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New Mexico: Comprehensive tax legislation affecting businesses enacted

New Mexico's governor on April 4, 2019, signed into law comprehensive tax reform legislation (House Bill 6).

The following discussion provides details about various tax changes included in the tax reform law.

Corporate tax changes

Combined reporting

Under current New Mexico law, taxpayers may elect among three distinct filing methodologies—separate reporting, unitary combined reporting, and consolidated reporting. Combined reporting is required for certain retailers with sales facilities in New Mexico having more than 30,000 square feet.

Under House Bill 6, corporations that are part of a unitary group must file a worldwide combined return unless an election is made to file on a water's-edge combined or consolidated group basis. Corporations electing to file on a consolidated basis must file on that same basis for federal income tax purposes (i.e., the federal consolidated group will be the same as the New Mexico consolidated group). This change is effective for all original returns filed for tax years beginning on or after January 1, 2020. Once a water's-edge or consolidated group election is made, that election is binding for at least seven consecutive years unless permission is obtained from the Secretary to file using a different methodology.

The unitary group will include all corporations that are related through common ownership that are economically interdependent, as demonstrated by the following factors:

- Centralized management
- Functional integration
- Economies of scale

"Common ownership" means the direct or indirect control or ownership of more than 50% of the outstanding voting stock, ownership of which is determined with reference to IRC section 1563. Specifically excluded from the definition of a "unitary group" are S corporations, insurance companies, and real estate investment trusts (REITs) other than captive REITs, which are taxable group members. The water's-edge group will include all corporations that are part of a unitary group except for corporations that are exempt from New Mexico corporate income tax under NMSA § 7-2A-4 (insurance companies, certain pension trusts and non-profit organizations), or corporations (wherever organized) that have less than 20% of their property, payroll, and sales sourced (under the Uniform Division of Income for Tax Purposes Act or UDITPA) to locations in the United States. The "worldwide combined group" means all members of a unitary group, except corporations that are exempt under NMSA § 7-2A-4—irrespective of the country where the corporations are organized or conduct business activity.

Tax base changes

House Bill 6 also revises several definitions in New Mexico's corporate income tax code in light of the switch to mandatory combined or consolidated reporting and to address certain aspects of federal tax reform. Under current New Mexico law, tax is imposed on the net income of corporations conducting a trade or business in New Mexico. House Bill 6 amends the law to impose tax on the "taxable income" of a corporation or a group of corporations (wherever organized or incorporated) that are engaged in transacting business in New Mexico or that are deriving income from any property or employment within New Mexico.

- "Taxable income" is defined as a taxpayer's apportioned net income minus the net operating loss deduction for the tax year.
- "Apportioned net income" means net income allocated and apportioned to New Mexico, excluding from the sales factor any sales that represent intercompany transactions between members of the filing group.
- The "net income" of a combined or consolidated group is the combined base income and losses of corporations that are part of the filing group computed after eliminating intercompany income and expenses in a manner consistent with the federal consolidated filing requirements.
- A taxpayer's "net operating loss deduction" means the portion of the net operating loss carryover that may be deducted from the taxpayer's apportioned net income under the Internal Revenue Code for the tax year in which the deduction is taken, including the 80% limitation under IRC section 172(a) calculated on the basis of the taxpayer's apportioned net income. There are complex rules for determining a taxpayer's "net operating loss carryover" that include computing a taxpayer's "grandfathered net operating loss carryover" as newly defined.

House Bill 6 revises the definition of "base income" to mean the federal taxable income or the federal net operating loss of a corporation for the tax year calculated under the Internal Revenue Code after the special deductions provided in IRC sections 241 through 249, but without any deduction for net operating losses. This does not include the deduction allowed under IRC section 250 that relates to "global intangible low-taxed income" (GILTI) and "foreign-derived intangible income" (FDII). This amount is to be computed as if the corporation filed a federal income tax return as a separate domestic entity. From this amount an addback is required for: (1) interest received on a state or local bond that is exempt under the Internal Revenue Code; (2) the amount of any deduction claimed in calculating taxable income for all expenses and costs directly or indirectly paid to, accrued or incurred by a captive REIT; and (3) the amount of any deduction, other than for premiums, for amounts paid directly or indirectly to a commonly controlled entity that is exempt from corporate income tax under New Mexico law.

