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

SPONSOR HTRC **DATE TYPED** 03/18/05 **HB** 410, 582, 844 & 1086/csHTRC/aSFL

SHORT TITLE House Taxation and Revenue Committee Substitute for House Bills 410, 582, 844 & 1086/aSFL **SB**

ANALYST Taylor

REVENUE

Estimated Revenue		Subsequent Years Impact	Recurring or Non-Rec	Fund Affected
FY06	**FY07**			
$14,953*	$31,588*	($3,073)	Recurring	General Fund
($2,618)*	($2,949)*	($3,348)	Recurring	Local Governments

(Parenthesis ( ) Indicate Revenue Decreases)

* Impacts are the sum of various provisions. The impacts associated with specific provisions are detailed in a table in the fiscal implications section of the FIR.

SOURCES OF INFORMATION
LFC Files
Taxation and Revenue Department

SUMMARY

The House Taxation and Revenue Committee substitute for House bills 410, 582, 844 and 1086 as amended by the Senate Floor proposes changes to tax laws regarding personal income taxes and gross receipts taxes. Provisions of the amended bill are summarized here.

Income Tax Rate Decreases Delayed. Personal income tax rate reductions provided in current law are delayed. Under current law top marginal tax rates are scheduled to be 5.3 percent in tax year 2006, and 4.9 percent in 2007. The bill would change this by making the top rates 5.8 percent in 2006, 5.3 percent in 2007, and 4.9 percent in 2008. These provisions are effective January 1, 2006.

Head-of-Household Filing Status. The sections delaying the income tax rate decreases also delete the current head of households filing class and merge head of households into the married individuals filing joint returns and surviving spouses filing status. These provisions are effective January 1, 2006.

Low and Moderate Income Tax Exemption. A new personal income tax exemption for low and middle income taxpayers is provided. The maximum exemption is equal to $2,500 per person claimed as an exemption. The following describes the maximum exemption and phase-out structure for various filing classes:

- For married persons filing separate returns, the maximum exemption applies to adjusted gross income of $12 thousand or less. The exemption is reduced for income above $12 thousand. The reduction of the exemption is equal to $2,500 less 30 percent of income greater than $12 thousand.
- For single persons, the maximum exemption applies to adjusted gross income of $16 thousand or less. The exemption is reduced for income above $16,000. The reduction of the exemption is equal to $2,500 less 22.5 percent of income greater than $16 thousand.
- For married persons filing joint returns, the maximum exemption applies to adjusted gross income of $24 thousand or less.

These provisions become applicable January 1, 2006.

Unreimbursed or Uncompensated Medical Care Income Tax Exemption . An income tax exemption is provided to persons 65 years of age and older for unreimbursed or uncompensated medical expenses for that person, his (her spouse) or dependent if those expenses exceed $28 thousand and are not reimbursed or compensated (by insurance or otherwise). The maximum size of the exemption is $3,000. These provisions are applicable beginning January 1, 2005.

Renewable Energy Production Tax Credit. Currently, a taxpayer would qualify for the tax credit if he or she "owns a qualified energy generator certified by the energy, minerals and natural resources department". This provision would remove this condition and include the following eligibility criteria: A taxpayer if eligible is the taxpayer:
(1) holds title to a qualified energy generator; or
(2) leases property upon which a qualified energy generator operates from a county or municipality under authority of an industrial revenue bond; or
In addition, a taxpayer can be eligible for the credit if they hold title to a facility generating electricity from a qualified energy resource or one that leases such a facility from a county or municipality pursuant to an industrial revenue bond. The bill would also allow a taxpayer to be allocated all or a portion of the right to claim a renewable energy production tax credit (without regard to proportional ownership interests) if the taxpayer owns an interest in a business entity that is taxed for federal income tax purposes as a partnership as long as the interest owner holds at least a five percent share in the energy-generating business entity and the allocation was certified by EMNRD. The amount of the tax credit is unchanged at $0.01 per kilowatt-hour of the first four hundred thousand megawatt-hours of electricity produced. However, the bill limits the total credit claimed by all taxpayers for a single qualified energy generator to $0.01 per kilowatt-hour. The provisions of this section are applicable to taxable years beginning on or after January 1, 2005.

