

Tax Matters

The Newsletter of the New Mexico Tax Research Institute

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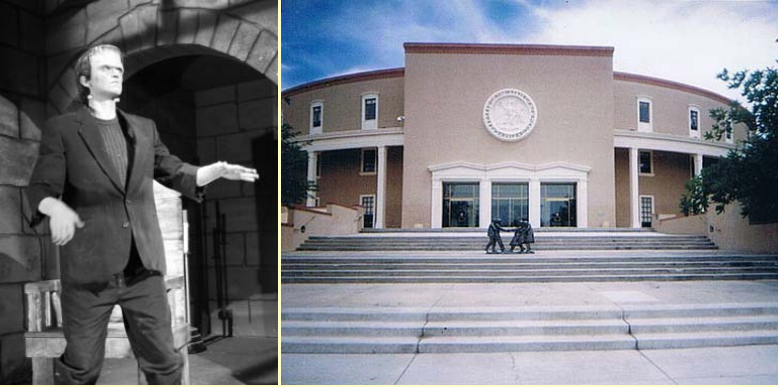
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TWO WEEKS INTO THE SPECIAL SESSION – FEELS LIKE LAST WEEK



The 2011 Special Session of the New Mexico Legislature began at noon on Tuesday, September 5th and will last no more than 30 days. The primary purpose of the session is to redraw legislative and congressional boundaries in following the 2010 annual census. More information on redistricting can be found on the Legislative Council Service website [here](#). New Mexico has an uncompensated volunteer legislature comprised of a 70 member House of Representatives and a 42 member Senate. Legislative sessions alternate between 30-day budget related sessions in even numbered years, and unconstrained 60-day sessions in odd-numbered years.

In addition to calling for bills to redistrict and pay for the session, the Governor's Proclamation added the issues they'd previously signaled as everyone expected. It asked for eleven other bills eliminating driver's licenses for undocumented workers, eliminating "social promotion" for third graders who can't read at grade level, a cleaned-up in-state procurement preference for state purchases, state and local government authority to restrict fireworks sales, capital outlay, restoration of funding for a supplemental food stamp program, and specified government restructuring. Specifically, the Proclamation requested bills consolidating the Tourism and Cultural Affairs Departments into a Department of Tourism and Cultural Affairs, integrating the Department of Information and Technology as a division into the General Services Department, placing the Department of Homeland Security and Emergency Management into the General Services Department as a division. The Proclamation can be seen on the Governor's website [here](#).

What's New

We're now up to 40 House and 34 Senate bills that have been introduced. Most of those bills are still redistricting related, however other bills continue to be introduced as well. On the tax front, the "fix" to the High Wage Jobs Tax Credit we've been expecting was introduced by Senator Phil Griego in the form [Senate Bill 27](#). The High Wage Jobs Tax Credit, one of the state's most lucrative business tax inducements, was found several years after the fact, to point indirectly to the Internal Revenue Code definition of Medicare "wages" found at IRC Sec. 3306(b). The problem was economic developers, taxpayers, as well as the NMTRD assumed the referenced "wage" definition in the credit act was "gross wages", simply because that's what was intended and made sense. Sec. 3306(b) wages are reduced by certain pre-tax deductions such as some cafeteria plan contributions, meaning marginal jobs could fall out of qualification based on an employee's plan participation. Using the statutory definition also reduced the benefit amount of the credit as that calculation also included "wages" as a starting point before adding benefits.

The administration has indicated it wants to honor its commitments with respect to promises made about the credit by economic developers and others. The proposal creates a single definition of “wages and benefits” for purposes of job qualification and benefit. This should be a plus for taxpayers as more jobs can qualify when benefits are included with wages; however the predictability problem remains to a lesser extent. The proposal limits the cost of the expansion by limiting the retroactivity of the new rules, inserting a statute of limitations on claiming the credit similar to other business tax incentives, and closing potential “loopholes” we discussed in prior issues addressing the ineffective “export” requirement and implications presented by reorganizations.

There’s been some movement on the other tax issue, unemployment taxes. Previously, we’d only seen Rep. Mimi Stewart’s [House Bill 19](#) introduced, which of course is the proposal similar to the one that passed both houses in the last regular session only to be vetoed. The proposal moves NM to contribution schedule 3, from contribution schedule 1, and is intended to stave off insolvency of the unemployment insurance trust fund (that means an increase from an average per employee contribution of \$214.50 to \$369.80. Proponents suggest that the alternative would be a mandatory shift to schedule 6 (\$512.21/employee) once the funds are sufficiently depleted. Although the business community supported the prior effort relative to the perceived consequences, and was willing to not call it a “tax increase” to provide political cover, the Governor viewed the measure as a \$100M+ tax increase on employers, and clearly prefers other approaches. Her preference was introduced as Rep. Doyle’s [House Bill 31](#). Her approach is to appropriate found money in the budget and reserves, thanks to more optimistic revised revenue forecasts, in order to keep the fund solvent. Senator Smith introduced a “compromise” proposal in his [Senate Bill 29](#). It does a little bit of both. Regardless, nothing non-redistricting is moving quickly.

