Blue Ribbon Tax Reform Commission
Equity Committee

List of Recommended Options
August 29, 2003

Preface: The Equity Committee's main task was to identify situations in which taxpayers in roughly similar circumstances are treated differently for tax purposes. Mindful of the Commission's tentative recommendation that New Mexico join the Streamlined Sales Tax Project, we also identified gross receipts and compensating tax provisions that do not meet streamlined sales tax requirements.

The Equity Committee reviewed all of the exemptions and deductions in the Gross Receipts and Compensating Tax Act. It also examined the Leased Vehicle Gross Receipts Tax Act, the Interstate Telecommunications Gross Receipts Tax Act, the two privilege taxes on promoting certain professional athletic contests and the several local-option gross receipts taxes. The Committee took note of the tax rates imposed under the Motor Vehicle Excise Tax Act and the Insurance Code (premiums tax). These taxes in sum form the largest pillar of support for the state General Fund and the general funds of the municipalities.

We believe this concentration is appropriate. The gross receipts tax has a famously broad coverage, affecting almost all businesses in the state. Thus it is most likely that any inequitable treatment would show up in the gross receipts family of taxes.

The Committee determined that most of the exemptions and deductions are proper implementations of the general design of the tax. Hence the Committee recommends that the exemptions and deductions not identified below should remain in place.

The Committee did find areas in which equity considerations suggest that a change should be discussed. These are itemized below.

If a revenue impact has been calculated for an option, it is entered in brackets at the end of the option's description. Otherwise "[Not available]" is indicated. Impacts are in millions of dollars.

<u>Gross receipts tax issues</u>:

(1) Agriculture (including farming and ranching) is an industry. Most industries in New Mexico are subject to registration for gross receipts tax or other taxes on their activities and outputs. Basic agricultural transactions, in contrast, are exempt from gross receipts taxes, meaning that this industry is not subject to the same registration and proof of nontaxability rules as is the typical industry. Also, some testimony indicated that some

suppliers to agriculture routinely sell products to persons not in agriculture but do not pay gross receipts tax on the receipts.
Alternatives:
(a) Take no action
(b) Design a new NTTC (or, better, modify an existing one) to be issued to agricultural businesses upon submission by that business of its Schedule F for the most recent tax year. Require submission of this NTTC in deductions at §7-9-58(agricultural tangible inputs) and §7-9-59 (agricultural service inputs). Allow annual reporting for these businesses. [Not available]

(2) Different types of vehicles are taxed at different levels. Motor vehicles are taxed at 3%, boats at 5% and non-registered aircraft and off-road vehicles are taxed at one-half the total local gross receipts tax rate (i.e., from 2.625% to 3.625%, depending on dealer's location). The streamlined sales tax rules do not permit partial deductions.
Alternatives:
(a) Retain registration requirements for boats and motor vehicles but repeal separate taxes and gross receipts exemptions and repeal 50% deduction at 7-9-62 for aircraft and off-road vehicles [Taxing boats and motor vehicles under gross receipts, $27 for state GF, $99 for locals; repealing deduction, $5 State GF + $4 locals]
(b) Create a separate tax levying the same rate of tax for vehicles, boats, off-road vehicles and non-registered airplanes. [Not available]

(3) Research and development services sold to a particular non-profit organization for sale or resale to the US Air Force are deductible. No sales to other Department of Defense entities or other federal agencies or to state, tribal or local governments or private entities are similarly deductible.
Alternatives:
(a) Take no action
(b) Repeal §7-9-54.1 [Not available]

(4) §7-9-57.2 provides a deduction to software development businesses who locate outside municipalities of 40,000 or more. No other business receives similar treatment in the gross receipts tax. Further, because this economic development incentive is buried within the normal reporting mechanism, its costs will not be discernible.
Alternatives:
(a) Take no action
(b) Convert the deduction into a credit that must be applied for, like most of the other gross receipts tax-based incentives. [Not available but probably close to zero]

(5) §7-9-62 provides a deduction of 50% on sales of agricultural implements to agricultural enterprises. No similar deduction is provided for the equipment or machinery used by other industries.

