NEW MEXICO TAX RESEARCH INSTITUTE

Sales Taxes and Gross Receipts Taxes – What Are They?

Presented to the Interim Revenue Stabilization and Tax Policy Committee

July 16, 2012

RICHARD L. ANKLAM, PRESIDENT & EXECUTIVE DIRECTOR

NMTRI Principles of Good Tax Policy

N.M. Tax Research Institute is a non-profit, non-partisan member-supported organization dedicated to advancing the following principles of good tax policy in New Mexico:

- ***Adequacy***
  - Revenues should be sufficient to fund needed services
- ***Efficiency***
  - Interference with the private economy should be minimized
- ***Equity***
  - Taxpayers should be treated fairly
- ***Simplicity***
  - Laws, regulations, forms and procedures should be as simple as possible
- ***Comprehensiveness***
  - All taxes should be considered when evaluating the system
- ***Accountability***
  - Exceptions should be rare and should be carefully evaluated and justified

Sales Taxes – History

- Mississippi enacted the first modern sales tax in the 1930's
- Sales taxes were generally imposed only on sales of tangible personal property
  - More recently, many states and localities have extended their taxes to at least some previously untaxed services, which typically are specifically enumerated in their law
    - This is due in part on to both fiscal pressures as well as the growing significance of the services sector in the overall economy

Sales Taxes - History

- "Sales" taxes can take many forms and operate in different ways, and classified in different ways by different authorities
  - According to Haig & Shoup's *The Sales Tax in the American States 3* (1934):
    - Retail Sales Tax – imposed only on the sales of tangible personal property at retail or for use or consumption.
    - General Sales Tax – imposed on sales of tangible personal property at retail or for resale, and including extraction of natural resources and manufacturing.
    - Gross Receipts Tax – imposed on the similarly to general sales taxes plus sales of personal and professional services as well as intangibles in some cases.
    - Gross Income Tax – imposed on all of the above as well as non-business income such as rents, interest and salaries.
  - According to Shultz & Harris's' *American Public Finance* (7th ed. 1959)
    - Retail sales tax;
    - Single-stage excise on sales by manufacturers, wholesalers, and retailers;
    - Multiple-stage "gross sales" or "turnover" tax applying to mfg, wholesaling and retailing;
    - "Gross income" tax, applying to sales of goods and services; and
    - "value added" tax, which may be considered a general consumption tax as well as a general business tax

Sales Taxes - General

- The "general retail sales tax" is the most significant form (we'll refer to from now on generically as a "sales tax")
  - In principle, it is a single-stage levy on consumer expenditures applying to final sales for use and consumption
  - The theoretically ideal tax would exclude all business inputs from the tax base(1)
    - None do however, and approx. 40% of state sales taxes are attributable to business purchases(2)
  - No state has a "pure" tax, but
    - Every states excludes sales for resale from it's tax base
    - States commonly exclude sales of ingredient component parts of produced property
    - Other common provisions reflect the view that all business inputs should be excluded from the tax base regardless of whether they can be directly tied to the output product
      - Examples include common exclusions for machinery and equipment used in production

(1) Due & Mikesell, *Sales and Local Structure and Administration 16* (2d ed. 1994)

(2) Raymond J. Ring Jr., "The Proportion of Consumers' and Producers' goods in the General sales Tax," 42 Nat'l Tax J. 147, 175 (1989)

Sales Taxes - General

- 45 states and the District of Columbia impose some sort of sales/use tax
  - Those that don't ("NOMAD" states):
    - New Hampshire
    - Oregon
    - Montana
    - Alaska*
    - Delaware

(*) No state level sales taxes but there are local jurisdictions that impose sales taxes

Sales Taxes - General

- A "sales tax" is a transactional tax imposed on transactions involving tangible personal property and some services.
  - In contrast, income, franchise and property taxes are not transactional taxes, as they are imposed on net income from earnings, the privilege of doing business measured by net income or net worth, or the ownership of property.
- Local Power to Tax
  - Local jurisdictions generally have no inherent power to tax. Any authority comes from their legislatures or constitutions;
  - State governments generally administer sales tax laws and distribute tax revenues; and
  - Tax bases are generally the same; but
    - There are exceptions
      - "home rule" jurisdictions such as Colorado, Arizona and governing structures like those found in Louisiana present most likely exceptions