Rural Jobs Tax Credit . The rural job tax credit is made permanent. Under current law this credit would sunset as of June 30, 2005. The rural job tax credit is available to qualifying employers located in rural New Mexico. Rural New Mexico is defined by exception. Excepted are Los Alamos County and incorporated municipalities within a metropolitan statistical area with a population of 30 thousand or more. A qualifying employer is one who has been approved by EDD for participation in the in-plant-training program. The value of the credit is equal to 6.25 percent of the first $16 thousand in wages paid for a qualifying job, where a qualifying job is also determined by qualification for in-plant-training and has been held for at least 48 weeks in a 12 month period. The employer may take the credit for 4 years in "tier one areas", which is defined as municipalities in a rural area with a population lower than 15 thousand or any other part of a rural area that is not located within municipal boundaries. Employers may take the credit or two years in "tier two areas", which is defined as municipalities in a rural area with a population greater than 15 thousand. This provision is effective as of July 1, 2005.

Film Production Tax Credit. This section provides an additional tax credit against personal or corporate income tax to a film production company for 5 percent of certain direct production expenditures. The tax credit is refundable, so that if the credit exceeds the taxpayer's tax liability, the excess credit would be refunded to the taxpayer. Eligible production expenditures are as follows:

- made in New Mexico or by a New Mexico resident for the purposes of this section
- of which 60 percent of the below-line crew payroll are residents of New Mexico
- on equipment, goods, services, vehicles or other direct production expenditures provided by individuals or companies paying gross receipts tax in New Mexico for a minimum of 2 years
- on rental equipment if it is in New Mexico for a minimum of one hundred eighty-three days per year
- that are made for the purpose of producing a television series

The provisions of this act apply to taxable years beginning on or after January 1, 2005; a delayed repeal is included, effective January 1, 2009.

Small Businesses Technology Tax Credit. A new credit is provided to qualified research and development small businesses. The credit is equal to the sum of all gross receipts taxes, compensating taxes or withholding taxes owed to the state. A qualified business is defined as a corporation, general partnership or similar entity with less than 25 employees, revenues less than $5 million per year and qualified research expenditures equal to 20 percent of total expenditures in the year the credit is claimed. The credit can be claimed for up to three years. This provision has an effective date of July 1, 2005.

Affordable housing tax credit. A new credit, the affordable housing tax credit, is created. The Mortgage Finance Authority (MFA) is authorized to issue investment vouchers for persons investing in affordable housing projects. The value of the vouchers is 50 percent of the investment. Vouchers can be sold or transferred. The MFA is required to adopt rules for the approval, issuance and administration of the vouchers. The value of the vouchers is established for the first two years as follows: in 2006--$200 thousand; in 2007--$500 thousand. The value of the vouchers in subsequent years would equal $1.85 multiplied by the state population plus an annual inflation adjustment. The vouchers may be applied against gross receipts, compensating tax, withholding tax, personal income tax and corporate income tax liability. Unused credits may be carried forward for up to five years. These provisions are effective July 1, 2005.

Defense Transformation Gross Receipts Deduction. A new gross receipts deduction for receipts from "transformational acquisition programs" performing research and development, test and evaluation at New Mexico major and test facility bases is provided. The bill's definition of transformational specifies that it applies only to new programs, excluding those tested before July 1, 2005. The deduction does not apply to receipts from national laboratory contracts. The deduction exists through 2008 (effectively this is a sunset provision).

Aircraft Services Gross Receipts Deduction. Eligibility for receiving a tax deduction against gross tax receipts from aircraft services is expanded. The bill would add the service of "maintaining" an aircraft carrier to a list of existing services that qualify for the deduction (such as refurbishing, remodeling, or otherwise modifying). The type of aircraft specified on which the services would be performed would also be changed from “transport category aircraft”, to a broader specification of “commercial or military carrier”. The bill also reduces the weight requirement for the aircraft from 65 thousand pounds to ten thousand pounds. The effective tax date for this provision is July 1, 2005.