Alternatives:

(a) Repeal the deduction [$5 to state GF; $4 to locals]

(b) Add agriculture equipment to the tax base suggested in #2(b)

(6) Newspapers and magazines are taxed differently from each other but both get more favorable treatment than other manufacturers.

Alternatives:

(a) Take no action

(b) Repeal §7-9-64, the deduction for selling newspapers at retail [$2 state GF; $1 to locals]

(7) §7-9-70 provides a deduction for receipts from leasing vehicles to be used for transporting passengers or freight for hire in interstate commerce under regulations or authorization of any US agency. Deduction does not apply to rental or leasing of vehicles for in-state movements. Since the abolition of the Interstate Commerce Commission, no federal agency regulates the economic side (tariffs, routes, etc.) of bus or truck transportation. The US Department of Transportation continues to regulate hours of work, driver standards, vehicle and safety standards and the like but that does not seem to fit the type of regulation that would inspire the need for this deduction. Almost all of the DOT/FHSA regulations on interstate traffic apply to in-state movements as well.

Alternatives:

(a) Take no action

(b) Repeal the deduction [May be zero]

(8) §7-9-74 exists to allow Native American manufacturers of jewelry who reside and conduct business on their own reservation or pueblo grant (and who therefore are not required to register for gross receipts tax purposes) to acquire raw materials without paying passed-on gross receipts tax and without having to execute NTTCs (which they cannot get because they are not registered). The $5,000 limit appears arbitrary. If the object is to protect or encourage tribal enterprise, the presence of any limit seems counter-productive. Also, it has been suggested that the limit on this deduction has not been rigorously enforced. Streamlined sales tax rules bar such dollar limitations.

Alternatives:

(a) Take no action

(b) Remove the $5,000 limit [Close to zero]

(9) The deduction at §7-9-55 (Subsections A and B) for receipts from transactions in interstate commerce actually offers little guidance as to what is deductible. Translated it says such receipts are taxable unless the federal government says they are not. Most states follow a delivery rule: if it is delivered to the buyer out-of-state, it is exported and deductible. New Mexico in contrast requires not only that the good be delivered out-of-state but also that title and risk of loss pass to the buyer out-of-state. (See regulation 3.2.213.12 NMAC.) Training counter clerks in the subtleties of this rule is difficult;

determining whether a particular transaction met the rule upon audit years after the fact can be impossible. At least some businesses in practice follow the delivery rule now.
Alternatives:

(a) Take no action

(b) Replace Subsections A and B of §7-9-55 with a "delivery rule" like other states [(Not available, perhaps unknowable)]

(10) §7-9-65 grants a series of deductions for use of chemicals and reagents by oil, natural gas and mining companies. One refers to chemicals sold in 18-ton lots (i.e., a carload). The streamlined sales tax rules bar quantity limitations.
Alternatives:

(a) Take no action

(b) Re-write the language to retain the deduction without the quantity specification [No fiscal impact]

(11) One issue wrestled with but without arriving at any generally satisfactory answer was whether to continue the favorable tax treatment afforded non-profit entities. (One part of this question, how to deal with nonprofit and for-profits hospitals was split off and dealt with separately.) In general, receipts of organizations determined by the Internal Revenue Service to qualify for nonprofit status under IRC §501(c)(3) and of some under §501(c)(6) are exempt from gross receipts tax, except for receipts identified as "unrelated business income". Other nonprofit organizations enjoy other exemptions, which may in some cases cover the organization's entire receipts. Receipts of certain facilities for retired elderly people are exempt, as are dues and registration fees of a wide range of nonprofits.

When these entities sell goods and services, however, they are competing with business. This may be especially true when the nonprofits provide services under contracts with governments. The level or seriousness of the competition can vary considerably by industry. On one hand, businesses in the health and fitness industry in the recent past have sought legislative action directed against their nonprofit competitors. On the other, few grocers, if any, have voiced concern about Girl Scout cookie sales.

The most visible example is the disparate treatment afforded our two major national laboratories. Los Alamos National Laboratory is operated by a 501(c)(3) organization. Sandia National Laboratory is operated by a for-profit business. LANL's receipts are exempt; SNL's generally are taxable. The major client for both is the US Department of Energy. The present tax scheme certainly puts for-profit entities at a disadvantage when competing for the operator contracts.

