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**PROFESSIONAL TAX
STUDY
COMMITTEE
REPORT**

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The legislature and the governor authorized the creation of a Tax Study Committee, otherwise known as the Professional Tax Study Committee (PTSC) in House Bill 900, Laws of 1994. A copy of House Bill 900 appears in Appendix A. In relevant part, the house bill states:

A. The co-chairmen of the Legislative council, in consultation with the governor, shall appoint a tax study committee. The tax study committee shall be composed of five public members who are experts in the field of tax policy and tax law.

B. The committee shall examine the manner and subjects of taxation and the foundations and goals of current and recommended tax policy. The committee . . . shall report its findings and recommendations, including proposed bill drafts, to the members of the appropriate interim or special legislative committee, the legislative council and the governor prior to the commencement of the forty-third legislature.

As required by House Bill 900, PTSC submits this report of its findings and recommendations, including a proposed bill draft. A summary of PTSC's actions can be found in Appendix B. The Committee emphasizes that the bill draft is not final and is intended only to illustrate, in legislative form, the concepts discussed in this report. The bill may contain technical inaccuracies that the Committee will eliminate as it continues its deliberations.

1. Overview

The members of PTSC are: Janice M. Ahern, a Santa Fe attorney with Gerber, Ahern & Aikin, P.A., Robert J. Desiderio, Committee Chair, Professor of Law, University of New Mexico, James W. Francis, a Hobbs certified public accountant with Johnson, Miller & Co, Brian McDonald, Director, Bureau of

Business and Economic Research, University of New Mexico, and Benjamin C. Roybal, an Albuquerque attorney with Rodey, Dickason, Sloan, Akin, Robb, P.A. PTSC has been served ably by the Legislative Council Service; Jessica Sutin provided support from the PTSC's creation to August 1996, at which time Cleo Griffith began assisting the Committee.

Gail Reese, Taxation and Revenue Department (TRD) Deputy Secretary, attended many of PTSC meetings and shared her knowledge and insight into New Mexico tax law, particularly in the areas of the Motor Vehicles and Leased Vehicles Excise Taxes as well as rule and regulations regarding nontaxable transaction certificates. Laird Graeser, Director of Tax Research and Statistics, also provided the Committee with invaluable research, discussion papers for Committee deliberation and recommendations for possible amendments to current tax law.

The first meeting of PTSC was in May, 1994. Franklin Jones, the late tax attorney and former Commissioner of Taxation, was an important asset during the Committee's initial meetings. Franklin gave Committee members a context in which to understand the current tax structure by providing a full history of New Mexico tax law. In addition, Franklin directed the Committee's initial tax policy discussion by preparing a section by section review of the Gross Receipts and Compensating Tax Act and enumerated, from his perspective, important issues for Committee review.

Since May, 1994, PTSC held regular, monthly meetings that were open to the public. Each meeting was conducted in a fashion that provided for open discussion between Committee members, state agency representatives and interested parties representing individual taxpayers, organizations, associations and business. In this context, the debate between the Committee and the public was unassuming and straightforward. Interested persons who attended committee meetings had ample opportunity on a regular basis to participate in committee discussion, engage committee members in questions and comment on any topic presented on PTSC's agenda.

In addition, committee members responded to written letters and statements presented by interested parties at those meetings where the topic of the letter or statement was on the agenda. In most instances, the Chair gave concerned individuals the occasion to speak on behalf of their particular topic and allowed enough time for a question and answer period. Finally, each committee member took it upon himself and herself to speak with individuals, community organizations

and businesses on the purpose and work of the Committee to educate the public about the progression of committee discussions, review and consideration of tax laws that has ultimately lead to these proposed findings and recommendations of PTSC.

Each PTSC meeting produced technical and well thought deliberations regarding why changes and modifications are necessary for New Mexico's tax system. Committee members have reviewed and discussed scores of issue papers, tax policy articles and reports concerning tax issues in New Mexico and has compiled an extensive library of local, regional and national tax and related fiscal policy materials. The following report is a compilation of committee discussions and debates, issue papers and bill drafts that represent the outcome of the Committee's two year commitment to review New Mexico tax policy. It is important to note, however, that two years was not enough time for the Committee to address each New Mexico tax. This report does not address the Individual Income Tax Act, Severance Taxes and the Property Tax. Because the committee decided to give the gross receipts and compensating taxes, the crux of New Mexico's tax base, long and arduous review, it did not have sufficient time to review these other taxes. In addition, the Committee was only able to begin its deliberations on the Investment Credit Act, Industrial Revenue Bonds and the Corporate Income and Franchise Tax. In order to continue its review of these taxes as well as beginning to examine the taxes that received no consideration, PTSC is requesting an additional two years to extend the important work already initiated by Committee members.

2. Tax Policy Criteria

The charge to PTSC was to review New Mexico's tax laws from a tax policy perspective. In this regard, the Committee's first task was to establish the tax policy criteria necessary to review New Mexico tax law. This criteria was then used as the foundation for determining if a certain tax law was in need of modification or alteration. PTSC adopted the most universally accepted criteria for assessing tax systems: adequacy, equity, efficiency and simplicity.

"Adequacy" gauges the ability of a tax to raise the revenues necessary to fund government spending. It looks more to quantity of revenues produced by the tax system, while the other criteria address the quality of the tax system. A tax,

however, is adequate not only if it generates the requisite revenues in the current year, but also if it is sufficiently elastic to react to changes in the economy.

“Equity” generally means fairness. Fairness is measured in two ways: First, a tax is equitable if taxpayers with the same tax base pay the same amount of tax. This equity measurement is known as “horizontal equity.” Second, fairness is assessed by determining whether taxpayers who have a larger tax base, pay a larger percentage of that base in taxes. This evaluation of a tax is termed “vertical equity.” Vertical equity is the basis for a progressive tax. A progressive tax is one in which taxpayers with larger tax bases are better able to pay the tax otherwise known as the “ability to pay” standard.

“Efficiency” measures the effect of the tax on economic activity within a jurisdiction. Ideally, a tax should be “neutral;” the tax should not cause taxpayers to alter their activity to produce a more favorable tax treatment.

It is well recognized that tax neutrality is impossible. Therefore, the primary goal is to strive for a tax that has the least impact on economic decisions. Indeed, occasions arise when a legislature decides to stimulate certain activity, to aid the economy as a whole or to grant incentives to particular segments of the economy. Investment tax credits are examples of such decisions. Extending favorable tax treatment to selective taxpayers, however, necessarily results in inequitable tax treatment and interferes with the private economy. As such, wise tax policy suggests that tax incentives should be adopted sparingly.

“Simplicity” concerns compliance by both taxpayers and tax collectors. For taxpayers, the tax should be as simple as possible so that they may comply without undue cost and effort. A complex tax system will cause avoidance or incorrect reporting. For tax collectors, administration and enforcement of the tax should not be so costly as to prevent enforcement.

The Committee reviewed other criteria, such as the use of taxation to foster economic development and the exportability of a tax, but opted against their adoption. The use of taxation for economic development creates serious inequities. The Committee concluded that a comprehensive tax, with lower tax rates, would advance more lasting economic development. The Committee also determined that whether or not a tax can be exported is not a valid determinative of a good tax. A tax system that applies the same principles to all taxpayers, no matter who bears the

incidence of the tax, will result in a fair tax and thus advance economic development in New Mexico.

PTSC used these tax policy criteria to test each tax law and make a determination on whether that particular tax is adequate, equitable, efficient and simple. At the same time, Committee members took into consideration how changes to specific tax laws will affect New Mexico's tax system as a whole. In its final determinations, the Committee based its recommendations and findings first on changes made to each tax law under the scrutiny of the above mentioned tax policy criteria, and second on how that change will impact the overall structure of the New Mexico tax system. The overall goal of PTSC is to strike a revenue neutral tax base for the state. PTSC does not advocate an increase or decrease in taxes. In fact, an example of the Committee's goal is its recommendation to decrease the general gross receipts tax rate due to the increase in taxes resulting from other PTSC recommendations that will expand the gross receipts tax base

3. Gross Receipts and Compensating Tax Act (GRT)

The majority of this report discusses findings and recommendations to GRT and related excise taxes such as the Motor Vehicle Excise Tax, Leased Vehicle Excise Tax and Boat Excise Tax. Committee members made the conscious decision to dedicate a substantial amount of time to GRT because it is New Mexico's most important tax and greatest source of tax revenue. GRT represents approximately 47 percent of all New Mexico's general fund taxes and 37 percent of New Mexico's recurring revenues. (See Table 1). If the Motor Vehicle Gross Receipts, Leased Vehicle Gross Receipts Tax and Boat Excise Taxes are added to GRT, they produce 51 percent of all tax revenues and 40 percent of recurring revenues. (See Table 1). Without GRT or a similar sales tax, New Mexico would not be able to fund its most basic services. No single New Mexico tax generates similar revenues. In fact, all other general fund taxes combined equal what GRT produces. Thus, even a relatively small reduction in GRT would have serious, adverse consequences. For example, PTSC estimates that if food and prescription drugs were exempted from GRT, tax revenues would decrease by \$120 to \$140 million annually. Such a loss in state general funds would impact essential public services such as education. Moreover, since municipalities and counties obtain a majority of their revenues from GRT, they also would be negatively affected.

PTSC studied whether GRT should be replaced by a value added tax. A value added tax eliminates the pyramiding that exists in GRT from the imposition of gross receipts taxes on multiple sale of the same property and services.

Pyramiding causes higher prices for property and services that pass through more taxable transactions than competing prices of similar property and services that are subject to fewer taxable transactions. One consequence of pyramiding is inefficiency in the market system because the price of certain items are higher than others solely because of taxes imposed as goods and services move through the chain of commerce. A value added tax taxes only the final sale and therefore eliminates the pyramiding of gross receipts taxes, and the resulting inefficiency.

PTSC, however, opted against replacing GRT with a value added tax. The replacement of the present system with a tax only on the final sale will cause enormous transitional and definitional problems. In addition, a value added tax will effectively reduce the total tax base. Thus, the tax rate would have to be increased to approximately 15 percent to maintain revenue neutrality, and more importantly, to

TABLE 1

**OCTOBER GENERAL FUND CONSENSUS REVENUE ESTIMATES
FY97 and FY98**

(figures in millions) (1)

	FY98 (1995-96)	FY97 (1996-97)			FY98 (1997-98)	
	Pract.	Dec. 95 Est. Adj. for Legis.	Oct. 96 Est.	% Chng From FY96	Oct. 98 Est.	% Chng From FY97
Gross Receipts	985.8	1,072.0	1,037.0	5.2%	1,003.0	4.4%
Compensating	34.9	35.0	38.0	8.9%	40.0	5.3%
TOTAL GENERAL SALES	1,020.7	1,107.0	1,075.0	6.5%	1,123.0	4.8%
Tobacco	20.1	19.9	20.0	-0.5%	20.3	1.5%
Alcohol	36.3	34.5	38.0	2.0%	36.4	1.1%
Insurance	41.5	52.5	40.0	-3.5%	41.5	3.8%
Fire Protection Fund	19.5	22.0	21.0	7.7%	22.0	4.8%
Public Utilities	8.9	7.1	8.5	-8.5%	8.7	3.1%
Racing	0.9	0.9	0.8	-11.1%	0.7	-12.5%
Private Car	0.9	1.0	1.0	11.1%	1.0	0.0%
Motor Vehicle Excise	75.3	82.0	81.0	7.8%	84.0	3.7%
Boat Excise	0.4	0.6	0.6	80.0%	0.6	0.0%
Gasoline & Special Fuels	1.0	0.0	0.0			
Leased Veh. GRT & Surcharge	7.8	8.5	8.0	5.3%	8.1	1.3%
TOTAL SELECTIVE SALES	208.4	223.0	214.9	2.8%	221.3	3.0%
Personal Income	634.6	653.3	677.0	6.7%	714.0	5.5%
Corporate & Franchise Income	163.4	190.0	180.0	-2.1%	185.0	3.1%
Estate	10.1	10.0	10.5	4.0%	11.0	4.8%
TOTAL INCOME TAXES	808.1	853.3	867.5	4.9%	890.0	5.0%
Oil & Gas School Tax	102.2	98.4	125.5	22.9%	115.1	-8.4%
Oil Conservation Tax	6.5	3.8	7.0	7.7%	6.6	-6.7%
Resources Excise	9.8	11.2	10.0	4.2%	10.0	0.0%
Natural Gas Processors	24.7	8.0	10.0	-82.5%	10.0	0.0%
TOTAL SEVERANCE TAXES	143.0	121.4	162.8	6.7%	141.7	-7.1%
Finl. Instits.	1.5	1.8	1.8	6.7%	1.6	0.0%
Mfg. Housing	0.9	1.2	1.0	11.1%	1.1	10.0%
Construc. Inco.	5.7	6.2	6.0	5.3%	6.0	0.0%
Securities	7.5	7.0	7.5	-1.3%	7.7	2.7%
Corporate Filing	2.3	2.0	2.2	-4.3%	2.4	9.1%
Alcoholic Beverage	3.7	4.0	3.7	0.0%	3.7	0.0%
Corporate Special	3.5	2.6	3.0	-14.3%	3.0	0.0%
Other License Fees	1.5	2.9	2.5	66.7%	2.5	0.0%
TOTAL LICENSE FEES	28.7	27.6	27.6	3.0%	28.0	1.8%
Permanent Fund	203.0	208.5	208.0	1.5%	206.7	1.3%
Earnings on State Bal	22.2	27.0	27.0	21.6%	28.5	-1.9%
Severance Tax Perm. Fund	132.1	132.6	132.8	0.4%	133.0	0.3%
TOTAL INTEREST	357.3	368.1	365.8	2.3%	368.2	0.7%
Federal Mineral Leasing	117.4	114.0	138.5	16.4%	136.0	-0.4%
State Land Office	13.2	8.7	10.8	-18.2%	9.3	-13.9%
TOTAL RENTS & ROYALTIES	130.6	122.7	147.4	12.9%	145.3	-1.4%
Magistrate Court Costs	1.2	1.2	1.2	0.0%	1.3	8.3%
Metro Court Costs	0.3	0.4	0.4	33.3%	0.4	0.0%
MVD Penalty Acct	7.1	5.0	5.0	-29.6%	5.2	4.0%
Fines & Forfeitures	7.1	6.0	6.0	-15.5%	6.2	3.3%
Birth/Death Certificates	0.4	0.5	0.5	25.0%	0.5	0.0%
District Judges' Receipts	1.2	0.9	1.2	0.0%	1.2	0.0%
Secretary of State Fees	0.6	0.6	0.7	16.7%	0.7	0.0%
Unclaimed Property	6.5	2.4	2.5	-61.5%	3.0	20.0%
Other Miscellaneous	5.5	4.6	3.5	-36.4%	4.0	14.3%
TOTAL MISC. RECEIPTS	29.9	21.6	21.0	-29.8%	22.5	7.1%
Reversions	21.2	14.0	21.0	-0.9%	21.0	0.0%
TOTAL RECURRING	\$2,746.9	\$2,694.6	\$2,672.5	4.6%	\$2,916.6	1.9%
Adjustments & Non-Recurring:	6.0	60.5	67.0		29.0	
GRAND TOTAL	\$2,751.9	\$2,855.1	\$2,939.5	6.8%	\$2,945.2	0.2%

(1) Detail may not add to column totals due to independent rounding.

raise the revenues for existing public services. Citizens of New Mexico would probably react negatively to a 15 percent rate. Moreover, business that is thinking about moving into New Mexico would question the wisdom of such a move. Hence, PTSC decided not to endorse a value added tax but to retain GRT, and work to produce a more equitable GRT for New Mexicans. Specifically, PTSC recommends that GRT tax base become more comprehensive to enhance equity. Second, PTSC has attempted to eliminate pyramiding, causing GRT to be more efficient. These changes will create a more simple tax.

a. Basic principles

GRT is a tax imposed for the privilege of engaging in business in New Mexico. N.M. Stat. Ann. § 7-9-4 (Repl. Pamp. 1995) (hereinafter § 7-9-__"). The purpose of GRT is to raise revenue by taxing most retail sales of property and services, See §§ 7-9-2, 7-9-3 (E). The object of the tax is the gross receipts from the sale of property and services. *Id.* Thus, the tax is imposed on the seller, although the seller inevitably passes the tax to the buyer. The state gross receipts tax rate is 5 percent. In addition, local governments can impose a local option gross receipts tax on the same gross receipts that are subject to GRT. The added imposition makes the actual rate greater than 5 percent, with a variance between a low 5.125 percent and a high of 6.9325 percent.

GRT includes a second tax, the compensating tax. § 7-9-7. The compensating tax is imposed generally on the value of property brought into New Mexico if the purchase of the property in New Mexico had been taxed under the gross receipts tax. *Id.* The purpose of the compensating tax is to prevent unfair competition resulting from the purchase of property in another state and used in New Mexico. § 7-9-2. The compensating tax rate is 5 percent. § 7-9-7 (A). Unlike the gross receipts tax, local governments cannot add a local option tax to property that is subject to the compensating tax. Therefore, the effective rate for the compensating tax is 5 percent.

The gross receipts tax is, in theory, a consumption tax imposed on the amount realized by a seller from the sale or lease of services. The tax attaches when the transaction for the sale or lease occurs. Sales occur both at the business and consumer levels, making the occurrence of pyramiding more likely. To reduce the incidence of pyramiding, GRT attempts to fix the taxing event to when the property or services no longer are in the stream of commerce, but have reached the

consumer. A full review of pyramiding and PTSC's attempt to reduce the amount of pyramiding in GRT is discussed below.

A final principle adopted by PTSC concerns the situs of a transaction when more than one state has a legitimate interest in taxing the property or services. This issue arises when property or services are sent from one jurisdiction to another. PTSC agrees with the view accepted nationally that the situs of a transaction is the destination state of the property or services and therefore that jurisdiction is the state that will tax the transaction.

b. Multijurisdictional issues

In today's economy, property and services used or consumed in New Mexico are not always bought and sold in New Mexico. New Mexico buyers purchase property or services from out-of-state sellers, and New Mexico vendors sell to out-of-state buyers. Services, moreover, may be performed in New Mexico while neither the buyer of those services is present in New Mexico. The extent to which New Mexico can or should tax any portion of these interstate transactions is the subject of this section. The most important benchmark in determining which interstate transaction can be taxed in New Mexico is the Due Process and Commerce Clauses of the United States Constitution.

PTSC used the boundaries of the Constitution to evaluate which sections of GRT that encompass multijurisdiction transactions can potentially be taxed. In doing this review, the Committee discovered GRT places more restrictions on New Mexico's taxing authority than required under the U.S. Constitution. The Committee recommends several amendments to GRT that would allow New Mexico to tax gross receipts, to the extent the Constitution permits, from all property that is sold or used in New Mexico and all services that are performed or used in New Mexico.

Presently § 7-9-55 (A), (B) provides that receipts from transactions in interstate commerce may be deducted in calculating gross receipts. PTSC believes that receipts that cannot be taxed under the Constitution should not be a deduction but a part of the definition of gross receipts. PTSC, therefore, recommends the repeal of § 7-9-55 (A), (B). In its place PTSC expanded the definition of gross receipts and governmental gross receipts to exclude receipts, the taxing of which would violate the constitution. In addition, PTSC broadened the credit taxpayers may take for sales or use taxes paid to other jurisdictions with respect to the purchase or sale of property or services subject also to GRT. The combination of the expanded definition of gross receipts and the credit insulates New Mexico from any constitutional attacks.

GRT now permits sellers who ship property to buyers out-of-state when the buyer can take delivery in New Mexico to avoid paying gross receipts taxes. To respond to the avoidance scheme, PTSC added a new definition of when a sale occurs in New Mexico. The definition specifies that a sale occurs in New Mexico if the buyer receives the property or services in New Mexico, receives documents

indicating that the buyer has the right to receive the property or services in New Mexico, or simply has the right to receive the property or services in New Mexico. This new definition prevents a buyer who is in New Mexico from agreeing with a seller to have the property delivered outside New Mexico to avoid taxation.

PTSC firmly believes that a sale of services should be taxed the same as the sale of property. Therefore PTSC is proposing several changes to GRT to foster this similarity.

Currently, one difference in treatment between property and services is seen in the purchase of services from outside the state. Those services are not subject to either the gross receipts or the compensating tax. See §§ 7-9-7; 7-9-13.1. On the other hand, property that is purchased outside the state and is brought into the state is subject to the gross receipts or compensating tax.. PTSC recommends the elimination of the discrepancy between the tax treatment of services and property purchased from outside the state.¹ PTSC also recommends that the compensating tax apply to services purchased from firms outside New Mexico if the transaction is not subject to the gross receipts tax.

Working under the theory that receipts from services performed in New Mexico should be taxed, PTSC proposes that gross receipts from transporting persons or property within New Mexico, except when constitutionally prohibited, should be taxed. In this regard, PTSC recommends § 7-9-56 be repealed because of the limitation that section imposes on the taxing of transportation services. A new section is added to replace § 7-9-56 that explicitly provides that gross receipts attributable to transportation occurring in New Mexico are taxable.

Generally, all property purchased outside New Mexico that is not taxed under the gross receipts tax, but would have been subject to the gross receipts tax if the property had been purchased in New Mexico, is subject to the compensating tax.. A special limitation, however, applies to consumer goods. Section 7-9-7.1 states that TRD may not collect the compensating tax on the value of consumer products purchased by individuals. This limitation deals mainly with catalogue sales and sales through the internet and 1-800 numbers.

The bar on the collection of the compensating tax is inequitable. It results in

¹ PTSC has moved the special exemption for research and development services to a deduction.

unfair competition between New Mexico business and out-of-state business. An individual who purchases a product from a catalogue, when the seller is not physically present in New Mexico, pays approximately a 6 percent lower price for the product than an individual who purchases the same product from a New Mexico vendor. As such, New Mexico businesses are at a disadvantage; they lose business to out of state vendors. This disadvantage is not the consequence of product quality or normal business costs; New Mexico sellers' prices are higher only because they are subject to GRT, while out-of-state sellers are not subject to GRT. Yet, New Mexico businesses employ New Mexico employees and pay New Mexico taxes while out of state sellers do not.

PTSC recommends repeal of § 7-9-7.1. This repeal may cause collection problems. To address potential collection problems, PTSC recommends that the compensating tax be collected through the individual income tax return (PIT) annually. Individuals presently self-report their income tax; and PTSC suggests expanding this procedure by asking individuals to also self report their catalogue purchases. To give TRD the ability to discover which New Mexican households are purchasing from out-of-state, PTSC proposes that a provision be added to the Tax Administration Act allowing the Taxation and Revenue Department to inspect the books of sellers who have nexus with New Mexico.

c. *Pyramiding*

A critical task confronted by PTSC was to determine the extent and address the problem of tax pyramiding under GRT on various industries engaged in business in New Mexico. TRD describes the tax pyramiding problem as follows:

A tax is said to "pyramid" when it applies to more than one stage of production... Pyramiding is very uneven by nature, because its extent depends on the number of production stages, whether production is performed by one or many firms, how much is taxed at each stage, and whether the tax rate varies at each stage. Thus, some products may be heavily taxed due to pyramiding, and some will be taxed relatively lightly. Resulting differentials in effective tax rates cause distortions in economic decisions. For example, firms may integrate operations to avoid external transactions, or prefer to buy out of state rather than in state. Such distortions violate the neutrality criterion for judging the tax system.²

For its purposes, PTSC categorized pyramiding into two principal categories -- (1) transactional, or direct pyramiding, and (2) indirect pyramiding.³ Taxation of the sale of tangible personal property both on the sale by a distributor to a retailer and a retailer to a consumer is an example of the first type of tax pyramiding. GRT provides mechanisms to avoid most (but not all) pyramiding of this type. Taxation of both the sale of fuel to an electric utility to produce electricity as well as the sale of the electricity to the consumer is an example of the second type of pyramiding. GRT may or may not provide a mechanism to eliminate pyramiding of this type.⁴

² Taxation and Revenue Department Special Report, July 1991 p. 131.

³ Tax pyramiding also results where other taxes (generated under other tax systems) are added to the price of the product or service produced and passed on to the consumer. For example, a manufacturer's price for his product includes (as overhead item) a portion of personal and real property taxes paid by the manufacturer. New Mexico's low property taxes mitigate the effects of this type of situation.

⁴ TRD's Special Report to the 1991 New Mexico Legislature Tax Equity Task Force, includes a table of GRT's tax pyramiding avoidance provisions, together with an estimate of revenue gains if repealed. The table is included as Appendix C.

In an attempt to determine the nature and scope of the pyramiding problem under GRT, PTSC reviewed the gross receipts and compensating taxation of numerous industry sectors prevalent in New Mexico. The sectors evaluated included the following:

1. Manufacturing;
2. Construction;
3. Research and Development;
4. Wholesale Trade;
5. Retail Trade;
6. Professional Services;
7. Personal Services;
8. Medical and Dental Services;
9. Retail Automobile Sales and Services;
10. Electric Utilities;
11. Financial Institutions (Banks);
12. Gas Utilities;
13. For profit educational institutions;
14. For profit hospitals;
15. For profit long term health care providers;
16. Non-profit hospitals;
17. Non-profit long term health care providers;
18. Non-profit educational institutions;
19. Transportation;
20. Agriculture;
21. Oil and Gas Production;
22. Printing; and
23. Government contracting.

Brief summaries of GRT taxation of these industry sectors are included as Appendix D.

Several conclusions can be drawn from PTSC's analysis:

1. Virtually every industry segment analyzed suffers from some tax pyramiding under GRT. GRT taxes a broad range of goods and services, including goods and services sold to businesses. Since most businesses from time to time purchase goods or services from other businesses, and since it is customary to pass gross receipts tax on to the customer (as part of the price for its product or service), the transaction will effectively be taxed more than once.

2. Certain industries are subject to a greater level of tax pyramiding than others. However, in PTSC's view, only a few sectors suffer from material levels of transactional tax pyramiding under GRT, such as government contracting. PTSC has proposed legislation to eliminate this pyramiding problem.

3. While very few industries suffer from significant levels of transactional pyramiding, virtually all suffer from some form of indirect tax pyramiding. Depending on the industry, indirect tax pyramiding may or may not be significant.⁵ Moreover, taxation of these transactions is consistent with the taxation of the "last sale" principle of GRT. PTSC proposes legislation to eliminate some of the more egregious instances of this type of pyramiding.⁶

4. The ability of a taxpayer to take advantage of GRT's provisions eliminating transactional tax pyramiding may depend on the sophistication of the taxpayer. Many of GRT's tax provisions are complex and difficult to apply. As a consequence, a particular taxpayer may not realize that it may avoid tax pyramiding by structuring a particular transaction in a particular way. Thus, GRT system favors more sophisticated taxpayers over less sophisticated taxpayers. PTSC has proposed changes to simplify compliance of provisions designed to eliminate tax pyramiding.

⁵In PTSC's view, some amount of tax pyramiding is present in most tax systems, and consistent with the adequacy principle of tax policy, cannot be eliminated from the tax base.

⁶The GRT taxes the sale of fuel to electric utilities, the principal "raw material" in the production of electricity. However, the wood and glue used by a furniture maker to make a table is not taxed. Thus, manufacturers of tables and chairs arguably enjoy more favorable tax treatment than producers of electricity. Similarly, the sale of construction services by one subcontractor to another subcontractor is not taxable. However, the sale of research and development services by one subcontractor to another may be taxable.

d. Exemptions and Deductions

PTSC spent much of its time evaluating GRT exemptions and deductions. PTSC broadly classified the exemptions and deductions into three groups:

(1) exemptions for transactions subject to other excise taxes, which include the motor vehicle, leased vehicle, and boat excise taxes; (2) exemptions and deductions covering non-profit organizations; and (3) all other exemptions and deductions. This section discusses PTSC's findings and recommendations with respect to other exemptions and deductions. The next section, section e, focuses on non-profit organizations; and section (f) looks at transactions subject to other excise taxes.

Exemptions are legislative exclusions from GRT tax base. Theoretically, the purpose of an exemption is to remove from the tax base those transactions that are not consistent with the conceptual construct of GRT. For example, GRT exempts wages, salaries, interest and dividends from the tax base, §§ 7-9-17; 7-9-25, because these exemptions prevent pyramiding.

Deductions, on the other hand, exclude those receipts that meet the theoretical definition of gross receipts, but may be subtracted from the tax base for policy reasons. A good example is a distributor's sales of inventory to retailers. See § 7-9-47. If a distributor is not permitted to deduct inventory sales, the value of the inventory will be taxed twice, resulting in pyramiding. The practical difference between an exemption and a deduction is that a taxpayer is not required to report exempt gross receipts, but the taxpayer must report gross receipts for which a deduction is applicable.

PTSC tested each exemption and deduction to determine whether it advanced or violated tax policy criteria, was consistent with the definition or purpose of GRT or prevented pyramiding. Generally, if an exemption or deduction did not further these tests, PTSC recommended its repeal.

i. exemptions

(1) GRT exemptions generally cover transactions with governmental and tribal agencies, §§ 7-9-13, -14, -31; transactions subject to other taxes, §§ 7-9-22, -22.1, -23, -23.1, -24, -26, -32, -33, -34, -35, -38.1; receipts that do not comport with the definition of gross receipts or that may not be taxed, §§ 7-9-17, -18.1, -20, -25, -27, -28, -36, -37, -38, and transactions involving certain industries or entities. §§ 7-

9-15, -16, -18, -19, -29, -39, -41. PTSC does not propose any change to the above listed sections dealing with government agencies and tribes (government gross receipts is discussed below). During the next two years, PTSC hopes to study the issue of dual taxation between the State of New Mexico and Indian tribes and pueblos.

(2) PTSC reviewed the Insurance Premiums Tax and its relationship to GRT. During the next two years, PTSC plans to continue to study this tax and recommend changes, if necessary, as New Mexico's health care delivery system continues to change.

Gross receipts exemptions inconsistent with GRT or receipts that by law may not be taxed were reviewed by PTSC. PTSC recommends no changes with respect to these exemptions, except to add a *de minimus* rule to exclude persons from GRT with relatively small amounts of gross receipts. Persons whose gross receipts in any year do not exceed \$5,000 will not have to pay gross receipts taxes.

ii. deductions

GRT deduction sections cannot be as easily categorized. They involve a variety of sections enacted for different purposes. Some deductions are intended to prevent pyramiding, others to provide an indirect subsidy to certain industries, and still others exist for administrative reasons. Similar to its review of GRT exemptions, PTSC tested each deduction according to whether the deduction was consistent with tax policy criteria. If any deduction was found inconsistent with the criteria, the Committee recommended its repeal.

(1) The agricultural industry is protected both by exemptions and deductions. Sections 7-9-18 exempts the sale of livestock, poultry, agricultural products and animal hides and pelts. Section 7-9-19 exempts receipts from feeding or pasturing livestock, penning or handling livestock prior to sale, and training livestock. Section 7-9-58 allows the seller to deduct the receipts from the sale of feed, and further permits an auctioneer of livestock and agricultural products to deduct their fees. Section 7-9-59 permits the deduction of receipts from warehousing agricultural products and from harvesting and cultivating agricultural products.

PTSC recommends that these agricultural exemptions and deductions be

retained only to the extent that they prevent pyramiding, and re-organized to comply with the language and purpose of the manufacturing deduction found in GRT. PTSC further recommends that the nontaxable transaction certificate (NTTC) rules apply to the agricultural industry as those rules apply to the manufacturing industry, except that the affected agricultural taxpayers will only have to report semi-annually instead of monthly.

(2) PTSC recommends that purses won by owners, jockeys and trainers be taxed. These purses are the receipts to owners, jockeys and trainers for entry of the horses into the race or for the service of training and riding the horses. Because other taxpayers who rent or license property or who receive payments when using the property are subject to GRT, the receipts of purses also should be subject to GRT. No tax policy reason exists for the exemption of racetrack purses.

(3) PTSC spent considerable time reviewing the media industry. PTSC learned that GRT rules with respect to advertising income differ between the broadcast media and the print media. Within the print media, the taxation of receipts from the sale of printed products differs between newspapers and other publishers.

Radio and television companies pay gross receipts taxes on receipts from the sale of local advertising. These companies do not pay taxes on the sale of advertising for certain out-of-state advertisers. The print media, however, pays gross receipts tax on the receipts from all its advertising. PTSC believes that this disparity between the broadcast and print media creates an unfair tax burden on the print media.

In its attempt to remedy this inequitable tax treatment, PTSC considered two alternatives. PTSC first studied whether the broadcast media should be taxed on all its advertising income. Although some members of PTSC wanted this approach, the Committee as a whole decided against it. Apportioning receipts from advertising that is broadcast to New Mexico listeners and to out-of-state listeners is just too difficult. PTSC elected for a second option allowing the print media to deduct advertising receipts from out-of-state advertisers. This structure permits all advertising to be treated equally.⁷

⁷ Under a TRD private letter ruling, magazines can apportion advertising based on in- and out-of-state circulation.

The sale of printed material presented a different problem. Presently, the receipts from the sale of books, magazines and similar printed materials are subject to the gross receipts tax. At the same time, receipts from the sale of newspapers are not subject to the gross receipts tax. To eliminate this inequity in GRT, PTSC recommends that the retail sale of newspapers, sold by subscription, at the counter and by vending machine, be subject to GRT.

(4) PTSC found disproportionate tax treatment with respect to persons who earn commissions. Generally, commission receipts for services are taxable. However, GRT presently provides deductions for commissions earned by real estate agents, § 7-9-66.1, travel agents, § 7-9-76, and retail sellers of lottery tickets, § 7-9-87. These deductions are industry specific and therefore create inequities between individuals who earn these particular commissions and other individuals who earn their living by other types of commission income. PTSC recommends that these deductions be repealed. PTSC, however, does not recommend repeal of § 7-9-66, which allows a deduction for commissions on the sale of property that is not subject to the gross receipts tax. These sales of property occur when the property has been purchased for resale or for use in manufacturing. In either instance, the deduction prevents pyramiding because it allows the commissions earned on the sale of property also to be excluded.

PTSC recommends the repeal of the remaining deductions that benefit a specific business. Those deductions include: 50 percent sales of unregistered vehicles or aircraft, §§ 7-9-62, -77; sale of property used in the manufacturing of jewelry, § 7-9-74 (most sales of this property will still be deducted as property sold for manufacturing purposes); and 40 percent of the receipts from the sale or use of jet fuel. §§ 7-9-83, -84.

