Blue Ribbon Tax Reform Commission

Pyramiding in & Around Gross Receipts Tax

By James P. O'Neill
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(1) "**DOUBLE TAXATION" VS "PYRAMIDING"**: there is a difference.

Double taxation: either multiple taxes imposed by same government on a single activity, product or transaction or same tax imposed by more than one government on the same activity, product or transaction.

Examples

Double taxation is not necessarily economically inefficient or non-neutral.

Pyramiding: Imposition of tax by one or more governments on successive stages of an activity or series of transactions.

Examples

Pyramiding always introduces economic inefficiencies and will be non-neutral at least as far as forms of production and marketing organization are concerned.

(2) **PYRAMIDING WITHIN THE GROSS RECEIPTS TAX SYSTEM**. About 15 years ago, the Taxation and Revenue Department estimated that about one-third of the gross receipts tax base consisted of business-to-business transactions. The economy has grown and changed since then. The gross receipts tax has been modified over that time too but not substantially. The inter-business proportion may be a little higher now but let's assume that one-third is still a reasonable approximation. The gross receipts tax collects about $2.1 billion dollars annually now for the state and its local governments. Therefore roughly $700,000,000 comes in from pyramiding.

Given the basic design principles underlying the gross receipts tax, it is hardly surprising that pyramiding rakes in this much. This outline means to help focus attention on pyramiding while breaking the issue into manageable chunks.

It would be extremely useful to have revenue estimates for each of these components. The gross receipts system, however, does not require its taxpayers to segregate sales to businesses, governments or households. It asks only for a crude sorting by the type of business that the taxpayer is in. Data therefore are simply not available for some of these categories and can produce only total taxable receipts for some of the others. A copy of the CRS-1 form (on which gross receipts tax information is reported) is displayed below. Except for information obtained through audit, the Taxation and Revenue Department collects no other data on the make up of the transactions engaged in by the taxpayer.

back of CRS-1 form

A Municipality / County Name		B Location Code	C Gross Receipts (Excluding Tax)	D Total Deductions	E Taxable Gross Receipts	F Tax Rate	G Gross Receipts Tax
TOTAL COLUMNS C, D and G.			$	$			

TOTAL GROSS RECEIPTS TAX	1	
COMPENSATING TAX	2	
WITHHOLDING TAX	3	
TOTAL TAX DUE	4	
PENALTY	5	
INTEREST	6	
TOTAL AMOUNT DUE	7	

Payment made by: ❑ **Automated Clearinghouse Deposit** **Date** ______________

❑ **Federal Wire Transfer** **Date** ______________

Check if applicable: ❑ **Amended Report**

TAXPERIOD Month Day Year through Month Day Year

NM CRS ID No. ______________________________ Phone No. ______________

I declare that I have examined this return including any accompanying schedules and statements, and to the best of my knowledge and belief, it is true, correct and complete.

Signature of Taxpayer or Agent ______________________________ Title ______________ Date ______________

Careful sifting through national data or other state sources could refine the estimates more or less reliably for some categories but not all of them. I simply did not have time to do any of that. Numbers presented are in millions of dollars and indicate *total estimated tax due* for all transactions, not just sales to business. They are taken from the "Analysis of Gross Receipts Tax by Standard Industrial Classification, Annual Summary, … Period Ending December 31, 2001", Taxation and Revenue Department.

A. The sale-for re-sale deductions (§§ 7-9-46 through 7-9-51, 7-9-52, 7-9-71, 7-9-73, 7-9-74 and 7-9-75 NMSA 1978) are intended to eliminate pyramiding on goods and services that move through the stream of commerce to ultimate consumers (who may be businesses). Generally the buyer simply must indicate that the purchase is for re-sale to receive a 100% deduction.

Problem: §7-9-48 NMSA 1978, the deduction for receipts from the **sale of a service for re-sale** imposes an additional condition. The buyer's subsequent sale (the re-sale) must also be subject to either the gross receipts tax or the governmental gross receipts tax. When the buyer's re-sale is either an export or a sale to another person for further re-sale, receipts from the transaction are deductible. That is, they are not subject to the gross receipts tax or governmental gross receipts tax. So our poor buyer cannot give the required signal to its vendor that the vendor may take a deduction. According, the vendor will tack on a charge for gross receipts tax.

