Deductions and Credits in the Gross Receipts and Compensating Tax Act

For the Revenue Stabilization and Tax Policy Committee
July 17, 2012
Pamela Ray
Damian Lara
Pam Stokes

Deductions are by far the most significant portion of the tax expenditures in the Gross Receipts and Compensating Tax Act. In case you do not know the difference between an exemption, a deduction and a credit in the Gross Receipts and Compensating Tax Act, you can use the following to differentiate them:

> An **exemption** is not reported, and the Taxation and Revenue Department (TRD) is required by law (Section 7-9-5 NMSA 1978) not to require someone that qualifies for an exemption to report gross receipts. An exemption **is an exclusion from paying gross receipts tax** or even having to calculate the gross receipts acquired from engaging in doing business. There are also exemptions from governmental gross receipts tax and from compensating tax.
>
> A **deduction** is an amount that **is subtracted from the gross receipts of a person engaged in doing business** and liable for gross receipts tax. The gross receipts tax is then calculated on the net gross receipts after the deduction has been subtracted. This also applies to governmental gross receipts deductions. They are subtracted from governmental gross receipts, and then the tax is calculated on the net remaining governmental gross receipts. Deductions for purposes of compensating tax are subtracted from the value of the goods or services used in the state after being purchased out of state. The compensating tax rate is then applied to the net value to determine the compensating tax liability of the taxpayer.
>
> A **credit** is an amount that **is subtracted from the gross receipts liability of a taxpayer**. The taxpayer states the gross receipts, applies the gross receipts tax rate and determines the taxpayer's liability. Then the taxpayer determines the amount of the credit for which the taxpayer is eligible and subtracts that amount from the

amount of tax owed.

Please open your blue "Exemptions, Deductions and Credits" booklet to the "Deductions" section. Again, as with the exemptions, we have divided the deductions into five categories. There are 81 deductions in total. Five of those deductions we have categorized as reflecting federal policies that preempt the state's ability to tax. In Sections 7-9-55, 7-9-56 and 7-9-70 NMSA 1978, numbers 1 through 3 of the deductions in this section of the booklet are deductions because taxing these activities would be seen as interfering with interstate commerce. These include:

(1) transmitting messages or conversations to out-of-state locations and involving receipts from regional or national radio or television advertisements;

(2) transporting items in interstate commerce and handling, storing, packing, moving or in some way providing a service to those items as they are present in-state as part of the stream of interstate commerce; or

(3) renting or leasing a vehicle for use in interstate commerce.

The United States does not have to pay gross receipts on payments, such as those for Medicare, that it makes for medical services provided in New Mexico. In addition, receipts are deductible from sales to diplomats or foreign missions when a treaty prohibits taxation of transactions with the diplomat or mission.

In numbers 6 through 14, we have identified deductions that are necessary to help define the base on which gross receipts, governmental gross receipts and compensating taxes will be levied. Deductions from gross receipts and governmental gross receipts from sales to governments or their subdivisions or instrumentalities, including tribal governments, are found in Section 7-9-54 NMSA 1978. Receipts from sales of services to an out-of-state purchaser can be deducted pursuant to Section 7-9-57 NMSA 1978. Receipts from sales of services or tangible personal property to a person with an out-of-state mailing address are deductible under Section 7-9-57.1 NMSA 1978. Section 7-9-67 NMSA 1978 provides a deduction from gross receipts and governmental gross receipts for uncollectible amounts, such as bad debts, and for refunds and allowances made to buyers. A dealer furnishing goods or services pursuant to a warranty can deduct the receipts that cover the cost of the warranty pursuant to Section 7-9-68 NMSA

1978. Receipts from the resale of manufactured housing can be deducted under Section 7-9-76.1 NMSA 1978. Finally, numbers 12 through 14, Sections 7-9-101 through 7-9-103 NMSA 1978, are deductions that can be claimed for equipment or services sold to the New Mexico Renewable Energy Transmission Authority (RETA) or from the value of equipment purchased out of state for use in an electric transmission or storage facility in New Mexico. These deductions are most likely provided because the RETA is an instrumentality of the state and, as such, would not be taxable.