[NMTRI note: while proponents argue over approach, no-one is suggesting that we do nothing and face the ugly consequences of insolvency. All approaches represent trade-offs and opportunity costs. A premium increase has the same effect as a tax increase on employers. Using general fund dollars to plug the hole rather than a rate increase means that that money can’t be used for program spending, other tax reductions, or to fund higher reserve levels.]

Other recently introduced bills of interest would include Senator Eichenberg’s [Senate Bill 26](#). It moves the Department of Information and Technology into the General Services Department as a division. Recall, Senator Eichenberg chaired last year’s legislative government restructuring task force. We forgot to mention last week that Representative Kintigh introduced his [House Bill 30](#), which proposes to merge the Homeland Security and Emergency Management Department into the Department of Public Safety, as a division.

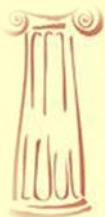
[NMTRI note: the savings sought after through the consolidation of cabinet level departments does not come from the pennies saved from paying a division director rather than a cabinet secretary. Instead, the savings are achieved by leveraging internal support functions rather than requiring their duplication, such as in the areas of the administrative services or legal divisions, as well avoiding the duplication of positions such as the deputy secretary].

Senator Dede Feldman introduced another fireworks ban bill in her [Senate Bill 28](#). It too provides for the ability to limit local fireworks sales when the governor declares an emergency

like Nate Gentry's [House Bill 20](#), however Sen. Feldman's proposal would extend to display fireworks whereas Nate's does not.

We'll see if the Governor's proposals start getting any traction this week. Stay tuned, and we'll keep you updated on the events and non-events of the Special Session!

NEW MEXICO TAX STUDY MOVING FORWARD



Before the new administration moved into Santa Fe, The City of Albuquerque and the Albuquerque Economic Development Department were attempting to recruit a large manufacturer to Albuquerque. Looking at a home in Mesa del Sol, the "Project April" was the stuff of dreams for economic development types: Intel scale and "green" jobs to boot (the target manufactured solar panels). The company inevitably chose Mesa, Arizona at its home, after Arizona passed some favorable legislation in the early part of the year. On the way out, the target cited the lack of a single sales factor apportionment option for purposes of the corporate income tax, and the imposition of gross receipts tax on electricity used in the manufacturing process. According to the company, that represented a 7% tax on their single largest input. Albuquerque's Mayor Richard Berry, reacting to his advisors, advocated for a tax study, reminiscent for some of his advisors to the 1997 *Business Tax Competitiveness Study* by KPMG LLP and its captive economic consulting group Berent's Group. The purpose of the study would be to identify competitive disadvantages in our tax code such that appropriate legislation could be formulated in response.

About that time, a study commissioned by the Council on State Taxation ("COST") performed by Ernst & Young LLP ("E&Y") released its "Competitiveness of State and Local Business Taxes on New Investment." New Mexico did not fare well in the study, ranking 51 out of 50 states (and D.C.) for return on investment resulting from effective tax rate. Maine ranked best. According to the study's announcement:

"New Mexico's state and local business tax system imposes the greatest burden of any state, resulting from factors such as a corporate income apportionment system that makes a large portion of the income from new investments taxable, an above average corporate tax rate and the imposition of a gross receipts tax on virtually all business activities".

The study was essentially a representative firm analysis that modeled a \$100 million investment in a Subchapter-C corporation in five differing mobile sectors: headquarter facilities, research and development facilities, office and call center facilities, durable manufacturing facilities and non-durable manufacturing facilities. The study did not include incentives, which we learned from the 1997 study that New Mexico relies more heavily upon than competing states to be competitive.

