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

**SPONSOR** Smith **ORIGINAL DATE** 2/16/17 **LAST UPDATED** **HB**

**SHORT TITLE** Reporting Sale Of Services By Jurisdiction **SB** 309

**ANALYST** Graeser

**REVENUE (dollars in thousands)**

| Estimated Revenue | | | | | Recurring or Nonrecurring | Fund Affected |
|---|---|---|---|---|---|---|
| FY17 | FY18 | FY19 | FY20 | FY21 | | |
| | Indeterminate, but probably positive (up to $2,000.0) | | | | Recurring | General Fund |
| | Indeterminate, but probably negative in aggregate | | | | Recurring | Municipalities (aggregate) |
| | Indeterminate, but probably negative in aggregate | | | | | Counties (aggregate) |

Parenthesis ( ) indicate expenditure decreases. ** R = recurring; NR = non-recurring

**SOURCES OF INFORMATION**
LFC Files

Responses Received From
Taxation and Revenue Department (TRD)
New Mexico Municipal League (NMML)

**SUMMARY**

Synopsis of Bill

Senate bill 309 alters the location sourcing rule for gross receipts in the business and professional services area. Gross receipts would be reported using the location where the service is delivered to the ultimate consumer. Gross receipts from the sale of lobbying services are to be reported to where the ultimate consumer is domiciled, if the ultimate consumer is an individual, or where the ultimate consumer has its principal place of business in the state, if the ultimate consumer is a business. Definitions of the terms “business services” and “professional services” are also added.

The effective date of this bill is July 1, 2017.

**FISCAL IMPLICATIONS**

The fiscal implications of this bill for the general fund are quite difficult to determine. The effects on individual municipalities and counties is even more difficult. For example, ancillary services related to construction, such as architecture, surveying, landscape architecture, by professionals with current business locations within municipalities would be reported to the location of the construction. Most of the fiscal impact of this proposed change has already occurred, with the 2012 expansion of the deduction of ancillary services (7-9-52 NMSA 1978).

For receipts from professional service performed by a taxpayer with current business location in a municipality, but where the delivery location is in the remainder of county, the general fund gains 1.225% of those receipts. The total business and professional services taxable gross receipts do not give answers to these knotty questions. A three-month sample of TRD's Report 80 for business and professional services at the 4-digit NAICS level reveals the following:

| 2016 3rd Quarter -- RP80 | ALL LOCATIONS | | Remainder of County (Ex Los Alamos) | | % | |
|---|---|---|---|---|---|---|
| NAICS Description | Count | Txbl Gross Rcpts | Rmdr Count | Rmdr Txbl Gross Rcpts | Count | Txbl Gross Rcpts |
| **54 - Professional, Scientific, and Technical Services Total** | 241 | $19,648,410 | 36 | $16,051,628 | 14.9% | 81.7% |
| **541 - Professional, Scientific, and Technical Services Total** | 6,741 | $204,099,732 | 1,212 | $28,041,080 | 18.0% | 13.7% |
| **5411 - Legal Services Total** | 3,057 | $111,290,171 | 156 | $1,493,519 | 5.1% | 1.3% |
| **5412 - Accounting, Tax Preparation, Bookkeeping, and Payroll Services Total** | 1,345 | $27,828,908 | 140 | $716,752 | 10.4% | 2.6% |
| **5413 - Architectural, Engineering, and Related Services Total** | 1,854 | $79,702,196 | 310 | $15,403,461 | 16.7% | 19.3% |
| **5414 - Specialized Design Services Total** | 600 | $10,993,228 | 72 | $702,158 | 12.0% | 6.4% |
| **5415 - Computer Systems Design and Related Services Total** | 1,764 | $52,859,883 | 232 | $6,270,641 | 13.2% | 11.9% |
| **5416 - Management, Scientific, and Technical Consulting Services Total** | 2,780 | $56,874,080 | 527 | $14,515,497 | 19.0% | 25.5% |
| **5417 - Scientific Research and Development Services Total** | 248 | $204,329,268 | 52 | $193,326,907 | 21.0% | 94.6% |
| **5418 - Advertising, Public Relations, and Related Services Total** | 488 | $13,367,485 | 72 | $232,965 | 14.8% | 1.7% |
| **5419 - Other Professional, Scientific, and Technical Services Total** | 3,730 | $213,287,375 | 724 | $19,005,662 | 19.4% | 8.9% |
| | 22,848 | $994,280,736 | 3,533 | $295,760,270 | 15.5% | 29.7% |

Total Taxable Gross Receipts for all locations would total about $4 billion for the whole year (the sample does not include the peak June and December months in which semi-annual filers report). Of this total, about 30% is reported to remainder of county locations. The big contribution here is Sandia National Laboratory. SNL is located in the remainder of Bernalillo County and the location of its receipts would change dramatically. The ultimate consumer of SNL's services would likely be the Department of Energy that provides most of the funding for SNL. In that case, the state general fund would not be affected, but Bernalillo County's GRT revenue would be devastated. They would receive no local option revenue. Albuquerque's revenue would also materially change as would general fund revenues for receipts that are currently reported to the city, but where the delivery location is in the remainder of Bernalillo County. In this case, Albuquerque would lose both the state share 1.225% and its local option taxes. Bernalillo County would gain slightly attributed to a .125%

In NAICS 54, the bulk of the remainder taxable gross receipts is currently sourced to San Juan County. Under the provisions of this bill, any of the services delivered to municipal locations would increase the current tax rate of 6.5625% to the rate in effect in the municipality. Assume the $60 million in annual TGR were all reported to Albuquerque (7.3125%)). San Juan County would lose $820,000, the state would lose the 1.225% state share, or $730,000, Albuquerque would gain $2,048,000.

