

Tax Matters

The Newsletter of the New Mexico Tax Research Institute

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New Mexico Tax Research Institute
P.O. Box 91657
Albuquerque, New Mexico 87199-1657

505-842-5833
Richard.Anklam@nmtri.org
www.nmtri.org

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REGISTER NOW for the Seventh Annual New Mexico Tax Research Institute Tax Policy Conference: May 20 - May 21 (Thursday and Friday), at the Sandia Resort and Casino in Albuquerque. Members of NMTRI may attend for \$160.00 per person. Interested government or academic folks may attend for \$165.00. Other non-members are welcome for \$195.00. Registration includes continental breakfasts both days as well as lunch and reception on Thursday. Reservations and payment should be received no later than May 17, 2010; however last minute decision makers can call (505) 842-5833. CPE and CLE are available (depending on the final state of the agenda and MCLE Board determination, we anticipate 10 hrs of CLE and 12 hours of CPE). We now have ethics! The conference program includes an early Friday morning hour regarding tax/business ethics, particularly useful for CPA's and attorneys and necessary for continuing education requirements.

The program will begin promptly at 9:00 a.m. Thursday. Registration begins at 8:00 and a Board of Directors and members meeting will be held at 8:15 – see below. The agenda is still evolving but the program is already spectacular. REGISTER NOW by clicking [HERE](#) or by calling the NMTRI at (505) 842-5833.

Speakers will include:

*David Abbey, Director, Director, N.M. Legislative Finance Committee
Topic: State Budget Update*

*Rosanne Altshuler, PhD., Director, Tax Policy Center; Senior Fellow, Urban Institute; and
Professor, Rutgers University
Topic: Federal Tax Policy Update*

*Bethanne Cooley, Manager of State Government Relations, Council on State Taxation
Topic: State Business Tax Trends and Changes*

*Robert J. Desiderio, Esq., Mower Sanchez Desiderio
Topic: Business and Tax Ethics*

*Harley Duncan, Managing Director – Washington National Tax, KPMG LLP
Topic: VAT and Implications to State Taxation*

*Jim Hamill, PhD., CPA, Reynolds Hix & Associates
Topic: Business and Tax Ethics*

*Helen Hecht, Esq., Federation of Tax Administrators
Topic: State Tax Litigation Landscape*

*Rick Homans, NM Cabinet Secretary, Taxation and Revenue Department
Topic: Taxation and Revenue Department Update*

*Kil Huh, PhD., Research Director, Pew Institute on the States
Topic: State Pension and Retiree Health Funding Crisis*

*LeAnn Luna, PhD., CPA, Associate Professor- Department of Accounting and Information Management and the Center for Business and Economic Research at the University of Tennessee
Topic: E-commerce, Nexus and State Tax Trends*

*Jim Nunns, PhD, Tax Policy Director, New Mexico Taxation and Revenue Department
Topic: TBD*

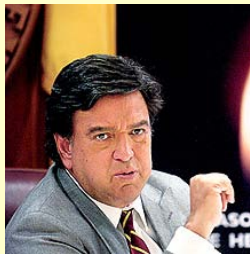
*Rob Plattner, Esq., Deputy Commissioner for Tax Policy
Topic: “Amazon” laws – the New York Experience*

*John Swain, Esq., Professor of Law, James E. Rogers College of Law, University of Arizona
Topic: Corporate Income Tax Apportionment*

Hotel reservations need to be made individually and be sure and identify yourself as being a part of the NMTRI Annual Conference in order for the NMTRI discounted rate of \$149/night to apply.

Individual hotel reservations should be made by calling Sandia Resort and Casino’s Reservations Department at 1-800-526-9366 or 1-505-796-7500

* A meeting of the NMTRI Board of Directors and members will precede the event. Telephonic participation will be allowed.



Governor Richardson Wraps-up Regular Session Legislation

The Governor signed into law all three bills passed in the special session. He did, however, line-item veto reinstatement of the municipal gross receipts tax on food. How did he pay for that? He didn’t completely. He did offset some costs by vetoing increases in the Low Income Comprehensive Tax Rebate (LICTR) and some cigarette tax distributions, while also promising to use some discretionary federal money he has control over. How the remainder is paid for this year will depend on how well the reserves hold up, and what other cuts and tax increases are made in this or subsequent years to restore depleted reserves and pay the ongoing cost of the veto. If reserves are depleted this year completely, the legislature gave the governor authority to reduce state expenditures pro-rata to address budget shortfalls. Still, the problem will spill into future years, meaning that to some extent the can has been kicked to future administrations, legislatures, and taxpayers to deal with. Governor Richardson’s executive message can be viewed on his website [here](#).

The tax proposals, described in more detail below, increase cigarette, statewide gross receipts and income taxes, plug a hole in the compensating tax, and provide for a tax amnesty. The increases could have been worse, with the GRT increase being potentially the most harmful economically.

It's almost April 15th already, so while waiting to see what happened, remember that if you itemize you need to increase your state income tax withholding this year.

The Veto

The food related provisions vetoed by the governor would have created a 5% state credit for food, and eliminated the “hold harmless” provision which forced the state’s general fund to compensate local governments for their share of the food tax cost. The measure would have effectively restored the local portion of the tax on food (on average, just over 2%). Eliminating the general fund subsidy of that local tax expenditure would have saved the general fund approximately \$68 million. Also vetoed was the increase in LICTR, a rebate program which was instituted decades ago to remedy the regressive effects of the GRT on the state’s most vulnerable. While it may make sense not to increase LICTR since the tax on food was not partially restored, the LICTR increase could also been used to offset the regressive effects of the statewide GRT or cigarette tax increase. The Governor also vetoed existing distributions from the cigarette tax to local governments, as well the new distributions to the public education department for early childhood education and to the CYFD (children, youth and families department) for early childhood programs, cutting programs and saving over \$12 million in FY10. Also vetoed was the language that would have returned the cigarette tax to its present law levels in four years. The real question that remains post-veto is whether those cuts and potential future cuts and tax increases are the lesser of the two evils—compared to a minimal tax on food—when it comes to lower income folks and the state economy in general.