(e) Nonprofit organizations

GRT has a number of provisions that provide exemptions or deductions that benefit nonprofit organizations and related persons. Table 2 describes those provisions. Without doubt, §§ 7-9-29 (A) and 7-9-60 are the most important. PTSC therefore, concentrated on those sections.

Section 7-9-29 (A) exempts gross receipts earned by organizations that have attained tax-exempt status under § 501(c)(3) of the Internal Revenue Code. The exemption, however, does not apply to gross receipts derived from an unrelated trade or business as defined in § 513 of the Internal Revenue Code. § 7-9-29 (C). Section 501(c)(3) organizations encompass most charitable, educational and religious institutions, and include private schools and universities, nonprofit hospitals, other nonprofit health care organizations, private social services organizations, organizations dedicated to the arts and churches and religious organizations.

Section 7-9-29(A) is inconsistent with the equity, and possibly the adequacy, tax policy criteria. Section 7-9-29 (A) exempts § 501(c)(3) organizations' gross receipts from commercial activity—their sales of property and services. For-profit businesses, on the other hand, that engage in the same commercial activity must pay gross receipts taxes. Persons engaging in the same activity are taxed differently, the distinction grounded solely on the status of the one not taxed.

The exemption, if left in place, also will cause GRT tax base to shrink. Section 501(c)(3) organizations engage generally in service activity. Our economy is moving from one dominated by sales of property to an economy involving the sale of services. As § 501(c)(3) organizations expand and capture more of the services market, under § 7-9-29(A), a larger portion of gross receipts will become non-taxable. The reduction of GRT base will affect its adequacy.

PTSC has attempted to learn the extent to which § 501(c)(3) organizations are engaging in non-taxed commercial activity. Comprehensive, easily accessible information does not exist. TRD does not collect such information, and it would take much too long to acquire the data from the Internal Revenue Service (IRS), assuming the IRS would give the data to PTSC. To help fill the void, PTSC sent a questionnaire to more than forty, different organizations (for example, hospitals, private schools, health clubs, youth organizations). A copy of the questionnaire

TABLE 2

LIST OF SECTIONS PROVIDING ECEMPTION OR DEDUCTION FROM GROSS RECEIPTS TAXATION TO NONPROFIT ORGANIZATIONS OR RELATED PERSONS

(A) Charitable Organizations

(1) Section 7-9-29(A) exempts receipts by §501(c)(3) organizations (charitable organizations), except receipts derived from an unrelated trade or business activity.

(2) Section 7-9-60 allows sellers to deduct receipts from sales of tangible personal property to §501(c)(3) organizations if the latter give NTTC's to the former. The deduction is not applicable to receipts from property

(a) that will become an ingredient or component part of a construction project;

(b) that is not functionally related to the organization's exempt purposes; or

(3) that is used in the conduct of an unrelated trade or business.

(3) Section 7-9-15 exempts § 501(c)(3) organizations from the compensating tax, except if the property is used in an unrelated trade or business.

(4) Section 7-9-41 allows ministers of §501(c)(3) religious organizations to deduct receipts from individuals for religious services.

(5) Section 7-9-73.1 allows for-profit hospitals to deduct 50 percent of their gross receipts.

B. Business Leagues

Section 7-9-29(B) exempts receipts by a §501(c)(6) chamber of commerce or a business league to the extent that the business league performs functions of a visitor bureau or a convention bureau.¹ The exemption does not apply to receipts from an

¹Section 7-9-29(B) does not specify that the organization must be a business league; it states that the organization must be tax exempt under §501(c)(6). However, to be exempt under

unrelated trade or business.

C. Other Organizations

(1) Section 7-9-16 exempts receipts received by nonprofit retirement homes. Since receipts of tax-exempt retirement homes are exempt under §7-9-29(A), §7-9-16 applies to a very limited number of organizations, if any. The organization must nonprofit but not tax exempt under §501(c)(3).

(2) Section 7-9-20 exempts membership fees, dues assessments received by homeowners associations exempt under §528(c)(1) of the Internal Revenue Code from members who are owners of residential units.

(3) Section 7-9-39 exempts dues and registration fees received by social, fraternal, political, trade, labor, or professional organizations and business leagues.

(4) Section 7-9-85 allows an organization exempt under §501(c), other than a §501(c)(3) organization, to deduct receipts from two fundraising events.² This deduction includes fundraisers by labor organizations, clubs, and fraternal organizations.

§501(c)(6) the organization must be a business league.

² A bill that may be introduced this session would change the two fundraiser limitation to \$80,000 a year.

appears in Appendix E. However, PTSC received an insufficient response to allow it to use the questionnaire to reach valid conclusions. TRD, however, did provide PTSC with a summary of information supplied to the Attorney General by nonprofit organizations for 1994 under the Charitable Organizations and Solicitations Act. N.M. Stat. Ann. § 57-22-1 (Repl. Pamp. 1995). Bar graphs depicting the number and size of the organizations that have reported to the Attorney General appear in Appendix F. Although that summary proved extremely valuable, it is necessarily incomplete. The Attorney General's lists do not include all tax-exempt organizations; the Charitable Organizations and Solicitations Act does not apply to religious or educational organizations and organizations which do not receive more than \$2,500 a year in contributions (no matter the amount of their gross receipts). *Id.* at § 57-22-4. TRD summary does indicate that exempt organizations received \$618 million in program revenues (program revenues are gross receipts). Added to that amount should be part of the \$129 million received from governments. Government payments generally are contract fees for services performed by the exempt organizations for governmental agencies. The point is that the amount of untaxed gross receipts earned by § 501(c)(3) organizations is substantial. In fact, PTSC estimates that, at the present time, the amount of gross receipts taxes foregone by the state is at a minimum \$100 million.

PTSC also reviewed the history of § 7-9-29(A) to learn whether the reasons for tax exemption could be discerned from a historical perspective. Section 7-9-29(A)'s statutory history is summarized in Appendix G.

PTSC also studied recognized theories for granting tax exemption to § 501(c)(3) organizations. Very little literature deals with sales or gross receipts taxes; most of the material explains the reasons for exemption to income and property taxes. Those theories are abstracted in a memorandum from the chair to PTSC members, included in Appendix H. Finally, PTSC reviewed information from many tax-exempt organizations, including the hospital association, arts groups, private schools, and social service organizations.

After review of this information and debating the issue for over a year, PTSC concluded that sound tax policy does not support a blanket gross receipts tax exemption for § 501-(c)(3) organizations. Consequently, the Committee, with Janice Ahern dissenting, initially decided to recommend repeal of § 7-9-29 (A). The primary reason for the Committee's decision is that § 7-9-29 (A) violates the equity principle by granting tax relief to certain persons solely on their status c whether the

entity is exempt under § 501(c)(3) of the Internal Revenue Code. This inequity is illustrated by comparing for-profit health care providers with tax-exempt providers. The former pay taxes on their receipts for medical services. The latter do not pay gross receipts tax on the receipts for the same procedure.

PTSC presently is considering a special exemption for selected § 501 (c)(3) organizations. The exemption would apply to organizations that meet certain conditions. The kinds of conditions the Committee is currently discussing require that the § 501 (c)(3) organization: (1) provide certain services, like social services or health care; (2) dedicate most of its efforts to serving individuals who are at or below the federal poverty line; (3) not have gross receipts, on the average for a period of about three years, that exceed a certain amount (for example, \$1.5 million); (4) receive a minimum percentage of its gross receipts from a governmental agency; (5) not have a net worth in excess of a specified amount; and (6) apply for exemption on a periodic basis.

PTSC is of the opinion that the exemption described in the prior paragraph does not violate tax policy principles. The organizations are relatively small, serve individuals who are indigent, and receive the bulk of their funds from a governmental agency. Those § 501 (c)(3) organizations are not engaged in business in the sense anticipated by GRT. Instead, the organizations are acting for state or federal governmental agencies in fulfilling governmental functions. Moreover, they are organizations that generally do not compete with comparable for-profit businesses.

PTSC is not changing the law with respect to gifts, donations, or contributions to § 501(c)(3) organizations. No one pays gross receipts taxes on those items. GRT taxes only gross receipts from a sale of property and services.

PTSC also recommends that § 7-9-72.1 be repealed. That section permits for-profit hospitals to deduct 50 percent of their gross receipts. Since PTSC intends that nonprofit hospitals pay gross receipts taxes on all their gross receipts, PTSC saw no reason to permit for-profit hospitals a 50 percent deduction.

PTSC further recommends the repeal of § 7-9-41, allowing ministers of § 501(c)(3) religious organizations to deduct receipts for religious services. If a minister, or his or her church, receives a donation in gratitude for the religious ceremony, it will not be taxed. A donation is not a gross receipt. If, on the other

hand, the minister, as a condition of performing the religious services, charges a fee, the fee is a gross receipt and should be taxed.

Consistent with its decision that § 7-9-29(A) should be repealed, PTSC also recommends that §§ 7-9-60 and 7-9-15 be repealed. Section 7-9-60 permits sellers of tangible personal property to § 501(c)(3) organizations to deduct those sales from their gross receipts. Section 7-9-15 exempts § 501(c)(3) organizations from the compensating tax on their use of tangible personal property. These sections create inequitable results. Section 501(c)(3) organizations are treated differently from for-profit businesses that purchase or use the same property. The cost of the property to them is cheaper than similar property purchased by for-profit organizations.

After deciding that GRT provisions benefiting § 501(c)(3) organizations should be repealed, the Committee concluded that exemptions and deductions provided for other nonprofit organizations that are not exempt under § 501(c)(3), should also be repealed. Again, the benefits are extended because of the organizations' status, and not because the transactions producing the gross receipts deserve special treatment. PTSC therefore recommends repeal of §§ 7-9-16 and 7-9-29 (B). PTSC is not proposing the elimination of § 7-9-20, which exempts fees, dues and assessments paid to homeowners' associations, because this section eliminates pyramiding and does not extend a special tax benefit to those associations. Similarly, the Committee retained § 7-9-39, exempting dues paid to fraternal-type organizations. Moreover, PTSC recommends an amendment to § 7-9-39 to include dues paid to § 501(C)(3) organizations.

To allow § 501(c)(3) organizations the capacity to raise revenues through limited fund-raisers, the Committee is suggesting the expansion of § 7-9-85 to include § 501(c)(3) organizations. Section 7-9-85 presently allows tax-exempt organizations other than § 501(c)(3) organizations to conduct two fund-raisers without tax.

Finally, there are many small § 501(c)(3) organizations that do not generate large amounts of gross receipts. The costs, both to the organizations and TRD requiring those organizations to report and pay gross receipts taxes probably exceed the potential gross receipts taxes collected. As such, the Committee is recommending a *de minimis* for organizations described in § 501(c)(3), below which they are exempt from GRT. The *de minimis* is \$25,000.

f. Other excise taxes

Sales of registered motor vehicles and boats are not subject to GRT. See §§ 7-9-22, -22.1, 23.1. Motor vehicles are subject to the Motor Vehicles Excise Tax, § 7-14-1, and boats are subject to the Boat Excise Tax, § 66-12-6.1. The Motor Vehicles Excise Tax is imposed whenever any vehicle, subject to the Motor Vehicle Code, is registered. The tax rate is 3 percent and is generally assessed against the sales price of the vehicle. The Boat Excise Tax is 5 percent and is imposed on the registration of certain boats. § 66-12-6.1.

A special tax is also assessed against the leasing of certain vehicles. § 7-14A-1. Under the Leased Vehicle Gross Receipts Tax, a gross receipts tax is imposed upon any person who is in the business of leasing a passenger car for six months or less. §§ 7-14A-2 (D), (F), -3 (A). The tax rate is 5 percent and is imposed on the receipts from the leasing of the vehicle. §§ 7-14-2 (C), -3 (B). In addition, a \$2 a day surcharge (the "Leased Vehicle Surcharge") is added to the lease price of a vehicle. § 7-14A-3.1. The Leased Vehicle Surcharge translates into a tax rate of approximately 5 percent.

The Leased Vehicle Gross Receipts Tax and the Leased Vehicle Surcharge apply in addition to the gross receipts tax. Thus, a lessor of passenger cars is obligated to pay total gross receipts taxes of approximately 16 percent: 6 percent for gross receipts tax; 5 percent for leased vehicle excise tax; and 5 percent for leased vehicle surcharge. These taxes are added to the lease price for the automobile and are borne by the lessee.

PTSC found that these different excise taxes create inequities in that different tax rates apply to both vehicles and boats. The sale of motor vehicles is taxed at 3 percent; the short term leasing of motor vehicles is taxed at 16 percent; and the sale of boats is taxed at 5 percent. The sale or leasing of all other property is taxed at approximately 6 percent. These disparate tax rates cause inefficiencies in the market by making the price of cars and boats more or less expensive than alternative products. Different rates also mean that tax burdens are unfairly distributed among taxpayers. As such, PTSC recommends that the sale of registered vehicles and boats and the rental of cars be subject only to the rate imposed under GRT, the same as all other property.

In addition, the Committee recommends that the Motor Vehicle Excise Tax,

the Boat Excise Tax and the Leased Vehicle Gross Receipts Tax be repealed and that the selling and leasing of vehicles and the selling of boats be incorporated into GRT. The registration provisions for vehicles and boats will be retained. And, the payment of GRT on the sale of motor vehicles will be similar to the method of payment already in place.

In making this recommendation, PTSC recognizes that the Leased Vehicle Excise Tax and surcharge are usually paid by tourists. Tax exportation, however, is not an acceptable determinant in creating an equitable tax structure. Under a fair tax system, the sale or leasing of all property, no matter its character, should be taxed in a similar manner.

g. Governmental gross receipts

GRT contains a separate gross receipts tax entitled the governmental gross receipts tax, (GGRT) that applies to New Mexico governments. § 7-9-3.2. The rules applicable to GGRT generally trail the statutory principles applicable to gross receipts and compensating taxes. GGRT rate is 5 percent; it is imposed on any agency, instrumentality or institutions of government or any political subdivision (collectively "agencies"), except school districts and health care providers licensed by the Department of Health, that engage in certain activities. §§ 7-9-3.2, -4.3. The taxable activities under the GRT are the:

- (A) sale of taxable personal property other than water, from facilities open to the general public;
- (B) recreational, athletic or entertainment services or events in facilities open to the general public;
- (C) refuse collection, disposal, or both;
- (D) sewage services; and
- (E) sale of water by a publicly owned entity.

§ 7-9-3.2.

The policy reason behind the enactment of GGRT is to equate agencies with private institutions when the former venture into the private market. Agencies, that engaged in the listed activities competed unfairly with private business.

Many agency activities, however, are not subject to tax. For example, receipts for health care services by a public hospital, or tuition received by public education institutions are not taxed. Agencies, therefore, compete with private organizations which engage in similar activities without paying taxes on their gross receipts.

As discussed above, PTSC also recommends that § 501(c)(3) organizations be taxed on all their gross receipts (subject to the exception under consideration).

The activities that generate those gross receipts are similar to agency activities that are presently not taxed.

Therefore, PTSC recommends that agencies be taxed on all their receipts that meet the general definition of gross receipts. Those gross receipts would include receipts from educational, health care, recreational, artistic, athletic, entertainment, and similar activities.

PTSC proposes the repeal of § 7-9-13, to the extent it exempts taxation of agencies. The consequences of this proposal is to tax agencies the same as any private organization. However, the Committee has also decided to revisit GGRT and consider whether agencies should be taxed at all. Agencies generally engage in private-type activities when no private organization does so or when government decides to subsidize partially the activity to make it affordable to all citizens. Hence, agencies may not be "engaged in business," as that term is meant by GRT. The Committee disagrees with the present statute that taxes only certain activities. It believes that agencies should be taxed like other entities that generate gross receipts, or not be taxed on any of its receipts.

h. Nontaxable Transaction Certificates

Possession of Nontaxable Transaction Certificates (NTTC) is a condition for taking certain deductions (but not all) under GRT. See § 7-9-43. The purpose of the NTTC program is to improve compliance with the state's gross receipts tax statutes and to improve taxpayer registration. For example, the deductions of many unsophisticated taxpayers are disallowed because the taxpayers accepted the wrong NTTC from buyers. However, an NTTC, taken in good faith, provides a taxpayer with a safe harbor when questions arise as to the validity of a deduction. Currently, the NTTC program has fourteen (14) different certificates available to taxpayers.

In its review of the NTTC program, PTSC tried to create a more equitable and simple system. It felt that a deduction afforded to taxpayers under the NTTC program should not automatically be disallowed if a taxpayer accepts the incorrect type of certificate or fails to have it in hand if audited. Furthermore, the Committee did not believe that the NTTC program should prevent a taxpayer from presenting other evidence of the validity of the claimed deduction. The determination of liability of a taxpayer should not be based upon whether that taxpayer had the correct certificate or followed the proper procedure; instead liability should be determined by the transaction or the validity of a particular deduction.

In order to eliminate the disadvantages to taxpayers created by the current NTTC system, the Committee recommends changing the number of certificates available to taxpayers from 14 to 2 certificates. One certificate will be for taxable transactions that occur inside the state and the second certificate will be for taxable transactions that are considered interstate transactions. If a taxpayer takes one of the two certificates in "good faith" the certificate will provide a "safe harbor" against a challenge of its validity by TRD. In addition, a taxpayer, who does not have a NTTC or who possesses the wrong NTTC, may still claim a deduction provided that the taxpayer satisfies the substantive terms of the deduction.

PTSC has attempted to amend § 7-9-43, the NTTC statute. The Committee, however, believes that § 7-9-43 should be replaced with a less complicated section. Thus, the Committee intends to re-draft § 7-9-43 so that the statute communicates more simply and clearly the NTTC rules.

4. Insurance Premiums Tax

Insurance companies, regulated by the superintendent of insurance, pay a premiums tax in lieu of all other taxes imposed by the state. § 59A-6-6. Insurance companies do not pay the gross receipts tax or the corporate income tax. The premiums tax is 3 percent of the gross premiums earned by the insurance company. § 59A-6-2. In New Mexico, insurance companies include nonprofit health care plans, health maintenance organizations (HMO's) and prepaid dental plans. § 59A-6-6. Laird Graeser and Tom Clifford of TRD, Tax Research and Statistics Office and Jerry Fickes, Chief Actuary, New Mexico Department of Insurance, summarized the history and policy considerations of the Insurance Premiums Tax, raised concerns about the different tax treatment of insurance companies, which raises equity questions, and discussed issues surrounding the incorporation of health insurance premiums into GRT. This material is included in Appendix I.

The committee spent a substantial amount of time reviewing the materials presented by Mr. Graeser, Mr. Clifford and Mr. Fickes. Of primary concern to the committee, is the different effective tax rates applied to the health insurance industry. For example, if a patient has purchased a health insurance policy, individually or through an employment benefit plan, the premiums are subject to the 3 percent premiums tax. If that same patient visits a for-profit health care provider, the fee charged by the provider, paid in part by the patient and in part by the health insurance plan, is subject to GRT. The total tax in the second scenario approaches 9 percent, assuming an average GRT of 6 percent. If the provider is a for-profit hospital, the tax imposed on the hospital is approximately 3 percent. Under § 7-9-73.1, for-profit hospitals are entitled to deduct 50 percent of their receipts in determining gross receipts tax. The effective rate in this case is approximately 6 percent (3 percent premiums tax and 3 percent GRT). On the other hand, if the patient is a member of a provider HMO, GRT does not apply to the medical services delivered to the patient. The provider HMO is an insurance company and thus under § 59A-6-6, is not subject to any taxes other than the premiums tax. In that case, the total tax is 3 percent. Still further, if a patient with a health plan who is not a member of a provider HMO visits a non-profit health care provider, GRT taxes are exempt and the only tax is the premiums tax (a 3 percent tax). The constant in all these cases is that the patient receives the same health care services. Depending on the status of the provider, however, the effective tax rate on the price of those services differs.

PTSC believes that these varying tax possibilities are unfair. The committee has not completed its study of the Insurance Premiums Tax and has no recommendation at this time. In the next year, PTSC will return to the Insurance Premiums Tax taking into consideration the issues raised by the Taxation and Revenue Department and the Department of Insurance as well as consider how to create a more equitable tax.

5. Economic Development Tax Incentives

PTSC is considering whether tax incentives should be employed in New Mexico to attract business. Assuming that tax incentives provided to business are wise tax policy, the committee also is considering whether New Mexico's particular array of tax incentive devices accomplishes their purposes without undue tax loss to the state. Brian McDonald prepared a paper describing New Mexico's various incentive provisions and compared that information with incentives provided to business in other states. His paper is included as Appendix J. Dr. McDonald's paper exposes some important points. First, confusion exists nationwide whether tax incentives benefit states in the long term. Second, New Mexico has competed favorably with other states in attracting new business to New Mexico, suggesting that the state's tax incentives are adequate. Third, the ability of business to purchase equipment with Industrial Revenue Bonds (IRBs) as well as to receive an investment credit for the purchase of that equipment may be too rich an incentive to afford to corporations.

Specifically, IRBs are issued by local governments to attract out-of-state business into their communities. With the bond proceeds, facilities are constructed and equipment is purchased for new business. Moreover, the local governments own the facilities and equipment and rents them to the business. The rent is used to pay off the bonds. Because the local government owns the facilities and the equipment, those properties are not subject to the property tax. And, because local government purchases the equipment, the seller is not required to pay gross receipts taxes on those sales. § 7-9-54.

The initial purpose of the investment credit is to remove the disadvantage to which local manufacturers are exposed when they purchase manufacturing equipment. That equipment is subject to either the gross receipts tax or the compensating tax. Other states generally do not impose a sales or use tax on the purchase of manufacturing equipment. As a consequence of this difference, New Mexico manufacturers incur larger manufacturing costs than out-of-state competitors. This difference creates a disincentive for non-New Mexico corporations who want to move to New Mexico. Corporations that meet the conditions of the Investment Credit Act are granted a credit based on the purchase price of their equipment. That credit approximates the gross receipts or compensating tax rate.

In 1991, the Investment Credit Act was amended to cover Industrial Revenue Bond-financed equipment. Corporations can now take the credit even if they have not paid gross receipt or compensating taxes on the acquisition of the equipment. PTSC is reviewing the investment tax credit to determine if it should be limited only to non-Industrial Revenue Bond-financed equipment. In addition, the Committee will consider next year whether the better approach is to eliminate the investment tax credit and replace it with an exemption to GRT, excluding the acquisition of manufacturing equipment. Presently, only very large manufacturers enjoy the benefits on the investment tax credit: small manufacturers generally are not entitled to the credit. The proposed GRT exemption will help all manufacturers, large or small, local or out-of-state and thinking about moving to New Mexico.

6. Corporate Income Tax

PTSC just begun its discussion of the corporate income tax. Appendix K contains an article by Allen Maury and Laird Graeser, from the February 1, 1993 issue of State Tax Notes, describing New Mexico's corporate income tax. PTSC has learned that the corporate income tax will generate approximately \$160 million in tax revenues for the current fiscal year, which represents about 7 percent of all tax revenues. Further, 50 corporations pay approximately 75 percent of all corporate income taxes. The corporate income tax affects large corporations. Small, closely-held corporations pay very little of the tax. Small corporations have little taxable income, or can elect planning techniques, like S Corporation, that avoid the corporate income tax.

PTSC has listed the issues that it will consider next year when it continues its review of the corporate income tax. Those issues are:

(a) Whether New Mexico should require mandatory combined reporting for all corporations. The present separate reporting option allows for shifting of income to tax-haven states, like Nevada and Delaware.

(b) Whether the election to use the double weighted sales factor to apportion income should be repealed or made mandatory. See Appendix K.

(c) Whether the top corporate income tax rates are too high and whether the tax brackets cause a taxpayer to reach the higher rates too quickly.

(d) Whether the formula to apportion income between New Mexico and other states should be applied to taxable income instead of the corporate income tax.

(f) Whether the throwback rule should be applicable when a taxpayer's sales occur in a state without a corporate income tax.

(g) Whether, to prevent tax avoidance, TRD should be given the authority to allocate or apportion income, deductions, credits or other allowance among corporations controlled by the same interests, similar to the authority the Internal Revenue Service has under § 482.

(h) How should foreign dividends be taxed?

PTSC plans to review all these issues, and others that arise, beginning next year. Our objective is to propose a corporate income tax that is not unduly burdensome, fair, and not easily avoided.

APPENDIX A

HOUSE BILL 900

Section 5. ~~TAX STUDY COMMITTEE--CREATION--DUTIES.--~~

13
16 A. The co-chairmen of the legislative council, in
17 consultation with the governor, shall appoint a tax study
18 committee. The tax study committee shall be composed of five
19 public members who are experts in the field of tax policy and
20 tax law.

21 B. The committee shall examine the manner and
22 subjects of taxation and the foundations and goals of current
23 and recommended tax policy. The committee shall review the
24 long-term, strategic planning considerations of the New
25 Mexico horizons task force and shall report its findings and

1 recommendations, including proposed bill drafts, to the
2 members of the appropriate interim or special legislative
3 committee, the legislative council and the governor prior to
4 the commencement of the forty-third legislature.

5 C. To assist the members of the tax study
6 committee, upon their request, the director of the
7 legislative council service is authorized to contract for the
8 services of a draftsman to perform drafting and research
9 services for the committee.

10 D. Members of the committee may receive per diem
11 and mileage in the manner provided for non-salaried public
12 officers in the Per Diem and Mileage Act.

APPENDIX B

**PROPOSED MODIFICATIONS TO NEW MEXICO
GROSS RECEIPTS & COMPENSATING TAX ACT**

<u>Proposed Modification</u>	<u>Effect on GRCTA Tax Base</u>	<u>Committee Action</u>	<u>Tax Policy</u>
(1) Repeal moratorium on collection of compensating tax on personal purchases of tangible personal property purchased from out of state vendor. Collect under combined Personal Income/Compensating Tax Form filed annually. Provide for strict no fault penalties for failure to report or pay proper amount of tax. Institute information return reporting requirement for out of state vendors.	Expands Tax Base	Approved/No action on reporting and penalty	Moratorium violates equity principle of tax policy. Repeal places imports on equal footing with instate sales of tangible personal property
(2) Enact compensating tax on in state use by persons in New Mexico of services performed outside New Mexico. Exempt certain inter-company cost sales for affiliated companies (in a manner similar to that of current Section 7-9-69). Impose requirement that out-of-state vendors who pass on (or pay) gross receipts tax or collect compensating tax separately state the tax on its invoice for goods.	Expands Tax Base	Approved(with modifications)/ No Action on separate statement proposal	Exemption violates equity principle of tax policy
(3) Eliminate taxable subsequent sale requirement for sales of services for resale.*	Shrinks Tax Base	Approved	Repeal eliminates tax pyramiding on selected resales of services
(4) Repeal gross receipts tax exemptions (deductions) for the following selected industries and special interests:	Expands Tax Base		

* Assumes concomitant repeal of gross receipts tax exemption for 501(c)(3)'s.

<u>Proposed Modification</u>	<u>Effect on Tax Base</u>	<u>Committee Action</u>	<u>Tax Policy</u>
(a) Section 7-9-16 (receipts of non-profit retirement facilities);		Approved	Exemption violates equity principle of tax policy
(b) Section 7-9-18 (receipts from sale of agriculture products);		Approved as to retail sales; Sales for resale converted to deduction	Exemption for retail sales violates equity principle of tax policy
(c) Section 7-9-19B; 7-9-19C. (receipts from penning, handling or training livestock);		Approved	Exemption violates equity principle of tax policy
(d) Section 7-9-23.1 (receipts from sale of boats)		Pending	NA
(e) Section 7-9-26 (receipts from selling/use of gasoline or special fuel);		No Change	NA
(f) Section 7-9-33B. (receipts from storing crude oil, natural gas, and liquid hydrocarbons)		Pending	NA
(g) Section 7-9-36 (receipts from sale of fuel for pipeline transport);		Pending	NA
(h) Section 7-9-40A (race purses and commissions);		Approved	Exemption violates equity principle of tax policy
(i) Section 7-9-41 (receipts of ministers of tax exempt religious organizations);		Approved	Exemption violates equity principle of tax policy
(j) Section 7-9-51.1 (receipts from sale of railway roadbed materials);		Sunsets-1996	NA
(k) Section 7-9-58B. (receipts of auctioneers from sales of livestock and agricultural products)		Approved	Deduction violates equity principle of tax policy

<u>Proposed Modification</u>	<u>Effect on Tax Base</u>	<u>Committee Action</u>	<u>Tax Policy</u>
(l) Section 7-9-59A. (receipts from warehousing agricultural products)		Approved	Deduction violates equity principle of tax policy
(m) Section 7-9-62 (fifty percent of receipts from sale of agricultural equipment)		Approved	Deduction violates equity principle of tax policy
(n) Section 7-9-63 (receipts from publishing newspapers or magazines);		Approved	Publishers qualify for another deduction
(o) Section 7-9-64 (receipts from selling newspapers);		Approved	Deduction violates equity principle of tax policy
(p) Section 7-9-65 (receipts from selling chemicals and reagents)		Retained (with Modifications)	Deduction eliminates tax pyramiding on raw materials used in oil and gas industry
(q) Section 7-9-66.1 (commissions on sale of new construction)		Approved	Deduction violates equity principle of tax policy
(r) Section 7-9-76 (travel agents' commissions from sale of certain maritime and interstate transportation services)		Approved	Deduction violates equity principle of tax policy
(s) Section 7-9-83 (receipts from selling aviation fuel)		Approved	Deduction violates equity principle of tax policy
(5) Repeal compensating tax exemptions for the following selected industries and special interests:	Expands Tax Base		
(a) Section 7-9-30 (use of railroad equipment and commercial aircraft)		Pending	NA
(b) Section 7-9-37 (use of fuel for pipeline transportation)		Pending	NA

<u>Proposed Modification</u>	<u>Effect on Tax Base</u>	<u>Committee Action</u>	<u>Tax Policy</u>
(c) Section 7-9-38 (use of electricity for production and transmission of electricity)		Pending	NA
(d) Section 7-9-84 (use of aviation fuel)		Approved	Deduction violates equity principle of tax policy
(6) Repeal Section 7-9-29 gross receipts tax exemption for receipts derived from 501(c)(3) non profits engaged in business in New Mexico. Retain exemption for contributions/donations qualifying under IRC Section 170. <u>Possible Alternative:</u> Replace the exemption with a deduction for value of no cost or below cost indigent health care/subsistence provided by non profits to qualifying individuals (similar to ITC).	Expands Tax Base.	Approved/No action on Credit Alternative	Exemption violates equity principle of tax policy
(7) Repeal Section 7-9-66 deduction for commissions on wholesale sales of tangible personal property.	Expands Tax Base.	No Change	Deduction eliminates tax pyramiding on wholesale sales of tangible personal property
(8) Repeal Section 7-9-60 deduction for sales of tangible personal property to 501(c)(3)'s.	Expands Tax Base.	Approved	Deduction violates equity principle of tax policy
(9) Enact gross receipts tax deduction for the sale of fuel to produce power or fuel, such as the sale of coal or natural gas to an electric utility (or co-generation facility) to fire a coal or gas fired plant.	Shrinks Tax Base.	Pending	NA

<u>Proposed Modification</u>	<u>Effect on Tax Base</u>	<u>Committee Action</u>	<u>Tax Policy</u>
(10) Repeal premium tax on Health Maintenance Organizations ("HMO's"). Impose gross receipts tax on premiums received by HMO's (Brings HMO's into line with other health care providers).	Expands Tax Base.	Pending	NA
(11) Repeal Motor Vehicle Excise Tax. Impose gross receipts tax on receipts from sales of motor vehicles (Brings sales of motor vehicles in line with sales of other tangible personal property).	Expands Tax Base.	Approved	No tax policy reason for separate tax on motor vehicles; reduced rate violates equity principle of tax policy
(12) Expand Investment Tax Credit ("ITC") to cover equipment purchases for selected growth service businesses, such as software design and biotechnology research and development companies.	Shrinks Tax Base.	Pending	NA
(13) Eliminate ITC on equipment financed with Industrial Revenue Bonds ("IRB's").	Expands Tax Base.	Pending	NA
(14) Repeal the Section 7-9-56 deduction for gross receipts tax for <u>intrastate</u> portion of interstate transportation of persons and property.	Expands Tax Base.	Approved	Exemption violates equity principle of tax policy
(15) Repeal Section 7-9-56 deduction for <u>intrastate</u> portion of transportation of persons or property under single interstate contract.	Expands Tax Base.	Approved	Exemption violates equity principle of tax policy
(16) Modify Section 7-9-55 deduction for exports to provide deduction if product (a) physically delivered outside the state, and (b) initially used out of state.	Expands Tax Base.	No Change/Exports addressed in definition of New Mexico sale	NA

<u>Proposed Modification</u>	<u>Effect on Tax Base</u>	<u>Committee Action</u>	<u>Tax Policy</u>
<p>(17) Modify Section 7-9-55 deduction for exports to exclude retail sales from deduction. Provide statutory definition of retail sales. (Example: Sales by person who derives more than 50% of gross receipts from retail sales of tangible personal property to individuals.) Apply test on a combined entity basis.</p>	Expands Tax Base.	No Action	NA
<p>(18) Expand (or clarify availability of) Section 7-9-57 deduction for exported services for gross receipts tax derived from various types of other services which <u>do not</u> produce a "product". (Example: Mutual fund management companies providing management services to mutual funds, substantially all of whose shareholders are domiciled out of state.)</p>	Shrinks Tax Base.	Pending	NA
<p>(19) Enact NTTC "savings clause" pursuant to which distributors/subcontractors who have failed to obtain (or otherwise are unable to produce at audit) an appropriate NTTC to document an intermediate deduction, may still claim the deduction by establishing by a preponderance of the evidence that the transaction otherwise qualifies (without regard to the NTTC requirement). Require Taxation and Revenue Department to print requirements for deduction on each type of NTTC.</p>	Shrinks Tax Base.	Approved(with modifications)	Eliminates procedural tax trap for taxpayers

