

Fiscal impact reports (FIRs) are prepared by the Legislative Finance Committee (LFC) for standing finance committees of the NM Legislature. The LFC does not assume responsibility for the accuracy of these reports if they are used for other purposes.

Current FIRs (in HTML & Adobe PDF formats) are available on the NM Legislative Website (www.nmlegis.gov). Adobe PDF versions include all attachments, whereas HTML versions may not. Previously issued FIRs and attachments may be obtained from the LFC in Suite 101 of the State Capitol Building North.

FISCAL IMPACT REPORT

ORIGINAL DATE 01/31/17

SPONSOR White/Rep Trujillo, CA LAST UPDATED _____ HB _____

SHORT TITLE Taxation of Internet Sales SB 264

ANALYST Clark

REVENUE (dollars in thousands)

Estimated Revenue*					Recurring or Nonrecurring	Fund Affected
FY17	FY18	FY19	FY20	FY21		
\$0	\$8,820.0 - \$38,300.0	\$9,240.0 - \$39,800.0	\$9,720.0 - \$41,400.0	\$10,140.0 - \$43,100.0	Recurring	General Fund
\$0	\$5,880.0 - \$20,400.0	\$6,160.0 - \$21,200.0	\$6,480.0 - \$22,000.0	\$6,760.0 - \$22,900.0	Recurring	Counties and Munis

Parenthesis () indicate revenue decreases

* These revenue estimates are highly uncertain and might be challenged in court (see “Fiscal Implications” and “Significant Issues”)

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY17	FY18	FY19	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
Total	\$0	\$1.1	\$0	\$1.1	Nonrecurring	TRD Operating Budget

Parenthesis () indicate expenditure decreases

Duplicates HB202

SOURCES OF INFORMATION

LFC Files

Responses Received From

New Mexico Municipal League

New Mexico Association of Counties (NMAC)

Taxation and Revenue Department (TRD)

SUMMARY

Synopsis of Bill

Senate Bill 264 changes definitions to exclude any person without physical presence in the state and with less than \$100 thousand in average gross receipts during the prior calendar year from gross receipts tax (GRT) and compensating tax liability. By specifically excluding those with less than \$100 thousand in receipts, the bill therefore includes larger out-of-state sellers. The intent appears primarily to be to allow for collection of taxes from internet vendors.

The bill also includes in the definition of gross receipts third-party sales made over a multi-vendor marketplace platform that acts as the intermediary between the seller and purchaser. This captures third-party sales made through websites such as Amazon.com and eBay.

Additionally, the bill prohibits the Taxation and Revenue Department (TRD) from enforcing the collection of GRT for a tax period prior to July 1, 2017 if the person lacked physical presence in the state and did not report taxable gross receipts for the period.

Furthermore, the bill defines out-of-state sales by entities without a physical presence in the state as taking place at the location to which the property or the product of a service is delivered. This would require the seller to collect and remit GRT increments to the local governments.

Finally, the bill allows the refund of gross receipts tax to be applied against any compensating tax owed by that person's customer as a result of transactions with that person.

The effective date of the bill is July 1, 2017.

FISCAL IMPLICATIONS

The estimated fiscal impact is particularly uncertain. These are highly imprecise estimates, with the low end representing the low end of the range provided by TRD and the high end representing the amount estimated by LFC as the likely ballpark amount of GRT revenue lost through untaxed internet sales. The high end is a conservative estimate of lost revenues through such sales, but in this context, it assumes full compliance to reduce lost revenues to zero, which is unrealistic. The revenues the state would gain from this bill are more realistically going to fall in the middle or lower range of the spectrum, at least in the early stages of implementation, because it could take some time to bring vendors into compliance.

It is important to note there is not universal agreement this bill would not violate the U.S. Supreme Court Quill decision (see "Significant Issues" for a detailed discussion), potentially placing these revenues in jeopardy if courts order the taxes refunded to taxpayers.