[NMTRI note: the food tax “debate” has evoked emotional feelings not always justified by economic or tax policy, and probably made worse this year by the feeling of some that income taxes on higher income folks should be raised to solve budget problems. When it comes to concerns of regressivity, the conversation should be about the tax system as a whole and its relative burden, and what mechanisms are in place to address regressivity. In the case of food, for years the state addressed the problem with food stamps and LICTR. LICTR, in particular, was a vehicle that provides targeted relief and could have been expanded. While the governor vetoed the tax on food, he approved other new taxes that have negative implications for our economy in addition to being regressive. The increase in the cigarette tax is extremely regressive and makes the tax harder to enforce as sellers are incented to try and get around tax collection. That means the state has to take more tax from compliant taxpayers to get the same amount of money after “leakage.” The increase in the statewide gross receipts tax not only impacts the poor, who spend more of their earnings on taxable items, but also impacts businesses and makes the problem of pyramiding worse. The legislature deserves some credit for trying to balance the budget and do unpopular tax increases and budget cuts that they viewed as necessary - and with legitimate compromise - even in the face of intense populist opposition.]

The Approved Bills:

Senate Finance Committee Substitute for Senate Bill 10, 12 & 13 – non-vetoed portions:

- increased the statewide gross receipts and compensating tax rates by one-eighth percent,
- required the “add-back” of state income and sales taxes itemized and deducted on federal returns for state income tax purposes, and
- closed a “hole” in the compensating tax.
- VETOED - food and LICTR Related Provisions

The total general fund revenue generated by the bills is approximately \$137.5 million in FY11, and \$122.5 million in FY12 post veto (previously \$200 million).

The GRT/compensating tax rate increase is the first change in the base rate since 1990, and raises around \$60 million per year. NMTRI has expressed concern about overall rate growth in the GRT, including the repeal of the municipal credit which had the effect of increasing rates in municipal areas by .5%, more local option tax enactments, and new taxes for special purposes like the spaceport and train operations. Rate increases have negative implications including increasing the negative effects of pyramiding and making the system more regressive. The 1/8% increase is certainly less damaging than the 1/4% or higher increases that had been previously proposed.

The compensating tax proposal is said to raise (or stop the inevitable loss of) \$12 million per year. The estimate appears uncertain and represents over 20% of the state’s estimated \$58 million in anticipated general fund revenue from the tax for 2010. The fix aims to eliminate the potential problem that sales from remote vendors would be deemed “sales in New Mexico” for purposes of the compensating tax – causing them to be subject only to the gross receipts tax – even where the seller has no nexus to New Mexico such that it could be required to pay gross receipts taxes. It was a necessary change, but does put the taxpayer in the position of making “nexus” determinations with regards to their vendors, and we assume the TRD will develop and issue guidance such as presumptions that can be made for purposes of compliance.

The remaining tax increase provision of the bills requires personal income tax filers to add back state income or sales taxes itemized and deducted from their income on federal returns. The proposal is effective for tax year 2010 (read: NOW) and contains a penalty exception for those caught unaware relative to their estimated tax payment requirements. The proposal also contains the consistent change of eliminating the inclusion of state tax refunds in income after 2010. It does not include a provision to scale the add-back to the portion of federal itemized deductions actually allowed – a measure that would have added some intellectual consistency or fairness, but also would have reduced revenue and added complication. The measure was more palatable to those who wanted to see income taxes raised. It is progressive as it generally does not impact lower income non-itemizers. All but five other states that impose an income tax require some form of add back. So, relative to other income tax increase proposals, this form of tax increase should do the least harm to New Mexico’s competitiveness, especially on a regional and national rate comparison basis.

House Taxation and Revenue Committee Substitute for House Bill 3 - non-vetoed portions:

- Increased cigarette tax by 75 cents
- Changes distributions to hold some beneficiaries harmless
- VETOED – existing distributions to local governments and new distributions to the PED for early childhood education and CYFD for early childhood programs

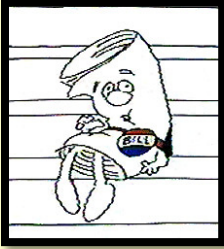
The total general fund revenue generated by the bill is approximately \$33.9 million post veto, (previously \$22.5 million).

In addition to the 75 cent per pack, distributions of tax revenues are altered to minimize impacts on non-General Fund tax beneficiaries (except for present law local government beneficiaries whose distributions were vetoed). The bill contains a requirement that tribes and pueblos must certify to the Taxation and Revenue Department that they impose a similar tax in order to remain eligible for the tribal exemption. Such language represents an attempt to address the serious policy defect high cigarette taxes create – that is the so-called “leakage” problem - the shifting of purchases to sellers who aren’t currently required to pay taxes or simply don’t report and pay them, like tribes and some internet retailers. The language in this bill contains a “fig-leaf” provision that gives the appearance of addressing the leakage problem but does not do so in a manner that will be effective. That means to make a dollar we have to take more than a dollar from our taxpayers. The cigarette tax is also one of the most regressive taxes there is, with consumption not responding to price as much as it does with most products (particularly with the leakage), as those concerned with the incidence of smoking would like.

