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

SPONSOR Beffort **ORIGINAL DATE** 01/30/12 **LAST UPDATED** 02/12/12 **HB**

SHORT TITLE Out-of-State Purchase Gross Receipts **SB** 181/aSCORC/aSFC

ANALYST Walker-Moran

REVENUE (dollars in thousands)

Estimated Revenue			Recurring or Nonrecurring	Fund Affected
FY12	FY13	FY14		
NFI	NFI	NFI	Recurring	General Fund

(Parenthesis ( ) Indicate Revenue Decreases)

Relates to HB 142

SOURCES OF INFORMATION
LFC Files

Responses Received From
Taxation and Revenue Department (TRD)

SUMMARY

Synopsis of SFC Amendment

The Senate Finance Committee amendment adds a sunset date. The deduction can be taken until July 1, 2017.

Synopsis of SCORC Amendment

The Senate Corporations and Transportation Committee amendment to Senate Bill 181 adds a requirement that the receipts may be deducted provided that the small business has entered into a separate contract with the out-of-state purchaser to provide those services and the services are delivered by remote delivery. No non-taxable transaction certificate or alternative evidence would be required to sustain the deduction.

Synopsis of Original Bill

Senate Bill 181 adds a new section to the Gross Receipts and Compensating Tax Act to provide a deduction for services to out-of-state purchasers.

The purpose of the deduction is to support small businesses with fewer than ten employees in New Mexico that sell services to out-of-state purchasers. The deduction applies to small businesses that have paid gross receipts taxes for five consecutive years prior to the first year in which a deduction is taken.

The effective date of this bill is July 1, 2012. The SFC amendment adds a sunset date of July 1, 2017.

FISCAL IMPLICATIONS

This bill no longer violates the LFC tax policy principle of adequacy since the amendment changes the fiscal impact to none. According to the LFC General Fund Recurring Appropriation Outlook for FY14 and FY15 the December 2011 forecasted revenues will be insufficient to cover growing recurring appropriations. Since currently forecasted revenues in FY14 and FY15 may not be adequate to fund government services there is insufficient funds for additional tax cuts.

2/9/2012: After amendment, the bill imposes no revenue impact on either the State or local governments, since the deduction duplicates that of Section 7-9-57 NMSA 1978. However, the costs to administer the provisions and requirements of the bill are substantial and adoption of the provisions will be minimal. See Administrative Impact below.

Impact of the original bill: According to TRD, the proposed bill could have substantial impact on revenues, but the impact is virtually impossible to quantify. To establish an order of magnitude of this deduction, the estimate above assumes that 10% of accommodations and food and drink services would qualify for this deduction. This does not include other services purchased by out-of-state visitors. Based on the RP-80 report, total taxable gross receipts of accommodation and food services were about $3.3 billion, and total gross receipts taxes were about $244 million in FY2011.

The estimated impact of this bill is difficult to determine as the exact amount of out-of-state purchases is unknown but is expected to be significant. For the purpose of this bill it is assumed that 10 percent of GRT is for out-of-state purchases but if the impact turns out to be 20 percent or more then the revenue loss to local government and the general fund could be twice as much or more.

SIGNIFICANT ISSUES

According to TRD, the language of the proposal is similar to Section 7-9-55 NMSA 1978, which provides a deduction for transactions in interstate commerce to the extent that the taxation is not preempted by general rules regarding interstate commerce. This covers most regular interstate transactions that can be envisioned. The provisions also largely duplicate those of 7-9-57 NMSA 1978 which require the purchaser provide the seller an NTTC or other evidence acceptable to the Secretary. The 7-9-57 NMSA 1978 deduction is not allowed if the purchaser or the purchaser's agent makes first use of the services in New Mexico. Therefore, this proposed deduction makes two significant changes: (1) it relieves the service provider (seller) of obtaining a resale certificate or alternative evidence (insignificant fiscal impact) and (2) it would permit the out-of-state purchaser to make first use of the services in the state without tax, as long as the product of the service were delivered remotely to an out-of-state address. For example, a travel agent could make a booking for a business traveler whose home address was Arizona but who was physically

present in New Mexico when making the request. The ticket confirmation would be mailed or emailed to the traveler's remote website. This is also virtually insignificant revenue impact.

PERFORMANCE IMPLICATIONS

The LFC tax policy of accountability is met when TRD is required to report annually to the interim legislative revenue stabilization and tax policy committee aggregate amounts of deductions taken, the numbers of taxpayers claiming the deduction and other information to determine whether the deduction is meeting its purpose.

TRD has an issue with the reporting. They state that requiring taxpayers to separately state deductions is an inaccurate method of capturing this information. Historically the Department has found that taxpayers do not follow this instruction very well, since there is no penalty for failure to report or to erroneously report. Confidentiality laws may limit the information that can be reported to the RSTP committee in determining if the deduction is performing its purpose.

ADMINISTRATIVE IMPLICATIONS

According to TRD, the administrative impact is nominal. This deduction will impose minimum processing impacts, but substantial costs for designing a separate form, building the manual-entry computer system to process the separate reports and extracting information from the system to prepare the annual report for the legislature. Instructions and publications related to the gross receipts and compensating tax program will need modification. Reporting and processing systems will need to be developed. One major problem is that "small business" is an unverifiable construct. What happens in the year that a small business hires its tenth employee? Would that tenth employee retroactively disallow the business from claiming this deduction? The bill creates a unique status for an insignificant number of taxpayers. The implementation costs and compliance costs for eligible taxpayers create a huge imbalance between costs and benefits.

TECHNICAL ISSUES

The definition of "small business" is different from HB-142. Statutory consistency dictates that the definition should be the same.

2/9/2012: The amendment needs to define the "remote delivery." This bill defines "out-of-state" based on a physical address. In addition to defining "remote delivery" to include electronic delivery, "out-of-state" should be redefined .to conform. If the purpose of this bill is to modernize some of the provisions of the Gross Receipts and Compensating Tax Act to adapt to electronic commerce, we should make sure that we do not allow residual inconsistencies.

OTHER SUBSTANTIVE ISSUES

2/9/2012: Per TRD, the receipts from the transactions addressed in the amendment are already deductible under current law. In addition, the small business would still need to maintain records to support the deduction for federal audit purposes. There would be very little incentive for the small business to claim this deduction. The bill demands that the business conform to separate procedures.

Requiring taxpayers to separately state deductions is an inaccurate method of capturing this information. Historically the Department has found that taxpayers do not follow this instruction very well, since there is no penalty for failure to report or to erroneously report. If three or fewer taxpayers elect to claim this new deduction, confidentiality laws would limit the information that could be reported to RSTP committee in determining if the deduction is performing its purpose.

Does the bill meet the Legislative Finance Committee tax policy principles?

1. **Adequacy**: Revenue should be adequate to fund needed government services.
2. **Efficiency**: Tax base should be as broad as possible and avoid excess reliance on one tax.
3. **Equity**: Different taxpayers should be treated fairly.
4. **Simplicity**: Collection should be simple and easily understood.
5. **Accountability**: Preferences should be easy to monitor and evaluate

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