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FISCAL IMPACT REPORT

SPONSOR: Hobbs DATE TYPED: 2/27/03 HB 742

SHORT TITLE: Out of State Buyer Gross Receipts SB _____

ANALYST: Smith

REVENUE

Estimated Revenue		Subsequent Years Impact	Recurring or Non-Rec	Fund Affected
FY03	FY04			
	(600.0)		Recurring	General Fund
	(400.0)		Recurring	Local Governments

(Parenthesis () Indicate Revenue Decreases)

SOURCES OF INFORMATION

Responses Received From
TRD

SUMMARY

Synopsis of Bill

Senate Bill 727 amends 7-9-57 to require written evidence to indicate that the buyer is out of state. Section 7-9-57 NMSA 1978 currently allows sellers of services to out of state buyers to deduct gross receipts, provided the buyer executes a nontaxable transaction certificate (NTTC) or other acceptable evidence [*that the sale is to an out of state buyer and which indicates that the initial use and delivery of the product of the service did not occur in New Mexico*—Taxation and Revenue Department Regulation 3.2.215.10].

The section is further amended to include two definitions:

1. “Delivery of the product of the service” is defined to require an identifiable act whereby the seller conveys the product of the service into the actual or constructive possession or control of the buyer.
2. “Initial use of the product of the service” is similar to the definition contained under current law Section 7-9-3, Paragraph O, but further requires an identifiable activity by the buyer that first employs the product of the service.

FISCAL IMPLICATIONS

TRD notes that there is no *direct* fiscal impact associated with this proposal. However, under this proposal, the written evidence provided by the buyer is only required to indicate that the buyer is out of state. This effectively eliminates the requirement that the seller accept the evidence with a good faith belief that there will not be initial use or delivery of the product of the service in the state. Hence, this bill will increase the likelihood that taxpayers will claim inappropriate deductions, and will make it harder for the department to determine the validity of those deductions. The result will be a reduction of audit efficiency, with fewer collections on audit. In addition, there will be ongoing erosion in the revenue base due to reduced compliance with the statutes.

The fiscal impact is based on the size of the services sector in the gross receipts tax base, and the level and efficiency of audit activity. In the absence of this legislation, audit recoveries from invalid deductions for the sale of services to out-of-state buyers will be close to \$2.3 million in fiscal year 2004. The fiscal impact assumes provisions of this bill will increase claims of invalid deductions by roughly 10%, and the audit recovery rate for these taxpayers will be cut by 25%.

ADMINISTRATIVE ISSUES

TRD also notes a significant administrative impact. The bill would impose an additional burden on limited audit resources. If the evidentiary requirement is relaxed, department auditors will have to establish other more time-consuming and likely more subjective means of determining the validity of taxpayer deductions taken under Section 7-9-57.

TECHNICAL ISSUES

In this case, the NTTC or other written evidence is a promise from the buyer to the seller that the buyer is out of state and product of the service will be initially used and delivered out of state. Hence, a seller can accept written evidence from a buyer as proof that a sale qualifies for deduction. In this manner, the provisions of Section 7-9-57 serve to protect the seller when the validity of the deduction depends on what the buyer intends to do with the product of the service. If it is later determined that the buyer inappropriately used the initial product of the service in New Mexico, the department would assess the buyer, not the seller who took the deduction in good faith. If these requirements were relaxed, the seller may have to identify other evidentiary means to substantiate any deductions taken.

OTHER SUBSTANTIVE ISSUES

TRD has substantial concerns over this bill. The department states that SB727 represents an attempt to erode and displace the current system of verifying and enforcing statutory deductions in a piecemeal manner. If the current system is to be fundamentally changed, it should be done so in a *consistent* and *all-encompassing* manner following a thorough and deliberate reform process including and addressing the concerns of industry as well as the concerns of protecting the state's interests. The "Blue Ribbon Tax Reform Commission" is scheduled to make its tax policy recommendations no later than September 1, 2003. This and similar proposals should be reviewed by the commission for consistency with the state's overall tax policy objectives. This proposal would increase the complexity and subjectivity of performing audits of some gross receipts taxpayers; it will have a negative impact on collections from these audits and could increase litiga-

tion and protest expenses. This bill will drive down audit efficiency. This directly opposes the goals of the Revenue Enhancement Audit Program (REAP).

Recently, the department has made a concentrated effort to modernize the NTTC system. In addition to expertise from internal personnel, the department has incorporated input from the legislature and private industry to streamline the process and minimize compliance and enforcement burdens. Included among the major improvements are plans to employ an electronic issuance process, including online application and approval. In addition, plans are being made to consolidate the number and types of NTTCs issued, from 15 certificate types into 6 main classifications. Overall, these changes are expected to expedite the application process and improve compliance. This is accomplished by eliminating reliance on paper documentation thereby reducing the administrative burden on the department, as well as taxpayers.

SS/yr