Senate Bill 2, introduced by Senator Phil Griego, authorizes the tax department, with the concurrence of the governor, to declare an amnesty period of no more than 180 days provided that that amnesty period shall occur within the fiscal year 2011. All collections resulting from the tax amnesty are to be identified specifically and reported to the legislature. The proposal works within the context of the state’s managed audit program and the Secretary is authorized to waive certain eligibility requirements of the managed audit program currently available to New Mexico taxpayers. Therefore, it could be applied to taxpayers currently being pursued for non-filed returns, taxpayers with existing debt, and taxpayers who have been audited in the past who have unreported and un-assessed taxes. The bill contains an emergency clause and is expected to collect an additional \$2.1 million in FY11 and \$6.8 million in FY12, declining after that as a result of payment plans. In addition, the Taxation and Revenue Department (TRD) is appropriated \$500,000 for the purpose of conducting the tax amnesty program.

[NMTRI note: the proposal represents minimal change relative to the existing managed audit program. Accordingly, any additional revenue associated with the program may arise as much from “good press” and outreach as the loosening of program requirements]

Bills with significant tax or revenue implications introduced in the first 2010 Special Legislative Session and passing both houses:



If no effective date is mentioned, the bill lacks one and would take effect upon enactment. Effective date for GRT and other tax bills is July 1, 2010 unless otherwise noted. Income Tax bills are essentially retroactive being effective tax years beginning on or after January 1, 2010 unless otherwise noted. “TYBA” = Tax years beginning on or after. Other notes: “CS” indicates committee substitute; “a” indicates amended

Bill No. Sponsor:	Title: Link to bill language: Description	Assignments -Location:
HB 3 Chasey	Cigarette Tax Increase and Tribal Stamp: HB 3 HTRC Committee Substitute for HB 3 increases the cigarette tax by 75 cents per pack for four years and changes distributions. Veto: eliminated 4 yr limit making tax permanent, and eliminated local government, CYFD and DOH distributions.	SIGNED/ Partial Veto
SB 2 Griego	Temporary Tax Amnesty Program: SB 2 Authorizes the Taxation and Revenue Department to administer a temporary tax amnesty program within the context of their managed audit program and appropriates \$500K for that purpose.	SIGNED
SB 10 Cisneros	Increase Low Income Comprehensive Tax Rebate: SB 10 Senate Finance Committee Substitute for Senate Bill 10 increases statewide GRT/compensating tax rates 1/8%, requires personal income tax filers to add back state income and sales taxes itemized and deducted for federal purposes, increases LICTR payment amounts, eliminates food deduction and some hold harmless provisions while creating a food sale GRT credit, and closes a hole in the compensating tax. Veto: struck food tax and LICTR related provisions.	SIGNED/ Partial Veto

The Hangover Ends – Final Disposition of Passed Legislation



The time to sign bills passed in the January Regular Session or let them die has passed - so the guesswork is over. Only 67 House and 62 Senate bills passed both houses in the session. Only one bill was vetoed and eight have been pocket vetoed (dying after not being signed by the deadline), with the remainder passing or signed into law. Only thirteen tax related bills passed both houses and made our list below. All were signed into law.

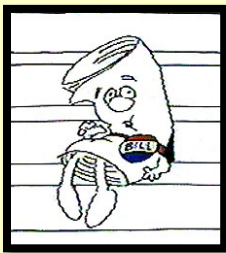
In case you’re interested, the vetoed proposal was a proposed delay in school reporting designed to evaluate and promote gender equality in athletics. The pocket vetoed legislation were non-tax, including a popular but questionable green investment

requirement for the severance tax permanent funds, the whistleblower protection proposal, a measure giving the Legislative Finance Committee oversight over certain federal funds, a couple of education related proposals, a game and fish licensing proposal for military personnel (a related proposal passed), and a proposal that would allow the Human Services Division to contract with contingent fee attorneys to recover money paid to false claims that it doesn't have the internal resources to pursue.

A list of tax related bills becoming law out of the 2010 Regular Session is compiled for your information below. We'll be doing it all again soon. The entire list of bill passing both houses can be found in a locator report on the Legislative Council Service ("LCS") website [here](#).

The LCS maintains copies of bills, compiles locators, and publishes lists of bill conflicts during the course of the session. Most information is available in a timely and electronic fashion from their rather robust website, which can be reached at <http://legis.state.nm.us/lcs/>.

Bills with significant tax or revenue implications introduced in 2010 Legislative Session, passing both houses and signed into law:



If no effective date is mentioned, the bill lacks one and would take effect upon enactment, May 19, 2010. Effective date for GRT bills is July 1, 2010 unless otherwise noted. Income Tax bills are essentially retroactive being effective tax years beginning on or after January 1, 2010 unless otherwise noted. "TYBA" = Tax years beginning on or after. Other notes: "CS" indicates committee substitute; "a" indicates amended

Bill No. Sponsor:	Title: Link to bill language: Description	Assignments -Location:
HB 8 B. Lujan	Development Training Funds HB 8 Appropriates \$5 million non-reverting funds for purposes of classroom and in-plant employee development training programs.	SIGNED
HB 112 A. Lujan	Las Cruces Tax Increment Project: HB 112 Authorizes the issuance of \$8 million for the Las Cruces main street downtown TIDD.	SIGNED
HB 120 B. Lujan	Withholding Tax Changes: HB 120 Merges to some extent the pass through entity ("PTE") and oil and gas proceeds withholding requirements, and further requires quarterly withholding on oil and gas proceeds or share of a PTE owner's net income unless payments are made to a New Mexico resident. The new withholding requirements take affect January 1, 2011. Definitions and "safe harbor" provisions have been added to the prior year's proposal, and publicly traded partnerships are excluded.	SIGNED
HB 144 Stewart	Unemployment Contribution Schedule: HB 144 Implements unemployment contribution schedule one, transfers fund balances, eliminates a fund, and decreases monthly benefits from 60% of the average weekly wage to 53.%.	SIGNED

