

January 1, 2013

During the 30-day Legislative Session in 2012 the construction industry was successful in helping Governor Martinez pass HB 184 which sought to curtail “Tax Pyramiding” for the construction industry. The bill passed, was signed into law, and became effective on January 1, 2013. Construction industry representatives worked with Tax and Revenue Department (TRD) leadership and staff to ensure implementation of the law change and how to utilize this opportunity.

One of the key changes in the new law is the creation of a class of “construction-related service” sub-contractor businesses who sell services directly to construction businesses. Some businesses in this new class have never been able to issue or accept Non-Taxable Transaction Certificates (NTTCs) before, and the accounting departments of construction businesses may find themselves having to educate these businesses in order to take advantage of the new GRT deductions.

During discussions with various members as the NMHBA Senior Officers have traveled around the state to update local HBAs over the past year, it has become apparent that our industry members have many questions about the process of compliance with the Gross Receipts and Compensating Tax Act. Even some suppliers of materials who have been accepting NTTCs for decades aren’t clear on the proper procedures for each transaction. These FAQs have been prepared by NMHBA staff to help clear up a few points. As always we encourage you to discuss these changes and your particular business situation with your accountant.

***Q.: How do I know if a transaction qualifies for the “construction-related service” deduction?***

***A.:*** HB 184 was pretty clear on inserting new language on this issue. The new law reads: “As used in this section, ‘construction-related service’ means a service directly contracted for or billed to a specific construction project, including design, architecture, drafting, surveying, engineering, environmental and structural testing, security, sanitation and services required to comply with governmental construction-related regulations; but “construction-related service” excludes general business services such as legal or accounting services, equipment maintenance and real estate sales commissions.” If you are a HERS/LEED rater, a consultant for stormwater runoff, or even a water truck operator spraying for dust control, then this new deduction applies to your services sold to construction businesses. HOWEVER, (illogically) the new law specifically does NOT allow for legal or accounting services, even if they are directly contracted for and billed to a specific construction project.

***Q.: The contractor paid sales tax when he purchased construction materials from my lumber yard; he’s paid all the GRT he needs to, right?***

***A.:*** **WRONG.** New Mexico does not have a “sales tax” like other states – we have a “Gross Receipts Tax” which means businesses pay a tax on their total receipts minus any non-taxable deductions. In New Mexico it is the seller of the goods or services who is responsible for paying the tax due on the transaction. It is customary for the seller to ask the buyer to pay the seller’s GRT and add it into the total purchase price. If you missed the explanation in Jack’s April 2012 *Housing Journal* article, we have attached it to the end of these FAQs.

***Q.: How does the NTTC process work?***

***A.:*** Put simply, a buyer (construction business or construction-related business) of goods or services issues an NTTC to the seller of the goods or services, certifying why the entire (or portion of a) transaction is deductible from the gross receipts of the seller’s business. The seller keeps these on file and reports their gross receipts (minus the deductions) to TRD on Combined Reporting (CRS) forms.

The seller keeps the actual NTTCs and must present them to TRD when requested (usually during an audit). If an audit reveals some transactions for which NTTCs usage was not appropriate, it is the seller who is responsible to pay the GRT (plus any interest or fines). Sometimes the seller will ask the purchaser who provided the inappropriate NTTC to pay the GRT retroactively.

This amounts to asking your customer to provide to you proof that they qualify for the deduction allowed. If the proof isn't acceptable to TRD, it is the seller who is responsible for paying the GRT.

***Q.: Does the buyer need to be a state-licensed contractor to be a “construction business”?***

**A.: No.** TRD rules define a “construction business” as someone who holds a contractor’s license issued by the state **or** who performs construction activities for which the Construction Industries Division (CID) does not require a contractor’s license.

If your customer is not required by CID to hold a contractor’s license but they are performing a “construction” activity listed in 7-9-3.4 NMSA, they need to ask CID for a letter stating that fact. TRD wants your customer to keep in their file documentation stating that as of the date they were performing the construction service they were not required to be licensed. As a seller whose transactions could be ruled invalid later, you may want to ask your customers to provide you with a copy of this documentation for your files.

