720.0)	($740.0)	($800.0)	($840.0)	Recurring	Small Cities –Comp. Tax Rate Reduction
	($16,000.0) to ($21,400.0)	($16,800.0) to ($22,500.0)	($17,900.0) to ($24,000.0)	($18,900.0) to ($25,300.0)	Recurring	Counties - GRT
	($29,600.0) to ($39,700.0)	($31,100.0) to ($41,800.0)	($33,100.0) to ($44,500.0)	($34,900.0) to ($46,900.0)	Recurring	Municipalities - GRT
	($46,800.0) to ($61,100.0)	($49,130.0) to ($64,300.0)	($52,330.0) to ($68,500.0)	($55,200.0) to ($72,200.0)	**Recurring**	**TOTAL Local Governments**

The estimated cost is lower than in previous estimates because of the reductions in GRT implemented in the 2022 regular legislative session and contemplated here. Higher GRT exacerbates anti-pyramiding and as GRT has been lowered the impact of the anti-pyramiding provisions has also lessened.

The estimated cost of reducing the compensating and gross receipts tax rates was calculated using the December 2023 Consensus Revenue Estimate.

This bill creates or expands a tax expenditure with a cost that is difficult to determine but likely significant. Estimating the cost of HB219 is difficult and unclear. More work, data, and agency analysis is needed. LFC has concerns about the risk to state revenues from tax expenditures and the increase in revenue volatility from erosion of the revenue base. This bill may be counter to the LFC tax policy principle of adequacy and equity. Due to the increasing cost of tax expenditures, revenues may be insufficient to cover growing recurring appropriations. However, Section 7-9-46.1 NMSA 1978 has a provision restoring the 4.875 percent rate if gross receipts tax revenues in any year are less than 95 percent of previous year's revenue. The business-to-business professional services deductions proposed here could contribute to the decrease in gross receipts tax revenue and trigger the restoration of a higher rate.

SIGNIFICANT ISSUES

This bill narrows the gross receipts tax (GRT) base. Many New Mexico tax reform efforts over the last few years have 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.

NMML reinforces this concern with specific concern about local GRT revenues:

> This expanded deductions for professional services included in this bill would have a significant negative fiscal impact on local governments. The overall cost of the deduction is very uncertain, as is the impact to individual municipalities and counties. The analysis for HB367 in 2023, a similar bill, showed a total impact for local governments of over $50 million in FY 2025 and growing in future years. This level of revenue loss would seriously undermine local revenue stability, affecting cities' ability to provide essential public services. public safety, and employee wage increases, among other needs.
>
> Additionally, the proposed deductions could negatively impact municipal debt service coverage ratios, in turn affecting municipal bond ratings. Bond ratings could be affected by both a reduction in revenue, as well as the negative impact revenue reduction would have on city budgets. Municipalities would not see a fiscal impact from the GRT rate reduction provision in HB 219, as a reduction to the state GRT rate would not affect the 1.225 percent local share of state GRT.
>
> This bill would erode the local gross receipts tax base of municipalities, which is contrary to the policy principles adopted by the New Mexico Municipal League.
>
> It also adds greater uncertainty to current and future revenue amounts for all cities. The fiscal impact estimates are based on industry NAICS codes, which are unreliable because they are self-reported by taxpayers. Further, taxpayers outside the identified NAICs codes may be legitimately eligible for the deduction, increasing the costs. In addition, estimating the share of business-to-business transactions within affected industries is challenging, with no reliable data source developed for this information in spite of several years of discussions surrounding this issue.
>
> By providing the deduction to a limited number of named professional and other services, the bill raises questions about the fairness of the legislation as it applies to other professional and non-professional services taxed as business inputs. It creates an incentive for future expansion of the deduction to address this fairness issue.

EDD supports the reduction in the gross receipts tax rate:

> Lowering the gross receipts tax and compensating tax rates can ease the burden on New Mexico residents who have been subject to increasing costs in their daily lives, a result of recent higher than average inflation.
>
> The gross receipts tax deduction on professional services could prove beneficial to businesses across the state as savings could be passed on from the servicers to the businesses hiring the service. In cases where small businesses in New Mexico may need a particular professional

service, potential cost savings on these services could free up working capital for businesses to utilize for the best of their business whether that be to grow or invest. That said, however, there is no guarantee that the deduction on professional services will be passed on but could instead be kept with the servicing company for their benefit, which could have a similar outcome as described above.

On last year's HB367, TRD provided the following policy perspectives:

[Sections 1 &2]: Good tax policy begins with taxing a broad base and imposing a low rate. Since 2019, New Mexico's State and local GRT base has been broadened to include internet sales and a broader set of hospital receipts. The state and local tax base has also been broadened to include adult use cannabis. With the broader base, a lower rate is justified, benefiting all New Mexicans. Although reducing the GRT and compensating tax rates reduces general fund revenues, this comes after significant increases in revenue from the broadening of the tax base over the last few years.