HB 171 Lujan	Transport of Dairy Waste for Gas Tax Credit: HB 171 Creates transferrable personal and corporate income tax credits for feedlots and dairies in the amount of \$5 per wet ton of agricultural biomass (i.e. manure) transported to a facility that uses biomass to generate electricity or make biofuels. The credit is capped at \$5 million dollars per tax program on a first come first serve basis.	SIGNED
HB 203 T. Garcia	Business Retention Gross Tax & Gaming Tax: HB 203 Creates a new county local option tax subject to voter approval in an amount up to 1/4% in 1/16% increments. Also creates a gaming tax credit for racetracks with takes under \$20 million not to exceed \$1 million per fiscal year if the county imposes the business retention gross receipts tax.	SIGNED
HB 208 Heaton	Oil and Gas Tax Reclamation Fund: HB 208 Increases the maximum rate of the Oil and Gas Conservation Tax on oil from .19% to .24% when the average price of West Texas Intermediate crude is above to \$70 for the prior quarter. The increase is distributed to the Oil and Gas Conservation Fund, which can be used to remediate facilities used for the storage, transportations, or disposal of waste from oil and gas operations.	SIGNED
HB 233 Stewart	No Solar Panels As Property Tax Improvements: HB 233 Excludes solar energy systems from the types of property that trigger re-valuation of property for tax purposes and prevent inclusion of solar equipment in property tax values at the time of installation.	SIGNED
HB 261 M.H. Garcia	Solar & Wind Energy Equipment Gross Receipts: HB 261 Expands present law GRT deduction for sale of wind energy nacelles and related equipment to governmental entities to include supporting structures (“construction”) and solar energy generation equipment and related equipment for generation and transmission. Creates a gross receipts and compensating tax deduction for the value of eligible generation plant costs from the sale of tangible personal property. The deduction requires nontaxable transaction certificates and certification from the department of environment.	SIGNED
SB 47 Keller	Economic Development Tax Incentive Changes: SB 47 Creates guidelines for the creation and review of economic development incentives.	SIGNED
SB 59 P. Griego	Extend Gas Tax Sharing Agreement Terms: SB 59 Increases the 10 year “buy-out”, or payments made equal to 40% of the gasoline tax revenue associated with the sale of 250K gallons of gasoline per year to Nambe and Santo Domingo pueblos from ten to twenty years.	SIGNED
SB 95 Papen	Las Cruces Tax Increment Project: SB 95 Authorizes the issuance of \$8 million for the Las Cruces main street downtown TIDD.	SIGNED
SB 144 Rodriguez	Affordable Housing Tax Credit Use & Vouchers: SB 144 Amends the affordable housing tax credit act by expanding the definition of “affordable housing project” to include counties with populations in excess of 100,000.	SIGNED
SB162 Sapien	County Gross Receipts for Certain Projects: SB 162 Provides for a 1/16% increment of the county gross receipts tax be	SIGNED

KNICK KNACKS

New Mexico Proposes New Tax Regulations

The New Mexico Taxation and Revenue Department has proposed new regulations pertaining to the Gross Receipts Tax Act. The propose change adds the “sale or exchange of renewable-fueled electricity generated from system installed in a personal residence” to the activities not considered not engaging in business. The gross receipts tax is imposed on the privilege of “engaging in business in New Mexico”, so in this case, persons that have renewable energy systems on their homes and sell or get credit for power returned to the grid won’t be required to register and file CRS-1 reports on a regular basis.

[NMTRI note: taxpayers in this situation could accept a Type 1 NTTC (New Mexico’s resale certificate for tangible personal property), so the proposal doesn’t create a “tax break”, but rather prevents households and the NMTRD from having to engage in the administrative exercise of registration and filing.]

The proposal further repeals the section of the regulation dealing with agency and reimbursed expenditures that addresses *employee leasing*. The repealed language was the subject of significant controversy and confusion for more than a decade, to include numerous refund claims that were paid and then re-assessed, and a court case decided in 2002 (see *MPC Ltd., d/b/a Manpower of New Mexico v. New Mexico Taxation and Revenue Department, 2003-NMCA-021, 133 N.M. 217, 62 P.3d 308*). The proposal further modifies the section pertaining to reimbursements of disclosed agents, striking the recordkeeping requirements deemed necessary to not include receipts of an agent in a disclosed agency capacity from gross receipts. It further adds examples of what reimbursements might or might not qualify for the deduction.

[NMTRI note: the current regulations have remained unchanged too long, and the elimination of the overreaching recordkeeping requirement is appropriate as it was an indicia at best and not required by accounting rules. The added examples add guidance, but if interpreted narrowly as they usually are by enforcement, may result in higher standards than those actually required for a disclosed agency relationship to exist under the law. Further guidance and clarification may be necessary. Relative to current TRD policy and industry practice, the result will be that more transactions will be considered taxable.]

Finally, pertaining to the “prescription drug” deduction (see §7-9-73.2 N.M. Stat. Ann.), the regulation eliminates the inclusion of property sold or dispensed for non human consumption unless prescribed by a veterinarian, meaning prescription drugs sold for non-human consumption will never be “prescription drugs” for purposes of the gross receipts tax deduction and taxable. *[NMTRI note: while the policy of taxing Fido’s medication is debatable, the change is appropriate as the statute defines “prescription drugs” as certain substances that are prescribed to a “person,” - which cannot be interpreted as an animal under present law.]*

Copies of these proposed regulations can be found on the New Mexico Register website or on the Taxation and Revenue Department’s website by clicking [here](#).