The inclusion of "insurance" in the definition of "business services" will have little impact. Insurance brokerages are not heavily taxed. This sector generates about $2,000,000 annually in taxable gross receipts, of which about $100,000 is currently sourced to county remainder locations. To a slight extent, inclusion of this sector in "business services" would result in a small increase in general fund for transactions where the business location is currently within a municipality, but would be reported to remainder county locations.

Lobbying services would generally be reported to non-Santa Fe locations – out-of-state if the client is a national or multinational firm, or other municipal locations for clients headquartered in Albuquerque or other cities in New Mexico. Santa Fe would lose substantial revenue, although the general fund would be approximately neutral.

In summary, the general fund would gain from transactions where the receipts, currently sourced to a municipality, would be sourced to the county remainder or out-of-state. Municipalities would generally lose from transactions where the receipts, currently sourced to that municipality, would be sourced to a county remainder or out-of-state. Counties would generally lose from transactions where the receipts, currently sourced to the county would be sourced to an out-of-state location.

**SIGNIFICANT ISSUES**

TRD comments on the policy issues: "… this bill fundamentally moves the GRT regime from an "origin-based" sourcing regime to a "destination-based" sourcing regime for sales of services. Construction services are already sourced on a destination basis under the GRT regime – i.e. the location of the construction project."

"From a policy perspective the bill implicates equity with respect to revenue distributions. It highlights countervailing interests between market and origin jurisdictions. Moving to the proposed system more equitably distributes tax revenue based on where the taxpayer's customers are located. On the other hand, host locations bear the direct costs of providing governments services to many service-based businesses. As GRT is imposed on the seller, not the purchaser, for the privilege of engaging in business, there is a synergy in the existing sourcing rules in that the location where the businesses most predominantly exercises that privilege receives the revenue."

"On a practical note, the proposed bill will have unpredictable consequences for local government revenue streams, as each jurisdiction will be affected differently based on whether they are provider-rich or market-rich with respect to services. This uncertainty will likely be compounded by anticipated taxpayer misreporting that both involves fundamental shifts in locational reporting and that cannot be quantified. At this juncture, given resource constraints, ROI expectations, and audit focuses, the Taxation and Revenue Department (TRD) will not be able to increase audit efforts for the sole purpose of ensuring correct locational reporting."

**TECHNICAL/ADMINSTRATIVE/PERFORMANCE ISSUES**

TRD has significant issues with implementing the significant changes proposed in this bill and implementing those changes by the July 1, 2017 effective date.

TRD's primary concern is with complication in the selected mechanisms for destination sourcing. The bill appears to borrow concepts from market-based sourcing principles for income taxation. While those principles generally serve well for annual income tax filings, they can be onerous for monthly GRT/sales tax regimes. In short, a more simple form of destination sourcing is preferable, most specifically, in two respects. First, "ultimate consumer" is not defined in the Gross Receipts and Compensating Tax Act and it may imply, in certain situations, a "look through" from an intermediary customer to a final customer. Second, for simplicity, it might be preferable to substitute billing address for a reasonable approximation test set forth in Section 1, E. For simplicity reasons, TRD recommends using the term "customer" to avoid "look through" issues and to have an easy-to-apply alternative, such as billing address, in lieu of a reasonable approximation standard. While arguably less precise, an easy-to-apply standard eases compliance burdens and provides more certainty to both taxpayers and local governments than "reasonable approximation."

Moreover, consideration should be given to the treatment of service out-flow. For example, lobbying services, and indeed other services, may be provided to out-of-state consumers that do not have a principle place of business in the state. Thus, some services that would otherwise be subject to a combined state and local GRT rate may end up being sourced to out-of-state locations by necessity, resulting in capturing revenue based solely on the state rate.

Another significant technical issue is that the bill contains no sourcing mechanism for "personal services." Only business, professional, and lobbying services are specifically sourced. This leaves a significant absence in law that is difficult to fill. Some personal services, such as stylists, can easily and appropriately be sourced to the business location of the provider. Others, such as online educational services, leave ample room for debate under a market or destination-based approach. Additionally, "construction managers are potentially subject to two different reporting jurisdictions. In Section B, it is where the construction project is performed. However, as a "professional services, see section G.2., it is where the service is delivered to the ultimate consumer of the project. This may not be where the construction project is performed. The person who buys the services may not be where the construction is located.

There may also be technical issues associated with language choices for the "business service" definition. In referring to the absence of a "product," this may, in certain circumstances, make administering deductions that focus on where the "product of the service" is delivered difficult.

Section E would have broad repercussions for taxpayers, municipalities, and TRD. Firstly, regarding the impact to taxpayers, by changing the reporting jurisdiction for all professional and business services from the jurisdiction of the primary place of business to the jurisdiction where the service is delivered to the ultimate consumer, taxpayers' method of record keeping would need to be expanded to include the location that the service was delivered to. In the case of an audit, every taxpayer selling services would need to be able to justify the use of each tax rate for each transaction being taxed. Second, depending on the definition of "ultimate consumer", if the taxpayer's service is being resold, they would be required to report based on where the service was delivered to the end user. This would be overly cumbersome for taxpayers. It is also possible that if after the service is resold to an end-user out of state, the transaction may not be subject to any tax.

The impact to TRD would increase the time this new factor would add to audits. The bill also states that the jurisdiction shall be reasonably approximated. In allowing loose accountability on the part of the taxpayer, any taxpayer found to be reporting incorrectly could be relieved of penalty if determined to owe additional tax, regardless of intention.

LG/sb