



**Before the New Mexico Legislature's
Revenue Stabilization and Tax Policy Committee**

Summary of Remarks on:

**ONLINE SALES TAXATION COMPLIANCE
AND NECESSRY LEGISLATIVE CHANGES
*PRELIMINARY ANALYSIS***

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October 29, 2012

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The New Mexico Tax Research Institute is a nonprofit, nonpartisan organization devoted to the principles of good tax policy. The NMTRI provides research, information and analysis on state and local tax issues to state and local policy makers, taxpayers and the general public through its publications and conferences.

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Outline

Overview	Page 4
History – how the state taxation of remote sellers has evolved.	Page 5
New Mexico’s Taxes – why it would be easier to conform the compensating tax.	Page 6
Revenue – estimates of additional revenue from collecting tax on remote sales.	Page 9
Requirements and Necessary Legislative Changes – as drafted and as discussed.	Page 10
Conforming the Gross Receipts Tax – summary of the additional difficulties.	Page 21
Opportunities for Tax Reform – based on the changing landscape.	Page 22
Appendix A – Copy of S. 1832 as Introduced	
Appendix B – Issues Affecting New Mexico’s Foregone Revenue from E-Commerce	



Overview

Growing Congressional Support for Sales Tax Legislation

There is growing bi-partisan support in Congress for legislation that would grant to states the authority to collect sales and use taxes from Internet and other “remote” (out-of-state) sellers who have no physical presence in the state. The legislation would require states agree to conform to certain minimum requirements aimed at making compliance simpler.

Potential Increase in Collections

The amount of additional tax revenue New Mexico might ultimately be able to collect using this authority will be affected by two things—the requirements imposed by the legislation and exactly how New Mexico decides to conform to those requirements. A rough estimate of the additional annual collections for New Mexico is \$70 million.

Legislation Would Impose Certain Requirements on the States

Different versions of possible legislation are pending in Congress. This paper focuses on a version of the legislation, as introduced and currently pending in the U.S. Senate, Senate Bill 1832 (S. 1832). It is likely that changes will be made to this bill before it is passed. We consider both the requirements in the bill as it is currently drafted and requirements that are reportedly being discussed. **NOTE: Requirements only apply to remote sales and sellers.**

Preliminary Analysis - Limitations

There are two things that limit the analysis here. First, the legislation is likely to change before it is enacted. Second, the version of the bill as introduced includes terms and provisions that are somewhat unclear, especially as they might apply to New Mexico's tax system. (See New Mexico Taxes, below.) So it is not currently possible to determine precisely what legislative changes New Mexico may need to make to conform to any requirements. If the bill is clarified, this may help. If not, additional analysis will have to be done and, even then, the choices may not be entirely clear.



New Mexico's Taxes

A fundamental issue is whether S. 1832 applies to the New Mexico gross receipts tax since it applies to “sales and use taxes,” but doesn’t define that term. (A proposed change would have states designate the tax(es) to which the law would apply, to remove any uncertainty.) It appears the intent, at least, is for the legislation to benefit New Mexico.

Apart from the terms used, there are also important differences between New Mexico’s gross receipts tax and the typical sales tax:

- ▶ A sales tax is:
 - ▶ A consumption tax imposed on the *buyer* by the state or local jurisdiction;
 - ▶ *Required to be collected* and paid over like a trust fund tax by the seller;
 - ▶ *Required to be separately charged* to the buyer by the seller; and
 - ▶ Imposed at the rate applicable at buyer’s location (“destination sourcing”).
- ▶ The gross receipts tax is:
 - ▶ A tax imposed on the *seller* for the privilege of engaging in business;
 - ▶ *Required to be paid* whether or not collected from the buyer;
 - ▶ *Not required to be separately charged* to the buyer by the seller;
 - ▶ Imposed at the rate applicable at seller’s location (“origin sourcing”).

Because the bill is modeled on a typical sales tax, New Mexico may have unique difficulties conforming the gross receipts tax to the bill’s requirements. In particular, the bill assumes local taxes are imposed on the purchaser on a destination basis, which is not true for the gross receipts tax. In contrast, the New Mexico compensating tax is very similar to a typical use tax and statutes impose a duty on sellers to collect that tax. See NMSA 7-9-10.

For purposes of our preliminary analysis of the requirements and necessary legislative changes, we assume that New Mexico could conform the compensating tax and enforce collection of that tax by remote sellers, without the need to conform the gross receipts tax and without giving up any significant benefit. While this appears to be the simplest solution, whether it is a viable one will depend on legal analysis of the legislation as enacted.



History

1900 to 1960 – Federal and State Tax Systems Diverged

During the early part of the 20th century, federal and state tax systems took different paths:

- ▶ States came to rely, in part, on sales taxes (exceptions - NH, MT, AK, DE & OR).
- ▶ The federal government relies mainly on income and payroll taxes.