LFC economists used a slightly different method from TRD economists to estimate the loss of GRT revenues through internet sales, taking the per capita amount of the national losses and then adjusting based on the state's population and differential in average real disposable income. The full TRD methodology is presented below.

Accurately estimating GRT revenue collections from sales by any internet-based retailer is extremely difficult, as there is a dearth of information that would allow for estimates

without the application of numerous assumptions. For this estimate, the base was calculated using information from a representative sample of “internet-based retailers”. TRD used publically available data from these companies’ U.S. Securities and Exchange Commission (SEC) filings for 2015, which in turn, contained data on the entities’ net sales and operating expenses in the U.S., North America, and other regions. Based on our analysis, gross sales in the U.S. were estimated at about \$130 billion. TRD does not know which component of that base would be taxable or exempt under New Mexico’s laws. The gross U.S. sales estimate of \$130 billion was then divided by the U.S. population (318.9 million) to come up with a “gross sales per capita” amount of \$407. This amount is used as a proxy of the average annual dollar amount spent on purchases fulfilled by “internet-based retailers”. Using New Mexico’s estimated actual average GRT rate in FY2016 of 6.93 percent, a sale of \$407 would generate a combined GRT revenue of \$28.19 for the state and local governments. This amount is multiplied by a hypothetical percent of the population¹. In this case, TRD assumed 25 percent of the population, or approximately 520,254 individuals in the state, would engage in such practice, henceforth producing an estimated \$14.7 million of “internet-based retailer” GRT revenue. The estimated revenue impact is presented in the form of a range to account for potential revenue collections outside of the sample of sales considered that are unaccounted for at this time.

SIGNIFICANT ISSUES

The Association of Counties reports, “NMAC has a policy to support any legislation and tax reform efforts that improve economic efficiency, economic development, ease of administration, and overall fairness of the state and local tax system. It is essential that NMAC fully participates in legislative and executive efforts to restructure and reform the state and local tax system. Therefore, NMAC would support this bill to broaden the tax base and level the playing field with our local small businesses. We do have concerns as to how the tax would flow to local tax districts.”

TRD provided the following analysis.

The bill implicates several principles of tax policy. It addresses revenue adequacy by increasing revenues to the state and local governments. It addresses equity and “main street” fairness issues by eliminating the competitive tax disadvantage borne by local, in-state vendors. The bill would however, increase tax burdens borne by New Mexico citizens on purchases from certain remote vendors. In the current landscape, and because constitutional principles of “nexus” (physical presence) have expanded and loosened in the last five to 10 years, especially through judicial decisions, some internet or remote vendors are already subject to GRT. Others, however, are not.

As written, the bill facially challenges the US Supreme Court’s decision in *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992). It begs resolution to two questions: (1) does the constitutional physical presence requirement apply to New Mexico’s GRT; and (2) if so, whether the *Quill* decision should be reversed. The New Mexico Supreme Court applied the *Quill* decision in their decision in *N.M. Taxation & Revenue Dep’t v.*

¹ New Mexico’s population as of July 1, 2016 was estimated at 2,081,015 inhabitants, according to the U.S. Census Bureau’s website located at <http://www.census.gov/quickfacts/table/PST045216/35>

Barnesandnoble.com LLC (2014). Once the department identifies a taxpayer as having no physical presence in the state, the department cannot tax that person. Other states do tax internet retail companies that do not have a traditional nexus with the taxing state, but their statutes do not use the term “without a physical presence.” If the bill’s purpose of amending the statute is to collect gross receipts taxes from persons that make a threshold amount of internet sales to New Mexico buyers, that goal can be accomplished by redefining what it means to engage in business in New Mexico, without using the term “no physical presence”. For example, “engaging in business in New Mexico includes out-of-state retailers who make more than X amount of sales to purchasers in New Mexico.”

As written, Section 7-1-14(E) NMSA 1978 proposes a potential constitutional violation of the U.S. Commerce Clause. TRD has strong concerns about taxing entities “without a physical presence in the state”. Under current law, a person that has no physical presence in the state is not subject to the gross receipts tax for an internet-based sale to someone in the state.