<u>Proposed Modification</u>	<u>Effect on Tax Base</u>	<u>Committee Action</u>	<u>Tax Policy</u>
(20) Enact compensating tax on in state use by individuals of selected entertainment services (such as satellite television or on line computer services delivered from outside the state by an out of state vendor). Collect under a combined Personal Income/Compensating Tax Form filed annually. Provide for strict no fault penalties for failure to report or pay proper amount of compensating tax. Institute information reporting requirement for out of state vendors.	Expands Tax Base.	Approved(with modifications)/ No Action on reporting or penalty proposal	Exemption violates equity principle of tax policy
(21) Repeal Section 7-9-62 50% gross receipts tax deduction for receipts from sale of certain off road vehicles.	Expands Tax Base.	Approved	Deduction violates equity principle of tax policy
(22) Repeal Section 7-9-68 deduction for receipts from furnishing goods or services to fulfill warranty obligations.	Expands Tax Base.	No Change	NA
(23) Repeal Section 7-9-77 50% compensating tax deduction for certain off road vehicles.	Expands Tax Base	Approved	Deduction violates equity principle of tax policy
(24) Impose compensating tax on use of transportation equipment in New Mexico. Enact apportionment provisions, pursuant to which use in more than one state may be apportioned among the states for compensating tax purposes. (Example: Apportion tax based on prior year's New Mexico UDITPA percentage).	Expands Tax Base.	Pending	NA

<u>Proposed Modification</u>	<u>Effect on Tax Base</u>	<u>Committee Action</u>	<u>Tax Policy</u>
(25) Repeal Section 7-9-73.1 deduction for fifty percent of receipts of "for profit" hospitals.	Expands Tax Base.	Approved	Deduction violates equity principle of tax policy

BCR/PTSC/GRCTA/P-mods

APPENDIX C

New Mexico's Gross Receipts and Compensating Tax Act: Exemptions and Deductions			
Page	Statute	Category	Repeal Impact (\$Millions)
		1a. Avoidance of Pyramiding-Channels of Commerce	
34	7-9-46	<u>Deduction for Property Used as an Ingredient in a Manufactured Product</u>	\$50
35	7-9-47	Deduction for the <u>Sales of Property for Resale</u>	\$100's
36	7-9-48	Deduction for the Sale of Services for Resale	\$30-40
37	7-9-49	Deduction for the Sale of Property for Subsequent Lease	Unknown
38	7-9-50	Deduction for the Lease of Property for Subsequent Release	Small
39	7-9-51	Deduction for <u>Materials Incorporated</u> into a Construction Project	\$25-30
40	7-9-52	Deduction for Sales of Construction Services to Construction Businesses	\$30-35
69	7-9-78	Compensating Tax Deduction for Sale of Property for Subsequent Lease	\$ 5
		1b. Avoidance of Pyramiding-Specific Situations	
9	7-9-19	Exemptions for Receipts from Feeding, Penning, and Handling of Livestock	Unknown
10	7-9-20	Exemption of Certain Receipts of Homeowners Associations	Small
21	7-9-30	Compensating Tax Exemption for Railroad Equipment and Certain Commercial Aircraft (also in category 4)	Unknown
28	7-9-36	Gross Receipts Exemption for <u>Pipeline Fuel</u>	Unknown
29	7-9-37	Compensating Tax Exemption for Pipeline Fuel	Unknown
30	7-9-38	Compensating Tax Exemptions for Electricity <u>used in</u> Production and Transmission of Electricity	Unknown
46	7-9-58	Deduction of Certain Sales to Farmers and Ranchers	\$3-5
47	7-9-59	Deduction for Certain Agricultural Services	\$.5-1

New Mexico's Gross Receipts and Compensating Tax Act: Exemptions and Deductions			
<i>Page</i>	<i>Statute</i>	<i>Category</i>	<i>Repeal Impact (\$Millions)</i>
50	7-9-62	50% Deduction for Agricultural Equipment and Vehicles Not Registered under the Motor Vehicle Code (to extend purchased by businesses) (also in category 8)	\$10
53	7-9-65	Deduction for Certain Chemicals and Reagents	\$1
54	7-9-66	Deduction for Commissions on Sale of Tangible Property Not Subject to Gross Receipts Tax	Small
55	7-9-66.1	Deductions for Commissions on the Sale of New Construction	\$1-2
57	7-9-68	Deduction for Goods and Services Provided under a Manufacturer's Warranty	\$.5-1
58	7-9-69	Deduction for Receipts from Services Provided an Affiliate Corporation	Small
60	7-9-71	Deduction for Certain Trade-ins	\$5-10
64	7-9-75	Deduction for Services Performed on a Manufactured Product	\$1-2
66	7-9-76.1	Deduction for Sale of Mobile Homes Subject to Gross Receipts Tax on Initial Sale	\$3
67	7-9-76.2	Deduction for Leasing and Licensing of Theatrical Tapes	\$.5-1
68	7-9-77	50% Compensating Tax Exemption for Some Agricultural Equipment and Vehicles Not Registered under the Motor Vehicle Code (also in category 8)	\$5
		2. Income Payments	
6	7-9-17	Exemption for Wages, Salaries, Commissions, Personal Remuneration	\$480 (3.65%)
16	7-9-25	(Part) Gross Receipts Tax Exemption for Interest and Dividends (also in category 5)	Unknown

New Mexico's Gross Receipts and Compensating Tax Act: Exemptions and Deductions			
<i>Page</i>	<i>Statute</i>	<i>Category</i>	<i>Repeal Impact (\$Millions)</i>
23	7-9-32	(Part) Gross Receipts Tax Exemption for Receipts from Mineral Leases (also in category 5)	\$450-90 (5%)
41	7-9-53	(Part) Gross Receipts Tax Exemption for Receipts from Lease of Real Property (also in category 5)	\$100
		3. Receipts Under Other Statutes	
11	7-9-22	Exemption for Sale of Vehicles Subject to Registration under Motor Vehicle Code	\$42
12	7-9-22.1	Gross Receipts Exemption for Sale of Boat Excise Tax	\$.5
13	7-9-23	Compensating Tax Exemption for Vehicles Registered under the Motor Vehicle Code (also in category 7)	Small
14	7-9-23.1	Compensating Tax Exemption for Boats Registered under the Boat Act (also in category 7)	Small
15	7-9-24	Gross Receipts Exemption for Insurance Premiums	None
17	7-9-26	Gross Receipts and Compensating Tax Exemption for Gasoline and Special Fuels	\$38
32	7-9-40	Gross Receipts Exemption for Jockeys' and Horsemen's Purses and Race Track Commissions (Commission are a portion of the Parimutuel handle, taxed under separate law. Purses are distributed largely from the commission.)	\$1-2 (4%)
61	7-9-72	Deduction for Sale of Special Fuel to Tax Excluded Users	Small
		4. Sales in Interstate Commerce	
2	7-9-13.1	Exemption for Services Performed Out-of-State with Initial Use in New Mexico	Hypothetical \$20-30
21	7-9-30	Compensating Tax Exemption for Railroad Equipment and Certain Commercial Aircraft (also in category 1b)	Unknown
43	7-9-55	(Part) Deduction for Sales in Interstate Commerce and Certain Radio and TV Broadcast Time	\$150-200 (5%)

New Mexico's Gross Receipts and Compensating Tax Act: Exemptions and Deductions			
<i>Page</i>	<i>Statute</i>	<i>Category</i>	<i>Repeal Impact (\$Millions)</i>
44	7-9-56	Deduction for Certain Intrastate Transportation and Related Services and Interstate Telephone Transmissions	\$20-30 (5%)
45	7-9-57	Deduction for Out-of-State Sales of Services	\$10-20 (5%)
59	7-9-70	Deduction for Leasing Certain Vehicles Used in Interstate Commerce	\$1-2
65	7-9-76	Deduction for Certain Travel Agents' Commissions	Unknown
		5. Real Property and Certain Intangibles	
16	7-9-25	(Part) Gross Receipts Tax Exemption for Sale of Stocks and Bonds (also in category 3)	Unknown
23	7-9-32	(Part) Gross Receipts Tax Exemption for Sale of Mineral Lease Interests (also in category 2)	Unknown
41	7-9-53	(Part) Gross Receipts Tax Exemption for Sale of Real Property (except new construction) (also in category 2)	Unknown
		6. Governments and Nonprofit Organizations	
1	7-9-13	Exemption for Receipts of Governmental Agencies	\$25
3	7-9-14	Compensating Tax Exemption for Use of Property by Governments	Small
4	7-9-15	Compensating Tax Exemption for Use of Property by 501(c)(3) Organizations	\$5-10
5	7-5-16	Gross Receipts Tax Exemption for Nonprofit Facilities Providing Accommodations for the Elderly	\$2-3
8	7-9	Exemption for Food Stamps (the food program is supported by the federal government)	\$3
20		Gross Receipts Exemption for Sales by 501(c)(3) Organizations	\$50-60
22	7-1	Gross Receipts Exemption for Selling Property by Base Exchanges	None

New Mexico's Gross Receipts and Compensating Tax Act: Exemptions and Deductions			
<i>Page</i>	<i>Statute</i>	<i>Category</i>	<i>Repeal Impact (\$Millions)</i>
31	7-9-39	Gross Receipts Exemption for Dues and Registration Fees of Nonprofit Organizations	\$1
33	7-9-41	Gross Receipts Exemption for Certain Receipts of Ministers of 501(c)(3) Organizations	Small
42	7-9-54	Gross Receipts Deduction for Sales of Tangible Property to Governments	\$25-30
48	7-9-60	Deduction for Sale of Tangible Property to 501(c)(3) Organizations	\$10-15
		7. Administrability	
7	7-9-18	Exemption for Receipts from Sales of Farm Products by Producers, Growers	\$2-3
13	7-9-18	Compensating Tax Exemption for Vehicles Registered under the Motor Vehicle Code (also in category 3)	Small
14	7-9-23.1	Compensating Tax Exemption for Boats Registered under the Boat Act (also in category 3)	Small
18	7-9-27	Compensating Tax Exemption for Personal and Household Property	Small
19	7-9-28	Gross Receipts Exemption for Occasional Sales	Unknown
24	7-9-33	Gross Receipts Exemption for Certain Oil and Gas Products	Unknown
25	7-9-34	Gross Receipts Exemption for Certain Products Subject to Natural Gas Processors Tax (also in category 8)	Unknown
26	7-9-35	Gross Receipts Exemption for Certain Products Subject to Resources Excise Tax	\$.7 (5%)
56	7-9-67	Deduction for Uncollectible Debts	Unknown
62	7-9-73	Deduction for Prosthetic Devices	Small
63	7-9-74	Deduction for Property Incorporated into Jewelry	Small

New Mexico's Gross Receipts and Compensating Tax Act: Exemptions and Deductions			
<i>Page</i>	<i>Statute</i>	<i>Category</i>	<i>Repeal Impact (\$Millions)</i>
		8. Others	
25	7-9-34	Gross Receipts Exemption for Certain Products Subject to Natural Gas Processors Tax (also in category 7)	Unknown
49	7-9-61.1	Deduction for Loan Origination or Assumption Fees	\$1-2
50	7-9-52	50% Deduction for Agricultural Equipment and Vehicles Not Registered under the Motor Vehicle Code (also in 1b)	\$10
51	7-9-63	Deduction for Publishing Newspapers	See Below
52	7-9-64	Deduction for Selling Newspapers at Retail	\$2
68	7-9-77	Compensating Tax Deduction for Agricultural Equipment and Vehicles Not Registered under the Motor Vehicle Code (also in category 1b)	\$5

APPENDIX D

**SUMMARY OF GROSS RECEIPTS AND COMPENSATING
TAXATION OF TRANSPORTATION SERVICES**

<u>TRANSACTION</u>	<u>TAX TREATMENT</u>
(1) <u>SALES</u>	
(a) Retail sale of intra-state transportation services in New Mexico	T ¹
(b) Sales of inter-state transportation services where transportation begins, passes through and ends outside of New Mexico	NT
(c) Sales of inter-state transportation services where transportation begins in and ends outside of New Mexico	NT
(d) Sales of inter-state transportation services where transportation begins outside and ends in New Mexico	NT
(e) Sales of transportation services to <u>Indians</u> on Indian Reservation	NT ²
(2) <u>PURCHASES</u>	
(a) Purchase of subcontracted transportation services resold in New Mexico	NT ³
(b) Purchase of subcontracted transportation services of persons or property by interstate carrier; persons or property transported in interstate commerce under single contract	NT ⁴
(c) Purchase of capital equipment	T/C ⁵
(d) Purchase of supplies	T
(e) Purchase of fuel for trucks	NT
(f) Purchase of general business services	T ⁶
(g) Rent for distribution center	NT

¹ Excludes certain air transportation of persons.

² See Laguna Industries vs. New Mexico Department of Taxation and Revenue, ___ N.M. ___ (1993)

³ Assumes resale of transportation services is taxable. Applies irrespective of whether the purchaser is in the transportation business or another line of work.

⁴ The next sale need not be taxable.

⁵ Investment tax credits are not available for transportation equipment.

⁶ General business services would include such things as legal, accounting and advertising services.

(h) Purchase of in house labor

NT

SUMMARY OF GROSS RECEIPTS AND COMPENSATING TAXATION OF PRINTERS

<u>TRANSACTION</u>	<u>TAX TREATMENT</u>
(1) <u>SALES</u>	
(a) Sales of finished products within New Mexico for resale	NT
(b) Sales of finished products @ retail	T
(c) Sales of finished products outside of New Mexico (Exports)	NT
(d) Sales of printing services at retail in New Mexico	T ¹
(e) Sales of printing services for resale in New Mexico	NT ²
(f) Sales of printing services for export outside New Mexico	NT ³
(2) <u>PURCHASES</u>	
(a) Purchase of raw materials	NT ⁴
(b) Purchase of power/fuel	T
(c) Purchase of subcontracted printing services	NT ⁵
(d) Purchase of transportation services to plant	NT/T ⁶
(e) Purchase of capital equipment	T/C ⁷
(f) Purchase of supplies	T

¹ Assumes the printing job constitutes a service under the predominant ingredient test.

² See footnote 1 above.

³ See footnote 1 above. Assumes product of service delivered and initially used outside New Mexico.

⁴ Assumes sale of product and not service.

⁵ Assumes next sale taxable.

⁶ Nontaxable if in interstate commerce or if transportation represents intrastate portion of transportation in interstate commerce under single contract; taxable if transportation entirely intrastate. Note: extremely unlikely that "transport in" will qualify for sale of service for resale deduction.

⁷ Credits available for tax paid to another state (if equipment purchased outside and put to use in N.M.) and under Investment Tax Credit Act (if requirements of that act satisfied).

- | | | |
|-----|--|-------------------|
| (g) | Purchase of general business services | T |
| (h) | Purchase of transportation services from plant | NT/T ⁸ |
| (i) | Purchase of in house labor | NT |

⁸ Nontaxable if in interstate commerce or if transportation represents intrastate portion of transportation in interstate commerce under a single contract; taxable if transportation entirely intrastate. Note: may qualify for sale for resale deduction to avoid double taxation on intrastate transportation.

SUMMARY OF GROSS RECEIPTS AND COMPENSATING TAXATION OF
MEDICAL/DENTAL SERVICES¹

<u>TRANSACTION</u>	<u>TAX TREATMENT</u>
(1) <u>SALES</u>	
(a) Retail sale of medical or dental services in New Mexico	T
(b) Sales of medical or dental services outside of New Mexico	NT
(c) Sales of medical or dental services to Indians on Indian Reservation	NT
(d) Sales of drugs and medical or dental supplies	T ²
(2) <u>PURCHASES</u>	
(a) Purchase of utility services (tel./elec.)	T
(b) Purchase of subcontracted medical or dental services (e.g. anesthesia)	NT ³
(c) Purchase of laboratory/diagnostic services	NT
(d) Purchase of medical/dental and other capital equipment	T/C ⁴
(e) Purchase of drugs and medical or dental supplies	T ⁵
(f) Purchase of general business services	T
(g) Rent	NT ⁶
(h) Purchase of in house labor (i.e. wages)	NT

¹ Includes medical and dental services provided by licensed physicians and dentists directly to patients. Excludes services provided as an employee of a hospital, HMO, PHO or similar organization.

² Refers to drugs and supplies used to treat patients.

³ Assumes resale of services is taxable.

⁴ Credit available for tax paid to another state (if equipment purchased outside and used in N.M.).

⁵ With a few practice specific exceptions, medical and dental supplies are generally taxed both on the sale to the physician/dentist and again on resale to the patient. Exceptions include: (i) oncologists and (ii) radiologists (radioisotopes). A request for a regulation providing for similar treatment for urologists is pending before the Taxation and Revenue Department.

⁶ Rent for the use of real property is not subject to gross receipts tax; build to suit real estate partnerships, which are common devices for group as well as sole practitioner medical practices, likely will pass on tax on construction materials and services to tenants in the form of higher rent.

SUMMARY OF GROSS RECEIPTS AND COMPENSATING TAXATION
OF 501(c)(3) NON PROFIT HOSPITALS

<u>TRANSACTION</u>	<u>TAX TREATMENT</u>
(1) SALES	
(a) Retail sale of health care services in New Mexico	NT
(b) Retail sale of health care services outside of New Mexico	NT
(c) Retail sale of prescription drugs to non patients	T ¹
(d) Retail sale of prescription drugs to hospital patients	NT
(e) Retail sale of medical supplies to hospital patients	NT
(f) Retail sale of medical supplies to non patients	T ²
(g) Retail sale of prosthetic devices	NT
(2) PURCHASES	
(a) Purchase of gas, water and electric utility services	NT ³
(b) Purchase of contract health care services ⁴	T ⁵
(c) Purchase of capital/diagnostic equipment	NT
(d) Purchase of supplies	NT
(e) Purchase of general business services (legal, accounting, advertising, etc.)	T
(f) Purchase of in house labor (i.e. wages)	NT
(g) Purchase of improved real estate or payments of rent	NT ⁶
(h) Purchase of laboratory services	T
(i) Purchase of drugs for resale	NT

¹ The sale of prescription drugs by a hospital pharmacy to non patients is unrelated business income and subject to gross receipts tax unless sold to Medicaid recipients pursuant to taxation and revenue regulation GR 54:11. Note: It is very unlikely that taxable sales of prescription drugs represent a material portion of a 501(c)(3) hospital's revenue.

² The sale of medical supplies by a hospital pharmacy to non patients is unrelated business income subject to gross receipts tax. The reasoning of GR 54:11, however, may apply to exempt receipts from sales to Medicaid patients from gross receipts tax. Note: It is very unlikely that taxable sales of medical supplies represent a material portion of a 501(c)(3) hospital's revenue.

³ Although generally viewed as a service, gas, water and electricity are treated as tangibles for gross receipts tax purposes and, thus, sales to 501(c)(3)s are deductible under §7-9-60. Telephone service is treated as a service and subject to tax. Leaco Rural Tel. Coop. v. Bureau of Revenue, 86 N.M. 629 (Ct. App. 1974).

⁴ The hospital may act as a billing agent for non staff physicians, so that the physician's bill is rendered directly to the hospital patient instead of to the hospital and passed on to the patient. The physicians services are still subject to tax.

⁵ An increasing trend in the health care industry is the integration of medical practices into non profit hospital systems. The effect is the elimination of gross receipts tax on those types of contract services.

⁶ The sale of construction services to 501(c)(3)s is subject to gross receipts tax. Thus, for example, the fee for constructing a new hospital wing or office building (excluding real estate and equipment) is subject to tax.

**SUMMARY OF GROSS RECEIPTS AND COMPENSATING TAXATION
OF NON-PROFIT LONG TERM HEALTH CARE PROVIDERS**

<u>TRANSACTION</u>	<u>TAX TREATMENT</u>
(1) SALES	
(a) Retail sale of long term health care (nursing homes) services in New Mexico	NT
(b) Retail sale of long term health care (nursing homes) services outside of New Mexico	NT
(c) Retail sale of prescription drugs to nursing home residents	NT
(d) Retail sale of medical supplies to nursing home residents	NT
(e) Retail sale of rehabilitation services in New Mexico	NT
(f) Retail sale of rehabilitation services outside New Mexico	NT
(g) Retail sale of nursing home management services to nursing homes located in New Mexico	NT
(h) Retail sale of nursing home management services to nursing homes located outside New Mexico	NT
(2) PURCHASES	
(a) Purchase of gas, water and electric utility services (NM)	NT ¹
(b) Purchase of contract health care/supply services for resale	T ²
(c) Purchase of capital equipment	NT
(d) Purchase of business supplies	NT
(e) Purchase of general business services (legal, accounting, advertising, etc.)	T
(f) Purchase of in house labor (i.e. wages)	NT
(g) Purchase of real estate or payments of rent	T/NT ³
(h) Purchase of lab services (for resale)	T ⁴
(i) Purchase of drugs for resale	NT

¹ Although generally viewed as a service, gas, water and electricity are treated as tangibles for gross receipts tax purposes and, thus, sales to 501(c)(3)s are deductible under §7-9-60. Telephone service is treated as a service and subject to tax. *Leaco Rural Tel. Coop. v. Bureau of Revenue*, 86 N.M. 629 (Ct. App. 1974).

² Sales of health care/supply or other services for resale are not deductible under §7-9-48 because the next sale is not taxable as required by §7-9-48.

³ The sale of construction services is subject to gross receipts tax. Thus, for example, the fee for constructing a new nursing home or office building (excluding real estate) is subject to tax.

⁴ Sales of lab services for resale are not deductible under §7-9-48 because the next sale is not taxable as required by §7-9-48.

**SUMMARY OF GROSS RECEIPTS AND COMPENSATING TAXATION
OF 501(c)(3) NON PROFIT EDUCATIONAL INSTITUTIONS**

<u>TRANSACTION</u>	<u>TAX TREATMENT</u>
(1) SALES	
(a) Tuition for educational services performed in New Mexico	NT
(b) Tuition for educational services performed outside of New Mexico	NT
(c) Tuition for correspondence courses performed in New Mexico for students outside New Mexico	NT
(d) Retail sale of textbooks/gifts/accessories to students	NT
(e) Retail sale of textbooks/gifts/accessories to non students	T ¹
(f) Retail sale of tickets to sporting/arts and entertainment events	NT
(g) Retail sale of food and beverages to students at school snack bar	NT
(h) Retail sale of food and beverages to students at school snack bar	T ²
(2) PURCHASES	
(a) Purchase of gas, water and electric utility services	NT ³
(b) Purchase of contract services (resale)	T ⁴
(c) Purchase of capital equipment	NT ⁵
(d) Purchase of supplies	NT
(e) Purchase of general business services (legal, accounting, advertising, etc.)	T
(f) Purchase of in house labor (i.e. wages)	NT
(g) Purchase of real estate or payments of rent	NT ⁶
(h) Purchase of textbooks/gifts/accessories for resale	NT
(i) Purchase of food and beverages for resale	NT

¹ The sale of books/gifts/accessories to non students is unrelated business income and subject to gross receipts tax. As a practical matter, compliance is likely to be minimal or nonexistent.

² The sale of food and beverages to non students is unrelated business income and subject to gross receipts tax. As a practical matter, compliance is likely to be minimal or nonexistent.

³ Although generally viewed as a service, gas, water and electricity are treated as tangibles for gross receipts tax purposes and, thus, sales to 501(c)(3)s are deductible under §7-9-60. Telephone service is a service and subject to tax. Leaco Rural Tel. Coop. v. Bureau of Revenue, 86 N.M. 629 (Cl. App. 1974).

⁴ Given the nature of the industry, it is unlikely that contract services are a big component of the typical school budget. As such, very little tax would be generated by these types of transactions.

⁵ The purchase of capital equipment for use in an unrelated business is subject to gross receipts tax. Given the low level of unrelated business activity reported by 501(c)(3)s, it is doubtful that very much, if any, capital equipment sold to 501(c)(3)s is actually taxed. If, in an audit, an activity is determined to be unrelated, the entity could (and likely would) be hit not only with the gross receipts tax (interest and, possibly, penalties) on the receipts derived from that activity, but also compensating tax (interest and, possibly, penalties) on the equipment (and other items) purchased (with) and used in that activity.

⁶ The sale of construction services is subject to gross receipts tax. Thus, for example, receipts (including receipts for construction materials) for constructing a new classroom, lab, gymnasium or office building (excluding real estate) are subject to tax.

**SUMMARY OF GROSS RECEIPTS AND COMPENSATING TAXATION OF
PERSONAL SERVICES¹**

<u>TRANSACTION</u>	<u>TAX TREATMENT</u>
(1) <u>SALES</u>	
(a) Retail Sale of personal services in New Mexico	T
(b) Sales of personal services Outside of New Mexico	NT
(c) Sales of personal services for Indians on Indian Reservation	NT
(2) <u>PURCHASES</u>	
(a) Purchase of utility services	T
(b) Purchase of transportation services to transport supplies to business	NT/T ²
(c) Purchase of tools and equipment	T/C ³
(d) Purchase of supplies	T/NT ⁴
(e) Purchase of general business services	T
(f) Purchase of in house labor	NT
(g) Rent	NT

¹ Includes most types of non-professional services, such as, for example, personal grooming, laundry, cleaning, and landscaping.

² Nontaxable if in interstate commerce or if transportation represents intrastate portion of transportation in interstate commerce under single contract; taxable if transportation entirely intrastate.

³ Credit available for tax paid to another state (if equipment purchased outside and used in N.M.).

⁴ May be nontaxable if purchased for resale; taxed on retail sale; taxable if used in connection of the performance of a service.

**SUMMARY OF GROSS RECEIPTS AND COMPENSATING TAXATION OF
PROFESSIONAL SERVICES¹**

<u>TRANSACTION</u>	<u>TAX TREATMENT</u>
(1) <u>SALES</u>	
(a) Retail sale of professional services in New Mexico	T
(b) Sales of professional services outside of New Mexico	NT
(c) Sales of professional services to Indians on Indian Reservation	NT
(d) Sales of professional services performed in New Mexico, product delivered and used outside New Mexico	NT
(2) <u>PURCHASES</u>	
(a) Purchase of utility services	T
(b) Purchase of subcontracted professional services	NT ²
(c) Purchase of transportation services to transport products of services to customers	NT/T ³
(d) Purchase of capital equipment	T/C ⁴
(e) Purchase of supplies	T
(f) Purchase of general business services	T
(g) Rent	NT
(h) Purchase of in house labor	NT

¹ Professional services generally include legal, accounting, engineering and consulting services (medical and dental services covered under health care outline).

² Assumes resale of services is taxable.

³ Nontaxable if in interstate commerce; taxable if transportation entirely intrastate.

⁴ Credit available for tax paid to another state (if equipment purchased outside and used in N.M.).

**SUMMARY OF GROSS RECEIPTS AND COMPENSATING TAXATION OF
RESEARCH AND DEVELOPMENT SERVICES**

<u>TRANSACTION</u>	<u>TAX TREATMENT</u>
(1) <u>SALES</u>	
(a) Retail sale of research and development services in New Mexico	T
(b) Sales of research and development services performed outside of New Mexico the product of which is delivered and initially used outside New Mexico	NT
(c) Sales of research and development services performed in New Mexico (for out of state customer) the product of which is delivered and initially used outside of New Mexico	NT
(d) Retail Sale of research and development services performed outside New Mexico, the product of which is delivered and initially used in New Mexico	T
(2) <u>PURCHASES</u>¹	
(a) Purchase of tangible personal property	T/NT ²
(b) Purchase of power/fuel	T
(c) Purchase of research and development services (from sub-contractors)	NT ³
(d) Purchase of transportation services to transport tangible personal property to research and development facility	NT/T ⁴
(e) Purchase of capital equipment	T/C ⁵
(f) Purchase of supplies	T
(g) Purchase of general business services	T
(h) Purchase of "in house" labor	NT

¹ As applicable to New Mexico based company.

² May be nontaxable, in certain circumstances, if trade practice is to separately bill for materials and labor, and if separately billed (See GR 47:3).

³ Assumes next sale of research and development service is taxable.

⁴ Nontaxable if in interstate commerce or if transportation represents intrastate portion of transportation in interstate commerce under single contract; taxable if transportation entirely intrastate unless sale for resale.

⁵ Credit available for tax paid to another state (if equipment purchased outside and used in N.M.).

SUMMARY OF GROSS RECEIPTS AND COMPENSATING
TAXATION OF ELECTRIC UTILITIES

<u>TRANSACTION</u>	<u>TAX TREATMENT</u>
(1) SALES	
(a) Sales of electricity within New Mexico at retail	T ¹
(b) Sales of electricity outside of New Mexico (exports)	NT
(c) Sales of electricity to Indians for use on Indian reservations	NT ²
(d) Sales of electricity to governmental units in New Mexico	NT
(e) Sales of electricity to non profits in New Mexico	NT
(f) Sale of power management services performed in New Mexico	T
(g) Sale of power management services performed outside New Mexico	NT
(h) Sale of power management services performed in New Mexico, the product of which is delivered and initially used outside New Mexico	NT
(i) Charges for installing, connecting, and disconnecting service (in New Mexico)	T
(2) PURCHASES	
(a) Purchase of fuel to generate electricity	T ³
(b) Purchase of electricity for resale	NT
(c) Purchase of transportation services to transport fuel to power plant	NT/T ⁴

¹ Although commonly viewed as a service by most consumers, the sale of electricity actually constitutes the sale of a tangible under the gross receipts and compensating tax act.

² See GR Reg. 4:4.

³ Fuel obtained from a utility's own reserves (i.e., its own mineral interests) and used to generate electricity is not taxable.

⁴ Nontaxable if in interstate commerce or if transportation represents intrastate portion of transportation in interstate commerce under single contract; taxable if transportation entirely intrastate. **Note:** May, in certain circumstances, qualify for sale of service for resale deduction to avoid double taxation.

- | | | | |
|-----|-----|---|------------------|
| | (d) | Purchase of capital equipment | T/C ⁵ |
| | (e) | Purchase of supplies | T |
| | (f) | Purchase of general business services
(legal, accounting, advertising, etc.) | T |
| | (g) | Purchase of in house labor (including
salary and benefits) | NT ⁶ |
| (3) | | <u>USE</u> | |
| | (a) | Use of electricity in production of electricity | NT |
| | (b) | Use of electricity in the transmission of
electricity | NT |

⁵ Credits are available for tax paid to another state (if equipment purchased outside and put to use in NM.).

⁶ Some employee benefits may be effectively taxable. For example, receipts from the sale of medical services generally are taxed under the gross receipts and compensating tax act. If a patient obtains reimbursement under a medical reimbursement plan - an employee benefit - such benefit is effectively taxed. Of course, the same is true if the employee purchases the service directly with own funds.

SUMMARY OF GROSS RECEIPTS AND COMPENSATING TAXATION OF RETAIL SALES OF MOTOR VEHICLES AND AUTOMOBILE SERVICES

<u>TRANSACTION</u>	<u>TAX TREATMENT</u>
(1) <u>SALES</u>	
(a) Sales of motor vehicles within New Mexico at retail	NT ¹
(b) Sales of motor vehicles outside of New Mexico (exports)	NT
(c) Sales of additional equipment	T/NT ²
(d) Sales of repair services and parts within New Mexico	T
(e) Sales of automotive service contracts	NT
(f) Repairs under automotive service contracts	T ³
(g) Repairs under warranty obligations	NT ⁴
(2) <u>PURCHASES</u>	
(a) Purchase of motor vehicles for resale	NT
(b) Purchase of utility services (dealership)	T
(c) Purchase of transportation services to dealership	NT/T ⁵
(d) Purchase of capital equipment	T/C ⁶
(e) Purchase of supplies	T
(f) Purchase of general business services	T
(g) Purchase of parts for resale	NT
(h) Purchase of parts/labor to fulfill obligation under automotive services contract	T ⁷
(i) Purchase of in house labor (including salary and benefits)	NT ⁸

¹ Nontaxable under GRCTA; taxable at lower rate under Motor Vehicle Excise Tax Act.

² Nontaxable if the additional equipment (e.g. camper shell) is included in the computation of the motor vehicle excise tax.

³ Taxed on the retail value of parts and labor furnished to repair the vehicle and on any deductible or co-payment amount. Note: May not be taxable if the contract obligor is "paid" from a reserve established by the obligor with an auto service contract administrator or insurance company if certain requirements met.

⁴ No deduction allowed for co-payments or deductibles or for non-warranty payments.

⁵ Nontaxable if in interstate commerce or if transportation represents intrastate portion of transportation in interstate commerce under a single contract; taxable if transportation entirely intrastate. If in interstate commerce or if transportation represents intrastate portion of transportation in interstate commerce under single contract; taxable if transportation entirely intrastate. Note: may, depending on the facts, qualify for sale of service for resale deduction to avoid double taxation.

⁶ Credits available for tax paid to another state (if equipment purchased outside and used in N.M.).

⁷ Per GR 3(F):79; 47:32, and 48:22. The Regulations are of questionable validity.

⁸ Some employee benefits may be effectively taxable. For example, receipts from the sale of medical services generally are taxed under the gross receipts and compensating tax act. If the patient obtains reimbursement under a medical reimbursement plan - an employee benefit - such benefit is effectively taxed.

**SUMMARY OF GROSS RECEIPTS AND COMPENSATING TAXATION OF
FINANCIAL INSTITUTIONS (BANKS)**

<u>TRANSACTION</u>	<u>TAX TREATMENT</u>
(1) <u>REVENUES</u>	
(a) Receipts from interest on loans	NT
(b) Receipts from originating, making, or assuming loans	NT
(c) Receipts from handling loan payments	NT
(d) Sales of other service in New Mexico	T
(2) <u>PURCHASES</u>	
(a) Purchase of utility services	T
(b) Purchase of capital equipment	T/C ¹
(c) Purchase of supplies	T
(d) Purchase of general business services	T
(e) Purchase of in house labor (including salary and employee benefits)	NT ²
(f) Rent	NT

¹ Credits available for tax paid to another state (if equipment purchased outside and put to use in N.M.).

² Some employee benefits may be effectively taxable. For example, receipts from the sale of medical services generally are taxed under the gross receipts and compensating tax act. If a patient obtains reimbursement under a medical reimbursement plan - an employee benefit - such benefit is effectively taxed.