National Governor's Association Issues Report on State Fiscal Challenges

In a report issued by the National Governors' Association Center on Best Practices titled "*The Big Reset – State Government after the Great Recession*", the challenges facing the state budget in our anticipated slow recovery are discussed. The report discusses some of the things states are doing to address those issues, focusing on the delicate balance needed in maintaining those services that help the state prosper while eliminating those that provide the least value. It's an interesting read and can be found on the NGA website [here](#).

New Mexico Unemployment Rises – Worst in 22 Years

According to a recent report by the U.S. Department of Labor Statistics, New Mexico's unemployment rate increased from 5.9% to 8.5% from January 2009 to January 2010, the highest level of unemployment in New Mexico in 22 years. That puts New Mexico in the middle of the pack, ranking 22 of 50 states in overall unemployment, putting to bed the myth that New Mexico can suffer the lows, even if we don't always seem to feel the highs of the nation's economy. California experienced the highest absolute unemployment growth over the last year, followed by Florida and Texas. Michigan still holds the record at a staggering 14.3% rate of unemployment, while North Dakota is the best off with only 4.2%. According to the Department of Workforce Solutions, over 26,000 jobs were lost over the last year, with only 3 of 16 sectors showing any positive growth: leisure and hospitality, health, and information services. Even the government sector reported 200 fewer jobs from the prior year. The NMDWS information can be found on their website [here](#).

Tax Freedom Day Comes and Tax Foundation Releases Comparative Tax Study

According to the Tax Foundation, Tax Freedom Day, the day that Americans have worked enough to pay their taxes, is on April 9 this year, one day later than last year. That means Americans will work 99 days before they've worked enough to pay their federal, state and local taxes. The day also comes two weeks earlier than in 2007, so relative tax burdens have actually fallen in recent years. Still, Americans will pay more taxes in 2010 than they will spend on food, clothing and shelter combined. New Mexicans get to celebrate earlier than the average American with a date Tax Freedom Day of April 1, requiring only 91 days to pay their tax obligations. New Mexico has the 5th earliest Tax Freedom Day, with Alaska celebrating earliest after 85 days on March 26. Connecticut has the latest Tax Freedom Day of April 27, requiring 117 days of work to pay off. States vary because their tax policies vary, and poorer states like New Mexico also pay much less than average federal personal income tax.

On counting the federal deficit, the Tax Foundation says "Tax Freedom Day does not count the deficit even though deficits must eventually be financed. Since 1948, when Tax Freedom Day was first calculated, the difference between what governments are spending and what they're collecting has never been as great as during 2009 and 2010. If Americans were required to pay for all government spending this year, including the \$1.3 trillion federal budget deficit, they would be working until May 17 before they had earned enough to pay their taxes—an additional 38 days of work. This May 17 date for a deficit-inclusive measure is the second latest since World War II. Only in 2009 was it later, when an unprecedented budget deficit of close to \$1.5 trillion produced a deficit-inclusive date of May 21, fully 43 days later than Tax Freedom Day".

The Tax Foundation's annual report on Tax Freedom Day can be found on their website [here](#).

The Tax Foundation has also recently released its 2010 version of *Facts and Figures*, a pocket- and purse-sized booklet comparing the 50 states on 31 different measures of taxing and spending, including individual and corporate income tax rates, business tax climates, excise taxes, tax burdens and state spending. According to the study, New Mexico ranks quite favorably in most categories and would appear somewhat consistent with the results of the annual Washington D.C. representative family burden study. The studies are quite different in approach however, and readers should be cautioned when reviewing comparative studies as they are all a product of the methodologies, assumptions and data used, and misleading results can occur accordingly.

According to the study New Mexico ranked quite low in state and local tax burden per capita in 2008 at 46 (\$3,114 versus the U.S. average of \$4,283 or the highest, Connecticut, at \$7,007). In the category of state and local tax burden as a percentage of state income in 2008, New Mexico ranked 39 at 8.6%, as compared to the statewide average of 9.7% or the highest state, New Jersey, at 11.8%. Looking state business climates relative to their corporate, individual, sales, property and unemployment taxes, New Mexico ranked near the middle of the pack at 23, with New Jersey scoring the overall worst at 50 and South Dakota in first place (in case you were wondering, California was only third worst, having been edged out by New York for the number 2 slot). Within the tax programs, New Mexico scored 1 with its low property tax, but offset it with a score of 42 for its sales tax (our formerly broad based and low rate GRT which is increasingly focused on business to business transactions). New Mexico scored above the middle in individual income and employment tax with a rank of 19 in each, but lost some ground with a rank of 32 for its corporate income tax. Regionally most Western states scored favorably and the surrounding states all scored better than New Mexico with the exception of Oklahoma.

In other categories, NM had the 7th highest state revenue per capita in 2008 at \$6,934, compared to a statewide average of \$4,995. That presumably that is a product of permanent fund earnings, abundant natural resources and inordinate federal spending given the otherwise relatively unproductive economy. Not surprisingly, Alaska was the highest at \$23,168 in per capita revenue, and Nevada was the lowest at \$3,626. New Mexico ranked 38 in per capita personal income tax collections of \$614, a reflection of our relatively low rates coupled with comparatively low incomes. On the flipside, New Mexico had the 13th highest corporate income tax collections per capita at \$179. Alaska, with their five or six corporate taxpayers and low population was 1st, California was 6, with the remaining top 15 being eastern states.

The report can be found on the Tax Foundation website [here](#).



Department of Finance and Administration Chief Economist Retiring

Laird Graeser, chief economist at DFA and former long term chief economist at the Taxation and Revenue Department has announced his retirement on April 30. Laird's wide and varied career began with studies in physics and chemistry at Swarthmore College and Cornell, Laird also became an Enrolled Agent and prepared taxes in Santa Fe. He's taught tax and tax policy in Russia (loves to recite Russian poetry), and consulted on tax related issues in South Africa,

Uzbekistan, Azerbaijan, Turkey and Ethiopia for the U.S. Treasury, Office of Technical Assistance. With one of the most dynamic personalities in state government, Laird has influenced state tax policy for more than two decades and along with Jim O'Neill (see article below), is the foremost authority on the history of New Mexico tax policy.