Section 7-1-29(C) NMSA 1978 is problematic because of a potential violation of confidentiality laws. The practical application of this is the bill would allow TRD to offset a refund of gross receipts tax paid from one taxpayer against the compensating tax liability of a different taxpayer. Unlike offsetting credits within the same tax program for the same taxpayer, the proposed amendment allows TRD to offset a refund of gross receipts taxes from one taxpayer against another taxpayer’s compensating tax liability based only on a purchase which would have to be shared with the department by the seller in order to locate the correct account(s), at a minimum this would violate the confidentiality of both taxpayers.

The following analysis contains historical and technical details from the New Mexico Tax Research Institute related to internet taxation issues.

In 1992, the U.S. Supreme Court in the *Quill* case said that some physical presence was necessary for a state to assert a sales tax collection obligation on a person selling to purchasers in a state. There was no internet retail commerce in 1992. Fast forward, and the volume of dollars at issue is huge and growing. Budget woes and fairness concerns have focused attention on overturning *Quill*, which was the genesis of the Streamlined Sales and Use Tax Agreement and proposed federal legislation including the Marketplace Fairness Act.

It was never entirely clear to what extent *Quill*’s physical presence rule applied to state taxes generally. In the early years, some states assumed it applied to all taxes, including business profits or corporate income taxes, for example. But over the years, as the limits of the case have been tested in the lower courts, there have been only a very few instances in which state courts found that it applied outside of the sales and use tax collection area. Nor has the U.S. Supreme Court ever expanded *Quill*’s scope. Therefore, the majority of states now hold that the case’s physical presence limit does not apply to income taxes. And Washington state, which has a broad gross receipts tax has successfully argued that it doesn’t apply to that tax. Ohio, with a similar tax, has taken a similar position, although the case is still being litigated.

States have also argued that physical presence may take different forms; for example, New York’s “Amazon” click-through nexus law (adopted by other states as well) has successfully established that internet sellers who have third-party representatives in the state promoting the

sellers' websites have physical presence. States also adopted “work-around” solutions like Colorado’s information reporting requirements which have been litigated in the Direct Marketing Association (DMA) case. In a recent opinion in that case, (which was before the U.S. Supreme Court on a procedural issue) Justice Kennedy suggested Quill’s physical presence rule is outdated.

Alabama, South Dakota and others have now enacted legislation designed to provide the basis for a challenge to Quill. Large internet sellers are responding, in many cases, by simply agreeing to begin paying tax.

One important development in the Direct Marketing Association (DMA) case affects New Mexico directly. In that case, the 10th Circuit Court of Appeals (our federal circuit) held that Quill was limited to sales and use tax reporting obligations exclusively. DMA filed a petition with the Supreme Court on another issue but chose not to appeal the question of whether Quill’s physical presence limit applies to anything other than sales and use tax collection requirements. So in this circuit, at least, the issue is settled. Additionally, the Supreme Court recently declined to hear the DMA appeal. There is no longer any reason to assume that Quill applies to our gross receipts tax – which is substantially different from a sales tax collection obligation.

The legislative intent behind our gross receipts tax “engaging in business” statute has long been much broader than the physical presence requirement of Quill. But enforcement of the tax was constrained on the assumption that Quill applied. The Legislature can now provide clarification that, given all these developments, there is no longer any reason to make that assumption.

Even if one were to take the position our tax is the equivalent of a sales tax (and it’s clearly not structured that way), we are still unlikely to see litigation challenging the position that Quill’s limit does not apply. This is because other aspects of the gross receipts tax makes it much simpler to comply with than a sales tax. Most importantly—there is a single statewide rate. And also, the tax does not have to be charged separately by the seller, so that unlike a sales tax, no purchaser can challenge the seller’s chosen method of recovering the tax—whether through separate statement or building it into the price of products sold.