**SUMMARY OF GROSS RECEIPTS AND COMPENSATING
TAXATION OF GAS UTILITIES**

<u>TRANSACTION</u>	<u>TAX TREATMENT</u>
(1) <u>SALES</u>	
(a) Sales of gas within New Mexico at retail	T ¹
(b) Sales of gas outside of New Mexico (exports)	NT
(c) Sales of gas to Indians for use on Indian reservations	NT
(d) Sales of gas to governmental units in New Mexico	NT
(e) Charges for installing, connecting, and disconnecting service	T
(f) Sales of gas to be consumed as fuel in pipeline transportation of gas	NT
(2) <u>PURCHASES</u>	
(a) Purchase of gas for resale	NT
(b) Purchase of transportation (including pipeline transportation) services to transport gas to customer	NT/T ²
(c) Purchase of capital equipment	T/C ³
(d) Purchase of supplies	T
(e) Purchase of general business services	T
(f) Purchase of in house labor (including salary and benefits)	NT ⁴
(3) <u>USE</u>	
(a) Use of gas in pipeline transportation of gas	NT

¹ Although commonly viewed as a service by most consumers, the sale of gas actually constitutes the sale of a tangible under the gross receipts and compensating tax act.

² Nontaxable if in interstate commerce or if transportation represents intrastate portion of transportation in interstate commerce under single contract; taxable if transportation entirely intrastate. Note: May, depending on facts, qualify for sale of service for resale deduction to avoid double taxation.

³ Credits available for tax paid to another state (if equipment purchased outside and put to use in NM.).

⁴ Some employee benefits may be effectively taxable. For example, receipts from the sale of medical services generally are taxed under the gross receipts and compensating tax act. If a patient obtains reimbursement under a medical reimbursement plan - an employee benefit - such benefit is effectively taxed.

**SUMMARY OF GROSS RECEIPTS AND COMPENSATING TAXATION OF
MANUFACTURING**

<u>TRANSACTION</u>	<u>TAX TREATMENT</u>
(1) <u>SALES</u>	
(a) Sales of finished products within New Mexico for resale	NT
(b) Sales of finished products @ retail	T
(c) Sales of finished products outside of New Mexico (Exports)	NT
(2) <u>PURCHASES</u>	
(a) Purchase of raw materials	NT
(b) Purchase of power/fuel	T
(c) Purchase of subcontracted manufacturing services	NT
(d) Purchase of transportation services to plant	NT/T ¹
(e) Purchase of capital equipment	T/C ²
(f) Purchase of supplies	T
(g) Purchase of general business services	T
(h) Purchase of transportation services from plant	NT/T ³
(i) Purchase of in house labor	NT

¹ Nontaxable if in interstate commerce or if transportation represents intrastate portion of transportation in interstate commerce under single contract; taxable if transportation entirely intrastate. Note: extremely unlikely that "transport in" will qualify for sale of service for resale deduction.

² Credits available for tax paid to another state (if equipment purchased outside and put to use in N.M.) and under Investment Tax Credit Act (if requirements of that act satisfied).

³ Nontaxable if in interstate commerce or if transportation represents intrastate portion of transportation in interstate commerce under a single contract; taxable if transportation entirely intrastate. Note: may qualify for sale for resale deduction to avoid double taxation on intrastate transportation.

**SUMMARY OF GROSS RECEIPTS AND COMPENSATING
TAXATION OF RETAIL TRADE**

<u>TRANSACTION</u>	<u>TAX TREATMENT</u>
(1) <u>SALES</u>	
(a) Sales of finished products within New Mexico at retail	T
(b) Sales of finished products outside of New Mexico (Exports)	NT
(2) <u>PURCHASES</u>	
(a) Purchase of products for resale	NT
(b) Purchase of utility services (retail space)	T
(c) Purchase of transportation services to store	NT/T ¹
(d) Purchase of capital equipment	T/C ²
(e) Purchase of supplies	T
(f) Purchase of general business services	T
(g) Purchase of transportation services from store	NT/T ³
(h) Purchase of in house labor (including salary and benefits)	NT

¹ Nontaxable if in interstate commerce or if transportation represents intrastate portion of transportation in interstate commerce under single contract; taxable if transportation entirely intrastate. Note: may, depending on facts, qualify for sale of service for resale deduction to avoid double taxation.

² Credits available for tax paid to another state (if equipment purchased outside and put to use in N.M.).

³ Nontaxable if in interstate commerce or if transportation represents intrastate portion of transportation in interstate commerce under a single contract; taxable if transportation entirely intrastate.

**SUMMARY OF GROSS RECEIPTS AND COMPENSATING TAXATION OF
WHOLESALE TRADE**

<u>TRANSACTION</u>	<u>TAX TREATMENT</u>
(1) <u>SALES</u>	
(a) Sales of finished products within New Mexico for resale	NT
(b) Sales of finished products outside of New Mexico (Exports)	NT
(2) <u>PURCHASES</u>	
(a) Purchase of products for resale	NT
(b) Purchase of utility services (office space or warehouse)	T
(c) Purchase of transportation services to Warehouse	NT/T ¹
(d) Purchase of capital equipment	T/C ²
(e) Purchase of supplies	T
(f) Purchase of general business services	T
(g) Purchase of transportation services from warehouse	NT/T ³
(h) Purchase of in house labor	NT
(i) Purchase of public warehousing services	T/NT

¹ Nontaxable if in interstate commerce or if transportation represents intrastate portion of transportation in interstate commerce under single contract; taxable if transportation entirely intrastate. Note: may, depending on facts, qualify for sale of service for resale deduction to avoid double taxation.

² Credits available for tax paid to another state (if equipment purchased outside and put to use in N.M.).

³ Nontaxable if in interstate commerce or if transportation represents intrastate portion of transportation in interstate commerce under a single contract; taxable if transportation entirely intrastate. Note: may, depending on facts, qualify for sale for resale deduction to avoid double taxation on intrastate transportation.

**SUMMARY OF GROSS RECEIPTS AND COMPENSATING TAXATION
OF FOR PROFIT EDUCATIONAL INSTITUTIONS**

<u>TRANSACTION</u>	<u>TAX TREATMENT</u>
(1) <u>SALES</u>	
(a) Tuition for educational services performed in New Mexico	T
(b) Tuition for educational services performed outside of New Mexico	NT
(c) Tuition for correspondence courses performed in New Mexico for students outside New Mexico	NT
(d) Retail sale of textbooks/gifts/accessories to students	T
(e) Retail sale of textbooks/gifts/accessories to non students	T
(f) Retail sale of tickets to sporting/ arts and entertainment events	T
(g) Retail sale of food and beverages to students at school snack bar	T
(2) <u>PURCHASES</u>	
(a) Purchase of gas, water and electric utility services	T
(b) Purchase of contract services (resale)	NT ¹
(c) Purchase of capital equipment	T
(d) Purchase of supplies	T
(e) Purchase of general business services (legal, accounting, advertising, etc.)	T
(f) Purchase of in house labor (i.e. wages)	NT
(g) Purchase of real estate or payments of rent	NT ²
(h) Purchase of textbooks/gifts/accessories for resale	NT
(i) Purchase of food and beverages for resale	NT

¹ Given the nature of the industry, it is unlikely that contract (resale) services are a big component of the typical school budget.

² The sale of construction services is subject to gross receipts tax. Thus, for example, receipts (including receipts for construction materials) for constructing a new classroom, lab, gymnasium or office building (excluding real estate) are subject to tax.

**SUMMARY OF GROSS RECEIPTS AND COMPENSATING TAXATION OF
CONSTRUCTION SERVICES**

<u>TRANSACTION</u>	<u>TAX TREATMENT</u>
(1) <u>SALES</u>	
(a) Retail sale of construction services in New Mexico (except underlying real estate)	T
(b) Sales of construction services outside of New Mexico	NT
(c) Sales of construction services to Indians on Indian reservation	NT
(2) <u>PURCHASES</u>	
(a) Purchase of construction materials	NT ¹
(b) Purchase of power/fuel	T
(c) Purchase of subcontracted construction services	NT*
(d) Purchase of transportation services to transport materials to construction site	NT/T ²
(e) Purchase of capital equipment	T/C ³
(f) Purchase of supplies	T
(g) Purchase of general business services	T
(h) Purchase of architectural and engineering services	NT/T ⁴
(i) Purchase of in house labor	NT

¹ Assuming "retail" sale of construction service is taxable

² Nontaxable if in interstate commerce or if transportation represents intrastate portion of transportation in interstate commerce under single contract; taxable if transportation entirely intrastate unless sale for resale.

³ Credit available for tax paid to another state (if equipment purchased outside and used in N.M.).

⁴ Nontaxable if purchase for resale; taxed on retail sale.

SUMMARY OF GROSS RECEIPTS AND COMPENSATING TAXATION
OF FOR PROFIT HOSPITALS

<u>TRANSACTION</u>	<u>TAX TREATMENT</u>
(1) <u>SALES</u> ¹	
(a) Retail sale of health care services in New Mexico	PT
(b) Retail sale of health care services outside of New Mexico	NT
(c) Retail sale of prescription drugs to non patients	PT ²
(d) Retail sale of prescription drugs to hospital patients	PT
(e) Retail sale of medical supplies to hospital patients	PT
(f) Retail sale of medical supplies to non patients	PT ³
(g) Retail sale of prosthetic devices	PT
(2) <u>PURCHASES</u>	
(a) Purchase of utility services	T
(b) Purchase of contract health care services	NT ⁴
(c) Purchase of capital/diagnostic equipment	T
(d) Purchase of business supplies	T
(e) Purchase of general business services (legal, accounting, advertising, etc.)	T
(f) Purchase of in house labor (i.e. wages)	NT
(g) Purchase of real estate/rent	T ⁵ /NT
(h) Purchase of lab services (for resale)	NT
(i) Purchase of drugs for resale	NT

¹ For profit hospitals may deduct fifty percent of gross receipts from taxable gross receipts under § 7-9-73.1.

² Receipts derived from the sale of prescription drugs by a hospital pharmacy to Medicaid recipients are fully deductible pursuant to taxation and revenue regulation GR 54:11.

³ The reasoning of GR 54:11 may apply to receipts from the sale of medical supplies by a hospital to Medicaid patients.

⁴ Sales of health care services for resale may be deductible under §7-9-48 if the statutory requirements are met. The deduction appears to apply even though for profit hospitals may deduct fifty percent of their gross receipts under §7-9-73.1.

⁵ The sale of construction services is subject to gross receipts tax. Thus, for example, the fee for constructing a new hospital or office building (excluding real estate) is subject to tax.

**SUMMARY OF GROSS RECEIPTS AND COMPENSATING TAXATION OF
AGRICULTURE PRODUCTS BY PRODUCERS**

<u>TRANSACTION</u>	<u>TAX TREATMENT</u>
(1) SALES	
(a) Sales livestock, live poultry, unprocessed agricultural products, hides or pelts in or out of New Mexico.	NT
(b) Sales of dairy products at retail in New Mexico	T
(c) Sales of dairy products at retail out of New Mexico	NT
(2) PURCHASES	
(a) Purchase of feed.1	NT
(b) Purchase of seed, roots, bulbs or plants.1	NT
(c) Purchase of soil conditioners, fertilizers, insecticides.1	NT
(d) Purchase of fungicides, germicides and irrigation water.1	NT
(e) General agricultural services that are an integral part of producing products or raising livestock such as ginning cotton or shearing sheet.	NT
(f) General business services.	T
(g) Hauling or loading of agricultural products.	T
(h) Hauling that is an integral part of harvesting.	NT
(i) Purchase of agriculture implements and unregistered vehicles. 2 (An agriculture implement is an article of equipment essential to the production of crops or livestock on a commercial farm or ranch.)	T

1A nontaxable transaction certificate is not required; however, a signed, written statement that the buyer is regularly engaged in the business of farming or ranching is required.

2Only have to pay tax on 50% of agriculture implements and unregistered vehicles.

**SUMMARY OF GROSS RECEIPTS AND COMPENSATING TAXATION OF
OIL AND GAS MINERAL INTERESTS**

<u>TRANSACTION</u>	<u>TAX TREATMENT</u>
(1) SALES	
(a) The sale or lease of oil and natural gas or mineral interest.	NT
(b) Products that are subject to the oil and gas emergency school tax and are sold for resale.	NT
(c) Products that are subject to the oil and gas emergency school tax and are sold outside of New Mexico.	NT
(d) Products that are subject to the oil and gas emergency school tax and are sold for other than resale in state.	T
(e) The sale or use of oil, natural gas, or liquid hydrocarbons consumed as fuel in the pipeline transportation of such products.	NT
(f) The sale of natural gas, liquid hydrocarbons, and their by-products, whose processing is subject to the natural gas processors' tax and sold for resale.	NT
(g) The sale of natural gas, liquid hydrocarbons, and their by-products, whose processing is subject to the natural gas processors' tax and sold outside of New Mexico	NT
(h) The sale of natural gas, liquid hydrocarbons, and their by-products, whose processing is subject to the natural gas processors' tax and sold for use as an ingredient or component part of a manufactured product.	NT
(i) The sale of natural gas, liquid hydrocarbons, and their by-products, whose processing is subject to the natural gas processors' tax and sold for other purposes	T
(j) The sale or processing of timber and minerals subject to the resources excise tax.	NT
(k) Sales of nonfissionable natural resources only for resale and subject to resources excise tax.	NT
(l) Sales of nonfissionable natural resources for use as an ingredient or component part of a manufactured product and subject to resources excise tax.	NT

(m) Sales of processed natural resources. T

(2) PURCHASES

(a) Storage of crude oil, natural gas, or liquid hydrocarbons. NT

(b) Fuel used in the operation of a production unit. T

(c) Products used on the production unit where they are produced. NT

(d) Chemicals or reagents for use in processing ore or oil, or in acidizing an oil well. NT

(e) Chemicals or reagents for use in treating oil wells to inhibit corrosion. (Less than 18 ton lots.) T

(f) Well drilling mud, explosives and other non chemicals. T

(g) Cost of clearing land for mining operations. T

(h) Oil and gas well servicing and drilling T

(i) General business services T

SUMMARY OF GROSS RECEIPTS AND COMPENSATING TAXATION
OF FOR PROFIT LONG TERM HEALTH CARE PROVIDERS

<u>TRANSACTION</u>	<u>TAX TREATMENT</u>
(1) SALES	
(a) Retail sale of long term health care (nursing homes) services in New Mexico	T/NT ¹
(b) Retail sale of long term health care (nursing homes) services outside of New Mexico	NT
(c) Retail sale of prescription drugs to nursing home residents	PT ²
(d) Retail sale of medical supplies to nursing home residents	PT ³
(e) Retail sale of rehabilitation services in New Mexico	T
(f) Retail sale of rehabilitation services outside New Mexico	NT
(g) Retail sale of nursing home management services to nursing homes located in New Mexico	T
(h) Retail sale of nursing home management services to nursing homes located outside New Mexico	NT ⁴
(2) PURCHASES	
(a) Purchase of utility services (NM)	T
(b) Purchase of contract health care/supply services	NT ⁵
(c) Purchase of capital equipment	T
(d) Purchase of business supplies	T
(e) Purchase of general business services (legal, accounting, advertising, etc.)	T
(f) Purchase of in house labor (i.e. wages)	NT
(g) Purchase of real estate/rent	T/NT ⁶
(h) Purchase of lab services (for resale)	NT ⁷
(i) Purchase of drugs for resale	NT

¹ The sale of long term health care services is subject to gross receipts tax under §7-9-4 and §7-9-3(F). If, however, the long term health care facility qualifies as a "hospital" licensed by the department of health, fifty percent of the its receipts would be deductible under §7-9-73.1. If a portion of the payment to the nursing home constitutes rent for real property, it may be deductible under §7-9-53.

² Receipts derived from the sale of prescription drugs to Medicaid recipients are deductible pursuant to taxation and revenue regulation GR 54:11.

³ The reasoning of GR 54:11 may apply to receipts from the sale of medical supplies to Medicaid patients.

⁴ If the services are performed outside the state they are not taxable. If the services are performed in New Mexico and the product of the service is delivered and initially used outside New Mexico, it may be deductible under §7-9-57.

⁵ Sales of health care/supply or other services for resale may be deductible under §7-9-48 if the statutory requirements are met.

⁶ The sale of construction services is subject to gross receipts tax. Thus, for example, the fee for constructing a new nursing home or office building (excluding real estate) is subject to tax.

⁷ Sales of lab services for resale may be deductible under §7-9-48 if the statutory requirements are met.

SUMMARY OF GROSS RECEIPTS AND COMPENSATING TAXATION OF GOVERNMENT CONTRACTING

<u>TRANSACTION</u>	<u>TAX TREATMENT</u>
(1) <u>SALES</u>	
(a) Retail Sale of contracting services in New Mexico	T
(b) Retail Sale of contracting outside of New Mexico	NT
(2) <u>PURCHASES</u>	
(a) Purchase of utility services	T
(b) Purchase of first tier subcontracted services	NT ¹
(c) Purchase of second tier subcontracted services	T ²
(d) Purchase of transportation services to transport equipment or supplies to business (where transportation purchased separately by the contractor)	NT/T ³
(e) Purchase of tools and equipment	T/C ⁴
(f) Purchase of supplies	T/NT ⁵
(g) Purchase of general business services (legal, accounting, advertising, etc.)	T
(h) Purchase of in house labor (including salary and benefits)	NT ⁶
(i) Purchase of real estate/rent	T ⁷ /NT

¹ Under current law, a sale of services is taxable unless the resale (i.e. next sale) of the services is taxable. Typically this will not be the case for Sandia National Laboratories ("Sandia") subcontractors because Sandia generally purchases such services for resale to the Department of Energy. The practical effect of this problem is that second tier Sandia contractors cannot sell their services free of tax to first tier Sandia contractors resulting in a significant pyramiding problem for Sandia contractors and increasing the price of Sandia contracts.

² See footnote 1.

³ Nontaxable if in interstate commerce or if transportation represents intrastate portion of transportation in interstate commerce under single contract; taxable if transportation entirely intrastate.

⁴ Credit available for tax paid to another state (if equipment purchased outside and used in N.M.).

⁵ May be nontaxable if purchased for resale and sold separately; taxable if used in connection of the performance of a service.

⁶ Some employee benefits may be effectively taxable. For example, receipts from the sale of medical services generally are taxed under the gross receipts and compensating tax act. If a patient obtains reimbursement under a medical reimbursement plan - an employee benefit - such benefit is effectively taxed. Of course, the same is true if the employee purchases the service directly with his own funds.

⁷ The sale of construction services is subject to gross receipts tax. Thus, for example, the fee for constructing an office building (excluding real estate) is subject to tax.

New Mexico Professional Tax Study Committee

*C/O University of New Mexico, School of Law
1117 Stanford, NE
Albuquerque, NM 87131-1431
(505) 277-0068
An Equal Opportunity Employer*

November 15, 1995

To non-profit organizations operating in New Mexico:

The Professional Tax Study Committee (PTSC) was formed last year by the state Legislature. Its mission is to study all aspects of the state's tax system and to propose needed changes. The Professional Tax Study Committee needs your help!

The PTSC is debating if the state's gross receipts tax should apply to activities of non-profit organizations. On one hand, many untaxed activities of non-profit organizations are in direct competition with profit-making businesses. This is not fair to taxpaying entities. On the other hand, many non-profit organizations provide needed services to state citizens. If non-profits did not supply these services, governments might have to provide similar services funded by tax dollars. Clearly, this issue is not simple and "fairness" has many meanings.

The Professional Tax Study Committee is developing policy recommendations in this area and many other areas. We would like to give clear, balanced responses to the Legislature but we need much more information than is currently available. We are asking you to help us by completing the attached survey. The focus of the survey is to measure tax consequences and economic impact on your organization based on various changes in tax treatment.

The Professional Tax Study Committee has accepted the Taxation and Revenue Department, Tax Research Office's offer to help compile the information received. Tax Research is bound by confidentiality requirements of the Tax Administration Act. The Office will not release any information you provide to other personnel or divisions of the Department. This information will not be used against your organization. The only use of the data obtained will be in providing a comprehensive profile of the state's non-profit organizations and the fiscal and economic consequences of a change in tax policy. The PTSC will use the information only for legislative policy recommendations. You will have the opportunity to support or reject any recommendations in public hearings.

Taxation and Revenue Department representatives will be happy to meet with you to explain or assist in completing the survey, or to reassure you of the purpose to which the survey information is directed.

New Mexico Professional Tax Study Committee

When completed, please return the survey to:

Tax Research and Statistics Office
Post Office Box 630
Santa Fe, New Mexico 87509-0630
505-827-0690

Thank you for your assistance!

Sincerely,



Robert J. Desiderio
Chairman, Professional Tax Study Committee

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APPENDIX E

Questionnaire

Please fill in the following spreadsheet for sources and types of income. Use actual figures if available. otherwise estimate categories to the best of your knowledge. Please feel free to submit copies of balance sheets and profit and loss statements to supplement the survey.

Description of Income Source	State & Local Gov't-Source Income	Federal Gov't-Source Income	Other Income Source	Value of In-Kind Donation	Total
Grants for specified activities or projects — no direct benefits received by grantor except a final project report.					
Restricted or unrestricted donations — no direct benefits received by donor.					
Membership income — absolutely no direct benefits received by member.					
Grants for specified activities or projects — small value benefits received, such as free or discounted tickets, merchandise awards, etc.					
Donations — small value benefits received, such as free or discounted tickets, merchandise awards, etc.					
Membership income — small value benefits received, such as free or discounted tickets, merchandise awards, etc.					
Membership income — payment of fee entitles member to use of facilities or programs not available to non-members.					

Description of Income Source	State & Local Gov't-Source Income	Federal Gov't-Source Income	Other Income Source	Value of In-Kind Donation	Total
Program revenue & fees for services/operating income, but not fund-raising apart from exempt purpose.					
IRS classified Unrelated Business Income Tax (UBIT)					
Sale of tangible personal property except as reported as fundraising					
Lease of real or tangible property					
Net Investment income — including sale of capital assets and other capital gains					
Advertising					
Other fund-raising income not listed above					
Unclassified income					
Total					

Questionnaire - Page 3

Please fill in the following spreadsheet for types of expenses. Use actual figures if available, otherwise estimate categories to the best of your knowledge. Please feel free to submit copies of balance sheets and profit and loss statements to supplement the survey.

Description of Spending Category	Cash	Volunteer & In-Kind Services	Total
Wages & salaries - operating personnel			
Wages & salaries - fundraising staff			
Wages & salaries - management			
Employee benefits, including employer's share of payroll taxes			
Consultants & contract expenses			
Tangible personal property purchased for resale			
Lease of real property.			
Lease of tangible personal property.			
Other <i>operating</i> expenses, excluding taxes, wages, salaries and benefits, consultants, cost of leases, fundraising expenses & tangible personal property for resale.			
Tangible personal property purchased for fund-raising			
Other fundraising costs			
Memo: State personal income tax withholding payroll taxes reported to TRD			
Capital expenditures			

Description of Spending Category	Cash	Volunteer & In-Kind Services	Total
Other expenses by type			
a.			
b.			
c.			
d.			
e.			
Total Expenses			

Questionnaire - Page 5

Economic Impact Section:

This section of the survey allows you to *quantify* the effect of any change in taxes imposed on your organization or activities. It is important to be as quantitative as possible. Please express your answers in percent of total activity, as well as dollars of impact. The final two questions allows *qualitative* input to the committee. For all the following questions, assume that there would be a tax increase on your activities of \$50,000 a year. What is the likely economic impact on your organization of a tax increase of this magnitude imposed on your organization's receipts or expenses. We will scale down your answer to various levels of possible tax changes.

- 1. the tax increase would largely be passed forward to customers... True False
- 2. the tax increase would largely result in decreased services... True False
- 3. the tax increase would result in layoffs or work week reduction for employees... True False
- 4. quantified employment impact (percent of total employment, and change in \$ of payroll): _____

- 5. quantified service (program) delivery changes (percent of total program and change in \$ of services): _____

- 6. Qualitative explanation of changes in organization's mission delivery driven by change in tax treatment of receipts or expenses: _____

Questionnaire - Page 6

7. Other comments: _____

Questionnaire - Page 7

To make this survey useful and relevant, we must be able to identify your organization. Please complete the following identification section:

Organization Name: _____

Mailing Address: _____

Physical Location of
major buildings or
facilities:

Your Name: _____

Your Telephone: _____

Your FAX #: _____

CRS ID # (e.g. 01-133450-004): _____

Alternative CRS ID#: _____

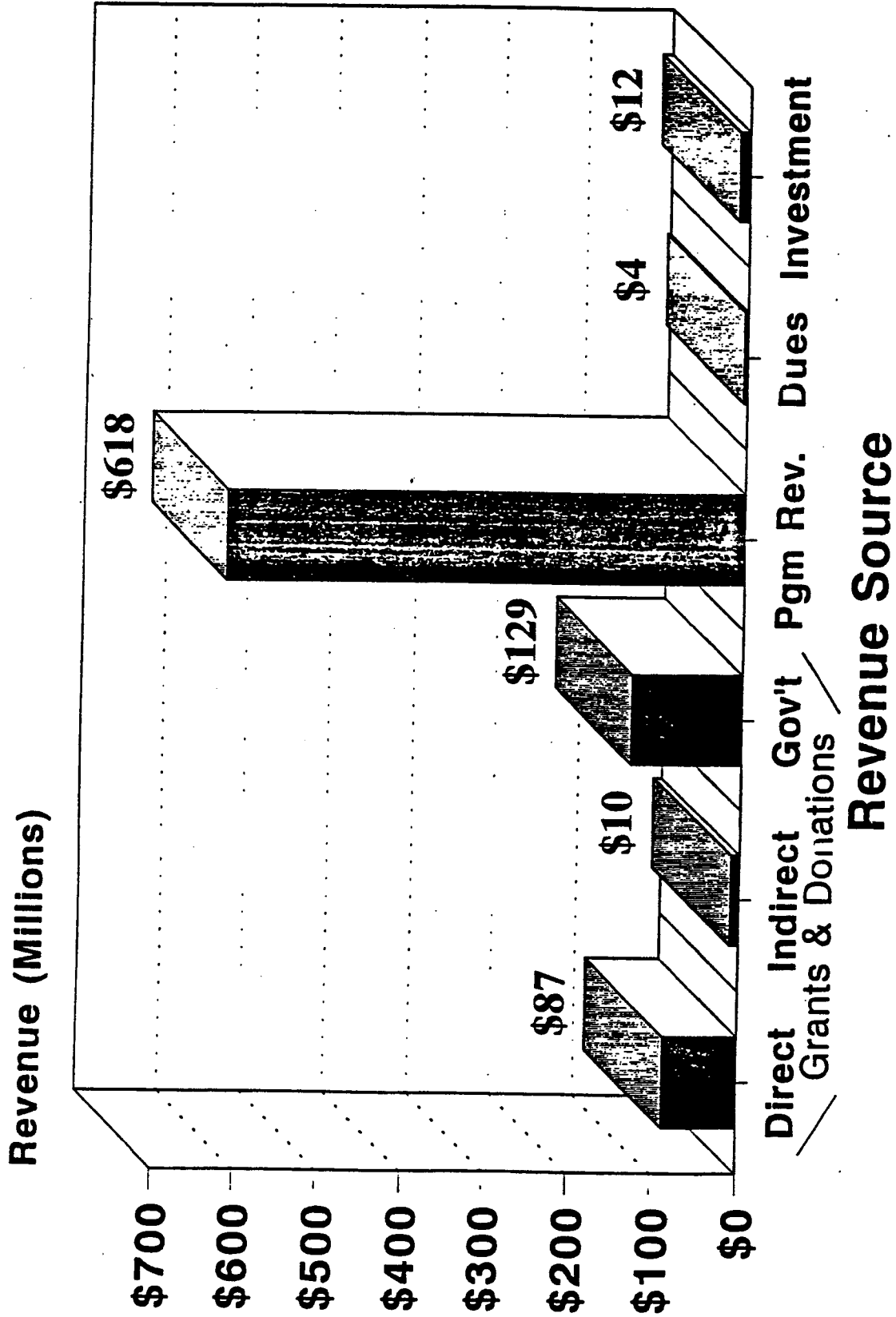
Please mail or FAX completed survey to:

Galen Garcia
Tax Research & Statistics Office
New Mexico Taxation and Revenue Department
P.O. Box 630
Santa Fe, NM 87504-0630

Telephone: (505) 827-0906
FAX: (505) 827-0331

APPENDIX F

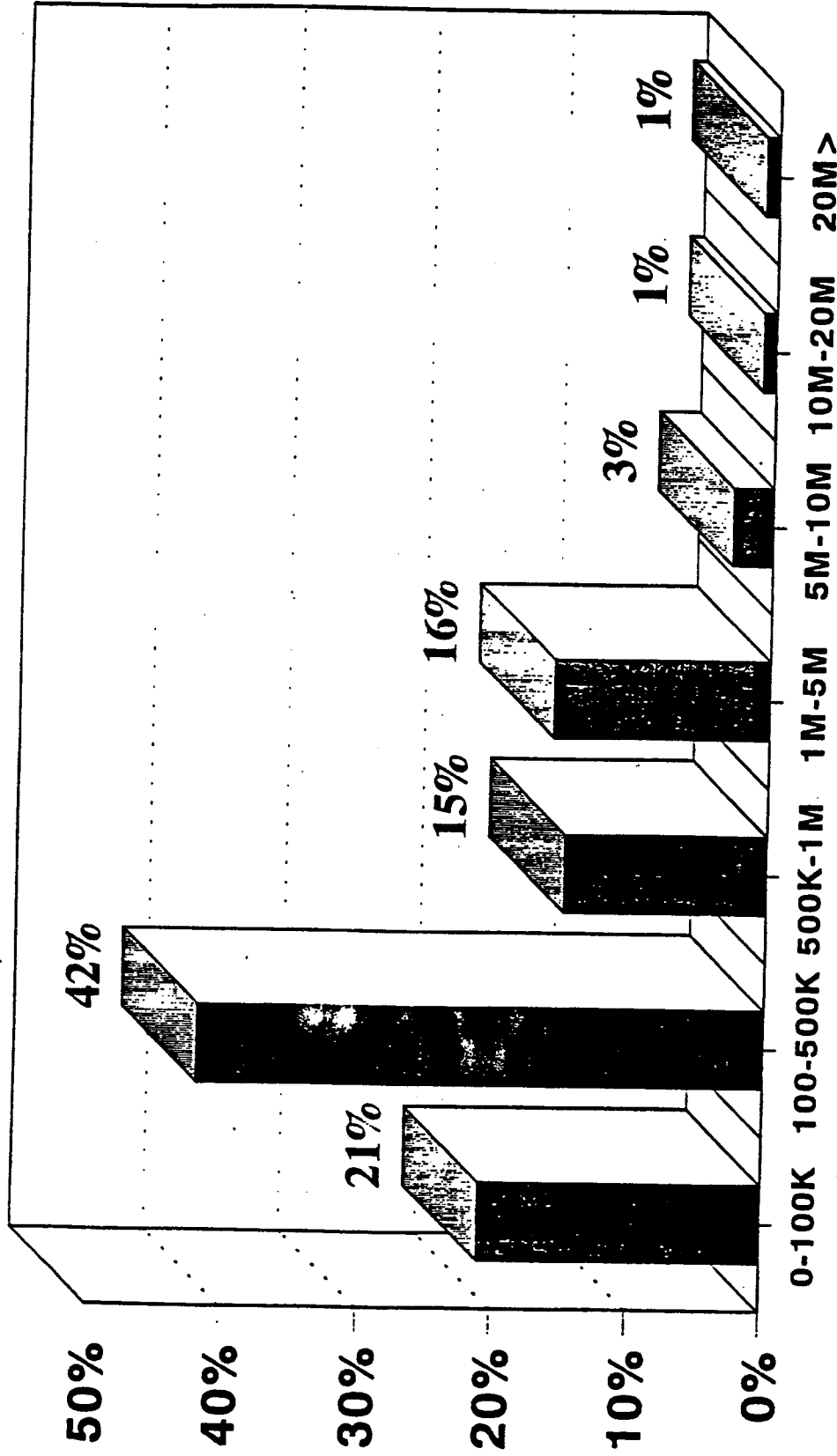
New Mexico Nonprofit Organizations Attorney General's List