***Q.: I am a supplier of construction materials. My contractor customers buy saw blades, drill bits, and sand paper in bulk using NTTCs, and store them until needed. Then they pull what they need out of their inventory and charge the exact amount used to the specific project. Is there a problem for me with this practice?***

**A.: Probably.** General business overhead expenses are not deductible. This particular issue continues to be the subject of many debates with TRD, however, at this time “consumables” like these are “tangible personal property” that, under current TRD interpretation, does not become a permanent part of the project because they can’t be seen or touched to become an “ingredient.” Therefore they are not deductible. (Pitching the used saw blades into the concrete footing doesn’t count, although maybe recycling them as an architectural detail would qualify for the deduction if the saw blades became an ingredient in something like the address numbers or a light fixture!)

The problem for you, as the supplier selling the supplies, is this: You may keep the contractor’s CRS number on file, and then keep a perpetual NTTC going for everything they purchase, without regard to the particular project or item sold. If this is your practice, you may be responsible for paying GRT for these items. If you did not collect the tax from your customers at the time of sale, you will either have to pay it or ask your customers for reimbursement. You might do yourself a favor and separate the “consumables” from the “sticks and bricks” type of construction materials on the sales ticket, and then collect the GRT for the consumables as you go along.

***Q.: I am a stucco sub-contractor who owns his own scaffolding. Can I accept an NTTC from a general contractor who rents my scaffolding for his other subs to use?***

**A.: Yes.** When the new regulations took effect on January 1, 2013, the rental of construction equipment became a deductible service, and if you “rent” or “lease” to another contractor you would be performing a “construction-related service” as defined in the changes due to HB 184, and the receipts from that rental are deductible. Just be sure to include the project address on the invoice so the transaction meets all of the requirements in the new law.

***Q.: I am a design firm who pays another company to print the drawings that I include in the sale of my services to construction companies. Can I provide an NTTC to the supplier of my drawings?***

**A. No.** Because you are not a “construction business,” the supplier of the drawings is not meeting the requirement of selling a service directly to a “construction business.”

***Q.: I rent scaffolding to contractors for their employees to use when installing drywall inside a building. My scaffolding rental agreement includes the delivery/pick-up charges and the labor to erect the scaffolding according to OSHA regulations. What parts of that bill are deductible?***

**A.:** Under the new regulations, all of the transaction should be deductible, and as a construction leasing business, you may accept an NTTC from the construction business. Just be sure you have the billing separated for each project location so it doesn’t appear the scaffolding is a general business expense that would be disallowed. That means don’t rent your scaffolding by the month – rent by the construction project.

***Q.: Electricity has never been something deductible as a construction material. How about the LP/Water I deliver to the construction site?***

**A.:** The Statutes specifically state electricity is a “tangible personal property,” which should mean it qualifies under 7-9-51 NMSA as a construction material. But because electricity is considered by TRD a “consumable” that cannot be touched or felt in the completed project, electricity is not considered an “ingredient” that can become part of the construction project, and therefore is not deductible. Nothing in the recent law change had an impact on this interpretation by TRD.

The same interpretation by TRD goes for Liquid Propane and Natural Gas.

However, interestingly, water is a tax-deductible ingredient when it is mixed into concrete, even though it evaporates when the concrete cures. And water sprayed on the ground for dust control or concrete wash-out for stormwater control efforts is deductible because it’s required for compliance with the federal Clean Air or Clean Water Acts, which was included in HB 184.

***Q.: I understand can accept an NTTC on the construction materials I sell to a construction business; how about the labor to install them?***

**A.:** The installation labor is the “service” you provide to the construction business and receipts for those services are deductible when billed to a construction business who installs those materials as an ingredient or component of a construction project that is subject to GRT upon completion, sale, or if the project is on Indian land. That means labor to install alarm systems, sprinkler lines, or carpeting is deductible just as the construction materials are.

***Q.: I am a rental business and rent cranes to construction businesses and the crane operator’s time is billed separately. Is the crane operator’s time deductible?***

**A.:** **Yes.** On January 1, 2013, the rental of construction equipment became a “construction-related” service. Included in that service would also be labor for the crane to be operated by someone with a license to operate the crane, and therefore is deductible.

***Q.: I am a designer and create plans for homes to be built in communities all across the state. How do I know which GRT rate to use?***

**A.:** If you sell your designs to a non-business consumer, your tax rate is determined by the location of your main office. However, if you sell your designs to a construction business and the project is taxable upon completion or sale, or located on Indian land, you would accept an NTTC and it will be up to the construction business to pay the rate of GRT for the community in which the project is built.

***Q.: I am a HERS rater performing blower-door tests in communities all across the state. How do I know which GRT rate to use?***

**A.:** If you sell your services to a consumer, your tax rate is determined by the location of your main office. However, if you sell your services to a construction business whose project is taxable upon completion or sale, or located on Indian land, you would accept an NTTC and it will be up to the construction business to pay taxes at the rate of GRT in the community in which the project is built.