Next, a subtraction is allowed for: (1) income from obligations of the United States, net of expenses incurred to earn that income; (2) other amounts that New Mexico is prohibited from taxing because of the laws or the constitution of New Mexico or the United States, net of any related expenses; (3) an

amount equal to 100% of the subpart F income, as that term is defined in IRC section 952, included in the income of the corporation; and (4) an amount equal to 100% of the income of the corporation under IRC section 951A (GILTI), after allowing the deduction provided in IRC section 250.

Finally, a taxpayer must make "other" adjustments deemed necessary to properly reflect income of the unitary business, including attribution of income or expense related to unitary assets held by related corporations that are not part of the filing group.

Apportionment changes

Under New Mexico law, an evenly weighted, three-factor apportionment formula is generally used to apportion business income to New Mexico. An exception to the general rule applies to: (1) taxpayers whose principal business activity in New Mexico is manufacturing; and (2) taxpayers with headquarters operations in New Mexico. These taxpayers may elect to use a single-sales factor formula.

House Bill 6 maintains the three-factor, evenly weighted apportionment formula for most corporations, but adopts market-based sourcing rules for sales of other than tangible personal property in lieu of the traditional UDITPA income-producing activity test.

Effective for tax years beginning on or after January 1, 2020, sales (other than sales sourced under the statute applicable to sales of tangible personal property), will be sourced to New Mexico as follows:

- In the case of a sale, rental, lease, or license of real property, if and to the extent the real property is located in New Mexico

- In the case of a rental, lease, or license of tangible personal property, if and to the extent the property is located in New Mexico

- In the case of a sale of a service, to the extent the service is delivered to a location in New Mexico

- In the case of a sale, rental, lease or license of intangible property, if and to the extent the intangible property is used in New Mexico

If the state(s) of assignment cannot be determined under the statutory rules, the taxpayer must reasonably approximate the state of assignment. Further, if the taxpayer is not taxable in the state to which a sale is assigned under the statutory rules or the state of assignment cannot be determined or reasonably approximated, then a "throwout rule" applies whereby the receipts at issue are excluded from the sales factor entirely. House Bill 6 states that the Department of Taxation and Revenue may promulgate rules "as necessary or appropriate" to carry out the purposes of this section.

Deduction to offset changes to deferred tax amounts

Effective for each of 10 consecutive tax years beginning on or after January 1, 2026, a filing group may claim a deduction to offset the financial statement impact of moving to combined or consolidated reporting and market-based sourcing, assuming the group members are part of a publicly traded company. The deduction for each tax year cannot exceed one-tenth of the amount of the aggregate increase in net deferred tax liabilities, the aggregate decrease in net deferred tax assets, or the aggregate change from a net deferred tax asset to a net deferred tax liability, as measured under generally accepted accounting principles (GAAP). To qualify, the amount of the aggregate change in deferred tax assets and deferred tax liabilities must be properly included in the calculation of the deferred tax asset or deferred tax liability reported as part of the consolidated financial statements for the first reporting period affected by the corporate income tax changes included in House Bill 6.

A filing group cannot claim a deduction unless it files a preliminary notice with the Secretary prior to January 1, 2023, and provides necessary information to show the calculation of the deduction expected to be claimed. The deduction may not exceed a taxpayer's net income, and any excess amount is to be carried forward to future years until fully utilized.

Gross receipts tax changes

House Bill 6 makes a number of changes to New Mexico's gross receipts tax regime. Among the most significant are:

- Adoption of a comprehensive system of local municipal and county compensating (use) taxes that will apply to property, services, licenses, and franchises used in the local jurisdiction. Under current law, there are no local compensating taxes.

- Revision of the state's sourcing rules to provide that sales of property and most services will be sourced to the location where the property is delivered to the customer or the location where the service is performed. Under current law, sales of property and most services are sourced to the business location of the seller.