Because of there is no federal sales tax to “piggy-back” on (unlike income tax) –

- ▶ There is less uniformity in sales taxes than in income taxes; and
- ▶ Enforcement of sales tax is made more difficult.

Income and sales taxes share one common element in that both require a third-party enforcement mechanism to make the tax work -

- ▶ Income taxes – withheld by employers;
- ▶ Sales taxes – collected by sellers.

When a state lacks jurisdiction over a seller, enforcement of sales tax is much harder.

As Interstate Commerce Grows, Supreme Court's View Changes

During this same period, as interstate commerce in the country grew, the U.S. Supreme Court began changing its view about when states have jurisdiction over interstate commerce for tax purposes under the dormant commerce clause doctrine.

- ▶ Old view – states could only impose “indirect” taxes.
- ▶ New view – states can directly tax interstate commerce if it is not unduly burdensome.
 - ▶ Court said interstate commerce should pay its “just share” of tax.
 - ▶ The first case to make this change was actually a New Mexico case – *Western Livestock* (1938).
- ▶ It took several decades for the Court to completely transition to this new view.



1960 to 1992 – Supreme Court's New View on State Taxes Takes Shape

Scripto (1960) – Temporary Presence

A state has jurisdiction to tax a business with employees or agents temporarily in the state to solicit sales.

National Bellas Hess (1967) – Mail-Order

A state does not have jurisdiction to impose sales tax on a mail-order seller with no physical presence in the state.

Complete Auto Transit (1977) – General Rules Including Nexus

Sets out the general rules for when states can impose taxes on businesses operating in interstate commerce. Rule No. 1 – business must have a connection (or “nexus”) with the state. This is the primary issue for sales tax.

Tyler Pipe (1987) – Independent Contractors

Independent contractors soliciting sales can also create nexus. (*Tyler Pipe* and *Scripto* are referred to as representative nexus cases.)

Quill (1992) – Physical Presence

North Dakota asked the Supreme Court to overturn *National Bellas Hess* on the basis that it was inconsistent with the Court's new view. The Court refused saying:

- ▶ The nexus requirement protects interstate commerce from undue burdens,
- ▶ Sales taxes are especially burdensome because states have different rules,
- ▶ Sellers should be able to rely on the safe-harbor (or “bright-line” test), and
- ▶ If Congress wants to allow greater state jurisdiction, it can.

Quill is often cited for the principle that a state cannot impose a sales tax on a business unless it has a physical presence in the state.

NOTE: In 1992 – there was no Internet retail commerce and no Amazon.com.



1992 to 2011 – State Cooperative Efforts to Reduce Sales Tax Burdens

Streamlined Group is Formed and Makes Progress on Uniform Rules

In 1999, in an attempt to persuade Congress to expand state taxing jurisdiction, the National Governor's Association (NGA) and the National Conference of State Legislatures (NCSL) formed the Streamlined Sales Tax group to simplify state sales taxes.

- ▶ 24 states now conform to Streamlined uniformity requirements.
- ▶ 6 biggest states—CA, TX, NY, FL, IL, and PA are not Streamlined states.
- ▶ The “big 6” have 40% of the U.S. population and almost 45% of GDP.

Congressional Efforts to Enact Streamlined Legislation Falter

While the Streamlined group drafted federal legislation allowing its members to collect tax from remote sellers, the legislation has not won widespread Congressional support.

Recent State Litigation and Legislative Efforts to Limit Quill

As Congressional efforts stalled, states began litigating issues and enacting state legislation to address developments in Internet commerce and limit the application of *Quill*, including:

- ▶ *Dell* cases – states argued that a computer seller had nexus in states where its independent contractor performed warranty services on products sold. (NM won its case and the U.S. Supreme Court denied cert.)
- ▶ “Amazon” or “click-through” statutes- requiring that Internet sellers collect sales tax if they pay commissions to instate “affiliates” for sales resulting from a link on the affiliate’s website connected to the seller’s website.
- ▶ “Bricks-and-clicks” laws – that require Internet sellers to collect and report sales tax if the seller has a related company with physical presence in the state and uses that presence to facilitate the Internet company’s business.
- ▶ Third-party reporting laws – that require Internet sellers to report to customers and/or to the state the amount of sales made into the state, but that do not require collection of tax.

U.S. Supreme Court Remains Silent on the Issue

The U.S. Supreme Court has not revisited *Quill* and most state courts have concluded that its bright-line (or physical presence) rule applies only to sales taxes and does not supersede the representative nexus cases (*Scripto* and *Tyler Pipe*).



Current

Congress Introduces the Marketplace Bills – Alternatives to Streamlined Legislation

Note that these bills have slightly different provisions. This paper focuses on the Senate bill.

