Pyramiding and Other Gross Receipts Tax Issues

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Pyramiding and Other Gross Receipts Tax Issues

Overview

My presentation will cover four broad issues in the gross receipts tax:

1. Pyramiding;

2. Special exemptions and deductions;

3. Rate differentials within the gross receipts tax; and

4. Rate differentials with related taxes

Pyramiding and Other Gross Receipts Tax Issues

Pyramiding

- **Pyramiding occurs whenever a business's receipts are subject to gross receipts tax <u>and</u> some or all of the business's purchases from other businesses are also subject to gross receipts (or compensating) tax**

- **Examples of pyramiding are the gross receipts tax on most services (including construction), utilities and equipment sold to businesses**

  - **The gross receipts tax on business equipment may be partially offset by the investment tax credit**

  - **It should be noted that many transactions between businesses are not subject to tax because of existing exemptions, deductions or credits**

- **Pyramiding causes economic distortions that reduce business activity and incomes in New Mexico**

  - **Some businesses do not locate, or do not expand, in New Mexico because their costs are increased by pyramiding**

  - **Small businesses may have trouble competing with larger businesses that can avoid gross receipts tax on business services like accounting by having their own accounting staff**

  - **Businesses that purchase from other businesses have an incentive to purchase out-of-state**

Pyramiding – Cont.

- **A comprehensive list of items that give rise to pyramiding is contained in the report prepared for TRD by Thomas Pogue, professor emeritus at the University of Iowa, "Tax Expenditure Budget: Defining the Benchmark GRT Base"**
  - **This report is available on TRD's web site**
- **Pyramiding could be addressed in several ways, such as allowing a general deduction or credit for sales to other businesses or allowing purchasing businesses a general deduction or credit for taxed purchases**
- **The alternative ways in which pyramiding could be addressed can have different policy, administrative and revenue effects, so need to be considered carefully**
- **Pyramiding represents a large portion of the gross receipts tax base, so addressing it comprehensively would require substantial replacement revenues**
  - **Some estimates are that pyramiding represents about 1/3 of the gross receipts tax base**
  - **If this estimate is correct, roughly $1 billion in gross receipts tax revenue is due to pyramiding**

Special Exemptions and Deductions

- **There are many exemptions and deductions from the gross receipts tax base, but most of these are necessary to define the gross receipts tax base and are not "special"**
  - **For example, the largest gross receipts tax exemption is for wages**
  - **The exemption for wages is necessary to avoid pyramiding, since virtually all business sales require utilization of some employees**
- **Special exemptions and deductions remove from the gross receipts tax base items that in principle should be taxed**
- **What "should" be taxed? There is general agreement that a gross receipts (or sales) tax should apply to all purchases of goods and services by households**
- **So, motor fuels, all food and all medical services purchased by households "should" in principal be taxed under gross receipts tax, but are not due to special exemptions or deductions**
- **Although special exemptions and deductions narrow the gross receipts tax base, they may have desirable goals**
  - **The food deduction was adopted to reduce the regressivity of the gross receipts tax**

Special Exemptions and Deductions – Cont.

  - **The medical deduction can be considered a way of avoiding taxation of medical services under both the insurance premiums tax and the gross receipts tax**

- **A comprehensive list of special exemptions and deductions in the gross receipts tax base is included in the report by Professor Pogue cited above**

- **Alternative approaches to achieving the goals of special exemptions and deductions would likely have different policy, administrative and revenue effects, so need to be considered carefully**

Rate Differentials Within the Gross Receipts Tax

- **There are significant rate differentials within the gross receipts (and compensating) tax:**

Location(s)	Average Rate in FY09	Highest Current Rate
Rates		
Inside Municipalities	**7.1%**	**8.5625%**
Remainder of County Areas	**6.0%**	**7.0%**
Out of State Seller*	**5.0%‡**	**5.0%‡**
Out of State Seller*, Delivery in NM	**0%**	**0%**
Rate Differentials		
Municipal/Remainder of County	**-1.1%**	**-2.4375%+**
Municipal/Out-of-State Seller*	**-2.1%**	**-3.5625%**
Remainder of County/Out-of-State Seller*	**-1.0%**	**-2.0%**
Municipal/Out-of-State Seller*, Delivery in NM	**-7.1%**	**-8.5625%**
Remainder of County/Out-of-State Seller*, Delivery in NM	**-6.0%**	**-7.0%**

*** Seller without nexus in New Mexico**
‡ This is an imposition of compensating tax
+ This is the largest municipal/remainder differential (Ruidoso/Lincoln)

- **These rate differentials, like pyramiding, cause economic distortions that reduce business activity and incomes in New Mexico**

- **In some cases, rate differentials cause greater economic distortions than pyramiding**

Rate Differentials Within the Gross Receipts Tax – Cont.

- **The rate differentials with out-of-state sellers provide a significant incentive to make purchases from out-of-state rather than in-state businesses**

- **The very large rate differential when delivery from an out-of-state seller is in New Mexico is due to a "loophole" in the compensating tax**

  - **Note, however, most purchases made from out-of-state sellers are made by businesses, so any gross receipts tax on these purchases may result in pyramiding**

- **The rate differentials between inside municipalities and remainder of county areas may encourage businesses to chose their location and families to make purchases only because of the rate differentials, not because of underlying economic considerations**

  - **Such changes in economic decisions waste resources and reduce the total income available to New Mexicans**

Rate Differentials with Other Taxes

- **The Motor Vehicle Excise Tax and the Insurance Premiums Tax are both imposed in lieu of the gross receipts tax**

- **The Motor Vehicle Excise rate is 3%, compared to a statewide average gross receipts tax rate of 6.7% and much higher rates in many municipalities**

- **The Insurance Premiums Tax rate on health insurance is 4.003%**

- **In principal, all goods and services purchased by households should be taxed at the same rate unless a differential rate helps achieve some other policy goal**

- **As noted above, the Insurance Premiums Tax can be considered a tax on (insurance reimbursed) medical services, so the rate should be coordinated with any gross receipts tax deduction**

- **The motor vehicle excise applies to vehicles purchased for business use, so may result in pyramiding**