Mr. Lara and Ms. Stokes will go through the next 17 deductions, which we are classifying as "anti-pyramiding" deductions. After that are six deductions that are classified as benefiting the "public good". Finally, there are 44 deductions that we consider to be "policy" decisions of the legislature, whereby businesses should be able to deduct their receipts from their gross receipts for various reasons, such as enticing a business to locate in New Mexico or encouraging certain fledgling businesses to begin and grow in New Mexico. These are deductions that will require more data to determine if they are actually providing the state the benefit expected if a deduction were granted. These include aerospace deductions; deductions for wind- and solar-generation equipment or any other solar energy system installation or sales; deductions for receipts from certain web site activities and software development; and agricultural deductions for receipts from warehousing, threshing, harvesting, growing, transporting or processing agricultural goods.

There is a partial deduction equal to 50 percent of the receipts from the sale of agricultural implements, aircraft, farm tractors and vehicles not required to be registered and for a manufacturer that sells aircraft, aircraft parts or aircraft services. A deduction is provided for receipts from maintaining, refurbishing, remodeling or otherwise modifying a commercial or military carrier over 10,000 pounds in weight.

Other deductions are provided for receipts from publishing a newspaper or magazine but not for receipts from the sale of advertisements. Receipts from selling newspapers are deductible. In addition, receipts represented by the trade-in of tangible personal property on the purchase of similar new tangible personal property are deductible from gross receipts. There are several medical deductions, such as from receipts for the sale of prosthetic devices, hospitals, prescription drugs, oxygen and oxygen services and for hearing and vision aids. Certain travel agent commissions are deductible if the commissions are paid as part of interstate travel.

Section 7-9-78.1 NMSA 1978 provides a deduction for receipts from selling equipment for uranium enrichment. Jet fuel has a partial deduction from the value on which compensating tax is calculated or from gross receipts of 55 percent of the value of jet fuel or the receipts from selling jet fuel. The deduction for jet fuel receipts or use will decrease to 40 percent in 2017.

Receipts from nonprofit 501(c) organizations that are not 501(c)(3) organizations are deductible from gross receipts from two fundraising events per calendar year. Section 7-9-86 NMSA 1978 provides a deduction for receipts from selling or leasing property and performing services to and for a film production company as part of the production costs.

Another deduction, for a uranium enrichment facility in Eunice, is found in Section 7-9-90 NMSA 1978 and was amended during the 2012 legislative session to include receipts from the sale of uranium hexafluoride and from providing the services of enriching uranium. Deductions enacted in the 2012 legislative session will be required to report separately the amount and specific deductions claimed on the combined reporting system (CRS) forms or an attachment.

Sections 7-9-92 and 7-9-93 NMSA 1978 are the food and medical deductions. They also must be reported separately from other deductions.

Other deductions are for biomass and biodiesel fuel, construction equipment used in building a project for a nonprofit organization or a foundation, receipts from nonathletic events on the New Mexico State University campus and receipts from staging professional boxing, wrestling or martial arts contests. Receipts from providing veterinary services or supplies may be deducted under Section 7-9-109 NMSA 1978.

The Union Pacific deductions for receipts from the sales of locomotive fuel or from the value of fuel used in New Mexico are found in Sections 7-9-110.1 and 7-9-110.2 NMSA 1978. There are deductions for the receipts from the selling or leasing of services or tangible personal property for development or construction of an electric generating facility or recycled energy project. Finally, there are deductions for transmission of electricity using electric conversion technology or for receipts from services provided by a market exchange dealing with the transmission of electricity.

In the next section of your blue book, you will see eight credits that are found in the

Gross Receipts and Compensating Tax Act. Of the first three, two appear to be offsets for similar taxes paid on the purchase of goods or services from out-of-state vendors. The third provides for a deduction on receipts from selling coal severed on the Navajo Nation. This is a "tax sharing" provision by which, if the Navajo Nation imposes its own tax at a rate similar to or higher than the gross receipts tax rate, 75 percent of the Navajo tax may be taken as a credit against the state gross receipts liability owed, and 25 percent of the state gross receipts tax may be credited against the Navajo Nation tax.

Five credits that were adopted for policy reasons are:

(1) for a rack operator that purchases and installs biodiesel equipment;

(2) for selling a service for resale, a small credit of 10 percent of the receipts from the sales of the service;

(3) for hospitals in municipalities, a credit of 3.775 percent against their gross receipts tax liability in each reporting period; and for hospitals in the unincorporated areas of a county, a credit of five percent against their gross receipts tax liability in each reporting period;

(4) for doctors or osteopaths, a credit for unpaid qualified health care services provided; and

(5) for taxpayers who incorrectly reported their food or medical deductions and were subject to a penalty owed to the TRD, a credit in Section 7-9-105 NMSA 1978 remains on the books, although it no longer can be claimed; it can now be repealed because it is no longer in use.