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FISCAL IMPACT REPORT

SPONSOR: Hobbs   DATE TYPED: 02/09/01   HB 348

SHORT TITLE: Tax Deduction for Sale of Service for Resale   SB

ANALYST: Eaton

REVENUE

Estimated Revenue		Subsequent Years Impact	Recurring or Non-Rec	Fund Affected
FY01	FY02			
	$ (15,000.0)	$ (40,000.0)	Recurring	General Fund
	$ (10,000.0)	$ (20,000.0)	Recurring	Local Govt.
		See Narrative Significant	Recurring	

(Parenthesis ( ) Indicate Revenue Decreases)

SOURCES OF INFORMATION

Taxation and Revenue Department (TRD)

SUMMARY

Synopsis of Bill

This bill proposes one major change and one technical change to the resale of services deduction under gross receipts tax. The major change is to remove the requirement that the subsequent resale be taxable. The technical change is that the resold service may be combined with other services, tangible personal property or licenses and still be eligible for a resale deduction. This accommodates an increasingly complex chain of events that take place in ordinary commerce.

FISCAL IMPLICATIONS

The Taxation and Revenue Department (TRD) estimate the full year impact of this bill would be to reduce the general fund by $40 million. Local government revenues would be decreased by an estimated $20 million.

The Taxation and Revenue Department report that these impacts should be considered an educated guess. Public testimony a few years ago put the gross receipts tax reimbursed by Los Alamos National Laboratory (LANL) to its subcontractors in the $15 million range. There is no method for estimating the proportion of the tax base that would become non-taxable under the provisions of this bill.

The technical correction portion of this bill, which allows services to be combined with other services, tangible personal property and licenses, is unlikely to cost more than $1million. Most of the more sophisticated taxpayers have already restructured contracts and payment relationships to take advantage of a services resale deduction. The cost of the technical correction portion of this bill is to extend the same deduction to less sophisticated taxpayers who have continued to pay gross receipts tax on the type of transactions listed in this bill.

ADMINISTRATIVE IMPLICATIONS

The Taxation and Revenue Department (TRD) report that there would be a minimal impact on processing but a significant impact on audit, taxpayer seminars and information, forms and instruction development, ruling and regulation, legal services bureau, protests and hearings.

These changes overturn decades of carefully developed case law and policy. Many rulings would have to be withdrawn and reissued. TRD estimates hundreds of hours of ruling and regulation development would be followed by hundreds of hours of audit, legal, protest and hearing activity as the agency struggles to implement the provisions of this bill. The level of activity required is not currently budgeted.

OTHER SUBSTANTIVE ISSUES

To illustrate the significance of the change proposed by this bill, the Taxation and Revenue Department (TRD) provided the following list of scenarios that would be affected.

- Services sold to Los Alamos National Laboratory (LANL) for resale to the federal government.

- Services sold to consolidation agents of Sandia National Laboratories (SNL). These agents receive Non-Taxable Transaction Certificates (NTTCs) directly from Sandia, but may not issue NTTCs to service subcontractors since the services are not taxable. Most of this exposure has been eliminated by judicious contract writing.

- Services sold to a reseller who subsequently sells the services outside the state. Under current law, the use of the service is in-state and taxable to the seller. Under this bill, the services would be deductible. Note: this is an area for tax planning under current law. If the reseller is an agent for the seller, then the sale from the seller to the ultimate buyer is currently deductible as a service for export. This bill would simply allow the deduction irrespective of this indirect procedure.

- Subcontracted health services, including diagnostic procedures, where purchaser is an Health Maintenance Organization (HMO) or 501(c)(3) not-for-profit entity.

- Doctors and other health practitioners who contract with 501(c)(3) for acute and emergency services through a personal Limited Liability Corporation (LLC). It is likely that under this proposal this practice will expand as hospitals will bill 3rd party payers on behalf of doctors with patient referrals at the hospital.

- Insured individuals will have insurance companies pay doctors directly. The insurance company (non-taxable entity) is reselling health services performed for individuals by the doctors. The mechanism of the reselling is the premium payment.

- If this bill passes, other areas of the Gross Receipts and Compensating Tax Act will be affected indirectly. It is likely that construction would become involved. First, receipts of architects and surveyors, for example, providing design and other essential services to construction contractors for speculative construction would arguably become deductible. Determining when a service is consumed as opposed to "re-sold" will become a much more active part of tax administration.

- Subcontracted specialized repair services have always created problems, and this bill would resolve that problem, at a modest cost in lost revenue.

- Including software in manufactured tangible personal property is a potential issue, although the Department has increasingly allowed the deductible inclusion of software in manufactured equipment, and the separate deductible inclusion of custom software in tangible personal property installed for and sold to government.

- A lot of entertainment is booked by non-profits organizations or governments. The state does not currently collect a lot of tax from entertainers and professional athletes, but the services provided by these persons are gross receipts taxable. When the producer or promoter is a taxable entity, the contracted services are eligible for an Non-Taxable Transaction Certificate (NTTC), but when the producer or promoter is a non-profit or government entity, the services are taxable because the ticket price is not taxable. Pursuant to the provisions of this bill, these entities could issue NTTCs and render the services non-taxable.

JBE/sb:ar