Gross Receipts Tax Holiday. A gross receipts tax holiday is established. Gross receipts for certain purchases during the first weekend of August each year would be deductible. Deductible purchases would include clothing and footwear items worth less than $100 each, school supplies normally used in the class room, computers whose sale price is less than $1,000 and associated computer equipment costing less than $500.

Gross Receipts Credit for Sales of Service for Resale. A gross receipts or governmental gross receipts tax credit is provided for receipts from selling a service for resale. The value of the credit is equal to the value of the receipts multiplied by 10 percent, multiplied by 3.775 percent if the sale of the service occurs within municipal boundaries (and by 5.0 percent, if the sale occurs in the unincorporated part of the county. The credit is only available for receipts where the resale is not subject to tax (Note: sale of services for resale that are subject to the gross receipts or governmental gross receipts tax are already deductible). The credit would not be available for sales to a governmental entity or prime contractor operating a national laboratory. The credit would only apply to the state general fund distributions (local governments would be held harmless). The credit would become effective July 1, 2005.

FISCAL IMPLICATIONS

Fiscal impacts of the bill closely follow the Taxation and Revenue Department estimates. Their summary table is replicated here.

FISCAL IMPACT (Thousands of dollars): Note: Parenthesis ( ) indicate a revenue loss:

Description	FY 2006	FY 2007	FY 2008	FY 2009	Fund
Delay Income Tax Rate Relief	32,500	60,500	28,000	--	State General Fund
Head of Household Bracket Changes	(1,100)	(2,200)	(2,000)	(2,000)	State General Fund
New Personal Exemption Amount	(8,250)	(16,500)	(16,700)	(16,900)	State General Fund
Medical Expense Exemption	(385)	(400)	(420)	(450)	State General Fund
GRT Deduction for Sales of Ser-vices	(3,100)	(3,255)	(3,418)	(3,589)	State General Fund
Rural Jobs Tax Credit	(75)	(225)	(236)	(248)	State General Fund
Defense R&D GRT Deduction	--	--	--	--	State General Fund
Aircraft Maintenance GRT Deduction	(700)	(1,470)	(1,544)	(1,621)	State General Fund
Increase Film Production Credit	--	--	--	--	State General Fund
Small Technology Business Credit	(1,500)	(2,200)	(2,420)	(2,662)	State General Fund
Expand Renewable Energy Tax Credit	--	--	--	--	State General Fund
Expand Film Production Tax Credit	(250)	(263)	(276)	(289)	State General Fund
Low-Income Housing Tax Credit	(87)	(200)	(1,740)	(3,050)	State General Fund
Gross Receipts Tax Holiday	(2,100)	(2,200)	(2,320)	(2,430)	State General Fund
Subtotal—State General Fund	**14,953**	**31,588**	**(3,073)**	**(33,239)**	
Rural Jobs Tax Credit	(25)	(75)	(78)	(82)	Local Governments
Aircraft Maintenance GRT Deduc-tion	(940)	(987)	(1,036)	(1,088)	Local Governments
Small Technology Business Credit	(300)	(450)	(495)	(545)	Local Governments
Low-Income Housing Tax Credit	(13)	(30)	(261)	(458)	Local Governments
Gross Receipts Tax Holiday	(1,340)	(1,407)	(1,477)	(1,551)	Local Governments
Subtotal—Local Governments	**(2,618)**	**(2,949)**	**(3,347)**	**(3,724)**	

In addition to the effects shown in the table, general fund revenue would be reduced in FY 2005 by $315 thousand due to the medical expense exemption and film credit provisions.

Income Tax Rate reduction delay and combining filing statuses.

1. Changing the rate in tax year 2006 from 5.3 percent to 5.8 percent raises $32.5 million in FY06. The 0.5 percent change has a $65 million impact on a full year basis, but the change is applicable on January 1, 2006 and thus applicable half way through the fiscal year.
2. The fiscal impact in FY07 is $60.5 million, and reflects the second half of the 2006 change and the first half of the 2007 change (from 4.9 percent in current law to 5.3 percent).
3. The fiscal impact in FY08 is $28 million, and reflects the second half of the 2007 change. In 2008 the top rate is reduced back to the 4.9 percent in current law, so the impact for that part of that part of the year is zero.