Large remote seller marketplace providers and platforms are currently picking and choosing which state taxes they will comply with based on their assessment of the risks of litigation. “Squeaky wheel” states are getting the grease—more than they expected—as sellers determine it is better to simply comply than continue to fight. New Mexico is fortunate in that, if we want to join the 14 or more states that are pushing back on Quill’s limitation, we have even more sound policy and legal reasons to do so now. And the approach for us is simpler than it is for the traditional sales and use tax states.

The approach in the proposed legislation amending the engaging in business statute could prove the fastest approach at improving voluntary compliance by remote sellers. It simply clarifies that it is now clear that Quill’s limitation does not apply to the tax and, at the same time, provides an exception for a small businesses that has limited receipts and no physical presence. It further ensures that there will be no looking backward on unsuspecting taxpayers who may have assumed that Quill applied to the gross receipts tax.

ADMINISTRATIVE IMPLICATIONS

There would be a minimal administrative impact on TRD's Revenue Processing Division (RPD) at a cost of \$1,100 for training purposes. The combined reporting system (CRS) team would need to be educated to become familiar with the updated forms and instructions and to learn how to answer questions from taxpayers about the changes proposed by the bill. Specifically, CRS staff would need to learn when and how to offset an existing compensating tax liability with the newly assessed gross receipts tax to remote sellers. The Audit and Compliance Division would also need training to insure that audits and collections are completed in accordance to the language of the bill. The CRS-1 Filer's Kit and publications released by the department would have to be updated. The bill would have a minimal impact to the Information Technology Division as well.

DUPLICATION

This bill duplicates HB202.

TECHNICAL ISSUES

TRD notes, "The proposed refund of GRT being applied to a compensating tax liability could lead to a significant decrease of GRT revenue distributions to local governments. Compensating tax only applies to the state jurisdiction (5 percent for services and 5.125 percent for sale of tangible personal property) and not the local government jurisdiction. The potential decrease in GRT revenue would affect distributions and could be severe enough as to cause an adverse event for small cities and counties that would prompt them to seek relief under Section 7-1-6.15 NMSA 1978 (HB-581 2015 Session).

Under current law, buyers of goods and services using the Internet from out-of-state vendors without a physical presence are subject to the corresponding compensating tax rate. If the bill becomes law, the state and local GRT assessed would exceed the equivalent compensating tax portion that would only have been assessed from the state jurisdiction for the same period. If the department refunds the GRT back to the seller once they prove they have no nexus in the state based on the \$100 thousand gross receipts threshold, the seller would benefit from the total GRT rate differential when the buyer is subject to the compensating tax. For this reason, TRD proposes the bill is amended to deposit into an escrow account the proceeds of the difference between the GRT rate and the compensating tax rate differentials, until they are refunded to the taxpayer who is the buyer."