New Mexico Nonprofit Organizations

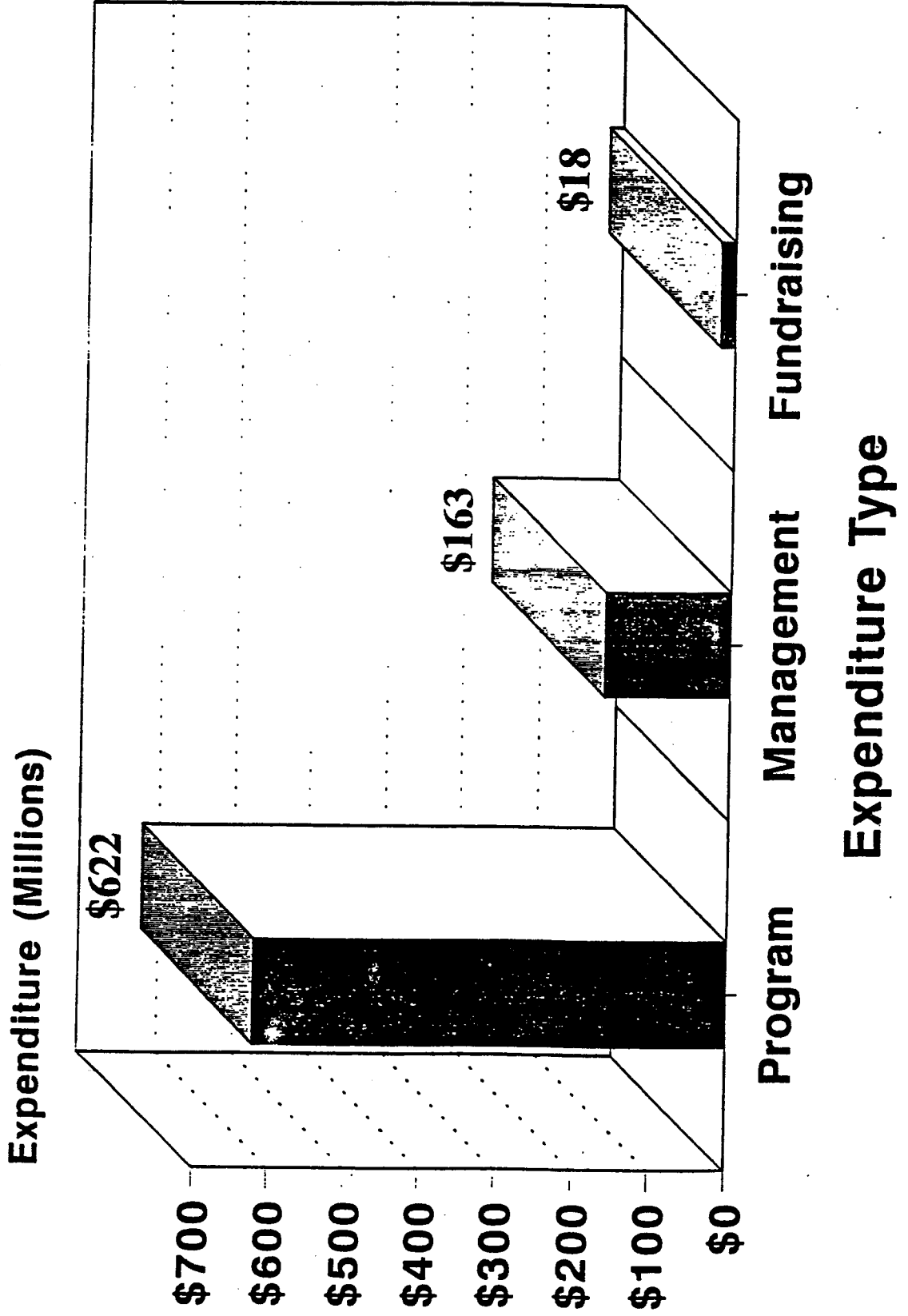
Attorney General's List

% of All Nonprofit Organizations

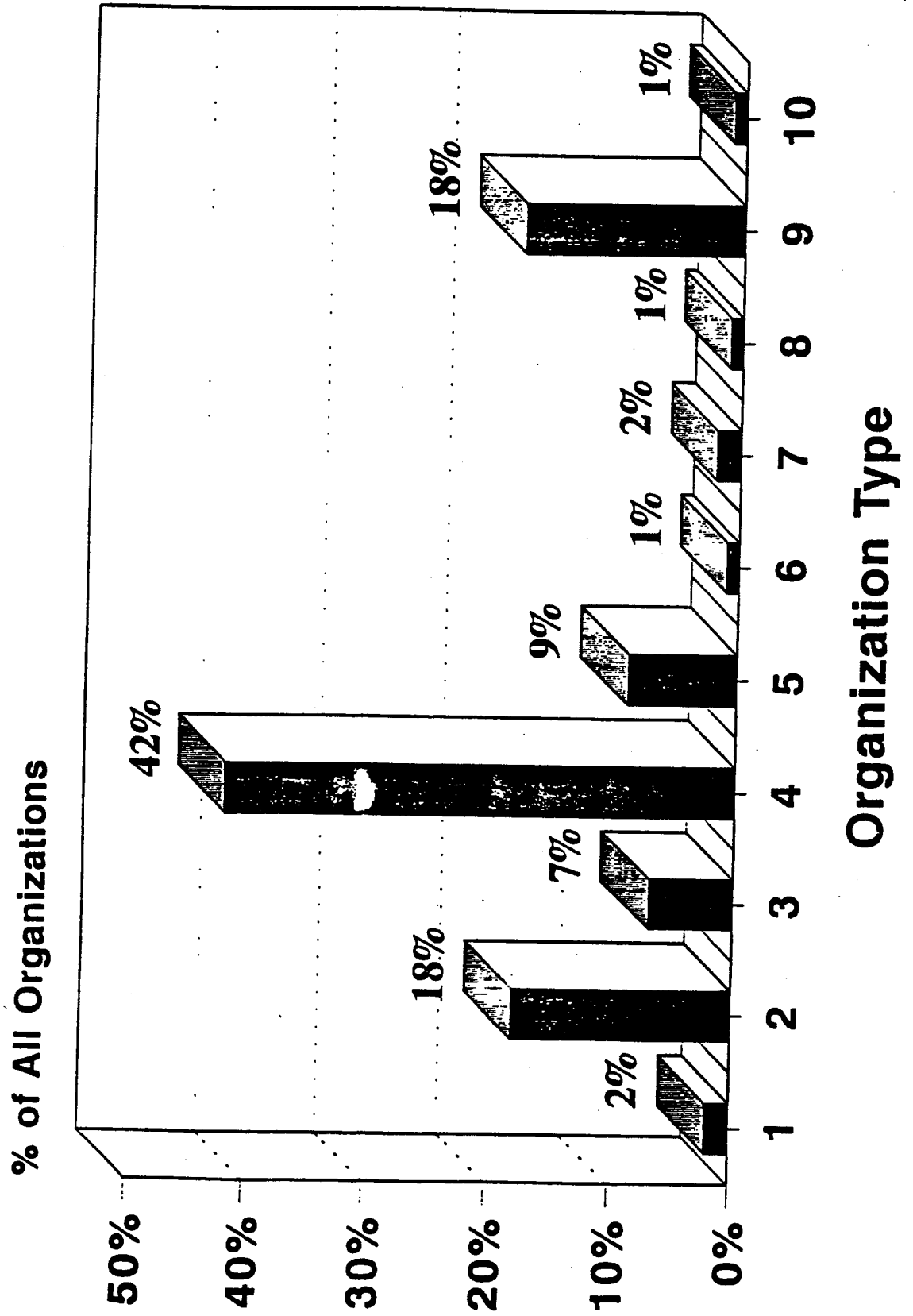


Total Revenue, All Types

New Mexico Nonprofit Organizations Attorney General's List



New Mexico Nonprofit Organizations Attorney General's List



Organization Types

- 1 Hospitals & Nursing Homes**
- 2 Non-Hospital Health Care**
- 3 Performing Arts**
- 4 Traditional Eleemosynary**
- 5 Youth Related**
- 6 Fraternal or Lodge**
- 7 Government Associated**
- 8 R & D**
- 9 Educational**
- 10 Religious**

APPENDIX G

History of § 7-9-29

An early version of § 7-9-29 is found in the Laws of 1935, ch. 73, § 212. The section exempted from the Emergency School Tax:

- (a) The business of societies and other organizations not operated for gain or profit;
- (b) Gross receipts of hospitals, infirmaries or sanitariums;
- (c) The proceeds of the sale of school books where the price is fixed by the state:
and
- (d) Gross receipts from dormitories and dining halls of state educational institutions.

Those exemptions remained in place until 1961, except that in 1937 the legislature changed (a) to read: "All sales or services made or performed by societies and other organizations not organized or operated for gain or profit." In 1956, The New Mexico Supreme Court held that this exemption applied to the University of New Mexico with respect to the operation of its golf course. The state attempted to tax UNM's gross receipts derived from public use of the golf course and purchase of food, and other products from the pro shop. *Regents of the University of New Mexico v. Bureau of Revenue*, 62 N.M. 76, 304 P.2d 878 (1956). The Court stated:

[T]he University is an institution not organized for gain or profit. Hence, the statute is controlling. Clearly, it is the institution itself which is exempt from the tax. The fact that some incidental activity of the institution may produce revenue in excess of its cost, and which is applied to operation expense, does not alter . . . [UNM's] tax status.

Id. At 77, 304 P.2d at 879.

In 1961, however, the legislature deleted the exemption for nonprofit societies and organizations, while retaining the exemptions for hospitals, sale of school books and dormitory and dining hall receipts of state education institutions. Laws of 1961, ch. 190. In 1969, the legislature again enacted major changes. First, it introduced an exemption from the compensating tax for the "use of property by nonprofit schools, colleges, universities, hospitals, religious or charitable organizations in the conduct of their regular . . . [exempt] functions." Laws of 1966, ch. 47, § 12 (c). The exemption for hospitals was retained, but the exemption for the cost of books was deleted and the exemption for state education institutions was expanded. The new exemption exempted:

[R]eceipts of public , parochial or private nonprofit schools, colleges or universities received from tuition payments, fees, dormitories or dining facilities.

Id. § 12 (Q).

In 1970, the legislature enacted the present version of the Gross Receipts and Compensating Tax Act. The exemptions from the gross receipts tax and the compensating tax for § 501(c)(3) organizations were added to the Act; at the same time the specific exemptions for hospitals and educational institutions were repealed. Finally, in 1988, the legislature added the exemption in § 7-9-29 (B) for § 501 (c)(6) organizations (trade associations).

APPENDIX H

To: PTSC
From: Robert J. Desiderio
Subject: Tax-Exempt Organizations
Date: November 13, 1996

MEMORANDUM

In this memo, I will attempt to explain the options the committee has with respect to the tax-exempt organization issue. We have discussed some of these options; others have surfaced as a result of my research.

Before presenting the alternatives, however, I thought it would be helpful to focus on the reasons for granting tax-exemption to certain organizations. Throughout our discussions, different explanations for tax exemptions have been posited. A review of the history of tax-exempt organizations, literature discussing that history and tax policy behind exempt status, indicate that there is no one value supporting tax exemption. Experts, however, continue to provide justification for tax exemption of certain organizations, assuming that tax exemption can be justified.

Professor John D. Colombo of the University of Illinois College of Law, recently summarized different theories of tax exemption. John D. Colombo, *Why is Harvard Tax Exempt? (And Other Mysteries of Tax Exemption for Private Educational Institutions)*, 35 *Ariz. L. Rev.* 841; 857-881 (1993). I am attaching a copy of Professor Colombo's abstract. Although his article's main thesis deals with educational institutions, Professor Colombo's summary of the theories applies to tax-exempt organizations in general.

Theories of tax exemption usually are submitted to support exemption from an income tax, and a property tax. I have found no literature that concentrates on the tax-exemption of gross receipts taxes. The reason probably is that few jurisdictions impose gross receipts taxes on receipts from the sale of services; hence, the question of tax exemption for §501(c)(3) organizations has not become a national issue.

Although there does not exist separate analysis for exemption from gross receipts taxation, my opinion is that the same theories that pertain for income and property taxes also apply to gross receipts taxes. Gross receipts taxes are a form of gross revenue (income) tax and, as such, any theory that supports exemption from the income tax should justify exemption from the gross receipts tax. I would appreciate your thoughts on theories of gross receipts tax exemption for §501(c)(3) organizations.

One's view of tax exemption depends on the theory to which he or she espouses. Bittker's Income Measurement Theory and Atkinson's Altruism Theory provide the most liberal bases for tax exemption. The subsidy theories, other than the Donative Theory, may justify tax exemption, depending on how one resolves the definitional problems. The Donative Theory is a suggested policy to provide support for tax exemption. I do not believe that we could propose a provision that bases tax exemption on a minimum amount of

PTSC

Page 2

November 13, 1996

donations that an organization receives, unless Congress would make this a condition of granting an organization tax exemption.

The options available include the two extremes: maintaining the status quo and repealing §7-9-29. I can discern no principle for maintaining the status quo, other than a "lesser of two evils" decision. Assuming that we cannot recommend a middle position between maintaining the status quo and repealing §7-9-29, we could conclude that the lesser evil is to maintain the present exemption rather than impose the gross receipts tax upon all transactions of all §501(c)(3) organizations.

The tax policy reason for repealing §7-9-29 is equity. Tax-exempt organizations are engaging in transactions that are the same as transactions engaged in by for-profit organizations. Yet, the latter organizations are liable for gross receipts taxes, while the former are not. We have been searching for values that might override the equity violation that lead us to options that do not repeal §7-9-29, but limit the application of tax exemption to certain activity by tax-exempt organizations.

The first option, offered by Laird Graeser, borrows from the government gross receipts tax. Section 7-9-3.2 imposes a gross receipts tax on sales by government agencies of sales of goods, entertainment offered in facilities open to the general public, refuse collection and disposal, sewage services and sale of water by a public utility. Tax-exempt organizations that sell the same goods or services do not pay gross receipts taxes. Laird's argument is that the legislature has articulated policy applicable to government agencies, which policy is equally applicable to tax-exempt organizations. The policy states that government agencies which engage in activity more akin to private commercial activity, should pay the same transactional tax to which the non-government organization engaging in like activity is subject. The underlying goal is to prevent government from having a competitive advantage over non-government organizations. The same policy applies to commercial activity of exempt organizations.

Although this option could be applied easily to the sale of goods and entertainment services, its application is more troublesome with other services. Laird suggests that we attempt a definition of the membership to whom sales would not be taxed, other than the "open to general public" rubric adopted in § 7-9-3.2(B). But who are the members of a hospital; its patients or the community at large? Who are the members of a youth organization that receives state funding; the youth, their parents, the state, or the community at large? In other words, can we define membership so as to draw the bright line between taxation and exemption?

A second option is to attempt to limit exemption to organizations that serve the poor. Following the lead of Bob Dole, see Albuquerque Journal, May 24, 1996, p. A-1, organizations that dedicate a certain percentage (Dole used 75 percent) of their total revenues (these could include donated as well as earned revenues) would be tax exempt. I see three concerns with this approach. First, the TRD may have an enforcement problem in trying to discover whether an organization in

PTSC

Page 3

November 13, 1996

fact has dedicated the requisite resources to help the poor. Second, although charity is generally associated with relief of the poor, tax exemption has not been so limited. Third, exemption would be based on "good works" and not on a particular transaction; that is, the exemption would not be transaction based.

The third option, which I have already proposed and which is similar to Laird's idea discussed above in option 1, is to limit tax exemption to an organization's receipts from government contracts or contracts with other §501(c)(3) organizations so long as the other organizations' funds from a government agency¹ for the performance of the service. The theory is that the organization is performing a service that the government would have been performed without taxation; thus the §501(c)(3) organization should not be taxed. The problem with this approach is that this option is in part entity based, and not solely transaction based.

A fourth option would be to attempt a stricter definition of unrelated trade or business. Under the federal definition of unrelated trade or business, which §7-9-29(C) accepts, an activity that is functionally related to an exempt purpose is related. However, the IRS and the courts have adopted a liberal interpretation of functionally related so that relatively few organizations are held to conduct unrelated trades or businesses. We could attempt to require that an exempt organization's gross receipts must come from the sale of goods or services that are more directly related to the organization's exempt purpose. The problem is defining activity that is "more directly related."

The final option is to attempt a listing of the particular transactions that we believe should be exempt. For example, we could decide that tuition for education services, receipts by hospitals, or receipts by social service organizations should be exempt. The problem is that without an entity-based limitation (§501(c)(3) organization), the exemption may exclude too much.

¹ This is a variation of my original proposal in which I suggested exemption for receipts under a contract from another §501(c)(3) organization. I now believe that was too broad; if the transferor organization would have been taxed if it had performed the services, the transferee organization should be taxed. My present idea adopts the converse. If the transferor organization would not have been taxed had it performed the service, the transferee organization should not be taxed.

APPENDIX I

Impacts of Repealing Insurance Premium Tax¹
Report to the Professional Tax Study Committee

Executive Summary

- Present law treatment of insurance company sales creates significant tax inequities including double taxation of expenses reimbursed through insurance, and also uneven treatment of similarly situated entities (especially medical providers).
- Gross receipts taxation of insurance premiums--with an accompanying deduction for expenses reimbursed through insurance--would eliminate double taxation, and also eliminate unfair treatment of providers of reimbursed medical services.
- Whole life and annuity business would be separated, and not taxed under the GRT, in order to preserve comparable treatment with banks and other financial intermediaries. These lines could continue to be taxed under the premium tax, or exempted, so that all corporate income of the insurance company could be taxed under the corporate income tax.
- Revenue impacts of the proposal appear to be modest, although reliable data are not available to provide a precise estimate. State revenues would decrease by less than \$30 million per year, while local government revenues would increase by less than \$20 million per year. Possible revenue gains from imposing GRT on term life insurance policies have not been included. Also not included are possible gains from imposing corporate income tax on insurance companies. If adopted, the CIT could possibly raise enough revenue to completely offset the negative impacts on the state.

¹This report was prepared at the request of the Professional Tax Study Committee. The analysis in the report does not necessarily reflect the position of the Taxation and Revenue Department.

Impacts of Repealing Insurance Premium Tax

Prepared for the Professional Tax Study Committee
by Laird Graeser and Tom Clifford
Tax Research and Statistics Office²

Background

A tax equal to 3 percent of gross premiums is owed by all insurance companies--including HMO's and bail bondsmen--with policies in force in New Mexico (59A-6-2). Gross premiums include membership and policy fees on contracts covering risks within the state, reduced by return premiums--including dividends paid or credited to policyholders--and by premiums received for reinsurance on New Mexico risks. Payment of the premium tax--as well as other licenses and fees in the Insurance Code--are in lieu of all other taxes imposed by the state or its subdivisions, excepting only property taxes and income taxes on agents and solicitors (59A-6-6).

Quarterly estimated payments of premium tax liabilities are required, with final adjustment for the prior year due April 15. Premium taxes are collected by the superintendent of insurance and credited to the insurance department suspense fund. Net amounts attributable to property and vehicle insurance are transferred to the fire protection fund. 10 percent of receipts derived from life, general casualty and title insurance are transferred to the law enforcement protection fund (29-13-3). Remaining amounts are transferred to the general fund (59A-6-5). The fire protection fund, less appropriations for the expenses of the fire marshal's office, is distributed annually to county and municipal fire districts. The balance in the fund at the end of the year is transferred to the general fund. In the current fiscal year, transfers from the fire protection fund to the general fund are expected to reach \$20 million, while the general fund transfer from other insurance will be about \$49 million.

The insurance premiums tax was first imposed--at a rate of 2 percent of gross premiums--as a substitute for all other taxes on insurance companies in 1909. In 1955 a reduced rate of 0.5 percent was introduced to benefit companies with 50 percent of admitted assets invested in New Mexico ("domestic" companies). Tax rates for both "domestic" and "foreign" companies were raised over time until finally equalized in July, 1993 at 3 percent. Specific exemptions apply to insurance purchased by the state, and also to payments received by an HMO from the federal government under the medicare program. According to representatives of the American Council of Life Insurers, at 3%, New Mexico has one of the highest rates of premium tax in the country.

²This report was prepared at the request of the Professional Tax Study Committee. The analysis in the report does not necessarily reflect the position of the Taxation and Revenue Department.

Tax policy implications of premium taxes

Insurance premium taxes have been adopted by a majority of states as a surrogate for other forms of taxation. Rates are usually low in nominal terms--2 to 3 percent of gross premiums--but represent a significant component of total state and federal tax liabilities. Life insurance companies alone reported a total of \$2.3 billion of state premium taxes paid in 1990. According to one industry analyst, these taxes are equal to or greater than life insurance companies' federal corporate income tax liabilities in some states.

The primary advantage of premium taxes appears to be administrative simplicity. Income taxation of insurance companies is a notoriously complex area of federal tax law. A separate subchapter of the Internal Revenue Code is dedicated to special rules applicable to income taxation of insurance companies (Chapter 1, Subchapter L). Were states to "piggyback" on federal income taxation of insurance companies, determining the appropriate allocation of income among the states would add to the complexity. Since a significant portion of insurance company income is derived from investment income, allocation issues would be proportionately greater than for other, non-financial enterprises.

Premium taxes, in contrast, are based on an easily measured, and easily apportioned category of income.³ Insurance companies argue that this simplicity--plus the low nominal rate--have lead states to an over-reliance on premium taxes. Premium taxes in some states amount to several times the state corporate income tax that would be owed on federal taxable income at prevailing state tax rates.

In New Mexico, of course, the premium tax at 3 percent is well below the amount that would be collected if insurance premiums were subject to the gross receipts tax (GRT). The following section presents a preliminary analysis of some possible ramifications of removing the premiums tax in favor of gross receipts taxation of insurance premiums. The analysis assumes that present law exemptions for interest and dividend receipts would continue to apply. The imposition of corporate income tax is not directly addressed. This would also result if the blanket exemption from other taxes in section 59A-6-6 is repealed.⁴ Most of the discussion is in terms of administrative issues. Analysis of the revenue implications of the changes described has not yet been completed.

³Premium taxes do not elude all of the definitional and analytical complexities that plague income taxation. One issue that has divided the industry and puzzled Congress is the appropriate treatment of policyholder dividends paid by mutual insurance companies. Stock companies have argued that these dividends represent returns to ownership of the company, and should be taxed as corporate income and should be taxable to the recipient, as are their dividends paid to shareholders. Under the present law premium tax, these dividends are netted out of the premium base, thus avoiding the premium tax and compounding the tax advantage enjoyed by the mutual companies relative to stock companies. This advantage could be eliminated under the proposal outlined herein by defining the base for the GRT as gross premiums.

⁴Another specific exemption from the gross receipts tax, section 7-9-24, would also have to be repealed.

Gross receipts taxation of insurance premiums

The initial step in making insurance premiums gross receipts taxable would be to include the insurance of risks as taxable under section 7-9-3. One possibility would be to include the insurance of risks as one of the types of intangible "property" under 7-9-3(I), along with patents, copyrights, licenses and franchises. In addition, it may be necessary to establish a new category of non-taxable transactions for sales reimbursed through insurance. Nexus issues should be addressed, presumably along the same lines as present law treatment for the premium tax, i.e. "insurance or contracts covering risks within this state."⁵

Health insurance

Because the insurance company serves as an intermediary in the health care market, imposition of gross receipts tax on health insurance premiums would require a deduction for medical expenses reimbursed by insurance companies to avoid double taxation. Since there is no sufficiently similar deduction under present law, a new category of non-taxable transaction would have to be established. This approach has two important advantages over present law:

- (1) the potential for double taxation of health care is removed. Individuals purchasing health care from taxable providers through health insurance are paying as much as 9 percent tax (6 percent GRT plus 3 percent premiums tax). Under the proposal, the total tax rate would be reduced to 6 percent.
- (2) tax treatment of health care by different types of entities would be made more uniform--as long as the care is reimbursed through insurance. Under present law, some health care is subject to the gross receipts tax while other care--HMO's and non-profit hospitals for example--is tax exempt. Under the proposal, all such care that is reimbursed through insurance would become deductible. In the case of HMO's, the tax on their premiums would increase, and would correspond more closely with that on traditional insurance plans.

The proposal would not directly affect the tax status of health care which is not reimbursed through insurance. Such care would continue to be taxable or exempt depending on the status of the provider. From the standpoint of economic efficiency, the proposal seems likely to reduce the net distortions introduced by taxes into the health care market. According to the Insurance Department, one problem with the proposal is that, by increasing the tax on premiums, the proposal would increase the incentive for qualified groups to self-insure. Such groups are subject to less regulation, and according to the Insurance Department, are more likely to experience financial stress in attempting to meet their obligations to insured parties. A memo outlining this argument is attached to this report.

⁵Section 59A-6-2(B) NMSA 1978.

Because the proposal would reduce gross receipts taxation **only** for expenses reimbursed through insurance, it appears that it should **reduce** total taxation of such care relative to care reimbursed through self-insurance. This would not be true, however, for insured care that is currently not subject to gross receipts taxation (e.g. HMO's). Such care will be taxed through premiums at a higher rate under the proposal.

Life insurance and annuities

Term life insurance should be treated differently from whole life and annuity premiums. In the latter case, the analogy to banking is close enough that the treatment should be parallel. Thus, premiums for whole life (less the term insurance component) and annuity premiums would not be defined as taxable gross receipts, just as these are not taxable under the premium tax. In addition, the exemption for interest and dividend income would be available. Term insurance, on the other hand, would constitute a type of taxable insurance under the new definition.

The Insurance Department notes in the attached memo that a significant increase in the taxation of term life would impose a burden on existing contracts because the premium rate promised to consumers has been premised on prior tax treatment. If a proposal were designed to affect only new policies, there would be a long phase-in period until all business is covered by the new rules.

Property insurance

Most types of property insurance would be included in the definition of taxable insurance. Thus, as in the health insurance market, a deduction for reimbursed expenses would be made available. Again, this would have the effect of reducing double taxation in the case of reimbursed expenses on which GRT is currently paid.

In the case of the transaction directly between the insured and the repair company, an additional mechanism--perhaps a credit--may be needed to avoid double taxation. If the insured shows proof to the insurance company of GRT paid on reimbursed expenses, then that proof could serve as the basis for a credit to the insurance company for taxes paid.

Revenue effects

A preliminary analysis suggests that the proposal would *reduce* state revenues by less than \$30 million per year and would *increase* revenues to local governments by less than \$20 million per year. Based on current premium tax receipts, a doubling of the tax rate should increase revenues by about \$90 million per year. The distribution of these revenues would shift--unless modified--so that local governments generally would receive more, although amounts earmarked for certain local agencies would fall. Because of the shift of revenues to local governments, the loss of revenue from GRT on insured expenses would not be fully offset for the state, but would be more than offset for local

governments. These estimates are only approximate since reliable data on several key parameters are not available at this time.

The estimate does not take into account any revenues from increased taxes on term life insurance policies. The policy arguments for increasing tax on these policies are not as strong as in other market segments. If an exemption is allowed for existing contracts, the revenue gain is likely to be quite small in the short run. Another potential source of revenue increase is imposition of the corporate income tax on insurance company operations in the state. If imposed on all lines of business of insurance companies, this tax could raise enough revenue to balance the loss to the state, and possibly enough to raise a small amount.

Retaliatory taxes

A complication for this proposal is the existence in almost all states of "retaliatory taxes" on insurance companies. New Mexico has such a statute⁶ which provides that an insurer is subject to "additional fees or charges" whenever any "form or rate-filing fees in excess of those imposed by the laws of this state are charged to insurers in New Mexico doing business in another state or whenever any condition precedent to the right to issue policies in another state is imposed by the laws of that state over and above the conditions imposed upon insurers by the laws of New Mexico." In such cases, "the same form or rate-filing fees shall be imposed upon every insurer from every other state transacting or applying to transact business in New Mexico so long as the higher fees remain in force in the other state." Such statutes could lead to an increase in taxes on New Mexico-based companies on their operations in other states. Whether this would occur in practice is unclear at this time.⁷

Conclusions

Replacing the insurance premiums tax with a gross receipts tax--accompanied by deductions for expenses reimbursed through insurance--addresses some important conceptual and procedural inequities in the current tax system. The double taxation of health care and also of reimbursed property damage claims could be eliminated. Inequities in the treatment of different categories of health care providers would be eliminated to the extent that these expenses are reimbursed through insurance.

Revenue effects of the proposal appear to be modest. State revenues would *decrease* because a larger portion of the GRT on premiums would be shared with local governments than is presently the case with the premium tax. Certain local government agencies would lose a dedicated revenue source, but overall local government revenues would *increase*. The loss of revenue for the state could possibly be offset by imposing the corporate income tax on insurance company operations.

⁶Section 59A-6-1(W) NMSA 1978.

⁷One possibility would be that companies could organize as separate entities in each state, thus avoiding the tax increase.

While the reaction of insurance companies to this proposal may be predictable, it is apparent that in many cases the overall rate of taxation on insured risks would decrease. A detailed examination of the incidence of the taxes involved has not been undertaken. If, as seems likely, most of the incidence of these taxes flows forward to the ultimate consumer, the overall burden on insurance companies may not increase. Meanwhile, from an economic efficiency standpoint, the dual goals of reducing double taxation, and of equitably treating similar taxpayers would be served.

This analysis does not address certain equity implications of imposing tax on premiums rather than on the medical services themselves. Obviously, the proposed tax falls more heavily on the individual who makes fewer claims during a given year than does the status quo. However, the purchase of insurance constitutes more than the purchase of the medical services themselves, it includes the value of spreading risk. As such, the proposed GRT treatment is consistent with the treatment of other services under present law, and, of course, with the present law treatment of insurance under the premium tax.

New Mexico
State Corporation Commission

Gloria Tristani
Chairman

Eric P. Serna
Commissioner

Jerome D. Block
Commissioner



INSURANCE DEPARTMENT

P. O. Drawer 1269
Santa Fe, NM 87504-1269

TELEPHONE (505) 827-4601
1-800-947-4722
FAX # (505) 827-4734

May 28, 1996

Mr. Tom Clifford
New Mexico Taxation and Revenue Department
1100 St. Francis Drive
Santa Fe, NM 87504-0630

RE: Impact of Repealing Insurance Premium Tax

Dear Mr. Clifford:

You asked if I could comment on your above referenced paper by the end of this month. I've read the report many times and it has raised some concerns that you maybe compounding the problem of the unfairness of the current tax system, not correcting it. This in turn could encourage insurance moving in a method unfair to all but those that benefit from it. This is true primarily in the field of health insurance, which includes Non Profit Health Plans and H.M.O.'s

Today most people fall under one of four general categories in this state for health insurance. They are:

- (1) Insured by insurance companies, HMO's, or non profit health insurers.
- (2) Insured by the state or federal government under medicare or medicaid.
- (3) Self-insured through an employer or a legal labor organization or a legal employee welfare arrangement exempted from state regulation.
- (4) Un-insured or individually self insured.

These groups are roughly the same size. However, every year the first group gets smaller and the other three groups grow. Only the first group pays premium taxes. The others do not. By group their taxation including gross receipts tax would be as follows:

- (1) 9% both gross receipts and premium taxes
- (2) 6% gross receipts tax only
- (3) 6% gross receipts only
- (4) 6% gross receipts if the person pays otherwise nothing.

page 2
Mr. Clifford
May 28, 1996

Removal of the premium tax and the placement of a gross receipt tax on the premiums instead, would cause the first group to pay 6% and the others nothing. This would encourage more movement to the third group and this is the group that has caused most of the problems over the past years.

Group 3, the self-insured groups are exempted from state law by E.R.I.S.A. They do not pay premium taxes, nor are they required to adhere to the states mandated benefits. Even though groups that insure more than one employer are required to file information with the superintendent, few have, and almost all of those who have been reviewed have been found to be in financial stress with the providers and the insureds and are having problems getting their bills paid.

Additionally, these self-insureds can exclude or limit benefits as they desire. A famous case was a self-insured firm who found an employee with an HIV positive condition. They immediately changed the benefit plan to limit AID's related sickness to a life time maximum of \$5,000. This was allowed federally and, since the state has no jurisdiction, it can not protect the individual as it would if the group had been a part of the first group. This group also lacks protection from the guaranty association, an association of the states insurers that guarantee the coverage, to a limit, in the event of an insolvency.

Because of the exemption from premium taxes and the benefit freedom from mandates more and more small groups are being lured from the group 1, insured by insurance companies to this self insured group 3. Since the group is really too small to take the risk of fluctuation an insurer then provides stop loss coverage for a small premium. The company also uses its provider network, collects the premium and pays the claims. Because only a small part of the cost is insurance premium very little premium tax is paid. No gross receipts tax are paid on the fee of the insurance company since they are exempted from other taxes by our law. Any other company doing third party administration (T.P.A.) would pay gross receipts tax on their fees.

Your suggestion will increase this activity, not decrease it. Also, the premiums falling into this third grouping do not support the Comprehensive Health Insurance Pool or the Health Insurance Alliance. Only the small groups that buy insurance directly from insurers would pay taxes, support the guaranty fund, support the Health Insurance Alliance and support the Comprehensive Health Insurance Pool.

The suggested gross receipts tax on insurance premiums and removal of the gross receipts tax on providers would indicate

page 3
Mr. Clifford
May 28, 1996

that big business (those who are the primary ERISA exemptees) and government should be protected from taxation at the expense of small business and individuals. If gross receipts tax is retained on providers and premium tax is removed from medical cost or reimbursement insurance premiums the four groupings would be placed on a more uniform paying field. Gross receipts on providers can be passed through to the insurer (at least the majority of it) except for those in the second grouping. It is this group (Medicaid and Medicare) that should be exempt from gross receipt taxes since the amount the provider can receive from government is limited and the provider is not allowed to pass through the cost of the gross receipts tax. The lost revenue from removing the premium taxes on this health business (premium taxes should remain on disability income and limited benefit plans). Gross receipts should be charged upon income to insurers acting as T.P.A.'s or conducting any other business activity other than insurance. This would also address your hospital problem.

Another area of concern is to apply gross receipts to term insurance. If this is done, current policies would have to be grandfathered since the companies have guaranteed premiums that often by contract can not be adjusted in future years. An increase in the taxation of these plan would not be a taxation upon the individual but directly upon the insurer, who would have no way to react.

Few states have higher premium taxes than New Mexico for life and health insurance. An increase to gross receipts tax rate would almost assure that indemnity insurers would lose their market and stop writing in New Mexico. HMO's and non profits would direct most of their business to look-a-like self insurance. In all probability tax revenues would decrease in total, not increase.

Please do not hesitate to call me if you wish to discuss any of these matters.

Sincerely,



Jerry W. Fickes, MAAA, FLMI
Actuary

cc: Chris Krahlung, Superintendent of Insurance

JWF:eb

APPENDIX J

ECONOMIC DEVELOPMENT TAX INCENTIVES IN NEW MEXICO AND OTHER STATES

Brian McDonald, Director
Bureau of Business and Economic Research
University of New Mexico

Introduction

Today, state and local governments offer an array of economic development incentives which include both expenditure and tax incentive programs. Examples of economic development incentives include tax abatements, exemptions, and credits, subsidized labor and training costs, site infrastructure improvements, free land, low interest rate loans or loan guarantees, and outright cash subsidies.

The policy of economic development incentives offered by state and local governments to relocating and expanding firms has come under fire recently. Critics argue that these incentives amount to nothing short of corporate welfare¹, while proponents argue that they expand business activity and ultimately the tax base. Economic research has found little empirical support for the proposition that tax incentives and/or low business taxes make a difference in terms of regional economic development.² Properly funded public services such as education, police, fire, and roads may have as much to do with economic development. A state which erodes its business tax base in the name of economic development may find itself unable to provide these vital public services. Or residents and existing business will find themselves with a higher tax burden to fund public services.

In 1992 the National Association of Corporate Real Estate Executives (NACORE) surveyed its membership on the relative importance of 28 individual site selection criteria, including relocation incentives offered by state and local governments. Out of the 28 criteria, tax incentives ranked only 23rd in terms of importance. Low lease rates, access to major highways, educated labor force, low construction costs, and access to primary consumer markets were the top five in importance.³ Low property taxes ranked 8th, while low corporate and business taxes ranked 10th.

