New Hampshire Department of Revenue Administration

Fiscal Note Quick Guide

25-0520.0

HB 503, *amending how revenues from taxes are allocated to the education trust fund.*

Ways and Means

<u>This bill This bill increases the rates of the business profits tax, business enterprise tax, and meals and rooms tax and reestablishes the interest and dividends tax. The bill provides for deposit of the additional revenue in the education trust fund.</u>

The proposed legislation would do four things.

> Sections 1 and 2 of the proposed legislation would reinstate a five percent interest and dividends tax, effective for taxable periods ending on or after December 31, 2025 with an increased threshold income level of $20,000.
>
> Sections 3 and 4 of the proposed legislation would increase the business profits tax rate by one percent and direct the additional revenue to the education trust fund (ETF) for taxable periods ending on or after December 31, 2025.
>
> Sections 5 and 6 of the proposed legislation would increase the business enterprise tax rate by one fifth of one percent and direct the additional revenue plus an additional .05% of the current revenue to the ETF for taxable periods ending on or after December 31, 2025.
>
> Section 7 of the proposed legislation would increase the tax on meals by one half of one percent and direct the additional revenue (and possibly other M&R revenue) to the ETF effective July 1, 2025.

The proposed legislation would not result in any additional ongoing administrative costs for the DRA to amend its forms, the taxpayer portal, Granite Tax Connect, and DRA's Revenue Information Management System ("RIMS") that could not be absorbed in the DRA operating budget. However, reinstatement of a new interest and dividends tax would require taxpayer outreach similar to that being engaged in now with respect to the repeal of I&D. While the efforts would be reduced due to the proposed increase in the filing threshold, the DRA estimates postage costs of up to $20,000 associated with one-time informational mailings. Given the cost-cutting measures currently being considered in connection with the ongoing budget process, DRA is not confident that its future operating budget could again absorb these costs.

Implementation of the proposed legislation as currently drafted would present a number of challenges for DRA as next described.

<u>Sections 1 and 2: New Interest and Dividends Tax (New Tax)</u>

The proposed legislation would reenact only two of the over 40 sections of RSA Chapter 77, formerly known as the interest and dividends tax (I&D) which are currently repealed effective January 1, 2025, applicable to taxable periods beginning after December 31, 2024.

At present, I&D continues to be administered by DRA, and I&D returns will continue to be audited by DRA for some time following the repeal. DRA is currently taking steps related to the repeal of I&D that include discontinuing the ability for taxpayers to carry a credit forward, returning any attempted overpayments to taxpayers, and notifying taxpayers of their rights regarding refunding of any older credit balances. By the effective date of the proposed legislation, these measures will have been almost completely implemented.

To the extent that the intention behind not re-enacting most sections of Chapter 77 is to create a tax that operates differently than I&D, DRA would strongly suggest that the New Tax be given a different name and established in a new and different Chapter of the RSAs to avoid taxpayer confusion. Even if it is the intention of the proposed legislation to re-enact I&D to operate exactly as it formerly did, the ongoing implementation of the current repeal just described will make it impossible to simply continue on with I&D as it currently exists. DRA is therefore analyzing the fiscal impact of the proposed legislation as if it were a New Tax.

Many of the provisions of Chapter 77 that are not re-enacted by the proposed legislation pertain to what is and is not considered taxable income for purposes of I&D (RSA 77:4, 77:4-b, 77:4-c, 77:4-d, 77:4-e, 77:4-g, 77:4-h, 77:6, 77:7, 77:8, 77:9, 77:10, 77:11, 77:13, 77:14-a, 77:14-b, 77:14-c, and 77:14-d). For purposes of estimating the fiscal impact of the proposed legislation, DRA assumes that these same definitional principles would apply to the term "income" when used here. However, to avoid confusion, DRA suggests that a definition of "income" be included in the proposed legislation so that it is clear whether any or all of the principles in the listed statutes continue to apply.