JC/jle

Attachment 1

2016 State Internet Tax Legislation (provided by NCSL)

State	Bill #	Status	Type of Legislation
Alabama	H.B. 660 (2015)	(Session Adjourned)	Expanded Nexus
	H.B. 116	Passed House (Session Adjourned)	Updates language should federal law pass
	S.B. 242	(Session Adjourned)	Amends definitions of TPP and Digital Goods
	Administrative Rule	Effective January 1, 2016	Requires Remote Sellers with more than \$250,000 in in-state sales to collect
Connecticut	S.B. 448	Passed Committee (Session Adjourned)	Reporting Requirement
Florida	H.M. 1207	(Session Adjourned)	Streamlined Sales Tax
Idaho	H. 581	Passed Committee (Session Adjourned)	Expanded Nexus
Illinois	S.B. 2793	Introduced - 2/17	Short Title
Iowa	H.F. 2319	(Session Adjourned)	Use Tax Line on Income Tax Return
Kansas	H.B. 2603	Hearing - 2/17 (Session Adjourned)	(obligation of consumers to remit)
Louisiana	H.B. 6	(Special Session Adjourned)	Expanded Nexus
	H.B. 30	Enacted	Expanded Nexus Reporting Requirement for \$50,000 of remote sales
	H.B. 96	(Special Session Adjourned)	Affiliate Nexus
	H.B. 110	(Special Session Adjourned)	Notice Legislation
	H.B. 113	(Special Session Adjourned)	Notice Legislation
	H.B. 1121	Enacted	Notification to Customers and DOR
Massachusetts	H.B. 96	Referred to Ways and Means Committee - 3/14	Expanded Nexus
	H.B. 2569	Passed Committee - 7/8/15	SST Conformity
	H.B. 2628	Hearing Held - 5/5/15	Quill is Dead/State can collect at 5.75% rate for remote sales
	S.B. 1541	Substituted for S.B. 1974 - 7/30/15	Anticipates Federal Action
	S.B. 1618	Hearing held - 10/6/15	Expanded Nexus
	S.B. 1974	Passed Senate 7/30/15, referred to House	Anticipates Federal Action
Minnesota	S.F. 2374	Introduced - 3/8 (Companion to H.F. 2769)	Expanded Nexus
	H.F. 2769	Introduced - 3/8 (Companion to S.F. 2374)	Expanded Nexus
	S.F. 3093	Introduced - 3/23 (Companion to H.F. 3124)	Expanded Nexus
	H.F. 3124	Introduced - 3/14 (Companion to S.F. 3093)	Expanded Nexus
	H.F. 848	Pocket Vetoed - Per Drafting Error (Omnibus Tax Bill)	Expanded Nexus (Marketplace Provider)
	H.F. 3787	Introduced - 4/1	Quill Challenge
Missouri	S.B. 795	(Failed upon Adjournment)	Streamlined Sales Tax
Mississippi	H.B. 418	Failed to Meet Committee Reporting Deadline	Amends definition of "retailer"
	H.B. 1693	Failed to Meet Committee Reporting Deadline	Expanded Nexus
	H.B. 1676	Failed to Meet Committee Reporting Deadline	Expanded Nexus
	S.B. 2052	Failed to Meet Committee Reporting Deadline	Expanded Nexus
Nebraska	L.B. 1087	(Failed upon Adjournment)	Expanded Nexus; Marketplace Provisions
Ohio	CAT Case	May 4th Hearing before Ohio Supreme Court	Applies to out-of-state businesses with \$500,000 in in-state sales
	H.B. 232	Introduced - 5/27/15	Expanded Nexus
Oklahoma	S.B. 1251	Passed Senate - 3/2	Requires Remote Sellers with more than \$1 million in in-state sales to collect
	S.B. 1301	4/7 - Passed House Committee Amended	Reporting Requirement
	H.B. 2531	Enacted	Expanded Nexus/Marketplace Provider/Reporting Requirement
	H.B. 2925	Missed Crossover	Affiliate/Limited Expanded Nexus
Rhode Island	H.B. 7375	(Failed upon Adjournment)	NCSL Model Legislation
	H.B. 7230	(Failed upon Adjournment)	Expanded Nexus
South Carolina	S.B. 170	Passed Senate - 5/12/15 (Failed upon Adjournment)	Affiliate Nexus
South Dakota	S.B. 106	Enacted	Quill Challenge
Tennessee	Administrative Rule	Proposed June 6/15/16	Requires Remote Sellers with more than \$500,000 in in-state sales to collect
Utah	S.B. 182	Passed Senate - 3/1 (Failed upon Adjournment)	Expanded Nexus
	S.B. 65	Missed Crossover	Expanded Nexus
	S.B. 85	Missed Crossover	Expanded Nexus
	H.B. 235	3rd Read - 3/1 (Failed upon Adjournment)	Remote Transactions Parity Act
	H.B. 873	Enacted	Reporting Requirement/ SD Collection
Washington	H.B. 2224	Failed to Meet Crossover Deadline	Repeals the nonresident sales and use tax exemption