The generic reason for exempting nonprofits organizations is that they should be treated like governments regardless of the competitive situation with business because they perform functions that the government might otherwise be required to take up. For many years of course the state exempted itself and its parts from gross receipts taxation except

for receipts from operating certain utilities. The Committee noted that this general exemption disappeared in 1991. The state, via the governmental gross receipts tax, taxes itself and a number of its agencies, instrumentalities and political subdivisions on receipts from sales of tangible personal property and a short list of services, including athletic, entertainment and recreational services and events.
Alternatives:
(a) Take no action
(b) Remove the exemption for commercial receipts of 501(c)(3) and 501(c)(6) entities [$86 to state GF; $58 to locals]
(c) Tax 501(c)(3) and 501(c)(6) organizations under a separate tax at a rate lower than 5% [$20 - $25 per 1%, to state GF]

<u>Compensating tax issues</u>:

(12) Although municipalities and counties have been granted authority to impose local-option add-on gross receipts taxes, they have never been allowed to impose similar local-option compensating taxes. The main purpose of the compensating tax is to protect in-state merchants from lower-taxed competition from out-of-state merchants. The compensating tax is also used to recover the amount of gross receipts that should have been paid when a deduction is mis-used. Both reasons seem to apply equally well to the local-option gross receipts taxes as to the state gross receipts tax. In addition, the streamlined sales tax concept (should Congress bless collection from remote sellers) will actually be a matter of collecting compensating tax, not gross receipts tax (at least as that tax is currently structured).
Alternatives:
(a) Take no action
(b) Authorize local option compensating taxes as of a certain date; impose such taxes at the state level for all local option gross receipts taxes already in place at the certain date [($3.5 state); $13 locals]
(c) Authorize local option compensating taxes as of a certain date; require local governments to impose those taxes [($3.5 state); $13 locals]

(13) Compensating tax applies only to imports of tangible personal property. It does not apply to imports of intangible personal property or of services. The gross receipts tax, however, applies to sale or leasing of intangibles as well as to performance of services. If the compensating tax is to perform its role as protecting in-state merchants from untaxed or lower-taxed competition from outside, then it should apply to these other areas as well as to tangible personal property.
Alternatives:
(a) Take no action
(b) Recommend detailed study of possible application of compensating tax to imported intangible property because situs and valuation issues are not straightforward
(c) Apply compensating taxes to imported R&D services when out-of-state vendor has no nexus (or is not compelled to pay tax under streamlined sales tax) [Not available but much smaller than option d]

(d) Apply compensating tax to every imported service when out-of-state vendor has no nexus (or is not compelled to pay tax under streamlined sales tax) [Not available]

(14) §7-9-7.1 was enacted in 1995. Although individuals who purchase merchandise from out-of-state vendors still acquire a compensating tax obligation, this statute bars the Taxation and Revenue Department from taking any action to enforce collection of the tax owed on purchases for household use. Not only does this breed contempt for the law, it denies businesses the same benefit simply because a convenient reporting mechanism exists for businesses but not households.
Alternatives:
(a) Take no action
(b) Repeal §7-9-7.1 [Not available]
(c) Repeal §7-9-7.1 at the time the New Mexico Gross Receipts and Compensating Tax Act is fully conformed to the streamlined sales tax rules [Not available]

(15) The compensating tax was last structured in the 1960s. It was designed to protect against untaxed competition from outside the state. In today's world, untaxed competition can come from in-state sources as well. The compensating tax does not address this condition.
Alternatives:
(a) Take no action
(b) Encourage more rapid entering into of tribal-state tax compacts [Not available]
(c) Amend compensating tax to apply to tangibles purchased on-reservation by non-members for use off-reservation when the transaction is not subject to tribal tax pursuant to a tribal-state compact [Not available]

<u>Other state gross receipts or sales taxes</u>:

(16) The governmental gross receipts tax is imposed upon the state of New Mexico and its agencies, instrumentalities and political subdivisions. First imposed in 1991, it imposes tax only on sales on tangibles and a short list of services. The main idea is to equalize the tax burden when government competes in the market with business. The services taxed are: recreational, athletic or entertainment; refuse collection, refuse disposal, or both; and sewerage. Government could be said to be competing in other services as well.
Alternatives:
(a) Take no action
(b) Place additional services on the list of taxable governmental services, such as: research and development services and parking (including tie-down at airports, docking at marinas, etc.) [Not available]