Head of Household filing status. Combining the head of household filing status with the married joint filing status provides tax relief for persons who currently file under the head of household status because the tax brackets for married filers covers a somewhat wider income range. Based on tax year 2003 tax returns, which were extrapolated to 2006 and beyond, TRD estimates that this reduces general fund revenue by $1.1 million in FY06 (applicable for half year only) and $2.2 million in FY07. The revenue impact decreases a little in the FY08 and FY09, reflecting the lower tax rates scheduled for those years.

New Personal exemption. TRD estimates that the $2,500 personal exemption will reduce general fund revenues by $8.25 million in FY06; this is a half-year impact (January 1, 2006 applicability date). The impact in FY07 is $16,500, double the FY06 impact; in later years the impacts grows slowly as underlying liability grows by approximately 6 percent, offset by scheduled rate reductions.

Medical expenses exemption. TRD estimates the revenue associated with the deduction to be $385 thousand. Assuming an average tax rate of 3.6 percent, this implies that the uncompensated care base for persons over 65 years of age is between $10 and $11 million.

GRT sale of services for resale credit. TRD estimates that this credit will reduce general fund revenues by $3.1 million in FY06. The impact of the credit grows by approximately 5 to 6 percent per year. TRD has estimated that the overall sale for resale of services tax base is $1.5 billion. Multiplying this first by the municipal rate of 3.775 and then by the 10% credit rate, implies a fiscal impact of $5.6 million. The TRD $3.1 million estimate presumably reflects the provision that exempts sales of services to national laboratories.

Defense Transformation gross receipts deduction. The fiscal impact of the new gross receipts tax deduction for "transformational acquisition programs" is estimated as minimal (probably zero). The minimal fiscal impact is based on the provisions limiting the exemption to new programs, which the department of defense staff have indicated probably would not be sent to New Mexico without the deduction.

ADMINISTRATIVE IMPLICATIONS

TRD reports that it could administer the provisions of this bill with existing resources.

OTHER SUBSTANTIVE ISSUES

The following issues and comments were provided by the Taxation and Revenue Department:

Personal Exemption:
The personal exemption proposal would provide relief to low-income individuals. For example, a family with four exemptions for federal purposes and adjusted gross income of $25,000 would be able to claim deductions totaling $12,000. Their taxable income would likely be approximately $17,500. Their tax obligation prior to claiming the credits would total $465. By reducing their taxable income to $5,500, the proposed measure would decreases their tax liability to $95 – thus providing them with $370 in tax relief – approximately 80 percent of their tax liability.

Head of household:
The head of household proposal would benefit approximately 121,500 individuals. The average benefit per return would be approximately $38.

"Pyramiding" in the Gross Receipts Tax:
New Mexico's gross receipts tax ("GRT") is one of the broadest-based transactions taxes of any state in the country. Maintaining a broad tax base enables New Mexico to collect adequate revenue with a relatively low tax rate. Transactions between businesses constitute a significant share of New Mexico's broad gross receipts tax base. Since the inputs and the outputs of businesses are subject to tax, the inclusion of business services in the tax base results in some degree of "pyramiding," i.e. multiple taxation of the same product or service. The GRT has been modified to limit pyramiding on sales of tangible items by providing deductions of sales for re-sale. In the case of services, the analogous deductions are limited to those cases where the next sale is taxable. In addition, many business services are not "for re-sale," but rather are "consumed" by the purchasing business. Thus, there exists a significant degree of multiple taxation of services within the GRT. The current system could be viewed as unfair to businesses that, due to the nature of their purchases, are subject to higher overall tax burdens than their competitors in New Mexico and in other states.

The proposal would address the pyramiding of tax on services to a limited extent. By removing a portion of tax from the sale of services for re-sale, the cumulative imposition of tax on re-sold services decreases. This would benefit, for example, a business re-selling services in interstate commerce. In such a case, the re-sale would not be subject to gross receipts tax, but under present law, the initial sale would have been taxable.

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