Two of the provisions of Chapter 77 that are not re-enacted by the proposed legislation pertain to what exemptions may be claimed from payment of I&D (RSA 77:5 and 77:5-a.) For purposes of estimating the fiscal impact of the proposed legislation, DRA has assumed that these exemptions do not apply to the New Tax and has applied only the new $20,000 threshold in re-enacted RSA 77:1. If this is not the intention, the proposed legislation may need to be clarified.

The remainder of the provisions of Chapter 77 that are not re-enacted by the proposed legislation pertain to administration and enforcement of I&D (RSA 77:17-a, 77:18, 77:18-a, 77:18-b, 77:19, 77:20, 77:21-b, 77:22, 77:23, 77:24, 77:24-b, 77:30, 77:33, 77:35, 77:36, and 77:37). For purposes of estimating the fiscal impact of the proposed legislation, DRA has assumed that it will have similar powers of administration and enforcement with respect to the New Tax. However, unless these provisions or something similar are in place, DRA will not have the same powers it does with respect to I&D, which will, in turn, impact the revenues to be realized from the New Tax.

<u>Sections 3-6: Business Tax Rate Increases</u>

Implementation of both the rate and fund distribution portions of these sections of the proposed legislation will require system changes in RIMS. DRA has assumed that both rate changes will be applicable beginning in tax year 2025 (applicable to taxable periods ending on or after December 31, 2025) for purposes of estimating the impact on state revenues. However, as a practical matter, the proposed legislation would likely become effective too late in the tax year for taxpayers to change their estimate strategies, such that the additional revenue estimated for FY 2025 is not likely to be fully realized and may instead shift into FY 2026. Additionally, the mid-tax year effective date may result in increased levels of underpayment penalties due to taxpayers being unaware or unable to timely adjust their estimate payments. To avoid these issues, the effective date and applicability provisions could be changed to correspond to the end of tax year 2026 to provide taxpayers sufficient time to adjust.

DRA has assumed that the distribution changes in the proposed legislation will be applicable to all payments received on or after July 1, 2025, regardless of the tax year to which they relate. This change may be easily implemented within RIMS. However, as with other proposed legislation that would cause BET and BPT to be split differently from one another, the proposed legislation will also impact revenue reporting as between the two business taxes and may result in incongruities between the reported fund splits in a given fiscal year and the actual splits being made at the time of the deposits. This is due to reallocations between the business taxes which are made in a different fiscal year than the fiscal year in which the revenue is received. With the fund splits for both business taxes the same, reallocation between the two taxes does not require reallocation between the two funds. However, when the two taxes have different fund splits, a reallocation between taxes also requires a reallocation between funds. Adjustments are often made in a different fiscal year than the fiscal year that the revenue is received because most business taxpayers initially make quarterly estimated payments or payments on extension. In these cases, DRA has processes in place to split the revenue received between BPT and BET based on historical data. The final split between the two taxes is not known until the taxpayer files their return, which may be 9 to 18 months after receipt of the first estimate. Consequently, many reallocations occur in a different fiscal year than the fiscal year that the revenue is received. Because under the proposed legislation, the effective BPT ETF split will become 47.9% (7.5% at 41% to the ETF and 1% at 100% to the ETF) and the effective BET ETF split will become 60.6% (.5% at 41% to the ETF and .25% at 100% to the ETF), any revenue initially overallocated to BET prior to receipt of the return will appear as a reduction to ETF revenue in a future fiscal year. This problem is avoided with the current uniform split between the taxes.

<u>Section 7: Meals and Rooms Tax (M&R) Increase</u>

The proposed legislation increases the rate of the tax on meals over $1.00 from the current rate of 8.5% to 9.0%. The proposed legislation is silent regarding the rate of the tax on rooms and rentals. DRA assumes that the tax rate for room occupancy and rentals will remain the same at 8.5%.

