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FISCAL IMPACT REPORT

ORIGINAL DATE 01/29/11

SPONSOR Chavez, E. LAST UPDATED _____ HB 102

SHORT TITLE Internet Sales Gross Receipts SB _____

ANALYST Golebiewski

REVENUE (dollars in thousands)

Estimated Revenue			Recurring or Non-Rec	Fund Affected
FY11	FY12	FY13		
	0	0	Recurring	General Fund

(Parenthesis () Indicate Revenue Decreases)

SOURCES OF INFORMATION

LFC Files

Responses Received From

Taxation and Revenue Department (TRD)
Attorney General's Office (AGO)

SUMMARY

House Bill 102 repeals the gross receipts tax exclusion for operating a worldwide web site as a third party content provider on a computer physically located in New Mexico. The bill also seeks to establish nexus for a seller with New Mexico affiliates who refer potential customers to the seller when those referrals result in sales exceeding \$10,000 per year.

FISCAL IMPLICATIONS

It is unclear whether this bill will have any effect on gross receipts revenues for a number of reasons. First, as the Attorney General's Office notes, nexus is determined under the Commerce Clause. Additionally, because of the size of the business community and the population of New Mexico, it is likely that major sellers will discontinue all affiliate relationships in New Mexico in response to the imposition of tax on internet sales transactions.

The discontinuance of affiliate relationships will likely have negative effects on New Mexico business's retail sales, and therefore, will have a negative impact on general fund revenues. With expectations of small positive impact on gross receipts revenues from those sellers who continue their affiliate relationships and the potential negative effects resulting from the dissolution of relationships between New Mexico business and major internet retailers, House Bill 102 is

expected to have no effect on general fund revenues.

TRD:

Nexus is not a concept based on state law but is a federal constitutional concept under the Commerce Clause. The proposed bill or any other change to state law cannot expand what constitutes nexus. There is a risk that this bill could in effect limit nexus. In particular, setting a definitive threshold based on sales volumes and not based on contract structures or in-state actions of affiliates may limit taxable nexus. For example, while referring only one customer may not create nexus, sales of less than \$10,000 could constitute nexus depending on the contract structure with affiliates or in-state actions taken by affiliates.

SIGNIFICANT ISSUES

TRD:

This bill is similar to a bill passed by New York State intended to capture internet sales from online retailers known as the “Amazon Law.” New Mexico’s tax structure is different than New York and most other states because of our gross receipts tax and Section 7-9-7.1 NMSA 1978 which bars the Department from taking any actions to collect the compensating tax on households or non-business individuals. The legal incidence or burden of New Mexico’s gross receipts tax is on the seller (not the buyer as in most states). A state can only tax a business if that business has an actual physical presence (nexus) inside the State. Nexus can be triggered by the business having property, employees, agents, or independent contractors inside the state. There is a large and expanding amount of case law prescribing what kind of actions and contractual agreements by related agents or contractors will actually trigger nexus. For example in *Dell Catalog v NM Tax & Rev.*, 2009-NMCA-001, 145 N.M. 419 a contractor physically present in New Mexico that serviced the computers sold by Dell gave Dell nexus and made Dell’s receipts subject to New Mexico’s GRT.

In 2009, major internet retailer, Amazon, Inc., cut ties with affiliates in North Carolina and Rhode Island in response to attempts to tax internet sales in those states. More recently, Amazon, Inc. sent letters to affiliates in Illinois in response to a bill that proposes to tax internet sales. The letter states the intention to break relationships with affiliates in Illinois if the bill is signed by the governor. Highly populated states with large business participation are those that appear to be insulated from these pressures; New Mexico is not likely to be one of these states.

In the absence of sales tax on internet transactions, retailers with physical nexus in New Mexico are at a competitive disadvantage. Internet retailers are able to offer lower prices artificially because they are not taxed. Additionally, the state is foregoing gross receipts tax revenue by not taxing internet sales. The frequency of internet sales has increased substantially over the past few years and is expected to continue growing. The issues associated with the lack of state sales tax on internet sales are anticipated to worsen in the coming years. On a larger scale, unified effort by the states will be necessary to further the discussion on the taxation of interstate sales.

ADMINISTRATIVE IMPLICATIONS

TRD:

The information that this bill uses to make a presumption for engaging in business would not be available to the Department other than by direct audits. The Department's Audit and Compliance Division does not believe this proposal would make the determination of nexus any easier than under current law.

Although this bill intends to increase compliance and help audit efforts it is not clear that compliance will increase or audit abilities will be simplified. Since the majority of these companies would not be registered with the department, it would be difficult to identify those who owe the gross receipts tax due to the affiliated nexus rule. Also, it would be difficult for the Department to identify sales that were made through the affiliate as opposed to the New Mexico customer going directly to the out of state companies website since the sales invoice would just identify the ship to address and not how the sale was solicited.

Page 3, lines 17-22, Every year a taxpayer would have to determine if they went over the \$10,000 threshold to determine if their receipts would be taxable. Those going over the threshold would then have to pay tax but would incur penalty and interest because they were waiting to see if they actually went over the threshold. Some may decide just to pay on an ongoing basis but may be able to claim a refund since their receipts may fall under the \$10,000 threshold.

An effective date of July 1 or January 1 would be easier to administer.

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

HB 102 is identical to SB 95

TECHNICAL ISSUES

AGO:

An argument can be made that subjecting an out-of-state seller, with no physical presence in New Mexico, to state gross receipts tax violates the Commerce Clause of the United States Constitution. The United States Supreme Court has established a four-prong test to determine whether state taxation of out-of-state businesses falls within the parameters of the Commerce Clause. See *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977). Under *Complete Auto*, state taxation of out-of-state businesses conducting interstate commerce will be upheld under the Commerce Clause so long as the tax (1) is fairly apportioned, (2) does not discriminate against interstate commerce, (3) is fairly related to the services provided by the taxing state, and (4) is applied to an activity with a substantial nexus with the taxing state *Id.* at 279.

The provision factor most likely at issue in this instance would be the fourth, requiring a "substantial nexus." The seminal United States Supreme Court case concerning "substantial nexus" under the Commerce Clause is *Quill v. North Dakota*, 504 U.S. 298

(1992). The New Mexico Court of Appeals also addresses this issue in *Dell Catalog Sales L.P. v. Taxation & Revenue Dep't*, 2009-NMCA-1, 145 N.M.419, 199 P.3d 863.

TRD:

The \$10,000 minimum provided in new Section 7-9-5(C)(2) is unnecessary and possibly contradictory to the provision in new Section 7-9-5(C)(1). The activities described in Section 7-9-5(C)(1) by themselves (under federal constitutional law) are sufficient to establish nexus with New Mexico regardless of the amount of actual sales.

New Subsection D also conflicts with new Section 7-9-5(C)(1). The contract agreements described in section 7-9-5(C)(1) provide taxable nexus regardless of whether there was solicitation activity in New Mexico.

Page 3, line 24 – the bill does not specify what proof would be acceptable to refute the nexus requirement.

The amendment to the definition of “engaging in business” to remove the exclusion for a website hosted in New Mexico seems unrelated to primary intent of the legislation. The taxability of large online retailers is not changed by removing this exclusion because hosting websites on server physically located in New Mexico does not constitute nexus under federal case law. Such a change of New Mexico law may result in added confusion over taxability that may harm New Mexico businesses that host websites on servers physically located in New Mexico.

JAG/bym