This on and off pattern affects any industry with long chains of service providers, such as defense R&D. It not only makes compliance difficult but it is hard to discern any rationale for this added requirement. The only creditable explanation for not having got rid of it by now is uncertainty about the size of the fiscal impact when the deduction was first crafted—in the 1960s.

B. **Services sold to businesses**. State governments in other states envy New Mexico's gross receipts tax base because it reaches services. For the same reason businesses (unfairly) impute an anti-business bias. Given that the service sector is, and has been for many years, growing faster than the goods producing and selling sectors, it really is short-sighted tax policy to fail to tax services. If the tax system is to deliver revenues adequate to fund public spending, then taxes ought to grow with the economy. Further, no theoretical reason favors household consumption of services over consumption of goods.

Problem: A main driver of the growth in the service sector is expansion of business-to-business services. The basic design of the gross receipts tax and the flaw in the deduction for the sale of services for re-sale (discussed above) combine to force business to absorb a lot of passed-on gross receipts tax that competitors in most other states do not face. A sampling of taxed business-to-business transactions follows.

Remember, the numbers shown are estimated taxes all sales, not just business-to-business sales.

Construction services: When the end product is sold to business, the gross receipts tax becomes an overhead expense for the buyer. Gross receipts tax is due on completed construction even when the project is funded by industrial revenue bonds. (Construction is one of the islands of sanity in which subcontractor services are deductible no matter how long the chain of subcontractors.)	$278.6
Telecommunications: Like the other utilities, telecommunications businesses are favorite targets for tax because they are virtual necessities and make efficient collectors of tax. In small communities, the utilities together may provide half or more of the tax base.	
Gross receipts tax	40.5
Interstate telecommunications tax	7.5
Financial, insurance and real estate: these infrastructure service businesses supply services to all other businesses.	45.2
Transportation:	
Motor vehicle passenger and freight transportation, including warehousing and related services	11.9
Railroad, air and pipeline	1.0
Commercial R&D	63.3
Professional services:	
Legal	30.4
Physicians, dentists and others	54.5
Engineering and architectural	22.7

C. **Property sold to businesses**. While it is true that the pyramiding of tax on goods moving through the supply chain is eliminated for all practical purposes, a lot of sales are to businesses as the final consumer. Businesses consume everything from manufacturing equipment to vehicles and computers to janitorial supplies.

Manufacturing equipment: New Mexico is one of the few states to tax manufacturing equipment. That gave rise to the Investment Credit to offset the disincentive for locating or expanding in New Mexico. Unfortunately, the tax records do not neatly distinguish such equipment from other types but 3 categories of machinery and equipment combine to 26.8

Utilities:

Electric, water and sanitary sewer	90.9
Gas	23.7

Computers, furniture, tools, supplies: While this undoubtedly is significant, this cannot be estimated with any reliability from the gross receipts data ???

Intangible property: Payments for franchises, patents, copyrights, trademarks and licenses are probably mostly inter-business but no data is available. ???

(3) **INTERACTION BETWEEN THE GROSS RECEIPTS TAX AND OTHER TAXES.**

A. **In lieu of taxes**: Some businesses pay a special excise tax in lieu of the gross receipts tax. Examples are insurance and HMOs (premiums tax) and legalized gambling (gaming tax, parimutuel tax). Some services cross over this tax divide and may incur more than one tax as a result. For example, HMOs are subject to the 3% premiums tax, and not the 5%+ gross receipts ax, on their receipts from providing health care services to their members. Often the HMO contracts with physicians to provide those services. The physician's receipts are subject to the gross receipts tax. Because of the requirement in §7-9-48 that the buyer's sale of the service be subject either to the gross receipts tax or the governmental gross receipts tax, the HMO may not execute and the physician may not accept a nontaxable transaction certificate to cover the HMO's purchase of the physician's service. So, two taxes would be due.

B. **Special excise taxes**: New Mexico levies special excise taxes on several defined products. Cigarettes, tobacco products, alcoholic beverages and motor fuels. All but the latter are also subject to the gross receipts tax on sale to the final consumer. Because of the nature of the "sin" products, the additional taxation may well be justified on health and other grounds.