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F I S C A L   I M P A C T   R E P O R T

SPONSOR Lujan, B.   **ORIGINAL DATE** 02/22/11   **LAST UPDATED** 03/09/11   **HB** 429/aHFL#1

SHORT TITLE Compensating Tax Transaction Requirements   **SB**

ANALYST Golebiewski

REVENUE (dollars in thousands)

Estimated Revenue			Recurring or Non-Rec	Fund Affected
FY11	FY12	FY13		
	*	*	Recurring	General Fund
	*	*	Recurring	Small Cities Assistance
	*	*	Recurring	Small Counties Assistance
	*	*	Recurring	Municipalities

(Parenthesis ( ) Indicate Revenue Decreases)

* Please See Fiscal Implications

SOURCES OF INFORMATION

LFC Files

Responses Received From

Taxation and Revenue Department (TRD)

Attorney General's Office (AGO)

SUMMARY

Synopsis of House Floor Amendment #1

The House Floor amendment #1 removes the provision in House Bill 429 that would increase the compensating tax rate from 5 percent to 5 and 1/8 percent on a subset of services rendered in New Mexico. The amendment would keep the tax rate on these services at 5 percent, which is one-eighth percent lower than the state GRT rate.

Synopsis of Original Bill

House Bill 429 would clarify that the compensating tax is imposed on tangible personal property in New Mexico that is acquired inside or outside New Mexico as a result of a transaction with a person located outside New Mexico. This transaction would have been subject to the gross receipts tax had the property been acquired from a person with nexus in New Mexico. HB 429 also increases the rate of compensating tax imposed on services from 5 percent to 5.125 percent to match the rate imposed on tangible personal property by the state.

FISCAL IMPLICATIONS

TRD:

The proposal clarifies an ambiguity resulting from 2010 changes to the compensating tax. No significant change in revenue should result. If the proposal is not adopted, however, some revenue may be lost in the future if taxpayers take the position that the ambiguity means their transactions are not taxable. See **Technical Issues** below. 10 percent of the compensating tax is distributed to the small cities assistance fund, 10 percent to the small counties assistance fund, approximately another 5.4% to all municipalities, and the remaining 74.6% is distributed to the General fund.

The proposal to raise the compensating tax rate by one-eighth percent on certain services transactions would bring that tax rate into conformity with the broader compensating tax rate increase adopted last year. The new increase applies to a small number of purchases of services in which the Department determines upon audit that a transaction which was not initially treated as subject to the gross receipts tax should have been taxable because of the buyer's subsequent use of the services. No significant change in revenue is expected from this provision.

SIGNIFICANT ISSUES

TRD:

The compensating tax is New Mexico's version of a use tax, and plays an important role in the state's tax structure. Since states are prohibited by federal constitutional rules from imposing their sales tax on sellers without a physical connection ("nexus") to the state, all states with a sales tax also impose a use tax on in-state purchasers buying from out-of-state sellers. This prevents the sales tax from creating an incentive to buy out-of-state, and levels the playing field for New Mexican businesses.

ADMINISTRATIVE IMPLICATIONS

TRD:

Because the change falls in the middle of a report period, there can be costs associated with educating taxpayers. An applicability date would simplify administration and compliance. Since the bill clarifies an ambiguity in the 2010 changes, an applicability date of July 1, 2010 would be appropriate.

TECHNICAL ISSUES

TRD:

The proposal would clarify an ambiguity resulting from 2010 changes to the compensating tax act. The 2010 changes were themselves needed to clarify the application of the compensating tax after a 2008 New Mexico Supreme Court decision (*Dell Catalogue Sale L.P. v. New Mexico Taxation and Revenue Department 199 P.3d 663*). In that decision, the definition of a "New Mexico sale" for purposes of the gross

receipts tax (GRT) was changed. A purchase from an out-of-state seller delivered to a New Mexico buyer was deemed to be subject to GRT if the seller has nexus. Although this may have expanded the base of the GRT in cases where the seller had nexus, the decision created a problem in the compensating tax. Since property delivered to New Mexico was now to be considered a "New Mexico sale", it no longer met the old law description of property "acquired outside the state" and thus compensating tax would no longer apply if the seller did not have nexus.

To address the problem of non-nexus sales, HB-281 of the 2010 regular session – later incorporated as Section 10 of SB-10 in the Special Session – changed the definition of the compensating tax. Instead of applying to sales that would have been subject to the GRT if they had occurred in the state the statute now applies to sales that would have been subject to GRT if the seller had nexus.

As amended in 2010, the compensating tax would clearly apply to purchases by a New Mexico buyer from a non-nexus out-of-state seller if the property is delivered into New Mexico. However, the new language created ambiguity about transactions in which property is acquired outside the state, because that transaction might not "have been subject to the GRT" even if the seller had nexus. Although the current language applying compensating tax "if the seller has nexus" could be interpreted to imply that the compensating tax would apply to these transactions, i.e. that the seller's nexus implies the tax would be "subject to the GRT," the proposed language removes the ambiguity, and prevents potential disputes over the issue.

AGO:

Note that the New Mexico Court of Appeals, in Dell Catalog Sales L.P. v. New Mexico Taxation and Revenue Dept., 2009-NMCA-1, 145 N.M. 419, 199 P.3d 863, upheld the application of the compensating tax, as not violating the Commerce Clause, to out-of-state taxpayer having a substantial nexus with New Mexico. The activity, as it concerned the compensating tax, pertained to taxpayer's distribution of catalogs designed, printed and prepared outside New Mexico and mailed to New Mexico. The case was decided under the former version of section 7-9-7(A)(2), which applied the tax to tangible property that was "acquired outside this state as the result of a transaction that would have been subject to the gross receipts tax had it occurred within this state."

JAG/mew:bym:svb