We're happy for Laird on his well deserved and forthcoming pension checks, although we know we haven't seen the last of him. He has an interest in keeping his professional career going in Santa Fe. We asked what else he wanted to do in his upcoming retirement and he told us responded in typical Laird fashion with the following list... not all inclusive of course:

Retirement plans, in no particular order of priority:

1. Finish construction of Santa Fe home.
2. Design and build a 1,200 to 1,400 sf addition to Santa Fe home.
3. Build and furnish in period style (1910) sheds for blacksmith shop which I bought last fall. Refresh blacksmithing skills. Start business forging (and, perhaps, casting) of animal heads and architectural wrought iron. Also volunteer a few days a month as blacksmith at Las Golondrinas village.
4. Buy and refurbish dump truck to go with 1968 Oliver industrial backhoe/loader.
5. Take certificate course in Prague in Teaching English as a Foreign Language (TEFL). Teach for a semester each in exotic locations, including China, Mongolia, Ekaterinburg, Russia, Japan, Malaysia, Vietnam and Philippines. Jonelle will teach creative and technical writing; I'll teach technical writing and leadership.
6. Continue international consulting – starting with building an economic tracking and concurrent forecasting tool in South Africa using monthly tax collections data.
7. Write a workbook/textbook to be published by OECD of the techniques developed for the South Africa project. Take this textbook and the subsequent book on the road and teach revenue estimating and forecasting workshops in a number of third-world and transition countries.
8. Write a "Workbook for Revenue Estimators" that will be (a) very practical; (b) download 25 years of experience building models and generating both baseline revenue forecasts and estimates of fiscal impact of legislative and economic change. I have roughly 250 models and techniques to document and explicate in the book.

9. Write a “Stories of Fiscal Policy in New Mexico” downloading material and retelling stories I’ve collected over my 30 years in the state. This will include a comprehensive history of revenues and expenditures, insofar as relevant documents can be unearthed. I have great data from Statehood forward, moderate data back to 1890 and sporadic data back to the mid-18th century. I will have as many bios of important players as possible.
10. Travel the Alcan in my RV purchased last fall in preparation for retirement.
11. Do a modest remodel of my daughter’s home in Hartland, Vermont.
12. Resurrect my old Local Government fiscal policy institute idea. We’d start with GRT models for all the cities and counties, then segue to other state-source local revenues such as motor vehicle fees and gasoline tax, then move into estimating property taxes. At some point, we’d deal with performance budgeting techniques and closing the loop between budget and performance.
13. Build a set of models to estimate public school populations and SEG distributions for current and five forward years.
14. Work the session as legislative staff.
15. Contract with the consensus group to build a continuous revenue tracking and estimating tool. This would be updated daily for OGAS futures and posted prices, monthly for employment and unemployment changes and actual revenues YTD. This would also embed other monthly population data, such as SNAP and Medicaid enrollments. PIRA, DOE/EIA and GI also publish monthly updates of economic aggregates. This tool would not supplement the formal quarterly consensus process, but would give policy makers from both the executive and legislative branches early warning of revenue issues.
16. Help my son move dirt and start building his home/guest house/office on Santa Fe’s north side.
17. Kidnap my grandson and granddaughter as often as possible and enrich all of our lives – through travel and cultural tourism.
18. Renovate the house and do color coat stucco on a small house west of Truchas that my son owns in partnership with two other families. We have already planted 20 mixed fruit trees and have run the trenches to irrigate these trees from the acequias. I need to plant some more trees and prepare for harvesting the produce in a few years.
19. Perfect my sourdough bread recipe (I’ve almost got it!), take my mobile horno on the road and bake bread semi-commercially for old-time gatherings and hold “bake days” at some of the schools in northern New Mexico.
20. Write my personal autobiography. This is a promise I have made to my children and grandchildren. And I need to write it before I forget all the stories.
21. Volunteer at Cerillos Hills State Historical Park – probably by assembling some of my large number of photos of landscape features – into a photo essay that could be sold at the visitor center to generate operating funds for this newest state park.
22. Rejoin the Santa Fe Symphony Chorus. I sang with this group from 1988 through 2002, but had to resign when I was out of the country half the year.
23. See if the Turquoise Trail Volunteer Fire Department could find something for me to do to assist the overall mission of the Department. I have some ideas, but may not be routinely available to take up most of the defined roles.

That sounds like a lot! The staff, board, and members want to congratulate Laird on his significant achievement not to mention his contributions to New Mexico tax policy, and look forward to picking his brain in the future.

The following article was contributed by NMTRI board member and longest tenured Assistant Secretary/Tax Policy Director of the New Mexico Taxation and Revenue Department in history.

New Mexico Corporate Income Tax Issues: Joyce versus Finnigan

James P. O'Neill
President, O'Neill Consulting LLC

One of the big problems in state-level taxation of corporate income is the fact that individual corporations can operate in more than one state. Corporate families being taxed as a group are even more likely to engage in business in multiple jurisdictions. This paper explores how income is divided among the states in which a corporation or corporate group operates, throwback rules in general and the New Mexico's confusing choice of throwback rule.

The most common technique is the set of allocation and apportionment rules embodied in the Uniform Division of Income for Tax Purposes Act (UDITPA).¹ New Mexico adopted this act in 1965.