(17) Two privilege taxes, in addition to the gross receipts tax, are imposed on boxing and wrestling events in New Mexico and on closed-circuit broadcast of such events to locations in New Mexico. Many such events are now held at venues on tribal land. Other athletic or entertainment events are not so taxed. Professional baseball is subject to the stadium surcharge instead of gross receipts tax. Racing events are subject to the pari-mutuel tax instead of gross receipts tax. Basketball and football games of public colleges and universities are subject only to the governmental gross receipts tax; most competing private schools are non-profits and pay no tax.
Alternatives:

(a) Take no action

(b) Change two taxes to fees based on cost of regulating the event and authorize Commission to enter into joint regulatory agreements with tribal governments [Not available]

(c) Exempt activities covered by the two privilege taxes because they are taxed by the two privilege taxes [($3 for state GF and locals)]

(18) Taxation of interstate telecommunications calls originally was handled within the Gross Receipts and Compensating Tax Act. The Federal Communications Commission, however, would not grant automatic pass-through of gross receipts tax rate changes unless the tax were in a separate act applying only to the telecommunications industry. In 1992, the Legislature acceded to this demand of the federal bureaucracy. The rate is set at 4.25% instead of the 5% levied on most other transactions for historical reasons stemming from the break-up of AT&T.
Alternatives:

(a) Take no action

(b) Equalize the rate at 5% [$4 state GF; $2 locals]

<u>Local-option gross receipts taxes</u>:

(19) There are 5 municipal local-option gross receipts taxes and 13 county local-option gross receipts taxes. The county taxes in particular contain a confusing welter of imposition conditions. Further, unlike practice for municipal taxes, only 6 of county taxes may be levied by all counties.
Alternatives:

(a) Take no action

(b) Adopt the simplification proposal entitled “Proposal to Restructure County GRT and County/Municipal Comparison”

<u>Cross-program issues</u>

(20) New Mexico’s taxation of hospitals is fragmented. Hospitals run by governments are exempt from both the gross receipts tax and the governmental gross receipts tax.

Hospitals owned by 501(c)(3) hospitals are exempt from the gross receipts tax. Hospitals organized as HMOs are taxed under the insurance premiums tax on their premiums income. Other for-profit hospitals are subject to gross receipts tax but with a 50% deduction; such hospitals are in the distinct minority.
Alternatives:

(a) Take no action

(b) Expand the deduction at 7-9-73.1(hospitals) to 100% but not to HMOs because the insurance premiums tax is related to bearing of risk, not provision of hospital services [($7 state GF; $5 locals)]

(c) Tax all hospitals at a uniform rate; if the uniform rate is to be less than the full state and local gross receipts tax rate, place under a separate tax act (to meet streamlined sales tax rules) [Not available]

(d) Tax for-profit hospitals under state and local gross receipt tax rate but continue deduction at 7-9-73.1 and add a deduction for uncompensated care [Not available]

(21) The Committee also discussed whether the unbalanced structure of today's tax system might be another source of inequity. New Mexico relies heavily on gross receipts and other excise taxes, which as a group are regressive. Cuts in the personal income tax are being phased in, which also make that tax significantly less progressive. We are one of the states least reliant on the property tax. Overall then New Mexico's taxes are regressive and probably becoming more so. Some argue that this is unfair to people at the lower end of the income scale.

We acknowledge that the system offers rebates to blunt the regressivity generated by this tax structure but a more direct approach may be helpful
Alternatives:

(a) Take no action

(b) Enact a property transfer tax [Not available]

(c) Propose a constitutional amendment increasing the maximum property tax rate imposable by governmental action alone along with an increase in the head-of-household exemption

(22) The gross receipts tax provides a credit of up to 0.5% against municipal local option taxes. The original intent was to reduce the incentive for sprawl since municipal gross receipts tax rates tend to be higher than county rates. There is no equivalent credit for county-imposed local option taxes.
Alternatives:

(a) Take no action

(b) Reduce to municipal credit to 0.25% [about $70 to state GF]

(c) Delete the credit entirely [about $140 to state GF]