A lower tax rate supports all industries in the economy, providing relief to local businesses and consumers, and makes New Mexico more competitive with other states. The reduction in the GRT and compensating tax rates reduces the impact of pyramiding, where the same final good or service is taxed multiple times in the production process and can result in effective tax rates significantly higher than the current 5.00 percent state GRT rate. This increases the cost of New Mexico exports, providing a significant obstacle to the manufacturing sector.

Consumers will receive the benefit, especially among lower-income families, because the GRT is a regressive tax; the lower a person's income, the higher percentage of their income is spent on GRT. The tax relief provided to New Mexico families may be used to increase savings, pay off debt, and improve quality of life. Lower income New Mexicans will circulate these tax savings back into the local economy.

[Section 3]: Tax pyramiding is one of the main problems with gross receipts taxes. Since all transactions are taxed, including intermediate services used as business inputs, the cost of those taxes is an input in the final price, and consumers end up paying higher prices through such inclusion. Eliminating pyramiding on business-to-business transactions is an effective way to alleviate the tax burden on final consumers and make New Mexico's tax structure more competitive. This bill extends the current anti-pyramiding deduction that allows deducting the receipts from selling professional services to manufacturers to a broader set of business-to-business transactions. The broader anti-pyramiding deduction will create new incentives to do business in New Mexico, fostering general economic activity, particularly considering that the sale of these professional services is typically made by small companies, representing most businesses in the economy. In general, it is expected that this reform will boost the number of economic transactions and, thus, aid New Mexico's economy to diversify, grow, and create jobs.

PERFORMANCE IMPLICATIONS

The LFC tax policy of accountability is met with the bill's requirement to report annually to an interim legislative committee regarding the data compiled from the reports from taxpayers taking the deduction and other information to determine whether the deduction is meeting its purpose.

ADMINISTRATIVE IMPLICATIONS

On last year's HB367, TRD expected a moderate impact. Assuming the same impacts, LFC has updated last year's expectation:

> TRD will make information system changes and update forms, instructions, and publications. The bill will require changes to GenTax, the tax system of record. The changes will have a low impact on TRD's Information and Technology Division (ITD) of approximately 100 hours or 1 month of workload and approximately $21 thousand of contractual resources for the tax rate changes.
>
> The Administrative Services Division (ASD) will work with ITD to implement the new rates and associated reports. ASD will have $5,200 in associated staff workload costs for approximately 40 hours.

Estimated Additional Operating Budget Impact*				R or NR**	Fund(s) or Agency Affected
FY24	FY25	FY26	3 Year Total Cost		
$21.0	--	--	$21.0	NR	TRD – ITD Contractual Costs
$5.2	--	--	$5.2	R	TRD – ASD

* In thousands of dollars. Parentheses ( ) indicate a cost saving. ** Recurring (R) or Non-Recurring (NR).

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

Provisions identical to 2023 HB367, with effective date of July 1, 2023.
Provisions similar to 2022 HB207, with effective date of July 1, 2022.

Conflict and companion bills this session:

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HB 257	CONVENIENCE STORE FOOD GROSS RECEIPTS	Jenifer Jones
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TECHNICAL ISSUES

For last year's HB367, TRD recommended a simplification by combination of provisions related to the deductions for Professional Services:

> To simplify and clarify eligibility to claim the deduction created in Section 3, TRD recommends amending page 5 line 18 through page 6 line 8 to read, "Receipts from selling professional services may be deducted from gross receipts or from governmental gross receipts if the sale is made to a taxpayer engaged in business as a sole proprietorship, a limited liability company, a partnership or a corporation and the purchaser presents a nontaxable transaction certificate to the seller or provides alternative evidence pursuant to Section 7-9-43 NMSA 1978."

OTHER SUBSTANTIVE ISSUES

In assessing all tax legislation, LFC staff considers whether the proposal is aligned with committee-adopted tax policy principles. Those five principles:

- **Adequacy**: Revenue should be adequate to fund needed government services.
- **Efficiency**: Tax base should be as broad as possible and avoid excess reliance on one tax.
- **Equity**: Different taxpayers should be treated fairly.
- **Simplicity**: Collection should be simple and easily understood.
- **Accountability**: Preferences should be easy to monitor and evaluate.

In addition, staff reviews whether the bill meets principles specific to tax expenditures. Those policies and how this bill addresses those issues:

Tax Expenditure Policy Principle	Met?	Comments
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.	✓	This concept has been presented the previous two sessions.
Targeted: The tax expenditure has a clearly stated purpose, long-term goals, and measurable annual targets designed to mark progress toward the goals. Clearly stated purpose Long-term goals Measurable targets	 ✓ ✗ ✗	Although the anti-pyramiding purpose for manufacturing has been deleted in this bill, the purpose is clear
Transparent: The tax expenditure requires at least annual reporting by the recipients, the Taxation and Revenue Department, and other relevant agencies	✓	Separate reporting and inclusion in the Tax Expenditure Report
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. Public analysis Expiration date	 ✓ ✗	Expiration date for deduction not stated. The deduction is intended to be permanent
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. Fulfills stated purpose Passes “but for” test	 ✓ ?	
Efficient: The tax expenditure is the most cost-effective way to achieve the desired results.	?	
Key: ✓ Met ✗ Not Met ? Unclear		

LG/ne/al