Rents, royalties and capital gains and losses associated with real or tangible personal property are allocated to the state in which the property is located. Allocated to the state in which the corporation has its commercial domicile are capital gains and losses from intangible property and interest and dividends. All business income is apportioned under a formula measuring the proportion of the corporation's total property, payroll and sales in the state. (Different states give widely varying weights to the three factors.)

This is clear enough when the state has nexus² with the corporation and jurisdiction to tax the income. What happens when a state does not have jurisdiction over a corporation which has made more than *de minimis* sales into that state? This would mean that less than 100% of the corporation's sales would be included in apportionment formulas reported to those states having tax jurisdiction. In turn, not all of the corporation's income would be allocated or apportioned and subject to tax, even in an ideal world where all states employed the same allocation and apportionment rules. Tax administrators refer to this as "nowhere income."

It occurred to some tax gurus that this could encourage corporations to pressure states to create corporate income tax havens. Corporate organizational forms and accounting practices could then be manipulated to ensure that a disproportionate share of income would be assigned to the tax haven states. Surely no one would support this for it promoted a race to the bottom among the states and fostered economically wasteful practices in the corporate world. Hence a

¹ Alas, in some critical areas states that have adopted UDITPA still vary considerably both in statute and in administrative practice. One area of nonconformity is treatment of throwback rules.

² When a state is said to have nexus with a taxpayer, there is sufficient connection between the state and the taxpayer's activities or presence in the state to justify the state asserting its taxing authority over the taxpayer.

mechanism was required under which the states with taxing jurisdiction mopped up the nowhere income.

According to the UDITPA (at Section 7-4-5 NMSA 1978), income of a New Mexico taxpayer is allocable or apportionable to another state only if that state has jurisdiction to tax the income-- regardless of whether it actually does. Further, it declares that a state lacks jurisdiction if it is barred by federal law from imposing tax (e.g., by P.L. 86-272; see 3.5.4.10 NMAC), and, in many cases, when the purchaser of tangible personal property is the U.S. government. So what happens when another state does not have jurisdiction but New Mexico does?

New Mexico in fact could have chosen to do nothing. If income is allocable or apportionable under the general rules to the other state, New Mexico could let that income go untaxed (at least by New Mexico). Like most other states, New Mexico instead opts to convert nowhere income into income assigned to itself. This is accomplished through what are called “throwback rules”.³

Throwback rules can also apply to the allocation of net rents and royalties, capital gains and losses and patent and copyright royalties but the most controversy surrounds their application to the apportionment sales factor.⁴ UDITPA assigns sales of tangible personal property to each state on a destination basis. Section 7-4-17 NMSA 1978 specifies the sale proceeds are to be added to the numerator of New Mexico’s sales factor when *tangible personal property* sold is shipped from New Mexico and either the property is purchased by the U.S. government or the taxpayer is not taxable in the other jurisdiction.

Application of a throwback rule is clear enough for a single corporation but when a New Mexico combined or consolidated return includes corporations that do not have nexus with New Mexico, how is this throwback rule to be applied? This question takes on added importance if New Mexico mandates that unitary corporations file combined returns since many more corporations will face it.

The two main variants of throwback rules both derive from California Franchise Tax Board decisions.⁵

Under the Joyce rule (the most commonly used rule), sales are thrown back to New Mexico (that is, added to the numerator of the New Mexico sales factor) if the other state has no jurisdiction to tax any of the corporations included in the New Mexico return **with which New Mexico has nexus**. The corollary is that only the sales of the nexus corporations into New Mexico may be apportioned to New Mexico; sales by the group’s non-nexus members into New Mexico are not counted as New Mexico sales.

³ See Sections 7-4-6B(2), 7-4-7B(2), 7-4-9A(2) and 7-4-17B NMSA 1978 – the throwback rules.

⁴ The sales factor is the amount of sales by the taxpayer into a state divided by the taxpayer’s total sales everywhere. Since some states (unlike New Mexico) apportion income solely on the basis of the sales factor, the amount of throwback sales added to the numerator can make a significant difference in the taxes due those states.

⁵ *Appeal of Joyce, Inc.* No.66 SBE 069 (CA St.Bd. of Equal. Nov 11, 1966) and *Appeal of Finnigan Corporation*, CA St.Bd. of Equal., August 25, 1988 [*Finnigan I*] and Op. on Pet. for Rhrg, CA St.Bd. of Equal., January 24, 1990 [*Finnigan II*]. California moves back and forth between the two rules, depending on which rule gives it the greatest revenue in the case at hand. This is precisely what states should not do if they want federal help in enforcing combined reporting.

Under the Finnigan rule, sales are thrown back to New Mexico only when the other state has no jurisdiction to tax **any** of the corporations included in the return. On the other hand, any sales into New Mexico made by any member of the group are apportionable to New Mexico. The inbound portion of the Finnigan rule skirts PL 86-272 by reasoning that a state using the Finnigan rule is merely measuring the actual business activity in the state of the unitary group, not taxing the non-nexus members.

New Mexico actually follows a modified Joyce rule; see Subsection D of 3.5.4.9 NMAC.⁶ The Joyce rule applies unless the taxpayer can demonstrate that the taxpayer would be subject to multiple taxation when the other state “follows a contrary rule”. This regulatory prescription is problematic and needs to be amended.

To create a context, imagine a unitary group of two corporations. One corporation (A) has nexus with state Z but not New Mexico and the other (B) has with nexus with New Mexico but not state Z. Under the Joyce rule, New Mexico would require B to calculate the numerator of its sales factor by including (throwing back) its sales to state Z but excluding A’s sales into New Mexico. If Z is a Finnigan rule state, it will require A to include in its Z apportionment numerator not only its sales in Z but also B’s sales into Z. It will not, however, require A to throwback to Z its sales into New Mexico. Clearly the unitary group can show that B’s sales into Z are included in the sales factor numerator of both New Mexico and Z.