¹ See, for example, Robert B. Reich, "Bidding Against the Future," a report presented at the conference, The Economic War Between the States, May 21 and 22, 1996, sponsored by Minnesota Public Radio and the Ford Foundation, and "Congress Should End the Economic War Among the States," Melvin L. Burstein and Arthur J. Rolnick, Federal Reserve Bank of Minneapolis, 1994 Annual Report, The Region, March, 1995, Volume 9, Number 1.

² See, for example, Therese J. McGuire, "Jobs and Taxes: Do State Taxes Affect Economic Development?", Institute of Government and Public Affairs Policy Forum, University of Illinois, Volume 6, Number 2, 1993.

³ Note that property taxes affect lease rates as well as construction costs, while in-plant training programs provide a subsidy to educate the local labor force.

Since all states offer some form of economic development incentives in what has become a very competitive bidding war for new industry, a key rationale for such incentives today is to be competitive with other states. A single state or local government would likely lose a competitive edge, if it unilaterally stopped offering them. Other rationale⁴ for economic development incentives include: (1) compensating for unique disincentives in the existing tax code that are a deterrent to economic growth. An example would be a state with very high property taxes and/or corporate income taxes which fall heavily on capital intensive industries; (2) offsetting economic disadvantages of a community such as long distance from markets, lack of a supplier base, and high land and construction costs; and (3) development of regions which suffer from high unemployment and underutilization of capital resources due to recent downsizing and economic recession.

Supporters of economic development incentives point to numerous benefits from the use of these incentives including employment, earnings, and training for unemployed workers, better quality jobs for the existing labor force, higher wages for all workers due to the greater demand for labor in the region, an increase in property values, an increase in profits of local businesses, higher state and local tax collections, the expansion of the local supplier base, and diversification of the local economy. Opponents of economic development incentives note several negatives or costs of these incentive programs including an increased tax burden⁵ on other taxpayers, a reduction in local public goods and services per capita, profit losses to local businesses as a result of higher wages and rents, higher local cost of living, particularly for housing, environmental and traffic congestion costs, and a deterioration in the quality of local public schools and other public services. Before any community uses economic development incentives, it should have a strategic plan which governs the use of incentives and an economic model which measures these benefits and costs of economic development over time.

States offer a bewildering array of economic development tax and expenditure incentives. This makes empirical analysis of their effects unreliable, and it makes comparisons of offers across states difficult, as well. This chapter has attempted to catalogue economic development tax incentives offered by states, primarily in the west, which have recently attracted a high tech manufacturer such as Intel or Micron. Through an analysis of state legislation as well as interviews with state and local economic development officials, we have identified the major incentives offered by the different states. See Table 6.1 for a state-by-state summary of major tax incentive

⁴ Another rationale for offering incentives is to make companies locating facilities in any of the 50 states competitive on an international basis. To keep jobs in the U.S. states must be competitive with foreign countries which often offer significant incentives to attract investment. However, if this is the case, these incentives should be offered and funded by the federal government, and not by state and local governments.

⁵ This assumes that the tax base expansion from the economic development does not pay for the cost of the incentives themselves as well as the public service requirements of the new population associated with growth.

programs. At the end, generalizations and conclusions are drawn which provide a policy context and perspective for evaluating the economic development incentives offered by New Mexico.

New Mexico

New Mexico offers a number of economic development tax incentives which are discussed below. Because of the State Constitution's anti-donation clause, New Mexico does not have a tradition of offering economic development expenditures on behalf of a new or expanding business. The state does offer in-plant training expenditures which represent a subsidy of labor and training costs for the business during a start-up phase. And in November, 1994 a constitutional amendment (Amendment 9 - Local Economic Development Act) passed which allows a local government in New Mexico to provide free land and buildings to a qualifying business as well as up to 5.0% of its general fund for infrastructure improvements.

IRB Property Tax Exemption

At a city or county government's option, property acquired under the (Municipal) Industrial Revenue Bond Act (3-32-1 NMSA 1978), the County Industrial Revenue Bond Act (4-59-1 NMSA 1978), and/or the Pollution Control Revenue Bond Act (3-59-1 NMSA 1978) may be exempt from some or all property taxes as long as there is an outstanding bonded indebtedness under the terms of the bond.⁶ Property financed with IRBs in New Mexico is titled in the name of the local government, and it is this feature which provides the tax exemption, since local governments do not pay property tax on their own property.

There are two types of industrial revenue bonds in New Mexico--tax free IRBs and taxable IRBs. Both are exempt from property taxes. However, the tax free IRBs are also exempt from the payment of federal and state income tax on the interest on the bonds. This feature provides an additional subsidy in the form of a lower interest rate. There is a federal cap on the annual issuance of tax free IRBs by states. In New Mexico the cap is \$150 million and of this amount only 15.0% (\$22.5 million) has been allocated to industrial projects. The balance is allocated to low income housing and educational projects. In New Mexico the tax free IRBs must also be approved by the State Board of Finance. There is no similar cap on the taxable IRBs.⁷ The vast majority of IRBs issued in New Mexico have been of the taxable variety.

The property tax exemption may apply to all property taxes paid to state and local governments, which varies by county and by city depending upon the mill levies. The property tax exemption also impacts the bonding capacity of the county, the city, and the local school district, since there is a constitutional limitation in New Mexico on outstanding general obligation bonds as a percentage of net taxable property value. At the local government's option, some of the property taxes may be excluded from this

⁶ But not for more than 30 years from the date of the first issuance.

⁷ The State of New Mexico does exempt the interest of the taxable IRBs from the state income tax.

exemption. For example, the City of Rio Rancho does not exempt the school district's property tax. And the term of the property tax exemption is also negotiable, as Sandoval County did with the 1993 \$2.0 billion Intel IRB. Finally, local governments also have the option to negotiate other conditions such as payments in lieu of taxes, water conservation, and environmental liability protections before approving an IRB.

The property financed by the IRBs can be held under a lease from a county or municipality, or the property can be sold to a person and remains free of property tax so long as the county or municipality has a mortgage lien on the property. The local government may not use IRBs to acquire property which it uses itself.

IRBs are not the general obligation of the municipality or county and the bonds are payable solely out of the revenue derived from the projects. An eligible IRB project includes real and personal property deemed necessary for: (1) manufacturing, processing or assembling of any agricultural or manufactured products, (2) storing, warehousing, distributing or selling agricultural, mining or industrial products (but not for retail, or the distribution of a public utility), (3) supplying services to the general public or to governmental agencies, (4) water distribution or irrigation system designed to provide water to any vineyard or winery, (5) hospitals and non-profit health care corporations including nursing homes, and (6) non-profit and/or private institutions of higher education.

IRBs are approved only by the county or the city government in which the property will be located. However, the property tax exemption may apply to all governmental organizations which share in the property tax, e.g., school district, community college, county, University of New Mexico Hospital (in Bernalillo county only), and the state of New Mexico. These latter, property-tax losing organizations have no say in the approval or disapproval of the IRB. For example, in the City of Albuquerque the city mill rate on nonresidential property is only 11.518 mills out of a total of 40.183 mills on all units of government.

Finally, in New Mexico there is no requirement to report taxable IRB approvals to a central organization. Thus, there is no quantitative accounting by city or by county of the total amount of IRB approvals outstanding. The total amount of IRBs approved in New Mexico since the inception of this law in 1975 is unknown.

Gross Receipts Tax Deduction for IRB-Financed Tangible Personal Property

The receipts from selling tangible personal property to any New Mexico governmental unit may be deducted from gross receipts or from governmental gross receipts. Since under the IRB the municipality or county is the purchaser of the tangible personal property e.g., manufacturing equipment, the gross receipts tax or the compensating tax is not due. The statute, 7-9-54, specifically states that this deduction does not apply to the sales of construction material nor to the sales of services to the governmental unit. Thus, under the IRB the gross receipts tax is not charged on the equipment which goes

into the plant, but is charged on the construction of the plant including the labor for the installation of the equipment.

Investment Tax Credit

An investment tax credit is offered by New Mexico equal to the percent of the compensating tax rate provided for in the Gross Receipts and Compensating Tax Act (currently 5.0%) applied to the purchase price of qualified equipment used in a manufacturing operation in New Mexico. The equipment must be owned by the taxpayer or owned by the United States or the state or a political subdivision thereof and leased or subleased to the taxpayer. The latter phrase was added in 1990, effective January 1, 1991, in order to qualify manufacturing equipment purchased by a local government using IRBs and leased to the taxpayer.

What constitutes tangible personal property has been subject to some TRD rulings and now may include flooring material, non-structural building components, and building mechanical systems.

There is an employment requirement in order to qualify for this credit. Until January 1, 1998 the taxpayer must employ one new FTE employee for every \$250,000 on the first \$2.0 million of qualified equipment; one new FTE employee for every \$500,000 of qualified equipment over \$2.0 million up to \$30.0 million; and one new FTE employee for every \$1,000,000 of qualified equipment over \$30.0 million.

After January 1, 1998 the employment requirement becomes one new FTE employee for each \$100,000 of qualified equipment. And after January 1, 1998 there is also a \$2,000,000 limit per year on the amount of qualified equipment for which the credit can be claimed. This would limit the investment tax credit to \$100,000 per year. Currently, there is no such limit.

The investment tax credit is taken as a credit against the taxpayer's compensating tax, gross receipts tax or employee withholding tax due to the state of New Mexico (these are filed and paid on the CRS form). The credit can be carried forward to future years, if the taxpayer cannot realize all of the credit on its annual CRS tax obligations.

The restriction of the credit to the tax obligations due to the state of New Mexico holds the municipalities and counties harmless from this credit in the state distributions of gross receipts tax to local government.

The objective of the investment tax credit is to level the playing field for manufacturers in New Mexico. Most other states do not impose or specifically exempt the gross receipts/compensating tax on equipment purchases by manufacturers, or provide a similar credit. Thus, it was conceived as a way to rebate the compensating tax paid by New Mexico manufacturers on their capital equipment purchases. Note, however, that the amendment in 1990 broadened the investment tax credit to IRB-financed manufacturing equipment, which is already exempt from the gross receipts/compensating tax under 7-9-54 NMSA 1978. Thus, the investment tax credit

on IRB-financed manufacturing equipment is not just the rebate of a tax already paid, but it represents a true out-of-pocket subsidy by the state of New Mexico.

Data from the New Mexico Taxation and Revenue Department show that the investment tax credit has become an expensive economic development program. Before 1991 when IRB-financed equipment was not eligible, the highest claims under the program were only \$268,184 in FY 1989 at an average cost of \$4,470 per job. After 1991, the claims accelerated so that by FY 1995 the annual claims were \$29.8 million in total and \$44,833 per job.⁸ Over the life of the investment tax credit program total claims have totaled \$83.3 million. The investment tax credit is paid up front to the taxpayer-manufacturer, and there is no provision to re-pay (claw back) the credit, if the taxpayer later leaves the state laying off the employees.

Double Weighted Sales In Apportioning Corporate Income To New Mexico For Multi-State Corporations

Before January 1, 1995 multi-state corporations apportioned corporate income to New Mexico based upon a three factor formula using the sales, payroll, and property located in New Mexico as a percentage of total corporate sales, payroll, and property. Each factor got an equal, one-third weight in the distribution formula. Now at the corporation's option the formula provides a double weight for sales. Thus, sales has a one-half weight, while payroll and property have one-quarter weights each. This provides a reduction in state corporate income taxes for corporations which are export-oriented, i.e., with the majority of sales outside New Mexico. These corporations have a small percentage of total corporate sales in New Mexico and this small percentage of sales now gets a double weighting in the apportionment of corporatewide income to New Mexico.

Many states now offer double weighted sales, particularly the industrial states of the midwest. In the west, Arizona and Oregon offer the double weighted sales formula for apportioning corporate income, while Colorado provides for a two factor weighting using only sales and property. Texas, whose franchise tax is a corporate income tax in disguise, allows for a single factor--sales--in the apportionment of corporate income.

Gross Receipts Tax Exemptions/Deductions That Are Economic Development Tax Incentives

The 1992 State Legislature provided a deduction for gross receipts from WATS, 800 numbers, and certain private communication services in order to attract telecommunication services to the state. This has been a successful tax incentive.

⁸ The claim that the investment tax credit is self-financing is dubious. Assuming an average salary of \$35,000 per job and an average state and local tax rate of 10.0% of salary, each job associated with the investment tax credit would generate only \$3,500 per year in state and local taxes. At a cost of \$44,833 per job it would take many, many years to pay for this tax credit program, and all the while the workers and their families would be making demands for public goods and services.

Southwest Airlines reservation center, Trace-Miller Technologies, Intuit's telephone support center, MCI, Taco Bell, Baxter Healthcare, and most recently America Online have all added or expanded telemarketing or back office accounting centers. Oklahoma has a similar tax incentive.

In 1989 the State Legislature enacted a bill that expanded the deduction from gross receipts to include any R&D service produced by a business with a New Mexico office, but sold to an out-of-state buyer, if the initial use of the service was out-of-state and the buyer does not take delivery in New Mexico. At the same time the gross receipts tax base was expanded to include R&D services performed outside of New Mexico, but initially used within the state. The initial bill was enacted as a four year experiment. The 1993 State Legislature made this tax change permanent.

In 1992 in order to attract a major military space systems activity the Legislature passed a bill which would have granted a phased-in deduction from gross receipts for certain R&D services. The bill was contingent upon a relocation announcement by the US Air Force by July 1, 1995. As amended in 1993, the law limits the deductions to non-profit entities and any potential operator of a New Mexico space port, and removes the contingency language.

ECONOMIC DEVELOPMENT TAX INCENTIVES IN OTHER STATES

The review of tax incentive programs in other states which follows includes those states which have recently attracted a major semiconductor manufacturing facility. Incentives do not always take the form of tax incentives so that in some cases non-tax incentives are mentioned. In New Mexico the most significant non-tax incentive is the in-plant training program which pays for a share of labor and training costs for an initial employee training period. Local governments also may pay some infrastructure development costs to bring roads, water and sewer to the project's property.

Economic development tax incentives offered in New Mexico were reviewed above. The discussion which follows concerning the incentives offered by other states is frequently on a project basis, i.e., a new semiconductor project. In order to provide a better basis for comparison to New Mexico the tax incentives provided to Intel Rio Rancho are summarized first.

Intel Corporation has received industrial revenue bond authority from Sandoval County, New Mexico since at least 1980. In 1993 Intel received \$2.0 billion in IRB authority for its new Fab 11 plant, which would employ up to 1,500 new workers. In 1995 Intel applied for and received \$8.0 billion in IRBs which would be used over the next 10 years for equipment modernization/replacement and some expansion involving up to 1,000 new workers. The IRBs have provided 100% property tax abatement to Intel⁹ as well as a gross receipts tax exemption on manufacturing equipment purchases.

⁹ For the 1993 \$2.0 billion IRB, the property tax exemption extends to the year 2010 for \$750 million (used to refurbish the existing Intel plant) and to the year 2023 for the balance which was used to construct the new Fab 11.

Intel also qualifies for the state investment tax credit program. However, because of confidentiality considerations the state Taxation and Revenue Department cannot release company-specific information on claims under this program. Finally, in 1993 Intel did agree to make payments in lieu of taxes to Sandoval County in the amount of \$500,000 per year until 1998 and then \$250,000 per year until 2010. For the 1995 \$8.0 billion IRB, Intel agreed to \$500,000 payments in lieu of taxes. However, it is not clear whether these are incremental payments or the same payments as negotiated in 1993.

Arizona

On April 21, 1994 Intel announced a \$1.3 billion computer chip plant in Chandler, Arizona. This plant is similar to the one Intel recently built in Sandoval County. Arizona enacted the following specific tax incentive programs to attract the Intel facility:

- *exemption for materials and other tangible personal property used directly in the manufacturing process from the transaction privilege (sales) tax.
- *exemption from the sales/use tax on overhead (indirect) materials used or sold in performing a contract with the U.S. government.
- *income tax credit for purchase of pollution control devices. This credit is up to 10.0% of the purchase price, or a maximum of \$750,000. After two years, the maximum drops to \$500,000. There is a five year carry forward provision.
- *income tax credit for purchase of new construction materials used to build or expand a qualifying facility used predominantly for manufacturing, fabricating, mining, refining, metallurgical operations, or R&D. The maximum credit is 5.0% of the direct cost of the materials purchased by the taxpayer from a supplier for incorporation in the facility. The credit is available as long as the total construction cost exceeds \$5.0 million. There is a five year carry forward.
- *a permanent accelerated depreciation for commercial and industrial personal property which affects the assessed value of personal property for property tax purposes.

Intel can also take advantage of the following existing tax incentive programs in Arizona:

- *research and development income tax credit equal to 20.0% of R&D expenses. There are annual caps imposed for the first five years and expenses must also exceed a base amount.
- *sales and use tax exemption for R&D equipment.

*an 80% property tax reduction for location within a foreign trade zone. Intel located the warehousing portion of the Chandler, Arizona plant within a foreign trade zone. The warehousing portion represents 100,000 square feet out of the total 1.5 million square feet for the Chandler facility. Note that Arizona established the foreign trade zone legislation in 1995 to attract Sumitomo.

*a personal property tax reduction on commercial and industrial property. The first \$50,000 will be assessed at only 1.0% of market value; 25.0% of full cash value above \$50,000.

Oregon

Intel also has a \$2.2 billion semiconductor plant under construction in Hillsboro, Oregon. While there was no new Intel-specific tax legislation passed, Intel has been able to take advantage of several existing tax incentive programs offered by Oregon:

*the Strategic Investment Program (SIP) exempts from the property tax the assessed value of a plant in excess of \$100 million. This \$100 million cap is adjusted annually to increase 6.0% per year. This property tax exemption extends for up to 15 years. The company must make a direct payment to the local government to support the community in meeting additional public service requirements. These payments are equal to 25.0% of exempted property taxes not to exceed \$2.0 million per year. Oregon economists have estimated the nominal value of this property tax exemption at \$52.0 million over the anticipated 15 year life of the Intel plant.

*a R&D tax credit is offered equal to 5.0% of the increase in qualified research expenditures over a base amount. Alternatively, the credit is 5.0% of the increased qualified research expenditures that exceed 10.0% of Oregon sales for the year. There is a maximum credit of \$500,000 per year and the credit may not exceed one-third of the tax liability before the credit.

Oregon also has an enterprise zone program. However, a facility is not able to take advantage of the tax incentives offered within an enterprise zone and those offered through the SIP above. Within an enterprise zone there is a total property tax exemption for a minimum of three years. This exemption can be extended for two more years at the discretion of the local zone sponsor, if the average wage paid by the facility is 50.0% higher than the average wage paid in the county.

Oregon also has a Special Works Fund financed by Oregon lottery funds. This provides loans of up to \$10 million and grants up to \$500,000. The particular financing is negotiated among the state, the community, and the property owners. Oregon also has an employee training program where the state will match 50.0% of the company provided funds for training either on site or at a community college.

Utah

In early 1995 Micron announced a \$1.7 billion semiconductor manufacturing plant to be located in Lehi, Utah employing 3,400 people. Utah provided a package of incentives which included an assistance loan, sales tax exemptions, and \$61.7 million in plant site infrastructure funded by a property tax increment financing program. The latter included the cost to provide water, sewer, power, natural gas and roads to the plant site. Utah is one of the few states which conduct a fiscal impact of economic development incentive projects on state and local governments. Utah also has specific economic development criteria which a project must meet before incentives are approved.

The following incentives were offered to the Micron facility in Utah:

*there is a pre-existing sales tax exemption for manufacturing equipment for new or expanding businesses in Utah. In 1995 it was extended to include replacement equipment and parts. The Utah Governor's Office of Planning and Budget estimates the cost of this tax incentive at \$16.4 million per year for the Micron plant, assuming \$800 million in total equipment and a three year average replacement.

*the Industrial Assistance Fund (IAF) was created specifically for Micron. The state of Utah will loan \$3.0 million to Micron, which pays the loan back out of earned credits based on payroll and in-state purchases. If sufficient credits are earned, the cost to the state is \$3.0 million. If insufficient credits are earned, Micron must pay back the loan with cash.

*an "economic development project area" was established at the plant site to provide infrastructure development, estimated at \$61.7 million. This \$61.7 million will be funded by a property tax increment finance program where property taxes generated within the project area (Micron plant site) will be used to pay for improvements desired by the firm. Annual property taxes are estimated at \$13.0 million per year. Micron will loan the "project area" \$30.0 million upfront to be paid back with 3.0% interest using the property tax increment in the future.

Note that Utah did not provide a general property tax exemption to Micron, but rather provided that Micron's property taxes could be used to finance site infrastructure. The Micron plant development was suspended in early 1996 due to market conditions in the memory chip market. Micron is at risk rather than the state of Utah for the infrastructure costs to-date because of the Micron \$30.0 million loan, which was to be paid back out of future property tax revenues.

Utah also provided non-tax incentives to Micron including a "custom fit" training program where the state pays \$350 per employee for an estimated 25.0% of the Micron labor force. The Utah Department of Employment Security provides job search/screening assistance, estimated at \$180 per new hire.

Washington

Intel announced on September 15, 1995 that it would build a manufacturing and research complex in Du Pont, Washington (population 600). The initial portion of the

plant is expected to cost \$50 to \$100 million. This will be a less capital intensive plant than Intel's semiconductor chip manufacturing plants in Arizona, Oregon, and New Mexico. The Washington facility will assemble computer systems and perform research functions.

There are no Washington ordinances which would allow for the exemption of this plant from property taxes. Thus, Intel has sought tax incentives in the sales/excise tax area. Washington imposes a sales tax on the construction of the plant including labor and equipment purchases. This sales tax is exempted for investments made within "distressed zones." While DuPont, Washington is not a distressed zone, Intel plans to hire up to 75% of their employees from one of these nearby zones, thus qualifying for this sales tax exemption. There is an employment requirement of one new job per \$750,000 investment to receive this sales tax exemption on the labor component.

Washington also offers a tax credit against the Business and Occupation Tax for manufacturing and research and development firms in distressed zones. The Washington B&O tax is an excise tax on business activity, primarily imposed by the state. The rates vary from 0.011% to 3.3% depending on the type of business. Manufacturers pay 0.00515 of the value of output. A tax credit of \$1,000 per new job is offered, if the number of FTEs during the year of application for the credit is 15.0% greater than the preceding year. There is a maximum credit of \$300,000.

A credit equal to 2.5% of R&D expenditures is also offered. This credit goes against the Business and Occupation Tax owed. The B/O tax on R&D is currently 7.5% so that this credit effectively lowers it to 5.0%. There is a maximum credit of \$2.0 million or the amount of the tax liability per calendar year.

Washington also recently enacted a statewide sales tax exemption for manufacturing and R&D machinery and equipment. The equipment must be used in the manufacturing process and have a useful life of over one year. Cogeneration equipment integral to the manufacturing operation and replacement equipment are also covered by this exemption.

Like most states, Washington offers worker training incentives including a pre-manufacturing employment program at community colleges.

California

California provides tax incentives primarily through the enterprise zone, but also has an R&D tax credit program. Enterprise zone incentives are available for firms that located within one of these zones, which include (1) accelerated depreciation of qualified property, (2) tax credits for wages paid to employees who live within the zone, (3) income tax credits for the purchase of the first \$20 million in machinery, which is equal to the sales/use tax paid, (4) interest paid on debt is deductible, and (5) there is a 100% carry over of credits for 15 years.

California also offers an R&D tax credit against the corporate income tax in an amount equal to 8.0% of the excess of qualified expenses over a base period and 12.0% of basic research payment.

A new manufacturing tax credit rebating the sales/use tax (5.0% after 1994) on purchases of equipment used in manufacturing, processing, refining, fabrication, recycling, or research and development was recently enacted. This credit is earned in addition to the enterprise zone credit for a business located in an enterprise zone. The credit can be carried forward for seven years. This incentive is a credit for the sales/use tax imposed on equipment purchases in California.

California also offers employment training funds to California businesses.

Colorado

Like California, the state of Colorado provides most of its economic development tax incentives through the use of enterprise zones. Tax incentives for firms locating in such zones are:

- *a 3.0% investment tax credit on purchases of equipment
- *\$500 job tax credit; doubled for agricultural processing, and a \$200 credit for employer health insurance.
- *a 3.0% R&D tax credit
- *a rehabilitation credit for vacant buildings
- *a credit for contributions to the zone, equal to 50.0% of the contributions
- *sales/use tax exemption for the purchase of manufacturing, mining and aircraft equipment.

Colorado also recently enacted an income tax credit provided to new or existing companies moving into a new facility, although details of this new credit are not available. In 1995 Colorado passed a sales/use tax exemption on the purchase of machinery, machine tools, and parts by a for-profit manufacturer on purchases greater than \$500. Previously, a business had to be located in an enterprise zone to receive this exemption.

Colorado has a direct state loan program for expanding businesses with state loans of \$5,000 provided per new job. However, only 35.0% of the project can be funded by the state and the business must provide 10.0% equity investment. Colorado also offers customized employee training programs with the state picking up some of the costs.

Local governments in Colorado can negotiate an incentive payment or credit to a new or expanding business where the credit must not exceed 50.0% of the local property tax liability for four years (a greater percentage if located in a foreign trade zone). The local school board must be notified of the property tax credit and must also approve.

Local governments may also issue industrial development bonds where the facility is exempt from property taxes. However, payment in lieu of property taxes is required.

Rockwell International recently announced that the company would locate a semiconductor plant in Colorado Springs. According to officials of the Colorado Economic Development Department, Rockwell located within an enterprise zone and is entitled to all the state tax incentives noted above. In addition, Colorado Springs provided a property tax reduction as a tax rebate up to 90.0% of property taxes due over the first four years.

Oklahoma

Oklahoma offers a wide variety of tax incentive programs. New businesses can choose between the Quality Jobs Program or the Investment Jobs/Income Tax Credit Package. The Quality Jobs Program consists of a ten year cash back incentive where the quarterly incentive payment is equal to 5.0% of new taxable payroll. The payments are made for no longer than ten years, and the firm must be engaged in manufacturing, R&D, or a service company with 75.0% of sales made outside of the state. A central administrative office also qualifies. New taxable payroll must be at least \$2.5 million for the first four quarters of the first three years of the program. Employees must be offered health insurance, and 80.0% of new employees must work 25 hours or more per week.

The Investment Jobs/Income Tax Credit Package offers a choice between an investment tax credit which is a 1.0% corporate income tax credit for new investment in qualified depreciable property or a job tax credit of \$500 for each full-time job created in manufacturing or processing. The investment must be greater than \$50,000 in the first year and the credit doubles if the facility is located within an enterprise zone. This credit program is available for five years. Firms which choose the Investment Jobs/Income Tax Credit are also eligible to receive other sales tax refund and income tax exemptions and credits offered by the state of Oklahoma.

Oklahoma offers a sales tax refund for R&D or computer services companies on the purchase of computers, data processing equipment, related peripherals, telegraph or telecommunications services or equipment. Certain revenue and employment restrictions apply.

Oklahoma also offers a sales tax refund to new and expanding facilities on the purchase of construction materials where the definition of construction materials includes equipment and personal property incorporated into or consumed into a new or expanding manufacturing facility.

Like New Mexico, Oklahoma offers a sales tax exemption for telecommunications which applies to WATS lines, 800 numbers, and business telecommunications systems.

Local governments in Oklahoma may provide property tax abatement in certain cases: for new, expanded, or acquired manufacturing facilities, distribution centers, R&D facilities, data processing, and some computer services. The exemption, however, is

limited to five years. There are certain investment and job requirements. A local government is also allowed to build a facility and lease it back to the company. In this case the facility is free of property taxes (similar to the New Mexico IRB example above). Subject to voter approval, local communities may also tax themselves to provide specific economic development incentives to relocating businesses. Tulsa, for example, passed a half cent sales tax increase to attract Whirlpool Corporation.

The state of Oklahoma also offers direct loan programs as well as employee training.

Texas

Texas provides the following tax incentives to firms locating in an enterprise zone:

*sales/use tax exemptions on machinery, equipment and building materials equal to \$2,000 for each job created up to \$1.25 million over a five year period.

*the state franchise tax is reduced by 50% of the increase in apportioned taxable net worth if the tax is calculated based upon net worth, and 5.0% of apportioned earned surplus income if the tax is calculated on corporate income, for a period of five years.

Texas recently enacted a sales/use tax exemption for the purchase or lease of tangible personal property that is necessary or essential to manufacturing, processing, or fabrication. Texas also has economic development incentive programs which involve loan guarantees, loans, and industrial development training.

At the local level communities may establish property tax abatement/reinvestment zones. This designation is for five years which may be renewed for another five years. The property tax exemption (up to 100%) applies to the property value for that year which exceeds its value for the year in which the zone was established. Local governments may also establish tax increment financing programs to pay for infrastructure improvements or other costs to promote development. School districts, cities and counties must agree to the abatement.

Austin, Texas offered property tax abatement to attract a \$1.3 billion Samsung Semiconductor plant recently. Forty percent (40%) of the property tax on real and tangible personal property was exempt for five to ten years. To qualify, Samsung had to invest at least \$50 million and there must be \$250,000 invested per employee. If Samsung hires from a pool of workers earning 80% less than the median household income, the company can be eligible for an additional 15% property tax abatement.

Amarillo, Texas offers grants to companies based upon the number of new jobs and the average wage paid. If the average wage is \$12/hr., then the company receives \$10,000 per job; if the average wage is \$9/hr., then the company receives only \$7,500 per job. The grant can be used to finance new facilities, equipment, employee training, or relocation costs. The source of the grant money was a half cent sales tax increase voted in 1989. Amarillo raises about \$8.5 million per year.

Generalizations and Conclusions

Most states place a maximum amount or a cap on the dollar value of many tax incentives. This limits the fiscal impact to state and local governments and makes the fiscal impact more predictable for revenue estimating purposes. In New Mexico the investment tax credit program has no maximum dollar value amount (except by 1998 under the current statute). Also, the IRB program in New Mexico has no limits so that the state's exposure in terms of lost gross receipts/compensation tax on manufacturing equipment is unlimited and unknown.

Most states provide a credit/rebate of the sales/use tax paid on manufacturing equipment purchases. In New Mexico the IRB financing accomplishes this. Or if the company is eligible for the investment tax credit (but not IRBs), this use/comp tax is rebated, assuming the company also meets the new employment criteria.

Most states do not provide 100% property tax abatement, as New Mexico does. And most states provide the property tax abatement for a short, limited time period. In New Mexico IRB-financed facilities may receive 100% property tax abatement¹⁰ for the life of the bonds, which is usually 20 to 30 years. In Arizona property tax abatement is provided only in foreign trade zones and even then is limited to 80%. In Oregon the assessed value of the plant is capped at \$100 million for property tax purposes, but the law provides for payments in lieu of taxes to local governments. In Utah the property tax abatement of Micron was dedicated to pay for site-specific infrastructure improvements through an increment tax finance program. California offers no property tax abatement. Colorado allows it at the local level, but the abatement is restricted to 50% (more in a foreign trade zone) and limited to four years. In Oklahoma local governments can provide local property tax abatement, but it is limited to five years. And in Texas local governments are allowed to offer local property tax abatement in defined zones for five years, where the abated taxes go to pay for infrastructure improvements within the zone.

Those states (except New Mexico) which allow some form of property tax abatement require all affected local governments (cities, counties, school districts) to approve the abatement. In New Mexico the local government approving the IRB has the final determination¹¹. Other affected local government organizations are not involved in the IRB approval process.

New Mexico's economy has outperformed the national economy for decades. Recently, New Mexico has been one of the fastest growing states in terms of job and personal income growth. This growth has largely been caused by the migration of new

¹⁰ In New Mexico there are some exceptions to this. In Rio Rancho the school district property tax was not abated in several recent IRB issues (Intuit, Fulcrum) and in Las Cruces the Leviton IRB carried less than 100% property tax abatement. Las Cruces and Sandoval County also negotiated payments in lieu of taxes.

¹¹ Except for tax free IRBs which must also be approved by the State Board of Finance.

businesses to the state, who are attracted by the state's competitive business climate. This competitive business climate includes an available labor force, a relatively low wage structure, quality of life, relatively low taxes on business, and economic development tax incentives. This evidence of New Mexico economy's above-average performance suggests that the state is competitive today in attracting and retaining business.

Because of the confusing array of state economic development incentives offered, it is difficult to provide a precise answer to the question: Are New Mexico's tax incentives adequate? But judging from the state economic performance and our recent success in attracting new businesses to the state, one must conclude that New Mexico's tax incentives are indeed adequate.