Sales Taxes - General

- Legal Imposition
  - “Sales taxes” can be legally imposed on buyers or sellers
    - Buyer imposition most common
  - In buyer (vendee) imposed schemes:
    - Often imposed as a “transaction tax” on transfer of TPP or certain services
    - Seller’s are typically regarded as “collection agents” and held financially accountable
    - Sellers typically required to separately state the tax
  - In buyer (vendor) imposed schemes
    - Often imposed as a “privilege tax” on engaging in business
    - Seller is the taxpayer but passes the tax on to the seller
    - Separately stating may or may not be required but still may pass on the economic burden of the tax
    - When does it matter?
      - When the tax isn’t properly paid
      - Refund situations
      - Transactions with the federal government (immunity)

Sales Taxes - General

- Economic Imposition
  - Sales taxes are generally considered to be borne by the buyer
    - Legal imposition doesn't generally matter
    - Most states require separately stating of tax, in some cases to make clear who th taxpayer is
    - Some states prohibit advertising "we'll pay your sales tax"
    - Most economic models assume sales taxes "roll forward" to buyers, but
      - Incidence can be shared or roll back to buyers
        - Competition – particularly multistate
        - Audit assessments
  - Sales taxes are generally viewed as "regressive"
    - Depends on degree of incidence
    - Depends on breadth of tax base
    - Depends on analysis

Sales Taxes - General

- A "sales tax" is a transactional tax imposed on transactions involving tangible personal property and some services.
  - In contrast, income, franchise and property taxes are not transactional taxes, as they are imposed on net income from earnings, the privilege of doing business measured by net income or net worth, or the ownership of property.
- Local Power to Tax
  - Local jurisdictions generally have no inherent power to tax. Any authority comes from their legislatures or constitutions;
  - State governments generally administer sales tax laws and distribute tax revenues; and
  - Tax bases are generally the same; but
    - There are exceptions
      - "home rule" jurisdictions such as Colorado and Arizona and governing structures like those found in Louisiana among likely exceptions

Sales Taxes – Common Issues

- Sales taxes have to play by certain rules
  - Sellers have to have constitutional nexus, generally viewed as having some sort of physical presence
    - See *Quill v. South Dakota*
    - Must provide credit for taxes paid to other states
      - To be constitutional, tax impositions must have mechanisms to address the concern that transactions aren't subject to multiple jurisdictions' taxation
    - Source of current "e-commerce" debates
      - Streamlined sales tax efforts
      - Mainstreet Fairness Act
- Sourcing/Situs – where is it taxed and at what rate?
  - Seller location (origin state/local jurisdiction)
  - Buyer location (destination state or local jurisdiction)
  - Order/acceptance location
- Taxable measure (what portion of the sale is taxed and what isn't?)

Sales Taxes – Common Issues

- Taxable measure (what portion of the sale is taxed and what isn't?)
  - Trade-in exclusions
  - Discounts
  - Coupons/Rebates
    - Retailers
    - Manufacturers
  - Returns and Allowances
  - Transportation charges
  - Drop Shipments
  - Finance charges
  - Bad debts
  - Mixed transactions (treatment of taxable items sold with nontaxable items)
    - Most commonly goods and services sold together

Use Taxes – General

- "Use" taxes, sometimes referred to as "compensating use" or "compensating" taxes (in NM), are complementary to sales taxes, designed to equalize tax burdens in-state and out-of-state businesses and services.
  - Without a use tax, an in-state consumer has incentive to purchase goods outside the state to avoid the home state's sales tax
    - It "compensates" for the absence of a sales tax
  - It's base and rate is generally the same as the sales tax
  - Sometime sellers collect, depending on structure of tax system
    - Seller's use versus buyer's use tax
  - Typically imposed on use, storage or consumption rather than sale or lease
    - "First functional use" test common
      - Often not imposed on temporary storage
  - Collection from individuals/households problematic

What's a Real Gross Receipts Tax?

- Gross receipts taxes are generally very broad based excise taxes imposed on the total receipts of an enterprise. They are characterized by:
  - Few if any exceptions to taxation;
  - Very low rates;
  - Pyramiding to a high degree

- Examples include
  - Washington's Business Activity Tax ("BAT" tax)
    - Imposes several different rates on different sectors
  - Ohio's Commercial Activity Tax ("CAT" tax)
  - Utility taxes
  - Shades of gray
    - Hawaii (General Excise or "GET" tax)
    - Texas Margins Tax

What Kind of Tax Does NM Impose?

- New Mexico's Gross Receipts Tax is most properly characterized as a broad based seller imposed general retail sales tax
  - It has always provided:
    - Deductions for sales for resale
    - Credits for taxes paid to other states
    - Exemptions to modify it's broadly defined imposition for
      - Wages
      - Dividends
      - Interest
    - Sales tax like rates
    - Sourcing rules and local option taxes
    - General administration
  - It is not a "true" gross receipts tax but does "lean" that way in the spectrum of taxes
    - Seller imposition
    - Broad general imposition including services generally

Questions