The proposed legislation also requires that 0.5% of the tax on meals *and rooms* over $1.00 will be deposited into the ETF. The DRA assumes that the 0.5% distribution to the ETF will come from both the meals and room occupancy portions of the tax. This will result in a shift in existing revenue related to room occupancy from the general fund (GF) to the ETF. If this is not the intention of the proposed legislation, the language may need to be clarified. DRA also notes that the language is inconsistent with RSA 78-A:26, which directs that all revenue net of the costs of administration, except vehicle rental revenue, and revenue transferred to the Meals and Rooms Municipal Revenue Fund be transferred to the GF. Currently, the tax on vehicle rentals is distributed to the ETF at 100%. DRA assumes this distribution will remain unchanged. For clarity, the DRA suggests that all of the language related to distributions to the ETF in the proposed legislation be moved to RSA 78-A:26 Disposition of Revenue under a new paragraph or harmonized with the existing language of that RSA.

In addition, the DRA suggests that the effective date of this proposed legislation be October 1, 2025, as there would not be enough time to inform operators of the rate change using the proposed effective date.

Interest and Dividends Methodology

The fiscal impact of this proposed legislation is an indeterminable increase to the General Fund, hypothetically starting in FY2025, but more likely shifting into FY 2026 for the reasons described in Section B. The Department has no definitive method to determine future income and dividend income and corresponding New Tax liability. However, the DRA has calculated a possible fiscal impact based on TY2022 Gross Taxable I&D Income as follows:

1. Since the proposed legislation would be applicable beginning with taxable periods ending on or after December 31, 2025 (Tax Year 2025) DRA begins its analysis with FY 2025.
2. The DRA did an analysis based on I&D in prior years to break out the split of tax year revenue to fiscal year revenue. The split breakdown used for FY 2025 and forward is: 6% attributable to two tax years prior, 68% attributable to prior tax year, and 26% attributable to current tax year.
3. The chart below reflects in each fiscal year, the portion of revenue from the respective tax years based on the New Tax rate in the proposed legislation.
4. To calculate the FY2025 thru FY2027 revenues, the DRA used TY2022 Gross Taxable I&D Income of $3.2 billion for the starting point.
5. The New Tax rate in the proposed legislation is then applied based on the relevant tax year in each fiscal year to come up with the revenue for each fiscal year in each comparative scenario.
6. The DRA then used the results in item (4) above and adjusted TY2022 Gross Taxable I&D Income for the $20,000 income threshold in the proposed legislation.
7. The estimated fiscal impact of the proposed legislation may be overstated or understated for future fiscal years depending on whether actual revenue is more or less than TY2022 Gross Taxable I&D Income as well as the impacts of interest rates and/or market forces.

New Tax- Static Analysis Using Tax Year 2022 Gross Taxable I&D Income				
Fiscal Year	**Current Law Revenue Using TY2022 Gross Taxable I&D Income**	**Estimated Revenue with Proposed Legislation**	**Estimated Fiscal Impact Per Year**	**Cumulative Fiscal Impact**
2025[1]	$0	$32,200,000	$32,200,000	$32,200,000
2026	$0	$116,400,000	$116,400,000	$148,600,000
2027 and Forward	$0	$123,800,000	$123,800,000	$272,400,000

[1] As set forth in Section B, this revenue may not be realized until FY 2026 due to the timing of the effectiveness of the proposed legislation relative to taxpayer estimate behavior.