- ▶ Marketplace Equity Act – House – H.R. 3179 (Rep. Womack)
- ▶ Marketplace Fairness Act – Senate – S. 1832 (Sen. Enzi)

Three things have happened in the last year to spur Congress to take action on legislation:

- ▶ The Retail Industry Leaders Association (RILA) is pushing to remove the competitive advantage Internet sellers have, and compromise with states on simplification requirements.
- ▶ Amazon.com has joined with RILA to support the legislation. Why?
 - ▶ It is building distribution centers around the country and is no longer protected by *Quill* in many states. It has made deals with several states to begin collecting the tax, including at least 3 (maybe more) of the big 6.
 - ▶ As the largest Internet seller with \$50 billion in annual sales, Amazon's agreements to collect tax reduce the leverage to force simplification.¹
 - ▶ Amazon's platform allows third-party vendors to collect tax. So requiring those sellers to report tax would make that platform even more attractive.
- ▶ Congress is considering budget cuts that will reduce transfers to the states and is looking for an offset to these cuts that will not impact the federal budget.

Outlook

Experts believe there is only a 50/50 chance Congress will act on legislation in the “lame-duck” session. Most also believe the legislation has a 50/50 chance or better of being passed next year. That said there are still significant questions to be addressed in terms of what type of requirements Congress can and should impose on states. (These questions are addressed further under the section on Requirements and Necessary Legislative Changes below.)

¹ Most of the top 20 Internet sellers have affiliated bricks-and-mortar stores (like Wal-Mart) and are, by and large, paying sales tax. The reason for this is that states have successfully litigated this issue. New Mexico's Supreme Court will be considering a “bricks-and-clicks” case in the coming term. See *BarnesandNoble.com v. Taxation and Revenue Department*, N.M. Sup. Ct., Docket No. 33,627 (cert. granted 6/22/2012).



Revenue

Maximum estimates of the impact of the proposed federal legislation on New Mexico compensating tax revenues are:

- ▶ \$75 -120 million
- ▶ less the effects of changes in the law that may need to be made to conform to the requirements of the federal legislation (see Requirements and Necessary Legislative Changes below), and
- ▶ less the effect of the small seller exception (in whatever amount that exception is ultimately set in the federal legislation).

In addition, three other factors, if not properly taken into account, will inflate the revenue estimates:

- ▶ Total remote sales into the state include both business-to-business sales and business-to-consumer sales. The state already has the ability to collect the compensating tax from local businesses on their purchases (when taxable).
- ▶ Not all e-commerce is protected from tax. Many Internet sales are made by companies which otherwise have a sufficient connection or nexus to New Mexico to report and pay the gross receipts tax.
 - ▶ For example, a number of Internet sellers that are affiliated with traditional “bricks-and-mortar” sellers are likely paying tax already.
 - ▶ The landscape in terms of which Internet sellers are already paying tax is changing rapidly and it may therefore be very difficult to keep revenue estimates from being overstated as time goes by.

The New Mexico Taxation and Revenue Department and the Legislative Finance Committee has studied the question of the additional revenue that would potentially result from expanded collection ability. The summary of their findings is included in the presentation copied in Appendix B. That study also lowed to a 2009 study of the issue conducted by researchers at the University of Tennessee. The following was taken from that 2009 study:



**ONLINE SALES TAXATION COMPLIANCE AND NECESSRY LEGISLATIVE CHANGES –
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October 29, 2012**

EXECUTIVE SUMMARY

The development of new technologies and digital processes has had a profound effect on the U.S economy as e-commerce sales have grown from \$995.0 billion in 1999 to \$2,385 billion by 2006. The rapid growth in e-commerce affects state and local economies in several important ways. First, state and local governments continue to lose sales and use tax revenues because of the inability to collect taxes that are due. Second, firms change their best business practices to avoid creating a collection responsibility in certain states. Firms choose to locate their selling or warehousing activities to avoid creating nexus rather than locating where they can operate most efficiently. Also, local vendors face a competitive disadvantage to e-commerce competitors as consumers browse in shops on Main Street but then make their purchases online to evade the tax. Finally, there may be distributional consequences if lower-income consumers are more likely to make purchases in local stores where the tax is collected.

We estimate state and local sales tax losses arising from e-commerce for 46 states and the District of Columbia using both a baseline forecast and an optimistic forecast for e-commerce growth. B2B (business-to-business) sales account for approximately 93 percent of total e-commerce. In the baseline case, we estimate that annual national state and local sales tax losses on e-commerce will grow to \$11.4 billion by 2012 for a six-year total loss of \$52 billion. The more optimistic growth case estimates losses to reach \$12.65 billion by 2012 and an aggregate loss of \$56.3 billion.

We view our estimates as lower bounds on the expected sales tax revenue losses. First, we use a conservative methodology for forecasting e-commerce. Second, we did not seek to account for the additional losses associated with non-registered vendors operating in the states. Third, we assume that the taxability of e-commerce transactions is the same as for overall commerce, even though we suspect that the ability to evade the tax should shift the mix of e-commerce more towards taxable sales.