TABLE 6.1

SUMMARY OF ECONOMIC DEVELOPMENT INCENTIVES

	NEW MEXICO	ARIZONA	OREGON	UTAH	WASHINGTON
Property Tax Abatement/Exemption	With industrial revenue bonds, up to 100% for life of bonds applicable to all property taxes; city/county may negotiate payments in lieu of taxes.	If located in foreign trade zone, 80% property tax reduction; accelerated depreciation for commercial and industrial personal property.	Assessed value of plant capped at \$100 million with annual adjustment for up to 15 years; payment in lieu of taxes required; 100% within enterprise zone for three years.	Property tax increment financing of infrastructure at plant site; 100% of property taxes used to pay for site improvements (Micron).	No
Sales/Comp. Tax Exemption, Manufacturing Equipment	100% exemption if financed with industrial revenue bonds; otherwise, may qualify for investment tax credit subject to employment requirement.	Exemption for materials and tangible personal property used directly in manufacturing process.	Imposes no sales tax.	100% exemption for new and replacement manufacturing equipment.	100% exemption for manufacturing and R&D equipment; also offer exemption on construction labor, if located within distressed zone.
Corporate Income Tax Credit	No	<ol style="list-style-type: none"> 10% of purchase of pollution control devices; maximum, \$750,000. 5% of purchase of new construction materials to excess of base amount with annual cap. 	<ol style="list-style-type: none"> 5% of qualified R&D expenses over a base amount; maximum of \$500,000 per year. 	No	<ol style="list-style-type: none"> \$1,000 per new job credit against Business and Occupation Tax with maximum of \$100,000. 2.5% of R&D expenses up against B&O tax up to maximum credit of \$2.0 million.
Double Weighted Sales, Corporate Income Apportionment	Yes, at company option.	Yes	Yes	No	No
Loans/Subsidies	Investment tax credit program is direct subsidy for IRB-financed equipment, with employment requirement.	No	Loans up to \$10 million provided and grants up to \$500,000, funded by lottery funds.	Loan of \$1.0 million to Micron to be paid back with credits earned based on new payroll & in-state purchases; if insufficient credits, aid back with cash.	No

TABLE 6.1
(continued)

SUMMARY OF ECONOMIC DEVELOPMENT INCENTIVES

	CALIFORNIA	COLORADO	OKLAHOMA	TEXAS
Property Tax Abatement/Exemption	No Accelerated depreciation of unaffiliated property in enterprise zone.	50% of local property tax credit for up to four years. IRB financing allowed with property tax exemption; abatement in lieu of taxes required.	Local government may exempt manufacturing facility from property tax for up to 5 years with investment and job requirements.	Property tax abatement/reinvestment zones with up to 100% exemption for 5 to 10 years for property value exceeding base year value.
Sales/Comp Tax Exemption/Manufacturing Equipment	Tax credit rebates tax on manufacturing equipment.	100% exemption for purchase of machinery, machine tools and parts greater than \$500.	Sales tax refund for new or expanding manufacturing facility equipment.	100% exemption for manufacturing equipment.
Corporate Income Tax Credit	1. Tax credit for wages paid to employees living in enterprise zone. 2. 5% credit for first \$20 million in equipment in enterprise zone. 3. R&D tax credit.	If in enterprise zone: 1. 3.0% investment tax credit on equipment. 2. \$500 per job tax credit. 3. 3.0% R&D tax credit. 4. 50% of contributions to the zone.	5% of new taxable payroll for up to 10 years or 1.0% of new investment or \$500 per FTE job created for up to 5 years.	If in enterprise zone, 1. \$2,000 per job up to \$1.25 million over 5 years. 2. reduced franchise tax for up to 5 years.
Double Weighted Sales, Corporate Income Apportionment	No	Offers two factor apportionment--sales and property	No	Sales only (franchise tax) as apportionment factor
Loans/Subsidies	No	\$5,000 per job as loan, but state loan may represent only 35% of total funding.	Local government may build and lease back plant free of property taxes. Subject to voter approval, taxes used for incentives. Direct state loans.	Loan guarantees and loans. Local grants financed by voter approved tax increases.
				Property tax increment financing programs allowed. Other restrictions may apply.

DWS Formula Description

Among the most difficult problems faced by states imposing corporate income taxes is the question of what portion of total multistate corporate income should be taxed.² The most common method of rationing corporate profits among states employs what is typically called a single-weighted three-factor formula (SWS). The formula uses state proportions of total corporate property, wages, and sales as an approximation for business activity attributable to any particular state. Each factor is weighted equally. The three-factor formula, as employed in New Mexico, appears as:

$$\text{NM Portion of Taxable Corporate Profits} = \frac{1 \text{ NM Sales} + 1 \text{ NM Wages} + 1 \text{ NM Property}}{3 \text{ Total Sales} \quad 3 \text{ Total Wages} \quad 3 \text{ Total Property}}$$

A portion of the right-hand side of the above equation — the ratio of in-state sales to total corporate sales — is typically referred to as simply the "sales factor"; ratios of in-state payroll to total payroll, and in-state property to total property are commonly called the "payroll" and "property" factors, respectively. The result of calculations shown above — the state portion of taxable corporate profits — may be thought of as the "state percentage" and, on New Mexico tax forms, is called the "average percentage." This term is simply the fraction of a corporation's *apportionable* income subject to tax in any particular state.³

The apportionment formula illustrated above is an outgrowth of historical difficulties experienced by states in taxing income of multijurisdictional businesses. These difficulties culminated in a resolution by the National Governors' Conference requesting a study of state income tax apportionment practices by the Council of State Governments. The result was formulation in 1957 of the Uniform Division of Income for Tax Purposes Act (UDITPA), which presents methodology for assigning multistate corporate income to states. UDITPA has been adopted by 24 states.⁴

Several years after development of UDITPA, "... the act became the center piece of the Multistate Tax Compact and provides the apportionment scheme for the 17 states that are members of the compact. Other states have adopted similar formulas."⁵ New Mexico adopted UDITPA in 1965, in what are now Sections 7-4-1 through 7-4-21 New Mexico Statutes Annotated (NMSA) 1978. Allocation and apportionment by UDITPA is required by Section 7-2A-8 NMSA 1978. In 1967, the New Mexico legislature adopted the Multistate Tax Compact (MTC). This action locked in New Mexico's commitment to UDITPA as specified in article 14 of the MTC. However, the

²States do not treat total (multistate) corporate profits as part of their corporate income tax bases for several reasons. First, if all states taxed total profits the resulting multiple taxation of any particular firm's income could easily exceed its profits. Secondly, justification for taxation of corporate profits by states stems essentially from either (1) services provided by the taxing jurisdictions, or (2) the extent of income generated within each state's boundaries. Hence to be consistent with this rationale, each state should tax any corporation in rough proportion to services it provides to firms, or in rough proportion to income earned within its boundaries.

³Businesses also *allocate* income to states; for an explanation, see footnote number 17.

⁴UDITPA VS 9-1 . . . "Take Note, New York State Legislative Tax Study Commission, Volume 1, No. 1, p. 2.

⁵James H. Peters, "Whither Unitary, Part II" *State Tax Notes*, November 4, 1991, p. 310.

compact does allow firms to elect taxation under other (non-UDITPA) taxing provisions. It would therefore be possible for New Mexico to alter its apportionment formula without relinquishing its commitment to the MTC.

Although a formula similar to the one illustrated above is most prevalent among states imposing corporate income taxes, a number of variations exist.⁶ Rationale underlying use of a formula incorporating only property and wages stems from the controversial method wherein sales shares appear in the three-factor formula. States (including New Mexico) that use the three-factor approach typically identify sales location on a *destination* basis, i.e., the purchaser's location. Hence, as Fisher has indicated, in cases wherein all of a firm's assets are located in a particular state, some portion of the firm's income goes untaxed by the base state if its sales are to individuals located outside its boundaries. Under such circumstances, the three-factor formula fails to apportion a firm's tax base in proportion to benefits received from base-state services.⁷

Other states move to the opposite extreme. Rather than apportioning income on the basis of property and payroll, they use a formula which effectively penalizes firms for deriving high proportions of sales within their borders, but fail to place high proportions of their property and labor force within the state boundaries. Also, as is indicated in what follows, a number of additional variations on the two and three factors are employed by states — for example, use of a DWS factor by firms in some industries but not others. In any case, as Peters has indicated: "Currently, there appears to be a movement towards a single sales factor formula or one that gives added weight to the sales factor."⁸

Rationale Underlying a Double-Weighted Sales Factor Formula

Under the double-weighted sales approach to income apportionment, the sales ratio is given a weight of one-half, while weights applied to property and wage factors are reduced from one-third to one-fourth. Applying this method in New Mexico would produce an apportionment formula which appears as:

$$\text{NM Portion of Taxable Corporate Profits} = \frac{1 \text{ NM Sales} + 1 \text{ NM Wages} + 1 \text{ NM Property}}{2 \text{ Total Sales} \quad 4 \text{ Total Wages} \quad 4 \text{ Total Property}}$$

A DWS factor formula, when imposed on a destination basis, tends to decrease tax obligations among corporations basing high proportions of their work force and property assets inside the taxing state, but who generate high fractions of their sales in other states.⁹ Apportionment formulae based on double-weighting the sales component tend to increase corporate tax obligations among firms that station most of their human and property assets outside the taxing state, but receive large proportions of their sales revenues from business with

⁶Fisher, Ronald C., *State and Local Public Finance* (Glenview, Illinois: Scott, Foresmen and Company, 1988) pp. 219-222.

⁷Fisher, p. 221.

⁸Peters, "Whither Unitary, Part II," p. 310.

⁹An example of a firm likely to benefit from a destination-based double-weighted New Mexico sales factor formula is a mineral extraction company that sells most of its product to residents of other states. An example of a firm which would probably find its corporate income tax obligation increased from a double-weighted formula is a vertically integrated corporation producing most of its product outside New Mexico, but who sells much of the final product in New Mexico.

state residents. Many firms — typically small corporations — are, however, unaffected by an apportionment formula change because all of their sales and assets are in the taxing state; they therefore do not apportion income.

The Case Against Double-Weighting Sales

Perhaps the most common justification for switching to a DWS formula is encouragement of economic development. The DWS approach rewards multistate corporations for placing capital and jobs in the taxing state by increasing their tax bills to a lesser extent than would occur under a single-weighted sales factor formula. The destination-based double-weighted approach also rewards corporations for selling products outside the state, because increased tax burdens resulting from the heavily-weighted sales factor are avoided if sales are to out-of-state residents. This type of reasoning that emphasizes encouraging exports and discouraging imports is occasionally referred to as "fiscal mercantilism" due to its similarity with the mercantilist economic philosophies prevalent in Europe from approximately 1,500 to 1,750.¹⁰ DWS opponents are rarely convinced by the neomercantilist rationale for imposing a DWS formula due to the demise of mercantilism as a guide to economic policy that occurred many years ago. Opponents also argue that it is difficult to demonstrate that policies of this sort do, indeed, encourage business to locate in a particular state. They also argue that if all states adopted DWS procedures, incentives for locating in any particular state would be eliminated by actions of other states.¹¹

Opponents of a double-weighted approach further assert that: (1) the scheme violates a fairly universal axiom of taxation that taxes should be imposed evenly on a broad base, (2) use of a DWS factor formula would impose what is, in some sense, a somewhat arbitrary and capricious tax increase on many firms who have established business operations in New Mexico on the basis of a single-weighted formula, and (3) a destination-

based formula emphasizing sales tends to violate the benefits-received principle of taxation. Finally, opponents tend to argue that since DWS economic development benefits are difficult to substantiate, the change would simply be a method of providing some businesses with tax breaks at the expense of others.

The Case in Favor of Double-Weighting

The case for double-weighting may easily be couched in terms of the case against use of the corporate income tax at the state (and federal) level. Many analysts believe the corporate income tax is not a particularly useful or appropriate taxing instrument due to a number of factors. First, its burden is unknown — that is, who actually pays the tax (i.e., corporate stockholders, corporate employees, or consumers of products produced by corporations) depends on a number of complex variables whose effects are difficult to measure. In any case, the burden of the tax is likely to be at least mildly regressive unless the tax is borne essentially entirely by corporate shareholders. Secondly, any form of business tax is likely to impede development of businesses and distort resource allocation, thus diminishing aggregate state and national income; retained earnings are more productive in the hands of corporations than governments. The negative view of corporate income taxes among analysts is exemplified by remarks of Charles McLure, Jr., an economist who served as deputy assistant secretary of the Treasury for Tax Analysis during the Reagan administration:

Allowing DWS apportionment as an optional reporting method tends to diminish the corporate income tax base, hence the role of corporate income taxes as state revenue sources.

"... the state corporation income tax is unlikely to be borne by shareholders (except in the short run) or by owners of capital, as is the Federal tax. Rather, it is likely to be born by economic agents who cannot leave the taxing state or who own factors of production that cannot easily leave, such as consumers, workers, and owners of land and some kinds of capital. ... If the states fully understood this basic result of elementary economic analysis, they would probably be somewhat less anxious to rely so heavily on this tax, which they probably incorrectly think can be exported in large part to residents of other states."¹²

and by Therese McGuire:

"To summarize, state corporation income taxes are likely to be inefficient because they do not approximate benefit taxes, and they may distort decisions concerning where to open or expand new operations. They are likely to be inequitable because, regardless of who actually pays the tax, the resulting burdens may differ across similar individuals and may not vary with income in a fair manner."¹³

¹⁰Snider, Delbert A., *Introduction to International Economics*, Sixth Edition, Richard D. Irwin Inc., Homewood, Illinois, 1975, p. 205.

¹¹To understand why this is true, consider the case of a firm whose business activities are confined to New Mexico and a bordering state. Assume the bordering state and New Mexico impose traditional single-weighted three-factor apportionment systems at identical tax rates. Further, assume essentially all the firm's property and payroll are in New Mexico, but its New Mexico sales are negligible. Its New Mexico percentage is therefore $2/3$ (i.e., $[1 + 1 + 0]/3$) while its average percent in the bordering state is $1/3$. All income is subject to tax. Next, suppose New Mexico imposes a double-weighted sales factor apportionment formula. The firm would receive an approximate 25-percent tax reduction in New Mexico because its average percentage would fall from .6667 to .5000. Simultaneously, 16.67 percent of the firm's income is not subject to tax and constitutes "nowhere taxation" because the average percentages in the two states sum to .8333 rather than one. Next, suppose the bordering state imposes a DWS formula. The average percent in the border state now rises from $1/3$ to $1/2$ and the firm experiences a 50-percent increase in taxes in the border state (i.e., $.5000 - .3333 = .1667$, and $.1667/.3333 = .5$). The "nowhere taxation" is eliminated, and the firm's total tax bill is identical to its tax obligation before the two states changed apportionment procedures. An interesting effect of this example is that New Mexico experiences a permanent tax loss, while the bordering state experiences a permanent tax gain. In this particular example, probable economic development effects are also negligible because the firm initially stationed all of its capital and labor in New Mexico. Even if the New Mexico formula shift encourages the firm to place additional capital and labor in the state, after the bordering state imposes a DWS formula the firm's total tax obligation would be unchanged; no incentive would exist for the firm to increase its total investment, and aggregate economic development effects would be negligible.

¹²McLure, Charles E., *Economic Perspectives on State Taxation of Multijurisdictional Corporations*, p. 2.

¹³McGuire, Theresa J., "Corporate Income Tax" (Chapter 6) in *State and Local Finance for the 1990s*, Arizona, School of Public Affairs, 1991, p. 89.

Allowing DWS apportionment as an *optional* reporting method tends to diminish the corporate income tax base, hence, the role of corporate income taxes as state revenue sources. Thus, to the extent a change to a DWS formula decreases states' reliance on corporate income tax revenues, the antipathetic view of corporate income taxation common among economists tends to applaud use of a double-weighted approach.

Another argument for using the DWS factor formula stems from the extremely uneven sizes of New Mexico corporate taxpayers. As shown in what follows, of the state's approximately 30,000 corporations filing tax returns, several each pay over seven percent of the state's total annual corporate tax bill. Roughly 20,000 of the 30,000 corporations reporting to New Mexico pay a combined total of roughly \$40 million of the \$60 million to \$75 million in net tax obligations. Thus, about half to two-thirds of the corporate tax bill is borne by (20/30,000) *one-tenth percent* of the corporate taxpaying population! It is therefore not surprising that several firms who (1) pay several million dollars annually in corporate income taxes, (2) invest heavily in New Mexico, and (3) would receive a tax reduction as high as 25 percent of their current obligations, would also applaud a change to a DWS factor formula.

Additional bases for mandating a double-weighted formula center around actions of other states. It is in some sense desirable that states impose uniform apportionment policies; it can easily be shown that to do otherwise encourages substantial waste of resources, as well as "double" taxation and "nowhere taxation."¹⁴ Hence, if a double-weighted approach becomes the dominant method used by other states, uniformity considerations suggest movement to a DWS formula by nonconforming

states. A similar claim centers around assertions by firms whose principal competitors are companies conducting most of their business in states that heavily weight the sales factor. Under these conditions, firms may face a serious competitive disadvantage if they locate in a state that uses the traditional three-factor formula. Hence, use of a DWS factor may, under some circumstances, indeed tend to discourage a particular firm from locating or expanding its operations in some states and, it may be reasonably argued, impose an unfair disadvantage on the firm's employees. It should be mentioned, however, that similar claims may be made by firms benefiting from the single-weighted formula facing competitors in single-weighted formula states.

General Impacts of a Double-Weighted Sales Factor Formula

Revenue impacts of switching to a DWS formula in any particular state depend on (1) current and probable future practices of other states, (2) the composition of corporations subject to state corporate income tax liability (i.e., each state's "economic base"), and (3) how corporations react to the change.

Actions of other states are important in the decision to change the apportionment formula because inconsistent policies among states may generate incentives for inefficient

economic behavior by corporations (e.g., moving operations in search of tax advantages rather than where resource conditions are most profitable), as well as for legal challenges from interests whose positions would be harmed by such a change. If other states follow suit after a major state changes its apportionment factor, the advantage of double-weighting the sales factor to any particular firm tends to be lost. If all states imposed either a double-weighted or single-weighted apportionment formula using identical rates, the tax effect would be identical; essentially all income would be subject to corporate income taxation at the same rate under either scheme.

If other states follow suit after a major state changes its apportionment factor, the advantage of double-weighting the sales factor to any particular firm tends to be lost.

The composition for New Mexico corporate taxpayers is important to fiscal impacts of a formula change because the types of firms doing business in New Mexico determines (1) whether New Mexico's corporate income tax revenues increase or decrease as a result of the change, and (2) likely corporate winners and losers from such a change.

Several rough generalizations are possible regarding each of the major impact groups mentioned above. Suppose a state's economic base is heavily concentrated on, say, manufacturing and mineral extractive activities that make substantial use of human and physical capital, while exporting most of their products to other states. Under these circumstances, the state may be characterized as an "export" state and a switch to a destination-based DWS formula will tend to decrease corporate income tax revenues. If, in contrast, most of the state's businesses are out-of-state retail firms that require minor amounts of in-state workers and capital, the state may be characterized as a "market" state and double-weighting the sales factor tends to increase total corporate income tax revenues. Extreme caution must be used with these types of generalizations, however. Large retail outlets, in fact, often find their taxes *decreased* when a state switches to a double-weighted formula, while certain firms in the mineral extractive business discover that their taxes *increase*. This statement also applies to aggregate state revenues. That is, if sales factors average less than the averages of property and payroll factors among taxpaying firms, their tax obligations will decline, as will state corporate income tax obligations.

What determines whether a firm gains or loses as a result of a formula switch depends on what is in some sense an arbitrary combination of numbers. *Any particular firm will benefit (i.e., receive a corporate income tax reduction) from movement to a DWS factor formula if its sales factor is less than the average of its property and payroll factors. A firm will experience an increase in its "state percentage," and consequently, an increase in corporate tax obligations under a double-weighted approach if the sales factor exceeds the average of its payroll and property factors.* Major determinants of gain or loss under the DWS approach therefore include: (1) presence of apportionable income, and (2) the ratio of sales factor to the average of property and payroll factors. If this ratio is less than one and

¹⁴That is, instances wherein some corporate activities are not subject to tax in any state. Nowhere taxation may, in principle, be eliminated by incorporating "throwout" or "throwback" rules into corporate income tax statutes. For an explanation, see Fisher's text.

Exhibit 1: Summary of State Apportionment Practices			
State	Apportionment Formula	State	Apportionment Formula
Alabama	3-factor, simple average	Montana	3-factor, simple average
Alaska	3-factor, simple average	Nebraska	100% sales
Arizona	3-factor, double-weighted sales	Nevada	No corporate income
Arkansas	3-factor, simple average	New Hampshire	3-factor, 1.5-weighted sales
California	3-factor, simple average	New Jersey	3-factor, simple average
Colorado	3-factor, simple average or average of sales and property only	New Mexico	3-factor, simple average
Connecticut	3-factor, double-weighted sales	New York	3-factor, double-weighted sales
Delaware	3-factor, simple average	North Carolina	3-factor, double-weighted sales
Dist. of Columbia	3-factor, simple average; 2-factor option for financial firms	North Dakota	3-factor, simple average
Florida	3-factor, double-weighted sales	Ohio	3-factor, double-weighted sales
Georgia	3-factor, simple average	Oklahoma	3-factor, simple average
Hawaii	option, 3-factor and 2-factor formula	Oregon	3-factor, double-weighted sales
Idaho	3-factor, simple average	Pennsylvania	3-factor, simple average
Illinois	3-factor, double-weighted sales	Rhode Island	3-factor, simple average
Indiana	3-factor, simple average; double-weighted sales in 1993 tax year	South Carolina	3-factor, simple average for manufacturers; option for others
Iowa	1-factor, sales	South Dakota	3-factor, simple average
Kansas	option, 3- and 2-factor formula	Tennessee	3-factor, simple average
Kentucky	3-factor, double-weighted sales, options	Texas	1-factor, gross receipts formula
Louisiana	3-factor for manufacture, merchandising; 2-factor for services	Utah	3-factor, simple average
Maine	3-factor, double-weighted sales	Vermont	3-factor, simple average
Maryland	3-factor, 2- & 1-factor options	Virginia	3-factor, simple average
Massachusetts	3-factor, double-weighted sales	Washington	No corporate income tax imposed
Michigan	3-factor, value-added tax, double-weighted sales	West Virginia	3-factor, double-weighted sales
Minnesota	3-factor, 15% property, 15% payroll, 70% sales	Wisconsin	3-factor, double-weighted sales
Mississippi	3-factor, simple average; double-weighted sales for retail	Wyoming	No corporate income tax imposed
Missouri	3-factor, simple average; 100% sales option		

Source: Survey by New Mexico Taxation and Revenue Department and Advisory Commission on Intergovernmental Relations, *Significant Features of Fiscal Federalism, Volume 1*, and 1992 *Multistate Corporate Tax Guide, Volume 1*.

the firm has apportionable income, the firm will experience a tax reduction under DWS; if the ratio exceeds one, the reverse will occur.

It may be fairly easily demonstrated that switching to a DWS factor apportionment formula imposes tax burden changes on any particular firm that are constrained by the numerical relationships underlying the formula change. As a result of a shift to a double-weighted formula, any particular firm may experience a maximum 50-percent increase in corporate tax obligations, or a 25-percent decrease in taxes. The former is true because, for example, a firm whose sales are essentially all in-state, but who places negligible numbers of employees and property in the state, would discover its "state percentage" increased from one-third to one-half — a 50-percent increase. Similarly, a firm with essentially no in-state sales would experience a decrease in its "state percentage" from two-thirds to one-half — a 25-percent decrease.¹⁵

¹⁵In fact, the maximum decrease is asymptotic to 50 percent as the sales factor declines, assuming all three factors are present. Similarly, the maximum increase in the state percent — and tax increases — is 25 percent as the average of the payroll and property factors increases. Reasoning underlying these statements is explained in Appendix B of this report.

Finally, how corporations react to a change in the apportionment formula and resulting impacts on corporate income (and other tax) revenues depends on a complex series of what economists call elasticities in the firm's product and resource markets. The DWS formula change is perhaps best viewed as a simple decrease in average costs of production in a particular location. The result is likely to be an increase in total production as the cost cut translates into product price reductions and enables the firm to capture a larger share of its product market. The extent to which this occurs — the "output effect" for purposes of the present discussion — depends on how quickly the firm is able to increase its production (i.e., supply elasticity) as well as how consumers react to reduced prices in product markets, or price elasticity of demand. Neither of these elasticities is readily measurable. The cost reduction will also tend to shift resources into the DWS state, an effect may occur more or less independently of the output effect. The extent of the resource shift depends, among other things, on costs of moving resources into the DWS state and the firm's assessment of whether other states are likely to match cost reductions from DWS via tax rate reductions, imposing similar formulas, or any of a host of other measures including investment tax credits and industrial revenue bonds. Assuming the firm was employing an essentially optimal location prior to the DWS decision, it seems

likely that any resource move to the DWS state will result in cost increases in at least some production factors — otherwise a firm would have placed additional resources in the DWS state before the formula change. All of these factors must therefore be compared with costs savings from the new apportionment formula.

Additionally, corporate income taxes are imposed on profits, while gross receipts or sales taxes are imposed on product sales. However, the decision to invest, relocate, or expand a plant is determined by net return to shareholders after taxes, whether imposed on property or sales. Corporations typically do not distinguish *legal* burden of taxes from ultimate burden in determining after-tax profit, since accountants and not economists compute actual and projected profits. In any case, the location decision is very complex; New Mexico simply does not have the capacity to estimate these types of impacts at the moment. No attempt was made to do so in the present study.

Apportionment Practices of Other States

Corporate income tax apportionment practices employed by various states in this nation are summarized in Exhibit 1. At one extreme is Iowa, which bases its apportionment strictly on sales; no counterparts exist, wherein sales are not part of the apportionment scheme. States that currently employ an apportionment formula emphasizing sales are indicated by shaded cells in the exhibit. As the table suggests, about half, or 24 of the 51 jurisdictions employ an apportionment scheme stressing sales, while 24 currently use a traditional single-weighted three-factor formula. Others, for example Nevada, currently impose no corporate income tax or, as in the case of Michigan, make use of a tax which is similar to, but is not in the strictest sense, a tax on corporate profits.

Approximately half the U.S. population therefore lives in states employing the traditional approach, while a similar fraction lives in states emphasizing the sales factor.

If apportionment practices are considered in terms of population, similar diversity exists. Large-population states employing the double-weighted formula or a similar one include New York, Illinois, Indiana, Ohio, Missouri, and Florida. Highly populous states using the traditional single-weighted procedure include California, Pennsylvania, and New Jersey. Approximately half the U.S. population therefore lives in states employing the traditional approach, while a similar fraction lives in states emphasizing the sales factor. Texas and Michigan impose business taxes that are not technically corporate income taxes; yet if their populations are counted among individuals living in states with DWS factor approaches, it may be stated that the majority of the U.S. population currently lives in states that emphasize the sales factor in apportionment.

As indicated in Exhibit 1, several states, for example Colorado, Kansas, Louisiana, and Mississippi, make use of approaches which either require a DWS factor for a particular industry, for example, retail trade, or allow firms the option of employing a DWS approach.

It is tempting to speculate regarding motivation for different states' choices of apportionment factors. If tax revenue maximization is the objective, it might be expected that the large "market" states — New York and Florida, for example, would employ a DWS factor approach, while the "export" states would tend to make use of the traditional single-weighted formula. In contrast, if the objective is to stimulate long-term economic development, one would expect export and market states to employ a DWS approach. In fact, generalizations of this sort are tenuous at best. In New York, the double-weighted formula has, by most accounts, produced a net loss in corporate income tax revenues. Moreover, when representatives of the New Mexico Taxation and Revenue Department asked analysts in states which recently switched to a DWS formula why they thought this particular decision was made, the most common explanation centered on the extent of lobbying effort available to firms who would gain from an apportionment formula emphasizing sales.

Nonetheless, if California and Florida are ignored, it appears that the states with large populations and manufacturing sectors tend to make use of formulas emphasizing the sales factor, while moderately populated states, particularly in the South (Alabama, Georgia, South Carolina, Tennessee, Virginia) and upper midwest and western portions of the country (Idaho, Montana, North Dakota) tend to employ the traditional single-weighted formula.

Finally, if one looks to the various states in close proximity to New Mexico with an eye toward the question of which formula predominates, the double-weighted approach, used by Colorado, Arizona, and Texas, tends to emerge. Yet Oklahoma and Utah — also in close proximity to New Mexico — use the traditional UDITPA formula.

New Mexico Corporate Income Tax Description

State income tax forms completed by most corporations filing in New Mexico consist of the CIT-1, CIT-A, CIT-B, and CIT-C forms. The description which follows is based on 1990 versions of these forms.¹⁶ "Average percentage" figures, representing application of the apportionment formula, are entered on the CIT-A form.

New Mexico's corporate income tax "piggybacks" on the federal Form 1120. That is, figures from the Form 1120 represent the starting point for New Mexico corporate income tax calculations. After several deductions are made from the Form 1120 taxable income, resulting "net taxable income" is subjected to a progressive rate structure ranging from 4.8 percent for the first \$500,000 to 7.6 percent for income in excess of \$1 million in income. The resulting "Income Tax Computation" figure is then multiplied by what is termed the "New Mexico percentage" on the CIT-1 form to determine the New Mexico tax obligation. The "New Mexico percentage" is essentially the sum of two fractions, namely the proportions of income allocated and apportioned to New Mexico.¹⁷ As described in the

¹⁶This report's conclusions are based primarily on data entered on 1990 forms.

¹⁷Under UDITPA, "nonbusiness income" or income not directly derived from the taxpayer's trade or business is *allocated* to the firm's state of commercial domicile. Differences between income allocation and apportionment often confuse people who are very familiar with state corporate income taxation. A useful way to keep the differences in mind is to simply remember that corporations allocate nonbusiness income, but apportion business income.

opening page of this report, the three-factor apportionment formula is captured in the "average percentage" term. The "average percentage," in conjunction with the firm's fraction of allocated income, comprises the "New Mexico percentage," which determines the fraction of taxes paid to New Mexico. The procedure may be summarized as follows:

Form 1120 net taxable income
times: NM tax rates
equals: income tax computation

and income tax computation
times: NM percentage
equals: New Mexico income tax

and
 NM percentage =

$$\frac{\text{NM allocated income}}{\text{net taxable income}} + \frac{\text{NM apportioned income}}{\text{net taxable income}}$$

Finally, the term on the right above

NM apportioned income =
 average percentage x NM apportionable income.¹⁸

An unusual and somewhat controversial feature of the system sketched above is that a theoretical measure of total taxes (payable to all states, based on New Mexico rates) is calculated as the "income tax computation" term. This figure is then apportioned and allocated to New Mexico. This approach therefore in some sense allocates and apportions tax obligations (determined after application of rates to a base) rather than income. The approach is, however, used by California and other states; the procedure has withstood a number of court challenges and is therefore likely to be a continuing feature of the New Mexico corporate income tax system.

Sketch of New Mexico Corporate Tax Base, Revenue Characteristics

New Mexico's corporate income tax program is relatively modest in comparison to other state revenue sources. It typically generates approximately \$70 million annually, — about three percent of the state's general fund. Annual New Mexico corporate income tax revenues vary widely, however; net corporate tax receipts have ranged from about \$50 million to \$80 million during recent years. The state also collects a franchise tax fee of \$50 per business with the corporate income tax. Franchise taxes usually total approximately \$1.5 million annually. Personal income tax receipts, in contrast, typically total about \$400 million to \$500 million, while gross receipts (sales) tax revenues normally sum to about \$1.1 billion annually, of which approximately \$750 million represent state revenues.

Roughly 30,000 firms file corporate income tax returns in New Mexico; yet only about 10,000 of the 30,000 filers incur a tax obligation in any particular year. The remaining 20,000 returns are filed by subchapter S corporations where profit is reported on individual income tax returns, and by nonprofit organizations or unprofitable for-profit firms incurring no cor-

porate income tax obligation in any specific year. Unfortunately for revenue estimation purposes, many corporations experience fairly large profits in some years, but large losses in others. As a result, the composition of firms with tax obligations, and total corporate tax revenues, vary widely annually.

Although many of the world's largest firms file New Mexico returns, their New Mexico corporate income tax obligations are often modest, simply because they have little presence in the state. As is suggested in Exhibit 2, firms in mineral-related activities constitute the state's major corporate income tax payers — 14 of the top 30 tax obligations are in this classification; their tax bills total approximately \$26.67 million, or 62 percent of the \$43.06 million shown as the total for the top 30 firms in Exhibit 2. As stated in the footnote to Exhibit 2, the classification scheme reflected in the table does not conform to standard industrial classifications; the Standard Industrial Classification (SIC) taxonomy does not portray a complete picture of business activities representing the source of income among major New Mexico corporate taxpayers. Under the SIC code approach, for example, oil and natural gas pipelines are typically classified as "transportation, communications and utility" firms. A more descriptive approach seems to be to list them as "mineral related" along with refineries and extractors of "hard" minerals as well as oil and gas.

Category	Value	% of Total	Number	% of Total
Mineral Related	25,967,551	60.31	14	46.67
Manufacturing	6,557,640	15.23	4	13.33
Retail	4,017,981	9.33	6	20.00
Communications	3,509,281	8.15	3	10.00
Utility	2,638,786	6.13	2	6.67
Service	366,235	0.85	1	3.33
Totals	43,057,474	100.00	30	100.00

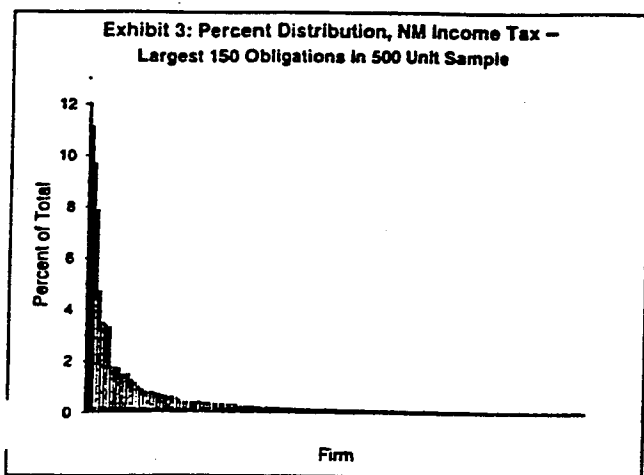
Note: Industry categories shown above do not conform to standard industrial classification (SIC) categories.

Many mineral industry firms perform a number of related activities — extraction, refining, transport, and retail sales. Additionally, aggregating various firms as shown in Exhibit 2 groups "hard" mineral producers with their oil and gas counterparts, thus preserving anonymity of taxpayers.

The second largest category shown in Exhibit 2, with tax obligations totaling about \$6.5 million, is manufacturing with four firms represented; the third largest group consists of six major traditional retail establishments whose combined income tax obligation totaled about \$4 million. Communications firms represent the fourth largest group in Exhibit 2, with a tax obligation totaling approximately \$3.5 million. Hence the picture emerging from a look at New Mexico corporate income tax obligations is one of essentially complete dominance by mineral-related firms. Although much has been said of the state's severe dependence on defense expenditures for income and employment, this generalization simply is not applicable to corporate income taxes, where firms engaged in finding, extracting, refining, and transporting minerals assume most of the tax burden. These are businesses with very large concentrations of plant and equipment that are not likely to leave the state in response to a tax increase. It should, however, be emphasized that the nature of income flows and numbers underlying firms in the mineral industry are extremely mixed. For example,

¹⁸On the New Mexico CIT-1 form, apportionable income is simply net taxable income less income allocated to other states and New Mexico.

profits from mineral severers, refiners, and exploration firms tend to be extremely variable and depend on vagaries of international energy markets. Yet pipelines, in contrast, tend to experience extremely stable revenues and profits. Their tax obligations, along with those of firms engaging in the related business of selling refined petroleum products, exhibit high degrees of income and tax obligation stability similar to revenue patterns of retail establishments. Yet since mineral industry firms have extremely large concentrations of assets, including pipelines and refineries, their corporate income tax flows tend to be destabilized by corporate takeovers and mergers. Hence with about half of the corporate tax base subject to extreme variation, it is hardly surprising that aggregate New Mexico corporate income taxes exhibit such annual variation.