- Expansion of the state compensating tax base to include services (other than certain research and development services) that are performed outside of New Mexico, but the product of which is initially used in New Mexico.

- Adoption of an economic nexus threshold for remote sellers and imposition of a gross receipts tax collection requirement on certain marketplaces.

The overall effect of these changes on the New Mexico gross receipts tax is substantial. First, the tax will change from a largely origin-based tax focused on the business location of the seller to a substantially destination-based system based on point of delivery or where a service is performed. Second, the tax base is significantly expanded by including services performed outside the state if the product of the service is intended for use in New Mexico. Third, the economic nexus and marketplace provisions will substantially expand the number of businesses responsible for collecting tax in New Mexico. Finally, and perhaps most significantly from a taxpayer perspective, the local gross receipts and compensating taxes at the municipality and county level are substantially expanded by the combination of the change in sourcing rules and the adoption of the local compensating tax regime. This last matter will affect both businesses that are currently engaged in business in New Mexico but may have limited local collection obligations (because of sales currently being sourced to the business location of the seller and the lack of local compensating taxes) as well as businesses with new collection obligations resulting from the economic nexus provisions. Importantly, the changes involving services performed outside New Mexico, the local compensating tax regime and the sourcing rules are not effective until July 1, 2021. The economic nexus and marketplace provisions, however, are effective July 1, 2019. More details on these changes are discussed below.

Sourcing for gross receipts and compensating taxes

House Bill 6 substantially alters the current gross receipts tax sourcing rules, and moves the tax from a substantially origin-based tax to a destination-based tax. Under current law, most sales of tangible property and services are sourced to the business location of the seller.

Under the new legislation, gross receipts and deductions from the sale or lease of tangible personal property and licenses (other than licenses to use real property) are to be sourced to the location of delivery of the property to the customer. Services (other than professional services, construction services and services related to the selling of real estate) are to be sourced to the location where the service is performed. Professional services will be sourced to the business location of the service

provider, while construction and real estate services will be sourced to the location of the construction project or the real estate sold.

Licenses for the use of real property will be sourced to the location of the real property. The Department of Taxation and Revenue is to develop a database of tax rates by jurisdiction to assist in determining the correct tax rate for various transactions. The sourcing changes are effective July 1, 2021.

New county and municipal compensating tax

Under House Bill 6, effective July 1, 2021, there is a new municipal compensating tax and a county compensating tax regime. As noted above, there are currently no local compensating taxes. The new compensating taxes will apply to tangible personal property, services, licenses, and franchises that are used in the municipality or county and that are acquired inside or outside New Mexico as the result of a transaction with a person located outside New Mexico that would have been subject to the state gross receipts tax had the property, services, licenses or franchises been acquired from a person with nexus with New Mexico. The taxes also apply to tangible personal property that was manufactured by a person using the property in New Mexico. These taxes will be collected by the Department in the same manner as the state gross receipts and compensating taxes.

The municipal and county compensating taxes are to be imposed at rates equal to the combination of certain local option municipal and county gross receipts taxes imposed under current law. As with the state tax, the scope of the local compensating taxes will include licenses and franchises used in the jurisdiction, and the state is to develop rules or procedures for apportioning the use of the license or franchise to the local government.

Taxation of services performed outside of New Mexico

Under current law, services performed outside of New Mexico are exempt from the gross receipts tax even if the product of the service is initially used in New Mexico with the exception of research and development services other than those sold between affiliated corporations and sales to the U.S. government by certain organizations. House Bill 6 limits the exemption for services performed outside the state, the product of which is initially used in New Mexico, **only** to those research and development services sold between affiliated corporation and to the U.S. government by certain organizations. The change is effective July 1, 2021.

Rate of state compensating tax applicable to services increased; compensating tax extended to licenses and franchises used in New Mexico

House Bill 6 increases the compensating tax applicable to services to be consistent with the compensating tax rate applicable to tangible personal property. As such, effective July 1, 2021, the compensating tax rate applicable to services is increased to 5.125%.