Changing the law to require remote vendors to collect sales and use taxes would recover a significant portion of the estimated losses, although we acknowledge that some noncompliance would remain. More importantly, our estimates are revenue losses associated with e-commerce and not all remote sales, and yet the proposed legislation covers other types of remote commerce, such as mail order, telephone orders, and deliveries made across state lines by unregistered businesses. Estimating the sales tax revenue losses associated with all remote commerce is beyond the scope of this study, but we believe the revenue implications are much larger than for e-commerce alone. For example, applying the methodology we used to estimate e-commerce losses, we estimate losses relating only to the B2C (business-to-consumer)



**ONLINE SALES TAXATION COMPLIANCE AND NECESSRY LEGISLATIVE CHANGES –
PRELIMINARY ANALYSIS**

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October 29, 2012**

component of mail orders sales to be \$6.8 billion by 2012. As a result, total revenue gains from requiring various forms of remote vendors to collect sales and use tax will be significantly larger than what we estimate in this report for e-commerce.²

The following summarized the results of the study:

Table 5: Total State and Local Sales and Use Tax Revenue Losses from E-Commerce Sales (\$millions)

	Baseline Scenario						Total
	2007	2008	2009	2010	2011	2012	
Alabama	108.3	115.5	103.9	128.9	151.6	170.4	778.6
Alaska	1.0	1.0	0.9	1.1	1.3	1.5	6.8
Arizona	235.2	250.8	225.6	279.8	329.0	369.8	1,690.3
Arkansas	72.4	77.2	69.5	86.2	101.3	113.9	520.4
California	1,211.2	1,291.6	1,162.1	1,441.1	1,694.4	1,904.5	8,704.8
Colorado	109.9	117.1	105.4	130.7	153.7	172.7	789.5
Connecticut	40.6	43.2	38.9	48.3	56.7	63.8	291.5
District of Columbia	22.6	24.1	21.7	26.9	31.6	35.5	162.5
Florida	511.2	545.1	490.4	608.2	715.1	803.8	3,673.9
Georgia	260.9	278.2	250.3	310.4	365.0	410.3	1,875.2
Hawaii	38.2	40.7	36.6	45.4	53.4	60.0	274.2
Idaho	29.5	31.4	28.3	35.1	41.2	46.4	211.9
Illinois	322.3	343.7	309.3	383.5	450.9	506.8	2,316.6
Indiana	124.2	132.5	119.2	147.8	173.8	195.3	892.8
Iowa	56.4	60.1	54.1	67.1	78.9	88.7	405.3
Kansas	90.9	96.9	87.2	108.1	127.1	142.9	653.2
Kentucky	69.9	74.6	67.1	83.2	97.8	109.9	502.5
Louisiana	251.8	268.5	241.6	299.6	352.2	395.9	1,809.5
Maine	20.4	21.7	19.6	24.3	28.5	32.1	146.6
Maryland	117.1	124.9	112.4	139.3	163.8	184.1	841.6
Massachusetts	83.5	89.0	80.1	99.3	116.8	131.3	600.0
Michigan	90.0	96.0	86.3	107.1	125.9	141.5	646.7
Minnesota	149.6	159.6	143.6	178.0	209.3	235.3	1,075.3
Mississippi	85.8	91.5	82.3	102.1	120.0	134.9	616.5
Missouri	134.0	142.9	128.6	159.4	187.5	210.7	963.0
Nebraska	39.0	41.6	37.4	46.4	54.6	61.3	280.4
Nevada	107.4	114.6	103.1	127.8	150.3	168.9	772.1
New Jersey	128.8	137.3	123.5	153.2	180.1	202.5	925.5
New Mexico	76.6	81.7	73.5	91.1	107.2	120.5	550.5
New York	550.4	586.9	528.1	654.9	770.0	865.5	3,955.7

² Donald Bruce, William F. Fox, LeAnn Luna, "State and Local Government Sales Tax Revenue Losses from Electronic Commerce."



**ONLINE SALES TAXATION COMPLIANCE AND NECESSRY LEGISLATIVE CHANGES –
PRELIMINARY ANALYSIS**

**Before the New Mexico Legislature's Revenue Stabilization Committee
October 29, 2012**

North Carolina	136.0	145.0	130.4	161.8	190.2	213.8	977.1
North Dakota	9.8	10.4	9.4	11.6	13.6	15.3	70.1
Ohio	195.8	208.8	187.9	233.0	274.0	307.9	1,407.5
Oklahoma	89.5	95.5	85.9	106.5	125.3	140.8	643.5
Pennsylvania	220.0	234.6	211.0	261.7	307.7	345.9	1,580.9
Rhode Island	18.5	19.7	17.7	22.0	25.8	29.0	132.7
South Carolina	79.2	84.5	76.0	94.2	110.8	124.5	569.3
South Dakota	18.9	20.2	18.2	22.5	26.5	29.8	136.1
Tennessee	261.3	278.6	250.7	310.9	365.5	410.8	1,877.7
Texas	553.6	590.3	531.1	658.6	774.4	870.4	3,978.3
Utah	56.3	60.0	54.0	66.9	78.7	88.5	404.3
Vermont	16.0	17.0	15.3	19.0	22.3	25.1	114.8
Virginia	131.6	140.4	126.3	156.6	184.1	207.0	946.0
Washington	179.3	191.2	172.0	213.3	250.8	281.9	1,288.7
West Virginia	32.2	34.3	30.9	38.3	45.0	50.6	231.4
Wisconsin	90.4	96.4	86.7	107.6	126.5	142.1	649.7
Wyoming	18.2	19.4	17.5	21.6	25.4	28.6	130.7
TOTAL	7,245.6	7,726.3	6,951.4	8,620.4	10,135.8	11,392.7	52,072.2