A final characteristic of the New Mexico corporate income tax can best be understood with the aid of Exhibit 3. This characteristic cannot be overemphasized, and is a key element in many of the conclusions discussed in what follows. The uneven distribution of tax obligations is shown by the "L-shape" of the chart in Exhibit 3. An even distribution would appear as a horizontal line in the figure. If a figure were to be constructed for the entire population of corporate income taxpayers, the result would be a chart with a very long and thin right-hand portion or "tail." The long "tail" portrays a distribution of tax obligations which is extremely uneven, with a mere handful of firms paying most of New Mexico's corporate tax bill. Data are illustrated in Exhibit 3 in terms of percent of the total tax bill paid by the largest 150 taxpayers in a 500-unit sample of New Mexico corporate income tax bills. The 150 firms in question had a combined tax obligation totaling almost \$55 million. Within the sample, several firms had tax obligations in excess of \$5 million; their returns each therefore represented between eight and 12 percent of the \$55 million total. These returns are near on the graph's left-hand region. Firms whose obligations are shown near the opposite end of the spectrum and rank near 150 are illustrated on the lower right-hand corner of the graph above. Obligations of the later group ranged from \$30,000 to \$40,000. If data in Exhibit 3 were extended to include the entire 500-unit sample population, obligations illustrated in the lower right-hand corner of the graph would be as low as \$5,000. Firms in the 500-unit

sample discussed below thus displayed obligations ranging from over \$5 million to \$5,000 — a factor of 1,000.

The extremely unevenly distributed distribution of corporate income tax obligations shown by the thin right-hand portion of Exhibit 3 is what makes it possible to make generalizations regarding New Mexico's corporate income tax system based on an extremely small sample; essentially all of the tax bill is paid by a mere handful of firms. As a result of this characteristic, simulations based on the 500-unit sample and 1,500-unit samples discussed in the following section produced essentially identical conclusions. Extending the sample population to 30,000 returns would be unlikely to alter major conclusions of this study.

Sample Population Characteristics

Sample Population Characteristics and Selection Procedures

A number of factors suggested use of a sample population for purposes of the present study. First, as discussed above, distributions of income and tax obligations among New Mexico corporate income taxpayers are extremely uneven, with most of the taxes paid by a relatively small number of firms. It is therefore possible to make meaningful generalizations regarding the population of returns on the basis of a relatively small sample. Secondly, it would have been prohibitively costly to recalculate the entire 30,000 returns as part of the present study. Thirdly, any group of returns selected is, in some sense, a sample of corporate income tax behavior over time due to the unstable nature of the return population — with some firms incurring very large tax obligations in one year, followed by a refund request in the next one. It was therefore clear from the outset of the study that some form of sampling approach would be necessary.

A major concern of researchers centered on criteria for selecting the sample. Returns for over 9,000 corporations were initially key-entered into a personal computer spreadsheet during initial phases of the present study. Essentially all information contained on New Mexico CIT-1, -A, -B, and -C forms was compiled from the returns. On viewing the return data, however, it was determined that a very high proportion of the tax obligations could be captured by selecting firms on the basis of net taxable income exceeding \$150,000. Under this system, a firm meeting the minimum taxable income sample criteria would pay approximately \$11,000 in taxes assuming all of its income were apportioned and allocated to New Mexico. The 9,000-unit sample set was accordingly sorted by net taxable income, and only firms whose net taxable income exceeded \$150,000 were selected for additional study. This procedure produced a sample containing information on about 1,500 returns. Since a high proportion of firms perform some sort of allocation or apportionment, this criteria captured a number of returns containing tax obligations well below \$11,000.

Selecting return data based on criteria described above resulted in a sample population containing return information submitted by approximately 1,500 firms whose tax obligations totaled roughly \$61 million. This sample set was difficult to manage, and tests using a sample containing data on only 500 firms yielded similar results, as shown in Exhibit 4. In fact, results roughly similar to those shown in the 1,500-unit sample can be produced with a sample whose size is as small as 150 firms. The problem with the 150-return sample was that when

Exhibit 6: Distribution of DWS Formula Gains and Losses Among 500-Unit Sample Population Arrayed by Tax Obligation

Tax Obligation	Gainers — Tax Decrease		Losers — Tax Increase		Unaffected	Net Gain	Ratio: Gainers/Losers	
	Number	Value	Number	Value			Number	Value
Top 10	6	3,864,447	4	411,309	0	3,453,138	1.50	9.40
Top 20	12	4,322,637	8	742,629	0	3,580,008	1.50	5.82
Top 50	25	4,623,374	22	1,135,248	3	3,488,126	1.14	4.07
Top 100	43	4,815,133	43	1,439,011	14	3,376,122	1.00	3.35
Top 200	70	4,874,912	98	1,800,510	32	3,074,402	0.71	2.71
Top 300	95	4,917,911	146	1,942,991	59	2,974,920	0.65	2.53
Top 400	120	4,945,096	202	2,021,624	82	2,923,472	0.59	2.45
Top 500	143	4,957,643	262	2,076,524	95	2,881,119	0.55	2.39

Note also that net gain figures in column six — net loss to the state — in column six of Exhibit 6 fall consistently as the number of firms expands. All of this suggests that the DWS approach would tend to shift the tax burden from larger to smaller firms.

Differences between groups likely to experience tax changes under a DWS formula are more apparent from data in Exhibit 7. The most obvious difference is, as is indicated in the final three rows of the table, the average of property and payroll factors exceeds the sales factor for gainers; as expected, the sales factor exceeds the average of the other two factors among losers. Note, however, that the absolute size of factors among firms receiving tax reductions is typically three times that of similar statistics for losers in the sample. This explains why the absolute level of losses is typically much smaller than gains.

Exhibit 7: Selected Averages for Characteristics of Firms in Sample Set Subject to Tax Changes Under DWS Formula

Average:	Gainers (1)	Losers (2)	(2)/(1)
Taxable Gross (1120) Income	190,559,319	137,888,405	0.72
Net Taxable Income	183,578,714	130,479,239	0.71
NM Income Tax	262,246	71,463	0.27
Property Factor	.26505	.07205	0.27
Payroll Factor	.23139	.07807	0.34
Sales Factor	.19084	.09741	0.51

Probably the most revealing sets of comparisons in the exhibit, however, appear in the table's first three rows. Recall that, as a result of the DWS formula change, firms in the "gainers" category would experience an approximate \$5 million tax reduction. This would partially be offset by tax increases totaling roughly \$2 million from firms in the "losers" category. Yet, as indicated in the first several rows of the table, depending on the measure used, incomes of the "gainers" substantially exceed incomes of the "losers." Thus, the DWS proposal would tend to shift the corporate income tax burden from larger to smaller firms. Since small firms represent a major source of job growth, it is at least questionable that the DWS proposal would result in a net gain in jobs in New Mexico.¹⁹

¹⁹See, for example, "Regional Economic Development in the 1990s," by Tim R. Smith and Mark Drabentott in *Regional Economic Development and Public Policy* published by the Federal Reserve Bank of Kansas City, containing the following statements: "... large manufacturing businesses are not likely to be good sources of job growth. Large industrial firms seldom relocate or start up branch plants and thus are a poor source of new jobs. Small indigenous businesses are a much better source of job growth. Growing evidence suggests that most new jobs come from new small businesses or expansions of existing businesses."

Impacts by Industry Group

Probable effects of imposing a DWS approach on all New Mexico corporate income taxpayers are illustrated in terms of standard industrial category in Exhibit 8. Note that in all categories except agriculture the number of losers exceeds the number of firms experiencing tax decreases under DWS as shown by the second-to-last column of the table. That is, for all SICs except agriculture, the ratio of gainers/losers is less than one. As might be expected, the mining and manufacturing sectors would be the greatest beneficiaries of a DWS formula approach, where net gains total approximately \$1.5 million and \$1.2 million, respectively, and about \$2 million in tax reductions is offset by roughly \$.5 million in tax increases in each category. The number of gainers and losers in the mining category is about even. Yet the value of taxes saved exceeds the value of tax increases by ratio of four to one, as indicated in Exhibit 8's final column. In the manufacturing sector, only slightly over one-third of the firms in the sample set would benefit. About half would experience tax increases which are, on average, much smaller than tax reductions which would be received by the manufacturing firms that benefit from the proposal. Firms in the TCU category would also receive tax reductions totaling almost \$.5 million. Yet, as is similar to what occurs in manufacturing, only about one-quarter of the firms would benefit from a DWS formula while about two-thirds would experience tax increases. Also, perhaps to be expected, the vast majority of retail firms would be negatively impacted — only about one in three would benefit while two-thirds of the state's retail firms would experience a tax increase under DWS. Impacts on firms engaged in wholesale trade are similar to those in retailing.

In addition to characterizations sketched above, figures in Exhibit 8 suggest another series of alternatives. Suppose, for example, the DWS approach were optional for all firms filing returns.

The result would be, based on simulations in the sample population, a net revenue loss to the state of roughly \$5 million, or eight percent of the tax base since the \$5 million in revenue losses by firms benefiting from the proposal would not be offset by \$2 million from the firms whose taxes would increase. Similar conclusions applicable to various SICs are apparent from viewing figures in the "gainers value" column (i.e., column two) of Exhibit 8. For example, the total tax cost of making DWS optional for manufacturing firms only would be about \$1.8 million, on a \$60 million base. If made optional for firms engaged only in mining, the total tax cost would be approximately \$2 million. The tax cost of making DWS optional for retail and wholesale trade would be \$61,000, or .1 percent of total tax revenues. These options can be extended to a greater

**Exhibit 8: Distribution of DWS Formula Gains and Losses Among 500 Unit Sample Population
Arrayed by Standard Industrial Classification**

SIC	Gainers — Tax Decrease		Losers — Tax Increase		Unaffected	Net Gain	Ratio: Gainers/Losers	
	Number	Value	Number	Value	Number	Value	Number	Value
Agriculture	4	13,608	1	798	2	12,810	4.00	17.05
Mining	21	2,057,968	23	512,510	11	1,545,458	0.91	4.02
Construction	4	880	9	14,550	8	-13,670	0.44	0.06
Manufacturing	42	1,777,699	64	557,890	12	1,219,809	0.66	3.19
TCU*	12	832,326	33	380,488	5	451,838	0.36	2.19
Wholesale Trade	12	31,401	28	181,962	10	-150,561	0.43	0.17
Retail Trade	13	29,679	39	286,019	21	-256,340	0.33	0.10
FIRE**	9	185,111	10	65,011	12	120,100	0.90	2.85
Services	24	27,573	52	65,638	13	-38,065	0.46	0.42
Not Reported	2	1,398	3	11,658	1	-10,260	0.67	0.12
Totals	143	4,957,643	262	2,076,524	95	2,881,119	0.55	2.39

*Transportation, Communication, and Utilities ** Finance, Insurance, and Real Estate

detail in the SIC system. That is, if the New Mexico legislature wished to provide tax benefits to a particular type of manufacturing firm, the DWS proposal could be keyed to four-digit SIC codes. An apportionment scheme designed to target any particular SIC category would, however, impose some administrative costs on the Taxation and Revenue Department as firms would be required to demonstrate their New Mexico activities are within the appropriate industrial classification. Firms would also experience increases in corporate income tax compliance costs.

Limitations of the Present Study

Prior to considering tax policy implications of simulations described above, it is appropriate to review some weaknesses inherent in the present study.

Comparative Static Research Methodology

Simulations described above employ procedures that are described in economic literature as "comparative statics" — i.e., they compare outcomes at one point in time with those resulting at the same or another point in time under varying assumptions. No attempt is made to measure dynamic effects — for example, employment growth over time. Hence, advocates of the DWS formula may argue that, for example, revenue increases from other tax programs (e.g., personal income, gross receipts) are likely to exceed the \$3 million in estimated corporate income tax losses as high-tech manufacturing firms located in New Mexico. Although fairly speculative by nature, this type of argument is not totally without merit. No attempt was made to assess long-term employment and income effects of the DWS proposal in the present study.

Missing Factors, Incorrect Tax Return Entries

Under current New Mexico practice, when a firm has no payroll or property, the associated factor may be excluded from the apportionment formula; the "average percentage" is based on the average of the factors present. Corporate income tax regulations allowing this refer to the denominator in any of the factors. Some firms, however, exclude a factor when they have no New Mexico sales, property, or payroll, and compute the average percentage on the basis of factors present. This practice seems in some sense irrational, because placing insignificant quantities of the missing factor in New Mexico and calculating

taxes on the basis of three factors would, in most cases, result in a reduced tax obligation.²⁰ Since excluding one or more factors from the formula increases the tax liability, the Taxation and Revenue Department allows firms to exclude factors in cases in which a zero factor appears in the numerator or denominator of any particular equation. Presence of missing factors presented a dilemma when generating estimates discussed above, because no clear guidelines were established for dealing with cases wherein a factor is missing.

If, for example, the property or payroll factor is missing from the basic equally weighted three-factor formula, double-weighting the sales factor would effectively assign the sales factor a weight of two-thirds, rather than one-half. Under these conditions, the percent change in tax obligations may exceed the 25-percent decrease and 50-percent increase limits discussed above. Initial recalculations revealed about 50 firms in the sample set that fell into this category. Since no clear guidelines for dealing with them were present, and since they were of relatively minor significance, returns of this nature were typically excluded from the data set. The net impact of a DWS approach stated above could, however, vary by several hundred thousand dollars, depending on what procedures are established for treatment of missing factors.

During the course of the study, a number of cases were noted in which, for various reasons, return data appeared to be incorrect. When returns are completed incorrectly, the New Mexico corporate income tax automated processing system normally corrects the error and notifies the taxpayer. As in cases discussed above, these instances were relatively minor and, for the sake of convenience, were simply excluded from the sample set.

Annual Variation in Industry Composition and Tax Obligations

Fairly severe variation in aggregate annual New Mexico corporate income tax obligations was mentioned in early sections of the present study. Variation of the same magnitude also

²⁰These cases should not be confused with zero entries shown in the sample set in which no factors are present indicating that the firm does not allocate income and the "New Mexico percentage" term is one.

characterizes many of the firms whose returns were in the study sample. One of the major gainers in the sample population, for example, recently reported annual tax obligations of roughly one-third those of the figures employed during simulations described in the present study. This type of variation, coupled with the extremely uneven distribution of firms who would benefit from the DWS proposal, (i.e., where the majority of benefit accrues to approximately 20 firms) creates a condition in which annual revenue losses from DWS could easily vary by as much as one-third. Hence, the DWS proposal might, in the normal course of events, be expected to lose \$2 million to \$4 million. It should be emphasized, however, that the underlying composition of New Mexico's population of corporate income tax obligations is dominated by firms in mineral extraction and manufacturing industries, with a relatively small retail component. Since manufacturing and mineral extractive firms engage in substantial product exports requiring high concentrations of human and physical capital, the DWS approach will probably always produce some degree of short-term corporate income tax revenue loss if employed in New Mexico.

Review of Policy Alternatives

Among major justifications for the DWS proposal listed in this document's opening sections were: (1) distributing the burden of corporate income taxation more evenly, (2) decreasing the state's reliance on corporate income taxes, (3) creating a corporate tax structure which is uniform with other states, and, perhaps most importantly, (4) stimulating economic development, particularly in the manufacturing sector. Simulations sketched above provide some fairly valuable insights regarding the four justifications listed above.

More Even Distribution of Corporate Income Taxes

If the objective is to distribute the burden of corporate taxation more evenly, the DWS approach accomplishes this objective very well by shifting the burden from approximately five percent of the tax obligation from the state's largest taxpayers to many other firms who apportion corporate income. The DWS formula does, however, impose somewhat erratic effective tax rate increases and rate decreases on firms, depending on each firm's configuration of apportionment factors. One factor tending to favor the redistribution effort is that the maximum tax increase faced by any particular firm would be about \$200,000, and most increases would be far less than that; the maximum tax reduction, in contrast, would be over \$1 million for several firms. Hence, the formula switch would produce a sizeable tax reduction for a number of the state's largest taxpayers, while imposing mild tax increases on a greater number of firms whose tax obligations are relatively small.

An alternative method of achieving the same objective would be to broaden the tax base to some degree by imposing an alternate minimum tax, while simultaneously reducing the maximum tax rate slightly. Although not suggested by numbers presented above, most of the 30,000 New Mexico corporate income taxpayers probably would, in fact, be largely unaffected by the DWS proposal because they do not apportion significant amounts of income; yet about half the firms with large tax obligations (say \$10,000 or more) would be affected.

Decreasing Corporate Income Tax Reliance

The DWS proposal would decrease New Mexico's use of corporate income tax revenue by about five percent if made mandatory in all industries. Double-weighting the sales factor

would diminish the state's reliance on corporate taxation by about eight percent if made optional for all firms. Since the corporate income tax only provides about three percent of the state's general fund revenues, an eight-percent reduction in corporate income taxes would represent less than a one-percent decrease in general fund revenues. In fact, recent annual variation in corporate income taxes exceeds the \$6 million in revenues that would be lost if a DWS factor formula were made optional. Yet cutting corporate income tax rates would probably be an easier way to achieve this objective than use of a DWS formula. If, alternatively, rates were increased slightly to offset the revenue losses under DWS, gainers would gain less and the losers would lose slightly more income.

Uniformity With Other States

If the objective of imposing DWS is to create a corporate income tax system that is similar to that of other states, adopting the DWS proposal is probably appropriate because, perhaps due to recent escalations in tax competition among states, the national trend is clearly in the direction of employing double-weighted sales. A look at apportionment practices of neighboring states provided in this document's initial sections, however, suggests that New Mexico is unlikely to lose businesses due to its use of a single-weighted sales factor formula; neighboring states employ double-weighted and single-weighted sales factor apportionment procedures. Additionally, any attempts to make New Mexico's corporate tax system uniform with other states should also consider other factors, for example, nominal and effective corporate income tax rates, as well as other taxes on business taxes.

Economic Development Considerations

Common objectives of state economic development efforts include reducing regional unemployment rates, increasing per capita income among state residents and other measures of economic growth, and perhaps most importantly, creating additional jobs. State economic development policies designed to achieve these objectives generally fall into two categories — traditional policies targeted at branch plant recruitment, and "new wave" policies targeted at small or existing businesses.²¹ Among the former are marketing efforts portraying areas as ideal branch plant locations, financial incentives to attract businesses, and other (nonfinancial) incentives designed to encourage branch plant location. Among the latter are capital market programs, information and education programs for small businesses, research and high-technology programs, and export assistance.²² The DWS formula represents a tax policy designed to encourage branch plant locations or expansions, and therefore falls within the traditional class of policies listed above.

Economic researchers have discovered few strong relations between regional tax policies and economic growth. Recent research efforts have discovered some relatively mild linkages between tax incentives and local economic growth, however.²³ Hence, most economists will probably agree that tax reductions created by policies similar to allowing firms to use DWS apportionment procedures are likely to stimulate local job

²¹Bartik, *Who Benefits From State and Local Economic Development Policies*, p.4.

²²See Bartik, p.4.

²³See Bartik, pp. 36-44.

creation to some degree. This conclusion may, however, be a moot point. The more important considerations in adopting a DWS formula center on the questions of (1) whether tax losses from DWS procedures are offset by tax revenue increases from other tax sources, and (2) particularly if the answer to question 1 is negative, whether benefits — including positive “externalities” of plant expansions caused by use of a DWS formula, exceed associated costs — including net tax losses and “external costs” from increased pollution and congestion from associated business activity expansions, as well as costs of increased infrastructure necessary to accommodate the new businesses, and finally (3) whether other policies are available that will achieve similar ends in more efficient ways.

Detailed discussions of these types of issues, particularly benefit and cost considerations, are beyond the scope of the present paper. Yet questions 1 and 3 deserve brief consideration. First, as shown in previous sections of this paper, the distribution of corporate taxpayers is extremely uneven in New Mexico. It is thus quite possible that the DWS formula could, via causing only a few large plant locations, produce long-run tax revenue increases that exceed associated short-run tax losses. Yet this event would be somewhat unusual. The most optimistic of observers conclude the long-run elasticity of business activity with respect to state and local taxes is less than one.²⁴ Hence, a tax reduction of, for example, 10 percent is likely to increase long-run business activity by substantially less than 10 percent. Secondly, a number of other policies are available to New Mexico lawmakers which may be expected to achieve economic development objectives similar to those likely from use of a DWS formula. These policies are discussed briefly in the following section.

Summary and Conclusions

A change to a destination-based double-weighted sales factor apportionment formula would tend to shift the burden of paying New Mexico corporate income taxes away from firms in the mineral extractive and manufacturing sectors, and increase the burden faced by firms in retail trade. Although some of the state's largest taxpayers are in the manufacturing and mineral extractive sectors, some of New Mexico's most consistent taxpayers — i.e., firms whose tax bills display little variation from year to year — are, in fact, in the retail sector. Hence, by adopting the DWS proposal, the state would effectively shift the corporate income tax burden slightly to a more stable revenue source.

Results of the present study suggest New Mexico would experience an approximate five-percent loss in corporate income tax revenues if it mandated a DWS factor formula for all industries. An approximate eight-percent corporate income tax reduction would probably result from allowing all firms the option of using DWS apportionment procedures.

The present study provides little information regarding how long-term revenues from all tax sources would change as a result of a DWS apportionment formula. It seems apparent, however, that major impetus for adopting a DWS formula would stem from a desire to stimulate economic development,

²⁴See Bartik, p. 43. Bartik is among the most optimistic of public finance economists regarding effects of taxes and similar policies on regional economic development.

particularly by attracting manufacturing firms. Hence, another policy option that lawmakers may wish to consider is a DWS formula limited to firms in the manufacturing sector. This procedure would produce an approximate two-percent short-term revenue loss if made mandatory for manufacturers, and an approximate 2.9-percent loss in corporate revenues if made optional for manufacturing firms. A major limitation of these types of policies, however, is that they simply are not well targeted; they tend to produce tax breaks for businesses that do not expand plants in New Mexico. Among alternative policies worthy of consideration are (1) extending New Mexico's investment tax credit provisions to corporate income tax obligations, (2) limiting DWS apportionment to new plant expansions, or attaching other conditions to use of the formula, for example job creation requirements, (3) reducing corporate income tax rates slightly while imposing an alternate minimum corporate income tax, and (4) other variations on the apportionment formula, for example, a scheme that reduces the weight applied to the payroll factor, while slightly increasing weights applied to the property and sales factors. In any case, the New Mexico legislature enacted the corporate income tax in 1933, and has modified it in many ways since that time. There is nothing particularly sacred about an SWS apportionment formula. Perhaps it is time for another major change in the system. →

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Technical Notes

1. Limits to percent change in tax obligations under DWS. As stated in the text, the maximum percent increase in tax obligations is 50 percent, while the maximum decrease is 25 percent, assuming all three factors are present. This follows from the nature of maximum change in weights applied to sales,

property, and payroll factors under the formula switch. In actual practice these limits are, in fact, often approached due to the nature of the population of apportionment factors. To understand the limits, consider the following equation portraying the difference in "average percentage" resulting from the formula change. Let SWS represent the "average percentage" under the double-weighted formula, and DWS represent the "average percentage" under the DWS factor formula. Then

$$\begin{aligned} \text{SWS} = \\ 1/3 \times \text{payroll factor} + 1/3 \times \text{property factor} + 1/3 \times \text{sales factor,} \\ \text{and} \end{aligned}$$

$$\begin{aligned} \text{DWS} = \\ 1/4 \times \text{payroll factor} + 1/4 \times \text{property factor} + 1/2 \times \text{sales factor.} \end{aligned}$$

Assume a firm has a very large sales factor — say one, but small payroll and property factors which are near zero. The firm will experience an increase in its average percentage figure. The increase is constrained by the size of the weight applied to the sales factor. The maximum increase in the weight will be .167, or 25 percent greater than the original 1/3: $.5 - .3333 = .1667$, and $.1667/.3333 = .500150$, or 50 percent. Next, consider the fate of a firm that has a sales factor of approximately zero, but has property and payroll factors that each equal one. The firm will experience a tax reduction limited to 25 percent, using reasoning similar to the previous case. The major difference is, however, that changes in weights applied to the property and payroll factors set the limits: $.3333 - .2500 = .0833$, and $.0833/.3333 = .2499$, or 25 percent. It is therefore changes in the weights coupled relative differences in the factors that combine with the weight shifts to determine the percent change in tax obligations experienced by any particular firm. This approach, incidentally, may be readily adapted to determine limits to tax increases imposed by various other combinations of weights — for example, a formula that weights the property, payroll, and sales factors .3, .3, and .4 respectively.

In practice, factors range from very small numbers — for example .00008 — to one. Thus, a firm with property and payroll factors of, say .0008 and .0007, coupled with a sales factor of .05 will in fact approach the 25-percent change in tax obligations when the apportionment formula changes from DWS to SWS. This particular example is not unrealistic; a number of similar ones occurred in simulations conducted in the present study. To demonstrate these effects, two cases are illustrated below. In both illustrations, a firm is assumed to initially possess property, payroll, and sales factors that are all equal to .05. In the first case, the sales factor is allowed to decline in 10 stages to .000049. Percent changes in the "average percent" variable as defined in New Mexico corporate income tax forms are calculated for each of the 10 sales-factor figures. Resulting percentage changes in the "average percentage" figures are shown in the final column of Table TN1. In the final simulation — shown in the bottom row of Table TN2 — the payroll, property, and sales factors are .05, .05, and .000049 respectively, with a resulting percent change in the average percent figure that is slightly under 25. Thus, as the sales factor becomes extremely small relative to the property and payroll factors, the percent change in the "average percent" factor under DWS approaches negative 25.

2. Expected outcomes of 500-unit sample simulations. On the basis of several fairly reasonable assumptions, one

would expect the DWS proposal to produce a net gain in New Mexico corporate income tax revenues. Assume, for example, the distributions of obligations and factors are random and unrelated in any systematic way. The number of firms gaining from the proposal would, under such conditions, approximately equal the number of firms experiencing a tax increase. Averages for sales, property, and payroll factors would be expected to be similar, and the DWS proposal would be expected to be a net revenue gainer for the state. This is true because, as mentioned above, the maximum increase of 50 percent for firms receiving a tax increase exceeds the maximum 25-percent tax reduction for those firms whose tax obligations would decline. Hence, the average increase will, with a reasonably large sample, exceed the average percent tax reduction. As is indicated in Exhibit 5 in the text, averages of sales, payroll, and property factors in the sample population are, in fact, remarkably similar. The average of the payroll and property factors (.1124) is within three percent of the average sales

factor. Yet the nature of New Mexico's corporate income-tax-paying population violates several assumptions stated above — namely the requirement that the number of gainers equals the number of losers, and that gain or loss is unrelated to the size of tax obligation. A number of factors may be responsible for this, including (1) few corporate headquarters exist in New Mexico, hence, sales and payroll factors are probably less than in-state sales warrant, and (2) New Mexico wages are lower than the national average, hence, corporate payroll factors, particularly among firms engaging in substantial exporting, tend to be less than sales factors. As a result, even though the number of firms likely to experience tax increases substantially exceeds the number of firms that would benefit from the DWS proposal, the DWS formula would, according to tests performed on the sample population, produce a slight loss in New Mexico corporate income taxes. This result is not unreasonable in light of the fact that resource endowments among American states are not randomly and evenly distributed. ☆

Table TN1: Maximum Percent Increases in Average Percentage* as Property and Payroll Factors Decline

Property Factor	Payroll Factor	Sales Factor	Average Percent		Percent Change
			SWS	DWS	
0.050000	0.050000	0.05	0.050000	0.050000	0.00
0.025000	0.025000	0.05	0.033333	0.037500	12.50
0.012500	0.012500	0.05	0.025000	0.031250	25.00
0.006250	0.006250	0.05	0.020833	0.028125	35.00
0.003125	0.003125	0.05	0.018750	0.026563	41.67
0.001563	0.001563	0.05	0.017708	0.025781	45.59
0.000781	0.000781	0.05	0.017188	0.025391	47.73
0.000391	0.000391	0.05	0.016927	0.025195	48.85
0.000195	0.000195	0.05	0.016797	0.025098	49.42
0.000098	0.000098	0.05	0.016732	0.025049	49.71
0.000049	0.000049	0.05	0.016699	0.025024	49.85

**Average percentage* as defined on the NM tax form and in the text.

Table TN2: Maximum Percent Increases in Average Percentage* as Sales Factor Declines

Property Factor	Payroll Factor	Sales Factor	Average Percent		Percent Change
			SWS	DWS	
0.05	0.05	0.050000	0.050000	0.050000	0.00
0.05	0.05	0.025000	0.041667	0.037500	-10.00
0.05	0.05	0.012500	0.037500	0.031250	-16.67
0.05	0.05	0.006250	0.035417	0.028125	-20.59
0.05	0.05	0.003125	0.034375	0.026563	-22.73
0.05	0.05	0.001563	0.033854	0.025781	-23.85
0.05	0.05	0.000781	0.033594	0.025391	-24.42
0.05	0.05	0.000391	0.033464	0.025195	-24.71
0.05	0.05	0.000195	0.033398	0.025098	-24.85
0.05	0.05	0.000098	0.033366	0.025049	-24.93
0.05	0.05	0.000049	0.033350	0.025024	-24.96

**Average percentage* as defined on the NM tax form and in the text.

Appendix: Tax Obligation Changes Under DWS — 500-Unit Sample Arrayed in Ascending Order								
(1,483,434)	(1,927)	(142)	0	16	410	1,524	3,676	19,601
776,819	(1,893)	(138)	0	20	419	1,529	3,834	21,445
(733,130)	(1,728)	(138)	0	21	425	1,542	3,895	21,638
(517,375)	(1,722)	(135)	0	37	461	1,562	3,905	23,399
(130,168)	(1,715)	(116)	0	40	470	1,564	3,939	26,600
(130,152)	(1,641)	(111)	0	43	482	1,574	3,943	27,030
(118,050)	(1,626)	(104)	0	46	489	1,591	4,003	28,914
(112,970)	(1,583)	(96)	0	56	501	1,612	4,049	34,412
(53,875)	(1,546)	(94)	0	60	521	1,613	4,125	37,824
(44,274)	(1,510)	(93)	0	75	558	1,638	4,153	40,352
(41,759)	(1,500)	(86)	0	77	576	1,682	4,242	44,191
(24,100)	(1,499)	(79)	0	79	600	1,700	4,340	49,801
(23,841)	(1,454)	(78)	0	90	639	1,704	4,786	51,020
(23,744)	(1,431)	(71)	0	95	640	1,731	4,808	66,287
(23,719)	(1,399)	(67)	0	96	645	1,791	4,970	81,687
(20,716)	(1,394)	(49)	0	101	654	1,816	5,003	93,700
(20,185)	(1,390)	(48)	0	108	721	1,884	5,313	138,192
(19,221)	(1,278)	(41)	0	113	743	1,914	5,410	139,926
(19,101)	(1,266)	(37)	0	114	746	1,963	5,410	167,617
(17,782)	(1,210)	(32)	0	116	748	1,984	5,422	205,480
(17,606)	(1,085)	(26)	0	117	769	2,030	5,548	
(17,446)	(1,075)	(18)	0	138	799	2,030	6,026	
(16,782)	(1,054)	(6)	0	148	816	2,043	6,042	
(15,744)	(985)	0	0	151	831	2,051	6,060	
(15,492)	(955)	0	0	155	850	2,058	6,335	
(14,490)	(914)	0	0	157	853	2,086	6,662	
(14,387)	(851)	0	0	161	865	2,138	6,688	
(11,226)	(830)	0	0	162	884	2,140	6,732	
(10,860)	(780)	0	0	164	889	2,157	7,102	
(10,103)	(722)	0	0	168	907	2,162	7,167	
(9,623)	(641)	0	0	198	907	2,197	7,183	
(9,416)	(637)	0	0	206	928	2,298	7,442	
(8,245)	(523)	0	0	207	947	2,355	7,895	
(7,751)	(500)	0	0	214	957	2,397	8,039	
(7,177)	(488)	0	0	220	983	2,400	8,150	
(5,489)	(483)	0	0	221	999	2,511	8,394	
(4,892)	(447)	0	0	228	1,003	2,542	9,785	
(4,628)	(410)	0	0	228	1,026	2,605	9,952	
(4,361)	(397)	0	0	229	1,050	2,652	9,997	
(4,236)	(345)	0	0	264	1,065	2,660	10,135	
(4,206)	(338)	0	0	278	1,103	2,865	10,812	
(4,160)	(336)	0	0	279	1,105	2,918	11,167	
(4,058)	(319)	0	0	285	1,165	2,938	11,246	
(4,021)	(312)	0	0	292	1,201	3,027	11,604	
(3,915)	(311)	0	0	295	1,220	3,045	12,259	
(3,836)	(307)	0	0	306	1,261	3,066	12,766	
(3,818)	(302)	0	0	309	1,285	3,109	13,097	
(3,362)	(300)	0	0	319	1,285	3,217	13,958	
(3,154)	(299)	0	0	324	1,325	3,330	14,873	
(2,872)	(288)	0	0	329	1,333	3,336	15,264	
(2,805)	(269)	0	0	335	1,362	3,378	16,617	
(2,753)	(268)	0	0	344	1,377	3,383	16,791	
(2,613)	(242)	0	0	354	1,391	3,402	16,826	
(2,476)	(232)	0	0	369	1,404	3,455	17,334	
(2,433)	(228)	0	0	370	1,420	3,495	17,389	
(2,392)	(221)	0	0	383	1,431	3,542	17,483	
(2,169)	(216)	0	0	390	1,439	3,568	17,828	
(2,158)	(198)	0	0	395	1,443	3,593	18,554	
(2,108)	(189)	0	6	397	1,491	3,621	18,685	
(1,994)	(159)	0	7	406	1,495	3,663	18,691	

Note: values in parentheses reflect tax reductions; other (nonzero) values indicate tax increases.