In addition, House Bill 6 extends the scope of the compensating tax to include licenses and franchises. Effective July 1, 2021, a person using a license or franchise in New Mexico is subject to an excise tax equal to the rate applicable to the compensating tax on tangible personal property (5.125%). The tax will be imposed on the value of the license or franchise used in New Mexico. The Department by rule, ruling or instruction is to "fairly apportion," when appropriate, the value of a license or franchise to its value used in New Mexico. For use of a license or franchise to be subject to compensating tax, the value of the license or franchise must be acquired inside or outside New Mexico as the result of a transaction with a person located outside the state that would have been subject to the gross receipts tax had the license or franchise been acquired from a person with New Mexico nexus.

Revised definition of engaging in business in New Mexico and marketplace provider provisions

Effective July 1, 2019, the definition of "engaging in business in New Mexico" has been amended to include a person, including a marketplace provider, that lacks a physical presence in the state, but has total taxable gross receipts in the previous calendar year from sales, leases, and licenses of tangible personal property; sales of licenses; sales of services; and licenses for use of real property sourced to New Mexico of at least $100,000. House Bill 6 specifically provides that the Department cannot enforce collection of gross receipts tax for a period prior to July 1, 2019, on persons engaging in business if the person lacked a physical presence in New Mexico. House Bill 6 amends the definition of "gross receipts" to include receipts collected by a marketplace provider from sales, leases, and licenses that are facilitated on behalf of a marketplace seller, regardless of whether the marketplace seller is "engaged in business" in New Mexico.

Under House Bill 6, a marketplace provider is defined as:

> *a person who facilitates the sale, lease or license of tangible personal property or services or licenses for use of real property on a marketplace seller's behalf, or on the marketplace provider's own behalf by: (1) listing or advertising the sale, lease or license by any means […] and (2) either directly or indirectly, through agreements or arrangements with third parties collecting payment from the customer and transmitting that payment to the seller, regardless of whether the marketplace provider receives compensation or other consideration in exchange for the marketplace provider's services.*

A marketplace provider engaged in business in New Mexico is not liable for incorrect amounts of gross receipts tax collected if the marketplace provider reasonably relied on erroneous information provided by the seller. In terms of audits, the Department will generally audit a marketplace provider (rather than a marketplace seller) for receipts from transactions it facilitates. The Department may audit the marketplace seller on occasion—for example, to determine whether the marketplace provider is to be relieved of liability.

A marketplace seller may deduct receipts from sales, leases and licenses of tangible personal property; sales of licenses; and sales of services or licenses for use of real property that are facilitated by a marketplace provider, provided that the marketplace seller obtains documentation from the marketplace provider indicating that the marketplace provider is registered with the Department and has remitted or will remit the taxes due on the gross receipts from those transactions.

Taxability matrix and certificated service providers

The Secretary is authorized to provide information, upon which taxpayers may rely, as to the taxability of gross receipts from particular transactions, including taxability matrices. The Secretary is further authorized to establish standards for the certification of certified service providers that offer software-based systems to enable taxpayers to properly determine the taxability of gross receipts from particular transactions. The term "certified service provider" is the same definition as in the Streamlined Sales and Use Tax Administration Act.

Gross receipts taxation of hospitals

House Bill 6 significantly changes the gross receipts tax treatment of hospitals, effective July 1, 2019. Under current law, nonprofit and governmental hospitals are not subject to gross receipts taxes. For-profit hospitals are subject to gross receipts taxes but are allowed a deduction equal to 50% of the gross receipts in determining the amount subject to tax. For-profit hospitals are also subject to local option gross receipts taxes.

Under House Bill 6, both for-profit and nonprofit hospitals licensed by the Department of Health are exempt from local option gross receipts taxes and are allowed a 60% deduction in determining their

state gross receipts tax. In addition, hospitals run by governmental agencies or entities are subject to the 5% governmental gross receipts tax, with a 60% deduction from the tax base.

Gross receipts tax extended to include licenses of digital goods

House Bill 6 applies the gross receipts and compensating tax to licenses of digital goods, effective July 1, 2019. "Digital goods" are defined as digital products delivered electronically, including software, music, photography, video, reading material, an application and a ringtone.

Read an **April 2019 report** [PDF 53 KB] prepared by KPMG LLP

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