Requirements and Necessary Legislative Changes

Notes on Requirements

Ambiguities in the Legislation as Drafted

The meaning of certain terms and provisions in the bill are unclear. We hope they will be clarified before the law is enacted. If not, interpreting and implementing the requirements may be more difficult. We note the specific questions where they impact our analysis below.

Requirements Apply to Remote Sales/Sellers Only

In the version of S. 1932 as introduced, all the requirements apply only to taxes on “remote sales” (or non-intrastate sales). So states need comply with the requirements only for taxes on remote sales. Unfortunately, the bill’s provisions are not entirely clear. On the one hand, the bill states that requirements apply to “remote” sales and sellers but it also says they do not apply to “intrastate sales.” Non-remote sales and intrastate sales are not the same thing, however. So, the bill’s use of the term “intrastate” creates some questions.

Also, it should be noted, that it is a fairly simple matter for a seller to go from being a “remote seller” (defined in the bill as a seller that does not meet the nexus requirement of *Quill*) to being a non-remote seller. So if differences in state rules provide incentives for sellers to become non-remote sellers, it is likely that many will.

Statutory Requirements are an Alternative to Membership in the Streamlined Group

The bill gives states two choices—either be a member state under the Streamlined Sales and Use Tax Agreement (SSUTA) or comply with an alternative set of statutory requirements. Because New Mexico is not a member of SSUTA, this paper focuses on the alternative requirements under Sec. 3 (b) of the bill. It should be noted that the requirements for becoming a member of the SSUTA would be much more extensive.

Preliminary Analysis is Limited to Specific Requirements

This paper focuses on changes need to conform to specific requirements. Other incidental changes may also be necessary to create consistency. They are not specifically addressed.



Summary of Requirements

NOTE: As a reminder, the requirements are analyzed in terms of what it would take for New Mexico to conform its compensating tax. (See footnotes on the gross receipts tax conformity, generally, as well as the Section on Conforming the Gross Receipts Tax below.) In this Section, we first provide a general summary of the requirements, both in the bill as introduced and other requirements currently being discussed, and whether New Mexico's compensating tax currently conforms. If it does, this paper will not address the issue further. Other requirements that may necessitate or benefit from legislative changes (see issues in bold below) will be addressed in more detail.

Summary of Requirements in the Bill as Introduced

To meet the requirements of the bill as introduced, a state must—

- ▶ Small Seller Exception – Exclude from tax any seller who falls under the exception.
 - The compensating tax does not explicitly conform and may benefit from legislative changes. **(See Small Seller Exception below.)**³
- ▶ State Level Administration - Have a single state-level agency for administering and auditing the tax and a single return for taxing jurisdictions in the state.
 - The compensating tax conforms.⁴
- ▶ Uniform Tax Base - Have tax base for all taxing jurisdictions in the state.
 - The compensating tax conforms.⁵
- ▶ Destination Rates - Impose tax on remote sales at the “applicable destination rate,” provide rate information software or services and relieve remote sellers from any liability for collecting an incorrect rate where they rely on this information.
 - It appears New Mexico's compensating may or may not conform. **(See “Destination Rate Requirements below.)**⁶

³ The gross receipts tax also does not explicitly conform to this requirement.

⁴ The gross receipts tax also conforms to this requirement.

⁵ The gross receipts tax also conforms to this requirement.



ONLINE SALES TAXATION COMPLIANCE AND NECESSRY LEGISLATIVE CHANGES –
PRELIMINARY ANALYSIS

Before the New Mexico Legislature's Revenue Stabilization Committee
October 29, 2012

- ▶ Certify Providers and Software - Allow remote sellers to use state-certified providers that provide software and services, hold providers harmless in relying on information provided by the state, and hold sellers harmless when using a certified provider.
 - ▶ New Mexico's compensating tax does not conform. **(See Provider Certification Requirements below.)**⁷
- ▶ Notice for Rate Changes - Provide 30 days notice of a rate change by any locality in the state and make local rate changes effective only on the first day of a calendar quarter.
 - ▶ New Mexico's compensating tax conforms.⁸
- ▶ General Sourcing of Sales - The state must follow the bill's general sourcing requirements for remote sales. See Section 6 (8) – definition of "Sourced"
 - ▶ New Mexico's compensating tax does not conform. **(See General Sourcing Requirements below.)**⁹

