The Streamlined Sales and Use Tax Agreement
and
New Mexico's Gross Receipts and Compensating Taxes

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This document sketches a comparison between the "uniform" provisions contained in the Streamlined Sales and Use Tax Agreement (adopted November 12, 2002) and the provision of New Mexico's Gross Receipts and Compensating Tax Act, local-option gross receipts taxes and Tax Administration Act. The idea is to highlight differences. If New Mexico decides to become an implementing state, it will have to deal with the differences by legislative or administrative action.

The blow-by-blow comparison is set out in Appendix A. Here let's look at the more important differences.

<u>Sales tax versus New Mexico's gross receipts tax</u>

The signatories to the Agreement are "sales tax" states. Their tax laws impose sales tax on the customer for the privilege of buying or consuming; vendors have an obligation to collect the tax due on each transaction from the customer and remit the amount to the state. Since the customer is the taxpayer, it is the customer's location that is central for determining applicable tax rates. Each state also has a companion tax, called a use or compensating tax. This is also levied on the customer, usually for the privilege of consuming goods bought from out-of-state sellers. The whole design of the Agreement is predicated on this arrangement.

New Mexico's compensating tax is just like the use or compensating tax in the signatory states. Its gross receipts tax, however, is a tax levied directly on the seller for the privilege of engaging in business. Whether or how the cost of this tax gets passed to the customer is not a concern of the state's. Since the business is the taxpayer, it is the business's location that is of primary importance in determining applicable tax rates.

Because of these fundamental differences, New Mexico's gross receipts tax operates in ways diametrically contrary to the assumptions of the Agreement's design. There are serious consequences.

a. States may not tax the federal government. Therefore sales to the federal government (who would be the taxpayer in sales tax states) may not be taxed. New Mexico collects tens of millions of dollars annually from its gross receipts tax on receipts of the federal government's vendors that it could not collect under a straight sales tax regime.

b. A change from applying tax at the seller's location to the buyer's could mean substantial changes in local tax bases, even if nothing significant occurs to the state's base.

Less critical issues emerge also and will have to be dealt with. For example, if businesses are performing the service of collecting and remitting taxes actually owed by customers, does the state owe those businesses a reimbursement for the expense they bear? Most states pay by offering a discount on the tax amount to be remitted. Would such a reimbursement be considered payment for a taxable service?

The tax base

The Agreement requires that local tax bases be identical to the state's. Fortunately this condition is nearly met in New Mexico. The only difference–that of excluding application of local option taxes on some transportation services–has no justification even under the current system. TRD has tried once or twice already to eliminate this anomaly.

The Agreement actually specifies few groups of related consumer goods, although more groupings are being developed. Initially these are the categories: clothing, computer-related products, food and health care products. These are all hot-button topics in virtually all the states. All items within a group must be treated the same way: either all taxed or all exempt. New Mexico has some problems here. New Mexico exempts prescription drugs but taxes everything else in the health care products group. Although all the items in the food group are taxed at present, strong efforts are being made effectively to cut the rate to the sum of the local rates. If a uniform local rate could be applied to food items, this might survive because, in a weak moment, the Agreement currently allows for a special differential rate on food.

Single uniform rate

The Agreement mandates that there be one single tax rate for the entire state. In addition, the compensating/use tax rate must equal the gross receipts/sales tax rate. New Mexico's patchwork of local taxes will have to be applied uniformly somehow. Municipalities and counties do not share the same taxing authority. Further, many county local option taxes are authorized for only one or a few counties. Local governments do not have authority to levy compensating tax; either the state has to absorb this gap or it needs to grant authority to the local governments.

Note: Separate rates may be applied to electricity, piped natural gas or other heating fuels, motor vehicles, aircraft, watercraft, modular homes and manufactured homes. New Mexico has separate rates for motor vehicles and aircraft. Watercraft are taxed at the same state rate but may be considered separate because the local option rates do not apply.

Administrative provisions

The Agreement is supposed to make it easier for taxpayers to register, report and pay. This entails much greater uniformity among state administrative procedures than has ever been contemplated previously. The Agreement anticipates much greater deployment and reliance on electronic data management to meet these goals. New Mexico, like many states, meets few of the Agreement's targets. Many of those aims, however, align with goals New Mexico has set for itself.

On-line registration is required. Registration of a multistate taxpayer with any signatory state will count as registration with all. Hence there either has to be a common registration database or extensive linkages among the separate state databases. Taxpayers must be enabled to report and pay electronically. Procedures for claiming deductions/exemptions are to become uniform and electronically accessible.

Tax jurisdiction rates and boundaries have to be entered into an accessible database. It is expected that this will be done by aligning tax jurisdiction borders with ZIP code boundaries. Eventually the state must be able to describe its tax base as a matrix of taxable and nontaxable items.

The Agreement anticipates that each member state use a common format for the tax return (for ease in electronic filing). It also envisions a common transaction exemption form, which is also to be primarily electronic. These are further down the road because they are to be developed by the Governing Board, which of course does not now exist.

The refund process is quite different. The Agreement directs taxpayers to look first to the seller for refund of overpaid tax, not to the state. It also anticipates emergence of intermediaries who will process and remit taxes on behalf of sellers; these intermediaries do not operate in New Mexico at present (unless as agents of the vendors).

A caution

Although a Governing Board is provided for, the Agreement does not arm it with disciplinary powers. If member states want to bend or break a rule or two, there appears to be no formal mechanism for forcing compliance with the Agreement once a state is accepted as a member. [State of Washington adopted a version of the Agreement that does not accept the Agreement's transaction sourcing rules.] This is the same flaw present in the Multistate Tax Compact (governing the allocation and apportionment of income among states). Almost every member of the Multistate Tax Compact (including New Mexico) violates the Compact's requirement that income be apportioned based on equally-weighted property, payroll and sales factors. Other than wringing its collective hands, the Compact's board has done nothing to stop members from adopting numerous variations.

The game plan of the states, once a sufficient number have signed on, is to ask Congress to require remote vendors selling into the member states to remit compensating/use tax on those sales. Business might have reason to ask Congress to require the Compact be amended to provide appropriate disciplinary tools.

Will the Agreement come into force?

Under its own terms, the Agreement triggers once at least ten states have adopted the Agreement and amended their own tax laws to conform. The adopting states must represent at least 20% of the population in the states imposing a general excise tax. There are 45 such states.

Since January, seven states (Arkansas, Indiana, Kentucky, North Dakota, South Dakota, Utah and West Virginia) have enacted the necessary legislation. The State of Washington also took the plunge but did not adopt the Agreement's tax sourcing rules. Legislatures are still meeting in several states, with live streamlining bills. Passage by the minimum number of states is likely to occur this year or in the first half of 2004. The current fiscal crisis in many states provides a strong spur.

Because of the nature of the Agreement, however, Congressional approval must be obtained as well.