***Q.: I am a business that rents portable toilets to construction businesses. The rental agreement includes the delivery/pick-up charges and weekly pumping of the units on-site. What parts of that bill are deductible?***

**A.:** Under the new regulations that took effect January 1, 2013, all of the transaction should be deductible, and as a construction-related business, you may accept an NTTC from the contractor renting from you.

Just be sure you have the billing separated for each project location so the transaction doesn't appear to be general business expenses that would be disallowed by TRD. You probably should not invoice for the toilet to be left for months at three house addresses in the same development, but charge each specific location for the portion of time that individual construction project was active. That means don't rent your product by the month, or even by the general development – rent by the specific construction project.

### **More Deductions, But Not Total Elimination of Pyramiding**

Many contractors have gotten caught making mistakes on the issues addressed in these FAQs during TRD tax audits, and simplification of the process and elimination of Tax Pyramiding are the two main reasons the construction industry promoted HB 184. While work progressed on drafting the TRD regulations to implement the law change as a result of HB 184, it was discovered that not all Tax Pyramiding has been eliminated. The best result of HB 184 becoming law will be the new law and regulations will be simpler for industry to understand and comply with.

We strongly suggest you discuss your particular situation with your accountant. Also, we suggest you and probably your billing staff actually read these regulations. They contain many useful examples. The regulations have been converted into a construction industry reader-friendly format, available on the NMHBA website at [www.nmhba.org](http://www.nmhba.org).

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**5931 Office Blvd., NE – Suite #1  
Albuquerque, NM 87109  
Phone: (505) 344-7072 1-800-523-8421  
FAX: (505) 344-3103 [www.nmhba.org](http://www.nmhba.org)**

## **New text of Gross Receipts Tax laws for construction industry that became effective on January 1, 2013:**

### **7-9-52. DEDUCTION--GROSS RECEIPTS TAX--SALE OF CONSTRUCTION SERVICES AND CONSTRUCTION-RELATED SERVICES TO PERSONS ENGAGED IN THE CONSTRUCTION BUSINESS.--**

A. Receipts from selling a construction service or a construction-related service may be deducted from gross receipts if the sale is made to a person engaged in the construction business who delivers a nontaxable transaction certificate to the person performing the construction service or a construction-related service.

B. The buyer delivering the nontaxable transaction certificate shall have the construction services or construction-related services directly contracted for or billed to:

(1) a construction project that is subject to the gross receipts tax upon its completion or upon the completion of the overall construction project of which it is a part;

(2) a construction project that is subject to the gross receipts tax upon the sale in the ordinary course of business of the real property upon which it was constructed; or

(3) a construction project that is located on the tribal territory of an Indian nation, tribe or pueblo.

C. As used in this section, "construction-related service" means a service directly contracted for or billed to a specific construction project, including design, architecture, drafting, surveying, engineering, environmental and structural testing, security, sanitation and services required to comply with governmental construction-related regulations; but "construction-related service" excludes general business services such as legal or accounting services, equipment maintenance and real estate sales commissions.

### **7-9-52.1. DEDUCTION--GROSS RECEIPTS TAX--LEASE OF CONSTRUCTION EQUIPMENT TO PERSONS ENGAGED IN THE CONSTRUCTION BUSINESS.--**

A. Receipts from leasing construction equipment may be deducted from gross receipts if the construction equipment is leased to a person engaged in the construction business who delivers a nontaxable transaction certificate to the person leasing the construction equipment.

B. The lessee delivering the nontaxable transaction certificate shall only use the construction equipment at the construction location of:

(1) a construction project that is subject to the gross receipts tax upon its completion or upon the completion of the overall construction project of which it is a part;

(2) a construction project that is subject to the gross receipts tax upon the sale in the ordinary course of business of the real property upon which it was constructed; or

(3) a construction project that is located on the tribal territory of an Indian nation, tribe or pueblo.

C. As used in this section, "construction equipment" means equipment used on a construction project, including trash containers, portable toilets, scaffolding and temporary fencing.





Jack C. Milarch, Jr.

## **Contractors and Gross Receipts Tax – The Basics and The Changes**

As reported in last month's Housing Journal the Legislature passed, and Governor Martinez signed, a new law aimed at curtailing construction project gross receipts tax pyramiding. The new law goes into effect January 1, 2013. As you can imagine we have been part of many discussions about New Mexico's Gross Receipts Tax (GRT) during and since the Legislative Session, with everybody from Governor Martinez and her officials to local contractors and their accountants. I believe a discussion of a few basics of this tax and the expected impact of the law is in order.