Summary of Other Requirements BEING DISCUSSED

- ▶ Vendor Compensation – The bill does not currently require states to allow sellers to retain a portion of the tax as compensation for administrative expense but such a requirement has been discussed in the past and Streamlined states currently provide it.
 - ▶ New Mexico's compensating tax does not conform. **(See Vendor Compensation below.)**¹⁰
- ▶ Digital Goods Sourcing – The bill currently imposes only general sourcing rules summarized above and discussed below but there has been discussion about including more extensive rules for things like digital goods and services.
 - ▶ New Mexico's compensating tax does not conform, but may not need to. **(See Digital Goods Sourcing below.)**¹¹

⁶ The gross receipts tax clearly does not conform and conformity would be difficult.

⁷ The gross receipts tax also does not conform to this requirement.

⁸ The gross receipts tax also conforms to this requirement.

⁹ The gross receipts tax also does not conform to this requirement and conformity would be difficult.

¹⁰ The gross receipts tax does not conform to this requirement and conformity might be more costly.



Legislative Changes that May be Necessary to Conform the Compensating Tax

Small Seller Exception

Specific requirements:

The bill as drafted excludes sellers that have less than \$500,000 of remote sales in the United States from having to collect taxes.

Conforming the compensating tax:

Certain sellers are currently required to collect the compensating tax under NMSA 7-9-10. That section provides that a person “carrying on or causing to be carried on any activity within this state attempting to exploit New Mexico’s markets who sells property or sells property and service for use in this state and is not subject to the gross receipts tax on receipts from these sales shall collect the compensating tax from the buyer and pay the tax collected to the department.” The section goes on to define what is meant by “activity.” It does not, however, contain a dollar-limit that tracks the federal small seller exception. Therefore, there is a possibility that it would impose collection duties on sellers who fall under that exception.

Moreover, NMSA 7-9-10 may also limit New Mexico’s ability to require collection of the tax beyond the small seller exception. For example, even a person that is not “carrying on” any “activity” as defined in the current section may be required under the federal law to collect the tax assuming the seller exceeds the small seller exception. So New Mexico may wish to remove these other statutory limitations. The exclusion of sellers who pay the gross receipts tax on their sales, however, should be retained so that there will not be the possibility of imposing multiple taxes.

It should be noted that New Mexico can presumably also retain any other limitation on its own jurisdiction to require collection of the compensating tax that it wishes to retain, even those that go beyond the federal small seller exception.

(See also the changes to NMSA 7-9-10 discussed under Sourcing Requirements below.)

¹¹ The gross receipts tax does not conform to this requirement.



Destination Rate Requirements

Specific requirements:

The bill as drafted requires that states require remote sellers to collect sales and use tax at the “applicable destination rate.”

- ▶ The “applicable destination rate” equals the “applicable state rate and any applicable rate for the local jurisdiction into which the sale is made.
- ▶ The state must also provide adequate software and services identifying the applicable destination rate.
- ▶ Also, the state must relieve remote sellers from liability for collection of the incorrect amount of sales or use tax, including any penalties or interest, if collection of the improper amount is the result of relying on information provided by the State.

Differences in New Mexico's compensating tax and the typical use tax.

States that impose typical sales and use taxes impose both state and local rates on the purchaser based on where the purchaser takes delivery of the purchased item and requires collection of the tax by the seller. If the seller is a remote seller and therefore does not collect the tax, the purchaser must pay use tax at the same local tax rate. In contrast, under New Mexico law, while there are local taxes that may increase the gross receipts tax rate, there is only one state-wide compensating tax rate imposed directly on purchasers for using property in the state.

What does the term “applicable destination rate” mean?

Because of differences between the compensating tax and a typical use tax, there is a question about how the term “applicable destination rate” would apply. On the one hand, it appears that the intent of retailers who support the bill is that the rate imposed be the same as the rate that would be charged on a sale in the local jurisdiction where the purchaser takes delivery. These groups want to make sure that remote sales are essentially taxed the same as local sales. Also, the bill is clearly drafted under the assumption that destination sourcing will be used for remote sales. That is, sales will be sourced to the location of the customer. (See General Sourcing Requirements below.)



On the other hand, one motivation for having the federal bill require a particular rate be used for remote sales, at least in the past, has been to simplify the burden of tax collection by making sure that remote sellers don't have to keep track of multiple tax rates for each local taxing jurisdiction (with certain specific exceptions). If that were the primary intent behind the provision here, then it wouldn't matter whether the one rate in each jurisdiction was the single statewide compensating tax rate or whether it was the local gross receipts tax rate for that jurisdiction.

