F I S C A L   I M P A C T   R E P O R T

SPONSOR: Rawson | DATE TYPED: 03/10/01 | HB

SHORT TITLE: Tax Deduction on Construction Material | SB 637/aSFC

ANALYST: Eaton

REVENUE

Estimated Revenue		Subsequent Years Impact	Recurring or Non-Rec	Fund Affected
FY01	**FY02**			
	<(100.0)	<(100.0)	Recurring	General Fund
	<(50.0)	<(50.0)	Recurring	Local Govt.

(Parenthesis ( ) Indicate Revenue Decreases)

Relates to House Bill 743

SOURCES OF INFORMATION

Taxation and Revenue Department (TRD)

SUMMARY

Synopsis of SFC Amendment

The Senate Finance Committee amendment modifies the definition of “construction material” to be “...tangible personal property that becomes or is intended to become an ingredient or component part of a construction project...”

Synopsis of Original Bill

This bill adjusts the definition of construction material somewhat more favorably for government entities and non-profits by redefining "construction materials" to allow governmental and 501(c)(3) organizations to avoid tax on the parts needed for simple repairs or replacement of fixtures. This bill also provides a "safe-harbor" if a seller accepts a Non-Taxable Transaction Certificate (NTTC) in good faith, accompanied by an written statement from a government or non-profit promising that the material will not be used in a construction project.

The Taxation and Revenue Department TRD) will regulate when a fixture replacement is part of a construction project and when it is a deductible repair. This line will be narrow to conform to the underlying premise of the Gross Receipts and Compensating Tax Act.

FISCAL IMPLICATIONS

The Taxation and Revenue Department (TRD) report that the full year impact to the general fund would be less than 100.0. Local government revenues would be reduced by an estimated $50.0.

ADMINISTRATIVE IMPLICATIONS

Minimal.

TECHNICAL ISSUES

The Taxation and Revenue Department (TRD) report that if the seller of the tangible personal property is also the installer, then the seller should retain the responsibility of determining whether a fixture replacement is construction or not. This ability to independently determine if an NTTC is appropriate or not means that the seller can not and should not be "off the hook". A seller who accepts an inappropriate NTTC in this case is simply not accepting it in good faith and, under the terms of the bill, will not be accorded the safe harbor. If the seller is not the installer, then he cannot verify the use of the tangible property and may claim the safe harbor.

TRD requests a July 1, 2001 effective date. Most other changes in gross receipts are generally effective January 1 or July 1.

TRD suggests including a provision that would punish a governmental unit for issuing a type 9 NTTC inappropriately by having its ability to issue any NTTC, for any purpose, revoked for one year.

OTHER SUBSTANTIVE ISSUES

The Taxation and Revenue Department provided the following background information and refer to it as the “Alamogordo” problem.

The founding drafters of the Gross Receipts and Compensating Tax Act (GR&CTA) created a unique tax instrument that allowed the state to tax services performed for the federal government. The mechanism is that the federal government reimburses by contract the amount of gross receipts tax the contractor pays the state on receipts from services provided to the federal government. The federal government cannot be the taxpayer, however.

The next clever thing the founding drafters did was define construction as a service, with materials largely ancillary. Thus, the full value of construction - labor, leased equipment, subcontract labor, profit and overhead and materials - is intended to be taxable, even when the construction is performed for the federal government (or state and local governments).

In the mid to late 1980s, state, local and federal governments began to separate construction materials from construction services. This avoidance strategy first became popular for metropolitan redevelopment projects, but was eliminated by 1985 amendment. Later, local and federal governments recreated the same avoidance strategy, but were forestalled explicitly in 1990 by amendment of 7-9-14 NMSA 1978.

Recently, in the Alamogordo area, local and federal governmental units were, once again, attempting to avoid reimbursing contractors for gross receipts tax paid by issuing NTTCs for tangible personal property in situations that they deemed to be repair or renovation, not construction. However, the GR&CTA is very clear on what constitutes construction. "Construction" includes altering and repairing. Thus, the governmental units, by issuing type 9 NTTCs, were in direct violation of the spirit and letter of the GR&CTA. Unfortunately, however, it is not the government units that are penalized, but the contractor. A contractor who accepts an inappropriate NTTC and deducts the receipts inappropriately has violated a good faith standard -- and the contractor is assessed pursuant to an audit.

At least one of the contractors so assessed has testified that the governmental units are quite deliberate in this avoidance/evasion scheme. Any contractor that includes the gross receipts tax in the price - explicitly or implicitly - will not get the contract.

JBE/ar