Fiscal Year	Tax Year	% Applicable to Tax Year	Current Law New Tax Rates	Proposed Law New Tax Rates
Fiscal Year 2025	Tax Year 2023	6%	0.00%	0.00%
	Tax Year 2024	68%	0.00%	0.00%
	Tax Year 2025	26%	0.00%	5.00%
Fiscal Year 2026	Tax Year 2024	6%	0.00%	0.00%
	Tax Year 2025	68%	0.00%	5.00%
	Tax Year 2026	26%	0.00%	5.00%
Fiscal Year 2027 and Forward	Tax Year 2025 and Forward	6%	0.00%	5.00%
		68%	0.00%	5.00%
		26%	0.00%	5.00%

Business Profits Tax (BPT) Methodology

The fiscal impact of the proposed legislation is an indeterminable increase to the ETF hypothetically starting in FY2025 but more likely shifting into FY 2026 for the reasons described in Section B. The increase is indeterminable because the DRA is unable to predict base business profits for future years. However, the DRA has calculated a possible fiscal impact based on TY 2022 revenue as follows:

1. To calculate FY2025 through FY2027 revenues under current law as well as under the proposed legislation, the DRA used TY2022 BPT tax base of $11.3 billion as the starting point. The applicable BPT rate for taxable periods ending on or after December 31, 2022, was 7.6%.
2. Because revenue for a given tax year is realized in multiple fiscal years, the DRA did an analysis based on prior years to break out the split of tax year revenue to fiscal year revenue and applied it to FY2025 and forward is: 12% attributable to two years prior, 69% attributable to prior tax year, and 19% attributable to current tax year.
3. The DRA applied the applicable BPT rate of 7.5% for taxable periods ending on or after December 31, 2023 to calculate the estimated revenue under current law, as shown in the second column of the table below.
4. The BPT rate change to 8.5% contained in this proposed legislation is then applied to calculate estimated revenue, as shown in the third column, and the year-over-year and cumulative impact shown in the fourth and fifth columns.
5. The proposed legislation allocates all revenue from the rate increase to the ETF. The second table below illustrates the impact of distributing that revenue to the ETF beginning in FY2025.

6. The estimated fiscal impact does not consider any overpayments/credit carryforwards on file.

Business Profits Tax All Funds- Static Analysis using TY 2022 Liability				
Fiscal Year	**Current Law Revenue Using TY2022 BPT Tax**	**Estimated Revenue with Proposed Legislation**	**Estimated Fiscal Impact Per Year**	**Cumulative Fiscal Impact**
2025[2]	$847,400,000	$868,900,000	$21,500,000	$21,500,000
2026	$847,400,000	$946,800,000	$99,400,000	$120,900,000
2027 and Forward	$847,400,000	$960,300,000	$112,900,000	$233,800,000

Business Profits Tax Education Trust Fund - Static Analysis using TY 2022 Liability				
Fiscal Year	**Current Law Revenue Using TY2022 BPT Tax**	**Estimated Revenue with Proposed Legislation**	**Estimated Fiscal Impact Per Year**	**Cumulative Fiscal Impact**
2025	$347,400,000	$368,900,000	$21,500,000	$21,500,000
2026	$347,400,000	$446,800,000	$99,400,000	$120,900,000
2027 and Forward	$347,400,000	$460,300,000	$112,900,000	$233,800,000

Fiscal Year	**Tax Year**	**% Applicable to Tax Year**	**Current Law BPT Rates**	**Proposed Law BPT Rates**
Fiscal Year 2025	Tax Year 2023	12%	7.50%	7.50%
	Tax Year 2024	69%	7.50%	7.50%
	Tax Year 2025	19%	7.50%	8.50%
Fiscal Year 2026	Tax Year 2024	12%	7.50%	7.50%
	Tax Year 2025	69%	7.50%	8.50%
	Tax Year 2026	19%	7.50%	8.50%
Fiscal Year 2027 and forward	Tax Year 2025 and Forward	12%	7.50%	8.50%
		69%	7.50%	8.50%

[2] As set forth in Section B, this revenue may not be realized until FY 2026 due to the timing of the effectiveness of the proposed legislation relative to taxpayer estimate behavior.