Also, there is nothing in the bill that requires the local jurisdictions in a state to impose an additional tax rate. The term "applicable destination rate" simply means "the applicable state rate and *any* applicable rate for the local jurisdiction." Presumably there are a number of smaller jurisdictions where no additional rate is imposed and at least one state (Connecticut) does not impose any local rates.

Depending on what the term "applicable destination rate" means, the compensating tax rate may need to be tied to the local gross receipts tax rate.

It appears that a reasonable interpretation of the term "applicable destination rate" where there is no local tax imposed, would be just the state rate. If this is the interpretation applied, New Mexico's compensating tax would presumably conform, since it is imposed under a single state-wide rate.

But if the term "applicable destination rate" is clarified or interpreted to mean the same rate imposed on a local sale, then the compensating tax rate would have to be raised to a rate equivalent to the total gross receipts tax rate in the jurisdiction where the purchaser takes delivery, at least for sales by remote sellers. New Mexico could still impose the statewide rate on purchases made outside the state and brought into the state by the purchaser.

Other related requirements.

The bill also requires that states make rate information available and hold sellers harmless for relying on that information. New Mexico would need a legislative change to provide relief from liability.



Provider Certification Requirements

Specific requirements:

Under the bill as introduced, a state must:

- ▶ Allow remote sellers to use single and consolidated providers to file returns and pay taxes for that seller;
- ▶ Provide certification procedures for those providers to make software and services available to remote sellers;
- ▶ Hold such providers harmless for any errors or omissions as a result of relying on information provided by the state; and
- ▶ Hold remote sellers using a single or consolidated provider harmless for any errors and omissions by that provider.
 - ▶ The term "consolidated provider" means any person certified by a state who has the rights and responsibilities for sales and use tax administration, collection, remittance, and audits for transactions serviced or processed for the sale of goods or services made by remote sellers on an aggregated basis.
 - ▶ The term "single provider" means any person certified by a State who has the rights and responsibilities for sales and use tax administration, collection, remittance, and audits for transactions serviced or processed for the sale of goods or services made by remote sellers.

Conforming the compensating tax.

It is likely that there will be model language drafted by the states to address this requirement. (Streamlined states already meet a similar requirement.)

The legislative changes are obviously just a small part of the work that will actually need to be done to conform to the requirements in this case. The state will have to put in place the process for providing certification for tax software and services to make sure that the certified providers are able to correctly determine, calculate, and collect the tax and file tax returns for sellers. A number of states have expressed concern over the scope of these requirements and have asked that the scope be further limited.



General Sourcing Requirements

Specific requirements:

The state must follow the bill's sourcing requirements for remote sales. See Section 6 (8) – definition of "Sourced"-

- ▶ The location to which a remote sale is sourced refers to the location where the item sold is received by the purchaser based on the location indicated by instructions for delivery that the purchaser furnishes to the seller.
- ▶ When no delivery location is specified, the remote sale is sourced to the customer's address that is either known to the seller or, if not known, obtained by the seller during the consummation of the transaction, including the address of the customer's payment instrument if no other address is available.
- ▶ If an address is unknown and a billing address cannot be obtained, the remote sale is sourced to the address of the seller from which the remote sale was made.

Conforming the compensating tax:

Assuming that New Mexico could, consistently with the federal legislation, have one statewide compensating tax rate (see Destination Rate Requirements above), then conforming to sourcing rules will also be easier. It will not be necessary to determine which local jurisdiction's tax might apply and so it will not be necessary to source to a specific local jurisdiction. New Mexico will simply have to apply the compensating tax in a manner that is consistent with the sourcing rules applied at the state level.

Under NMSA 7-9-7 (A)(2), the compensating tax is imposed on tangible property that was "acquired outside this state that would have been subject to the gross receipts tax had it occurred within this state." As discussed above, NMSA 7-9-10 makes certain sellers responsible for collecting the compensating tax from purchasers and paying it to the state. This provision does not specify that a seller can only be made to collect the tax if the sale is sourced to the state under any particular set of rules. Therefore these rules would need to be added to NMSA 7-9-10.



Vendor Compensation

Specific requirements AS DISCUSSED BUT NOT YET INCLUDED:

The version of S. 1832 introduced does not require states to allow remote sellers to retain a portion of the tax collected as compensation for their collection and reporting activities. The Streamlined states through their agreement do provide for so called “vendor compensation.” It is not clear if a similar requirement will be added to the federal legislation before it is enacted, but it is a possibility. The Streamlined states pay vendor compensation to all sellers, both remote and non-remote. It is possible that the federal bill would require the payment of vendor compensation only to remote vendors—or that it may require the payment of vendor compensation to all vendors who collect and pay over the tax—a potentially costly move. (Vendor compensation is a foreign concept to states with privilege taxes on the seller, akin to compensating individuals for preparing their own income tax returns.)

Conforming the compensating tax:

If New Mexico conforms the compensating tax it may be possible, depending upon how any requirement for vendor compensation is drafted, to limit compensation to remote vendors who collect the compensating tax. However, this could prove politically uncomfortable as it would mean paying out-of-state businesses but not local ones. The exact legislative change that would be necessary would also depend on how the requirement is drafted.