The decision was made by the Mayor and other stakeholders to contract with NMTRI to work with E&Y to review and refine the New Mexico assumptions, expand the scope to include incentives in New Mexico and select competing states, add industries and locations (i.e. rural), and ask additional policy questions (i.e. what happens to the rankings if we incorporate a single

weighted sales factor?). The Mayor went to NAIOP and asked for support from the business community, which he's received. Bernalillo County is supporting the effort, as is PNM, Realtors, contractors unions, and the Municipal League. Also participating is the Legislative Finance Committee, the Economic Development Department, the Taxation Revenue Department, and the Department of Finance and Administration. Stay tuned as the study is underway, and the questions that can be asked are only limited by budget (it's not too late to support the effort). The effort reeks of good government and true public/private partnership designed to obtain credible and useful information such that better policy recommendations and legislation can be developed. It's a welcome surprise that the effort came together as well as it has, and participation is as broad as it is. Keep a lookout for the results as they unfold.

The 1997 KPMG Berents Study can be found on our website [here](#). The COST/E&Y study can be found on the COST website [here](#).

KNICK KNACKS

Amazon Wars: California and Amazon.com Declare Strange Truce

Amazon.com has agreed to start collecting California sales/use taxes next September unless U.S. Congress takes action on the matter. They've also agreed to give up pursuit of a ballot measure preserving their ability to sell to Californians tax free, allowing California lawmakers to give up their efforts to block the referendum (which would require a super-majority). While congressional action on sales taxes in an election year isn't necessarily likely, the compromise represents an interesting de-escalation in the internet commerce tax wars.

President Signs Tax Patent Prohibition

On Friday morning, President Barack Obama signed into law the Leahy-Smith America Invents Act ([HR 1249](#)) Friday morning. The measure, discussed in our newsletter last week when passed by Congress, reforms the U.S. patent system and halts the granting of patents for tax strategies. Under the provisions of the act, any "strategy for reducing, avoiding, or deferring tax liability" is deemed to be "prior art" under patent law, and accordingly not patentable. The tax strategy provision applies to "any patent application that is pending on, or filed on or after" Sept. 16, 2011. The limitation does not apply to software, technology or method "that is used solely for preparing a tax or information return or other tax filing" or that is "used solely for financial management, to the extent that it is severable from any tax strategy or does not limit the use of any tax strategy by any taxpayer or tax advisor."

After a 1998 court decision (*State St. Bank & Trust v. Signature Fin. Group*, 149 F.3d 1368 (Fed. Cir. 1998)) tax strategies became patentable as business methods. The U.S. Patent and Trademark Office has since granted more than 160 patents on tax strategies. Another 167 applications were pending when the act was signed into law. Existing tax strategy patents are not affected by the new law, however pending tax strategy patent applications will be considered "prior art" under the new law.

Tax Policy Center Sponsors Budget Catastrophe Panel

The Tax Policy Center, a joint venture between the Urban and Brookings Institutions, is sponsoring a panel discussion on Friday, September 23 titled "Avoiding Budget Catastrophe." According to the TPC:

“Continuation of current U.S. fiscal policy will lead to an enormous accumulation of debt with potentially disastrous consequences. As the Joint Select Committee on Deficit Reduction attempts to produce a bipartisan proposal to trim \$1.5 trillion from budget deficits over the next decade, many commentators fear that their proposals might simultaneously undermine our fragile economic recovery while not really addressing the enormous long-term budget challenges. Please join us for a conversation about how to avoid a budget catastrophe. We will discuss options for fiscal reform and the trade-off between the immediate need to address a floundering economic recovery and the long-term need to achieve fiscal sustainability.”

Panelists:

- **Len Burman**, Daniel Patrick Moynihan Professor of Public Affairs, Syracuse University, and Affiliated Scholar, Urban-Brookings Tax Policy Center.
- **Michael Ettlinger**, Vice President for Economic Policy, Center for American Progress.
- **Alan Viard**, Resident Scholar, American Enterprise Institute.
- **David Wessel**, Economics Editor, *Wall Street Journal* (moderator).

You can read about it and find out how to participate on the TPC website [here](#).

State Bar Tax Symposium September 23rd

The Taxation Section of the New Mexico Bar is having its annual Tax Symposium on September 23, 2011 at the State Bar. This year, the focus is entirely on New Mexico gross receipts and compensating taxes. The program qualifies for CLE (as well as CPE for CPA's), and will be instructed by NMTRI board members James P. O'Neill (O'Neill Consulting), Tim Van Valen, Esq. (Brownstein Hyatt Farber & Schreck), and NMTRI's Richard Anklam. The agenda and registration information can be found on the Bar website [here](#).

TAX QUOTABLE:

“Government is the people's business and every man, woman and child becomes a shareholder with the first penny of tax paid.”

~ Ronald Reagan, 40th US President



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.



Join NMTRI today!

"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" Campaña General de Tabacos v. Collector, 275 U.S. 87, 100 (1927), Justice Oliver Wendell Holmes, dissenting.