The 30-day Legislative Session in 2012 saw the construction industry 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.

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. These FAQs have been prepared by NMHBA staff to help clear up a few points:

**Q.: I construct buildings, and I believe I “manufacture” real property, so is my construction business considered a manufacturing business for GRT purposes?**

**A.: No.** While it may be a shock to most in the construction industry, for GRT tax purposes the building of improvements upon land to create real property is considered a *service*, and not a manufacturing process. That means you must comply with TRD’s regulations for service companies.

**Q.: I paid sales tax when I purchased the construction materials from the lumber yard, and I paid taxes on each of the bills from my subcontractors; I’ve paid all I need 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, it is attached 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 a Non-Taxable Transaction Certificate (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. The seller keeps the actual NTTCs and must present them to TRD when requested (usually during an audit). If the audit reveals some transactions for which NTTCs were issued were 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.

**Q.: Do I need to be a state-licensed contractor to be a “construction business”?**

**A.:** 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. Listing a license number when it is not “attached” to the company involved in the transaction is fraudulent activity punishable by TRD.

If you are not required by CID to hold a contractor’s license but are performing a “construction” activity listed in 7-9-3.4 NMSA, you may ask CID for a letter stating that fact. TRD wants you to keep in your file documentation stating that at as of the date you were performing the construction service you were not required to be licensed.

**Q.: Does my construction activity have to be my “primary” business, or can I issue NTTCs for my construction business activities when my primary business is something else?**

**A.:** In the current economic climate there is sometimes not enough work to allow a business to perform only construction activities, and many companies have had to diversify to keep the doors open. Your company may issue NTTCs when you are performing construction activities.
Q.: I am a mechanical contractor whose company also manufactures mechanical components that are sold to other mechanical contractors. Am I a service or a manufacturing company for GRT purposes?
A.: Both. When performing mechanical contracting services for a general contractor or homeowner you are subject to the sections of the NM Gross Receipts and Compensating Tax Act that apply to construction businesses. All activities related to purchasing materials, manufacturing mechanical components and selling them wholesale to other mechanical construction businesses are subject to the sections concerning manufacturers.

Q.: I am a “Design-Build” construction business with a state-issued contractor’s license who includes design services. I pay another company to print the drawings that I include in the sale of my services. Can I provide an NTTC to the supplier of my drawings?
A. If you include the design services as part of the construction services you provide for the construction project for which you collect GRT, then your supplier may accept an NTTC from you for the drawings. Keep in mind, the person responsible for paying GRT to the state is the supplier of the drawings, and if either of you get audited by TRD, then the supplier is the one who will have to pay if you can’t prove you were a “construction business” at the time of the transaction.

Q.: I am a construction business. I buy saw blades and abrasives in bulk using NTTCs, and store them until needed. Then I pull what I need out of inventory and charge the exact amount used to the specific project. Is there a problem with this?
A. Not for you, but it might end up costing Lowe’s or Home Depot if they are ever audited by TRD. “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.” (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 is for the supplier selling you the supplies – they keep your CRS number on file, and then keep a perpetual NTTC going for everything you purchase from them in the future. It is the supplier who may have to pay GRT for these items, and if they did not collect the tax from you at the time of sale, they will either have to pay it themselves or come asking you to reimburse them. If you are purchasing from a supply house whose relationship you value, you might be doing them a favor to separate your “consumables” from your construction materials and pay the GRT for the consumables as you go along.

Q.: Is there a benefit to identifying some of my activities as “manufacturing” instead of “construction service?”
A.: Not under today’s regulations. However, sometime in late 2013 it is hoped that TRD will complete the new regulations for the manufacturing industry to implement their much broader deductions from GRT that allow deductions for utilities and materials “consumed” in the manufacturing process. In 2013, if you are manufacturing construction materials such as ducting for mechanical systems, there may be quite a benefit to identifying that portion of your business as manufacturing, even though you are required by the Construction Industries Division (CID) to hold an MM-3 or MM-98 contractor’s license to manufacture HVAC ductwork.

Q.: I understand I don’t have to pay GRT on the construction materials I buy as a construction business, how about the labor to install them?
A.: The installation labor is the “service” provided 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.
**Q.: Electricity has never been something I can deduct as a construction material. Has that changed?**

**How about LP/Natural Gas/Water?**

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 recognized as 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 as part of Best Management Practices for stormwater control efforts are deductible because they are required for compliance with the federal Clean Air and Clean Water Acts, which was included in HB 184.

**Q.: I am a stucco contractor who owns his own scaffolding. Can I accept an NTTC from a general contractor who rents my scaffolding?**

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.

**Q.: I am a contractor. When I rent a crane for my construction business 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.

**Q.: I rent scaffolding for my employees to use when installing drywall inside a building. The scaffolding rental agreement includes the delivery/pick-up charges and the labor to erect the scaffolding. 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 as added by HB 184.

**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, please read these regulations for yourself, as they contain many useful examples. The regulations have been converted into a reader-friendly format, available on the NMHBA website at [www.nmhba.org](http://www.nmhba.org).

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7-9-3.4. DEFINITIONS--CONSTRUCTION AND CONSTRUCTION MATERIALS.--As used in the Gross Receipts and Compensating Tax Act:

A. "construction" means:
(1) the building, altering, repairing or demolishing in the ordinary course of business any:
   (a) road, highway, bridge, parking area or related project;
   (b) building, stadium or other structure;
   (c) airport, subway or similar facility;
   (d) park, trail, athletic field, golf course or similar facility;
   (e) dam, reservoir, canal, ditch or similar facility;
   (f) sewerage or water treatment facility, power generating plant, pump station, natural gas compressing station, gas processing plant, coal gasification plant, refinery, distillery or similar facility;
   (g) sewerage, water, gas or other pipeline;
   (h) transmission line;
   (i) radio, television or other tower;
   (j) water, oil or other storage tank;
   (k) shaft, tunnel or other mining appurtenance;
   (l) microwave station or similar facility;
   (m) retaining wall, wall, fence, gate or similar structure; or
   (n) similar work;

(2) the leveling or clearing of land;

(3) the excavating of earth;

(4) the drilling of wells of any type, including seismograph shot holes or core drilling; or

(5) similar work; and

B. "construction material" means tangible personal property that becomes or is intended to become an ingredient or component part of a construction project, but "construction material" does not include a replacement fixture when the replacement is not construction or a replacement part for a fixture.
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.