Is this a conclusive demonstration of “multiple taxation”? What about the fact that A’s sales into New Mexico are taxed by neither state?⁷ Depending on the volume of A’s sales into New Mexico compared with B’s sales into Z and the tax rates of the two states, the combined tax owed to the two states under the conflicting rules may be less than the combined tax owed if both states used the same rule. Why would the “multiple taxation” then be an unfair result? Neither the regulation nor Department instructions shed any light on what “multiple taxation” means, what constitutes a contrary rule or how to determine when this sad state of affairs exists.

Worse, the regulation is not explicit as to the remedy when multiple taxation does occur. Is the taxpayer supposed to use the other state’s rule in computing the group’s New Mexico taxable income or do something else? All of this ought to be clarified.

A more fundamental question is: what is New Mexico trying to accomplish by following a Joyce rule? Arguably the Finnigan rule is closer to the spirit of the unitary concept. Further, market states, like New Mexico, usually generate a larger tax base under a Finnigan rule. New Mexico’s tax base, however, is dominated by the presence of oil, gas and minerals companies and certain high tech manufacturers. So, in New Mexico’s case, does the Joyce rule produce a bigger tax base or, it not, is it intended to be another economic-development-friendly feature?

Note that New Mexico’s version of UDITPA does not address which policy approach New Mexico should be following. The policy is set by the department’s regulation adopting the (modified) Joyce rule.

⁶ See below.

⁷ A clear example of “nowhere income”.

Assuming that New Mexico means to take a more-or-less business-friendly posture, it should clean up regulation 3.5.4.9 NMAC and adopt a new regulation along the lines suggested below.

3.5.4.9 TAXABLE IN ANOTHER STATE - WHEN A TAXPAYER IS "SUBJECT TO" A TAX:

...
D. When determining whether a taxpayer is taxable in another state, the term "taxpayer" shall apply to each separate member of a combined or consolidated filing group and shall not apply to the group as a single taxpaying entity [~~unless the taxpayer can demonstrate that application of this rule will subject it to multiple taxation based on the application of a contrary rule in the other state~~]. New Mexico follows the "Joyce rule."⁸

Section 7-4-19 NMSA 1978 provides for equitable adjustment of UDITPA allocation and apportionment rules when those rules do not fairly represent the taxpayer's business activities in New Mexico. It seems more appropriate to provide an adjustment under the authority of this section than under the section defining when a taxpayer is taxable in New Mexico and another state. Since the increase in aggregate taxes can arise because of the conflict between New Mexico's Joyce rule and the other state's "contrary rule" in either allocation rules or the apportionment sales factor, a new special rule seems to be called for. For example--

3.5.19.20 SPECIAL RULES: CONFLICTS IN RULES DEFINING WHEN A TAXPAYER IS "SUBJECT TO" A TAX IN ANOTHER STATE

A. A taxpayer may request, in accordance with 3.5.1.19 NMAC and instructions of the department, an adjustment of the allocation and apportionment provisions as applied to the taxpayer when:

- (1) the taxpayer is required to file a return with New Mexico and another state;
- (2) the other state has a rule that applies the term "taxpayer" in a manner contrary to Subsection D of 3.5.4.9 NMAC;
- (3) the different application results in some allocable income or apportionable sales being attributed both to New Mexico and the other state; and
- (4) the aggregate amount of tax owed by the taxpayer to New Mexico and the other state exceeds the aggregate amount that the taxpayer would have owed had both states followed the rule stated in Subsection D of 3.5.4.9 NMAC.

B. If the department grants the request, it may adjust the allocation or sales apportionment factor so as to reduce the excess aggregate amount of tax by _____ percent. [Since it takes two to tango, 50% suggests itself. A really taxpayer-friendly state of course would grant a 100% adjustment.]

C. If, subsequent to the department's granting of the adjustment, the other state finally determines that the amount attributable to that other state of allocable income or sales that had been attributed to both states is less than the amounts used in determining the adjustment, then the taxpayer shall file an

⁸ Even better would be inclusion of language spelling out what New Mexico means by the Joyce rule.

amended return with New Mexico reflecting the change within ninety days of the other state's final determination.

The New Mexico Legislature should also declare what the policy on throwbacks is, if not in the Uniform Division of Income for Tax Purposes Act, then in the Corporate Income and Franchise Tax Act, particularly in the sections dealing with combined and consolidated returns.

This paper addresses just one of the flaws in New Mexico's existing corporate income tax system. If the Institute permits me, I would like to discuss some others, such as: the adequacy or effectiveness the provisions of Section 7-2A-8.3 (combined returns) and 7-2A-8.4 NMSA 1978 (consolidated returns), the effect of limited liability companies and other pass-through entities on corporate income tax liabilities and whether the same rules ought to apply to determining when a business is subject to income tax as well as to sales/gross receipts tax.

TAX QUOTABLE:

“Like mothers, taxes are often misunderstood, but seldom forgotten “

~ Lord Bramwell



COMMENTS: Your suggestions and comments on this newsletter, the conferences (past or future), the Distinguished Lectures Series, our research or any aspect of NMTRI's operation and programs are welcome. Please send them to richard.anklam@nmtri.org, call 505-269-6791 or mail them to P.O. Box 91657, Albuquerque, New Mexico 87199-1657. We genuinely solicit your input and thank you for your support.



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"The power to tax involves the power to destroy" - McCulloch v. Maryland, 17 U.S. 316 (1819), Chief Justice John Marshall.

“Taxes are what we pay for civilized society” *Campañía General de Tabacos v. Collector*, 275 U.S. 87, 100 (1927), Justice Oliver Wendell Holmes, dissenting.