		19%	7.50%	8.50%

Business Enterprise Tax Methodology

The proposed legislation would result in an indeterminable decrease to the GF and a larger indeterminable increase to the ETF starting in FY2025, but more likely shifting into FY 2026 for the reasons described in Section B. The overall increase is indeterminable because the DRA is unable to predict the base business enterprise value for future years. However, the DRA has calculated a possible fiscal impact based on TY 2022 BET revenue as follows:

1. To calculate FY2025 through FY2027 revenues under current law as well as the proposed rate changes, the DRA used TY2022 BET tax base of $44.5 billion as the starting point. The applicable BET rate for taxable periods ending on or after December 31, 2022, was 0.55%.

2. Because revenue for a given tax year is realized in multiple fiscal years, the DRA did an analysis based on prior years to break out the split of tax year revenue to fiscal year revenue and applied it to FY2025 and forward as follows: 12% attributable to two taw years prior, 69% attributable to prior tax year, and 19% attributable to current tax year.
3. The DRA applied the current rate of 0.55% to calculate the estimated revenue under current law, as shown in the second column of the table below.
4. The BET rate change to .75% contained in this proposed legislation is then applied to calculate estimated revenue, as shown in the third column, and the year-over-year and cumulative impact shown in the fourth and fifth columns.
5. The proposed legislation allocates all the revenue from the rate increase as well as the revenue from an additional .05% of the current rate to the ETF. The second table below illustrates the impact of distributing the revenue associated with 0.25% of the BET rate to the ETF beginning in FY 2025.
6. The estimated fiscal impact does not consider any overpayments/credit carryforwards on file.

Business Enterprise Tax All Funds- Static Analysis using TY 2022 Liability				
Fiscal Year	**Current Law Revenue Using TY2022 BET Tax**	**Estimated Revenue with Proposed Legislation**	**Estimated Fiscal Impact Per Year**	**Cumulative Fiscal Impact**
2025[3]	$244,600,000	$261,500,000	$16,900,000	$16,900,000
2026	$244,600,000	$322,800,000	$78,200,000	$95,100,000

[3] As set forth in Section B, this revenue may not be realized until FY 2026 due to the timing of the effectiveness of the proposed legislation relative to taxpayer estimate behavior.

2027 and Forward	$244,600,000	$333,500,000	$88,900,000	$184,000,000

Business Enterprise Tax Education Trust Fund - Static Analysis using TY 2022 Liability				
Fiscal Year	**Current Law Revenue Using TY2022 BET Tax**	**Estimated Revenue with Proposed Legislation**	**Estimated Fiscal Impact Per Year**	**Cumulative Fiscal Impact**
2025	$100,300,000	$119,600,000	$19,300,000	$19,300,000
2026	$100,300,000	$189,900,000	$89,600,000	$108,900,000
2027 and Forward	$100,300,000	$202,100,000	$101,800,000	$210,700,000

Business Enterprise Tax General Fund and Education Trust Fund Full Implementation- Static Analysis using TY 2022 Liability			
Fund	**Current Law Revenue Using TY2022 BET Tax**	**Estimated Revenue with Proposed Legislation**	**Estimated Fiscal Impact Per Fiscal Year**
General Fund	$144,300,000	$131,400,000	$(12,900,000)
Education Trust Fund	$100,300,000	$202,100,000	$101,800,000
Total	**$244,600,000**	**$333,500,000**	**$88,900,000**

Fiscal Year	Tax Year	% Applicable to Tax Year	Current Law BET Rates	Proposed Law BET Rates
Fiscal Year 2025	Tax Year 2023	12%	0.55%	0.55%
	Tax Year 2024	69%	0.55%	0.55%
	Tax Year 2025	19%	0.55%	0.75%
Fiscal Year 2026	Tax Year 2024	12%	0.55%	0.55%
	Tax Year 2025	69%	0.55%	0.75%
	Tax Year 2026	19%	0.55%	0.75%
Fiscal Year 2027 and forward	Tax Year 2025 and Forward	12%	0.55%	0.75%
		69%	0.55%	0.75%
		19%	0.55%	0.75%

It should also be noted that increasing the BET rate will also increase the BET credit available to offset the BPT, decreasing BPT revenue. However, the BPT decrease will be less than the BET increase because not all taxpayers have a BPT liability to be offset by a BET credit and not all taxpayer's BET liability exceeds the BPT credit. In those situations, the BET gain in revenue is not offset by a decreased BPT liability.