Digital Goods Sourcing

Specific requirements AS DISCUSSED BUT NOT YET INCLUDED:

There have been discussions about the need for more extensive sourcing rules for certain kinds of sales—especially digital goods and services. Those rules would cover things like software, electronic books and music and services provided electronically.

Conforming the compensating tax:

Under NMSA 7-9-7, compensating tax is imposed only on tangible personal property acquired outside the state (that is, in a transaction with a remote seller), not to services or intangible property. Therefore, unless New Mexico wishes to expand the compensating tax to cover these items, it will not be necessary to conform to sourcing rules for most digital products, depending on how those products are specifically defined.



Conforming the Gross Receipts Tax

As noted above, even if the federal bill can be interpreted as applying to the gross receipts tax, conforming that tax may be difficult because of inherent differences between the gross receipts tax, as a privilege tax, and the typical sales tax. Difficulties may include:

- ▶ Local tax imposition statutes apply the tax to persons engaging in business in that local jurisdiction. New Mexico has long treated sellers who do not have a place of business in the state but sell into the state from locations outside the state as not being subject to these local taxes. The Destination Rate Requirements and General Sourcing Requirements would appear to require that this approach be changed so that remote sellers are subject to local rates.
- ▶ Imposition of tax under the local tax imposition statutes generally requires voter approval of a specific ordinance. See for example NMSA 7-19-12. Local ordinances in place likely would not allow expansion of the tax to businesses outside the jurisdiction.
- ▶ Under NMSA 7-1-14, taxpayers can only be required to report and pay at the local rate of tax if they “maintain one or more places of business” in that local jurisdiction. The Destination Rate Requirements and General Sourcing Requirements would require that the applicable rate on remote sales be the rate at the location of the delivery to the customer, regardless of the seller’s place of business.
- ▶ The bill’s General Sourcing Requirements currently are apparently intended to apply to only tangible goods. It does not explicitly say that, but the language is too simplistic for purposes of sourcing services. There is discussion of expanding the sourcing rules to cover digital goods and also certain services. Under the gross receipts tax, services are generally taxed only if they are performed in New Mexico and any sourcing rules would likely be destination based instead. Accordingly, New Mexico’s approach to taxing services would have to be changed.
- ▶ While it would not affect conformity, expansion of local taxes to businesses without business locations in those jurisdictions may also impact how taxes are distributed. See for example NMSA 7-1-6.4.



- ▶ Nothing in the bill would prevent changes in the distribution of taxes. However, local governments have an interest in the issue and may prefer to see the gross receipts tax be conformed to the federal requirements. Tribal governments having entered into intergovernmental agreements with the state (pursuant to NMSA 9-11-12.1) may hold a similar interest and non-participating tribes or pueblos may have a greater interest in doing so if federal legislation is enacted.

Opportunities for Tax Reform

Whether the tax implicated by pending federal legislation is the gross receipts or the compensating tax, or both, anticipated federal requirements will only apply to a state's tax to the extent they apply to remote sellers. So, lawmakers could choose not to change the tax as it pertains to existing taxpayers. However, maintaining two sets of tax laws may be confusing to taxpayers and difficult and costly to administer. It would also present the undesirable situation where a taxpayer could choose which set of rules to live by, by virtue of creating choosing to create physical presence in the state.

Thus, it is worth considering what it would take to conform both the compensating and gross receipts tax to the controlling federal requirements. As mentioned previously, the tax bases and rates of the gross receipts tax and compensating tax are not the same. If significant changes to a tax must be made, other reforms could be considered in concert. Proposals for local option compensating tax (conforming rates and broadening local government tax bases), for example, have been made in the past. There has also been discussion of the much more complicated question of including services performed outside the state and used here under the compensating tax.

There are good reasons to re-evaluate New Mexico's gross receipts and compensating tax structures in the context of the 21st century. The way business is conducted has changed a great deal in the last several decades, with both services and capital being more mobile than ever. Simultaneously, New Mexico has seen its broad-based and low rate tax system devolve, most notably of concern in the consumer base. The negative effects of pyramiding on New Mexico businesses have been made worse, and rendering local businesses less competitive as a result.



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Contracting practices in the government sector have also changed, and like tangibles, more services are purchased from out-of-state providers who don't charge or pay gross receipts taxes on top of their charges like local service providers must. Federal legislation represents an opportunity to pull services performed out of state into our tax base. But since most of those services are business-to-business transactions, rather than business to consumer, there is also a danger of increasing pyramiding.

In the spirit of not wasting a crisis, there is a lot that can be considered within the context of making necessary legislative changes to conform to potential federal law.



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APPENDIX A - Copy of S. 1832 as Introduced



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APPENDIX B - Issues Affecting New Mexico's Foregone Revenue from E-Commerce