First of all, there is still some misunderstanding of what our GRT really is all about. In short, the name says it all! This tax is levied upon each construction business (and many other types of businesses as well) for the privilege of existing and doing business in New Mexico, and the basis of the tax is a percentage of the business's gross receipts. I have had several contractors tell me they avoid paying the GRT because they "pay the tax" when they buy their materials. The GRT is NOT a sales tax! New Mexico does not have a sales tax requirement. Many businesses succeed in getting their customers to pay their GRT by disguising their GRT as a sales tax added to the bottom of the customer bill. This leads to lots of confusion. If your business paid some other business's tax (as in "I paid the tax when I bought the lumber") that has no bearing on the fact that your business owes a percentage of your gross receipts to the government.

The next subject we need to discuss is the Non-Taxable

Transaction Certificate (NTTC). This is a document the buyer in a business-to-business transaction gives to the seller. It allows the selling business to duck paying GRT on the income generated by the sale. Income generated by the selling business under these tax-sheltering NTTCs is listed on the selling business's tax report as "non-taxable" receipts and the state loses out on the tax they would normally get based on those receipts. This is a concession to the phenomenon of "pyramiding" of taxes. In a construction context pyramiding occurs when subsequent business-to-business transactions rack up tax on tax, which some would consider immoral, but which isn't illegal in New Mexico. Again, in a construction context, pyramiding occurs because the subcontractor's subs have to pay tax on their receipts, then the subs in turn also have to pay tax on their receipts, and so on, until the entire project is finally sold in a retail transaction, which once again generates a tax on the business which makes this final sale. This is easy to understand if you remember that without NTTCs, each and every business simply owes a portion of their GROSS RECEIPTS to the state of New Mexico as a tax.

Now let's talk about what is changing. Prior to passage of the GRT bill this last Session, purchasing contractors were restricted on the type of purchases where they could give the seller an NTTC. For many years the basic rule of the Tax and Revenue Department (TRD) held the position that only purchases related to materials that would eventually become a component part of a building could use NTTC tax sheltering. The law on that has changed effective January 1, 2013. Contractors will soon be able to give those who provide the services required to complete a construction project an NTTC. Easy to spot services would include professional design fees, job-site fencing, and portable toilets. You should carefully examine your operations for other potentially tax-sheltered and project-specific services like bank fees, energy ratings, and temporary power costs so you will be ready when the new TRD rules take effect next year.

Our Taxation and Revenue Department still needs to give us their rules for implementation of the new law, and that process is always a challenge. It is not unusual to find that our bureaucrats' interpretation of a law change is different than we have envisioned during the legislative process! Getting new rules completed by next January is very important, nevertheless. Any of you who have had the pleasure of undergoing a tax audit by TRD officials

will understand the urgency in getting clear and definitive rules for how we are expected to implement this law change.

NMHBA has drafted a rules revision we believe appropriately implements this new law, and we are busy meeting with the leaders of other industry organizations to promote our version of the rules. We plan to meet with TRD officials soon as well.

In the meantime I am recommending that you scrutinize your business practices to see how you and your service providers can take advantage of this law change. In order to help you I have compiled four rules I believe serve as a “test” for services for which you may be able to use new NTTCs, starting next year. Each and every point must be met for a particular service to qualify.

Construction Service and Construction Related Service Deductions from Gross Receipts taxation are transactions that:

- add value to an particular real property; and
- are a business-to-business sale to a contractor; and
- the project culminates in a “retail” sale by the contractor to a consumer; and
- GRT is paid on the resulting “retail” sale.

We estimate the savings for the contractor to be \$1,200-\$2,500 on a \$200,000 home sale depending on the project and the local GRT rate, so this is worth dedicating some time to understand how it will work. We also suggest you have a chat very soon with your accountant about how you might need to re-arrange your accounting practices to accommodate the new tax shelter for you and your service providers. You may be handing an NTTC to a whole new set of service providers who have never seen such a document before, and you may need to educate them on what this is all about. If your business is part of the construction team that provides a service to contractors, you need to be thinking about this and talking to your accountant too.

Copies of the new law are available on the Internet. If you need help finding this, please contact Melanie at the NMHBA office. Also, if you or your accountants are willing to slog through our draft of new rules to see if you agree with our ideas, we have these available too.