Meals and Rooms Methodology

The proposed legislation would result in an indeterminable decrease to the GF and an indeterminable increase to the ETF. The DRA is unable to determine the exact future impact of the proposed tax rate increase to 9.0% on taxable meals and the additional distributions to the ETF because the DRA cannot precisely predict what the total revenues from the M&R tax will be in future years. However, using M&R reported liability for FY 2024, the DRA can estimate the fiscal impact using a static analysis. Since M&R is due by the 15th day of the month following the taxable period, the impact of the proposed legislation would be recognized in August 2025 and onwards.

1. To estimate FY2026 revenue under current law as well as under the proposed legislation, the DRA used the M&R tax liability reported on a cash basis during FY 2024 of $476.9 million as the starting point. Operators retained commissions of $12.5 million (2.6% of the total collected based on data reported by operators in FY 2024). Thus, the total tax remitted to DRA by operators for FY 2024 was $464.4 million.
2. Of the M&R collected, the meals portion of the tax collected on a gross cash basis during FY 2024 was $377.7 million. Again, operator-retained commission on the meals tax amounted to $9.8 million. Thus, the meals tax remitted to DRA by operators for FY 2024 was $367.7 million.
3. Assuming operator-retained commissions remain at the same rate, the meals tax of $367.7 million is divided by 8.5% and then multiplied by 9.0% to calculate the proposed meals tax increase of $21.6M to $389.3 million.
4. The table below illustrates the change to the meals tax under the proposed legislation. (The rooms and rentals portion of the tax is also included in table below to give a holistic view.)

Meals & Rooms Tax - Static Analysis using FY 2024 Reported Liability Less Commissions			
M&R Tax Component	**FY 2024 M&R Revenue - Current Law (cash basis less commissions)**	**FY 2024 M&R Revenue - Proposed Law (cash basis less commissions)**	**Estimated Fiscal Impact Per Fiscal Year**
Meals	$367,700,000	$389,300,000	$21,600,000
Rooms	$87,200,000	$87,200,000	-
Rentals	$9,500,000	$9,500,000	-

Total	**$464,400,000**	**$486,000,000**	**$21,600,000**

5. The proposed legislation amends the M&R transfer to the ETF to include 0.5% of the taxes on meals and rooms in addition to 100% of the tax on rentals. Because the 0.5% rate increase only applies to the meals portion of the tax, there is an indeterminable decrease to the GF because the rate for the rooms portion of the tax remains unchanged at 8.5%.
6. The second column of the chart below shows the amount of M&R allocated to the GF and ETF under current law, with 100% of the tax on meals and rooms distributed to the GF and 100% of the tax on rentals distributed to the ETF.
7. The third column of the chart below shows the amount of M&R allocated to the GF and the ETF under the proposed legislation, with 95% of the tax on meals and rooms distributed to the GF and 100% of the tax on rentals and 5% of the tax on meals and rooms distributed to the ETF.

Meals & Rentals Tax - Static Analysis using FY 2024 Reported Liability Less Commissions			
Fund	**FY 2024 M&R Revenue - Current Law (cash basis less commissions)**	**FY 2024 M&R Revenue - Proposed Law (cash basis less commissions)**	**Estimated Fiscal Impact Per Fiscal Year**
General Fund	$454,900,000	$452,700,000	$(2,200,000)
Education Trust Fund	$9,500,000	$33,300,000	$23,800,000
Total	**$464,400,000**	**$486,000,000**	**$21,600,000**