



SALT DEVELOPMENTS – THE NEW MEXICO EDITION

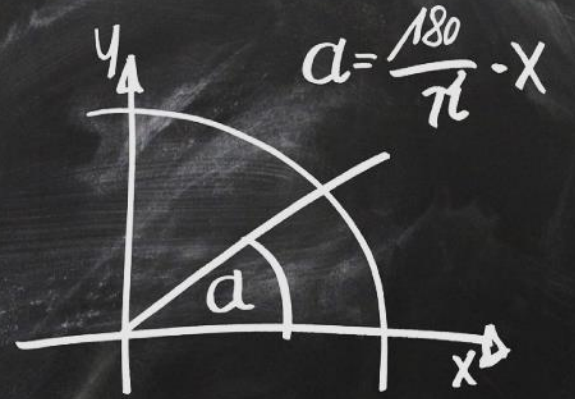
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The views expressed in this presentation are not necessarily the views of the presenters or organizations that they represent.

$$X_{1/2} = \frac{-b \pm \sqrt{b^2 - 4ac}}{2a}$$



$$X^2 + px + q = 0$$



$$X_{1/2} = -\frac{p}{2} \pm \sqrt{\left(\frac{p}{2}\right)^2 - q}$$



$$x = 6 - 2y$$

$$x + a = b$$

$$f(x) = \tan x$$

$$f(x) = \sin x$$

WHAT A YEAR (PLUS) IT HAS BEEN

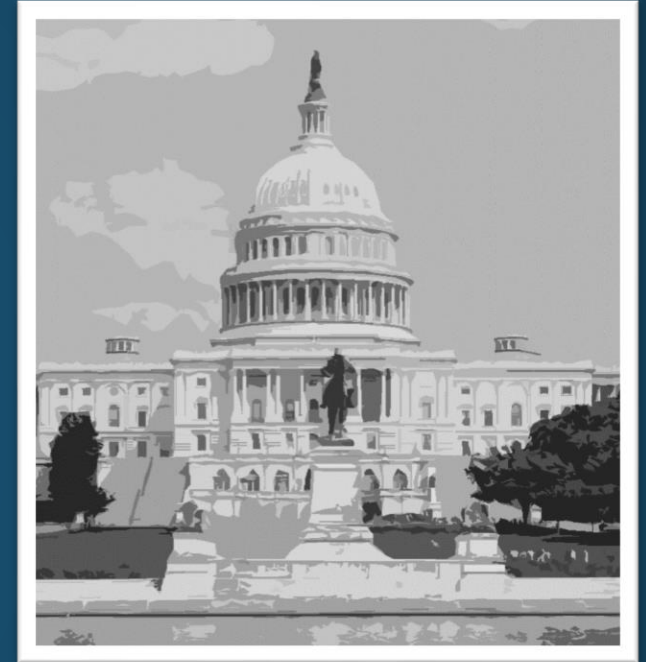
Here's just a bit of what happened nationally that affects state taxes:

Starting at the end of 2017



CONGRESS

Bi-Partisan Budget Act of 2015 Tax Cuts and Jobs Act



BIG FEDERAL CHANGES AFFECTING STATES:

1. Centralized partnership audits
2. Personal income taxes – increasing the standard deduction
3. Personal income taxes – zeroing out the personal exemption
4. Corporate income taxes – one-(last)-time repatriation tax
5. Corporate income taxes – limiting the interest expense deduction
6. Corporate income taxes – international changes

SUPREME COURT

Wayfair



OVERTURNING THE *QUILL* CASE:

- Under *Wayfair*, so-called “remote” sellers will no longer be protected from having to collect or pay sales and use (or gross receipts) taxes. And, because of the role that marketplace facilitators play today, most states will also impose tax collection /payment obligation on them as well.

WHAT A YEAR IT WILL BE FOR NEW MEXICO

Legislative and administrative changes

GRT on
Remote
Sellers

Marketplace
Facilitator
Collection

Combined
Filing

Market
Based
Sourcing

Other
Changes

NEW MEXICO LEGISLATURE



H.B. 6 Passed and Signed by the Governor Recently

1. PIT changes – to counter some effects of TCJA and raise revenue
2. GRT changes – destination sourcing, \$100,000 threshold for remote sellers, marketplace facilitator taxation, other
3. CIT changes – moving to combined filing, market-based sales factor sourcing rules, expanding single sales factor, etc.
4. Administrative changes – changes to protest and refund processes
5. Other

“

*No [state] is an island entire of itself;
every [state] is a piece of the continent,
a part of the main**

”

John Donne (paraphrased)

* Even Hawaii.

TORTOISE OR HARE

There are advantages to being the tortoise – the chief of which is that you can learn from the mistakes of the hare.





GRT CHANGES - DESTINATION SOURCING

- New Mexico has long been an origin sourcing state
- Local taxes did not apply to out-of-state sellers
- To be constitutionally proper—instate and out-of-state sellers need to be able to pay the same amount of tax (or less)
- Other states are struggling with the same issues – and other proposed solutions are still to be tested
- See *Associated Industries of Missouri v. Lohman*, 511 U.S. 641 (1994)

CIT CHANGES – COMBINED FILING



- New Mexico's default rule is worldwide combined filing with a "water's edge" election
- Water's edge group includes any corporations unless
 - They have less than 20% of property, payroll, and sales in the U.S.
 - Following sourcing rules of UDITPA

COLORADO 80/20 CASES

- Colorado has a statute that looks only to property and payroll.
- Colorado also has a regulation saying that companies with zero property and payroll (certain holding companies) are treated as excluded from the group.
- But does this create a loophole—so that all a group has to do is interpose a holding company in order to break up the group?
- See *Colorado Department of Revenue v. Agilent Technologies Inc.* and *Colorado Department of Revenue v. Oracle Corp.*

CIT CHANGES – COMBINED FILING



- Members of the combined filing group must be unitary
 - In addition to common ownership (> 50%) the entities must be “economically interdependent with one another as demonstrated by the following factors:
 - (a) centralized management;
 - (b) functional integration; and
 - (c) economies of scale;”

OREGON UNITARY BUSINESS CASE

- Oregon's Tax Court in a suit involving a question of how to interpret this language defining a unitary business:
 - 'Single trade or business' means a business enterprise in which there exists directly or indirectly between the members or parts of the enterprise a sharing or exchange of value *as demonstrated by*:
 - (A) Centralized management or a common executive force;
 - (B) Centralized administrative services or functions resulting in economies of scale; *and*
 - (C) Flow of goods, capital resources or services demonstrating functional integration.
- This language was later amended to change "and" to "or" and regulations that had indicated all three factors must be present were also amended.

OREGON UNITARY BUSINESS CASE

- *Rent-A-Ctr, Inc. v. Dep't of Revenue*, No. TC-MD 111031D, 2014 BL 131984 (Or. T.C. May 12, 2014).
- This case demonstrates the need for states to be clear that their statutory standard (like many such standards) is intended to be coterminous with the constitutional standard – which the U.S. Supreme Court has determined is based on certain factors, but not limited to a strict application of those factors.

RECENT CALIFORNIA CASE

- *ComCon Prod. Sers. I., Inc. v. Cal. Franchise Tax Bd.*, No. B259619, 2016 BL 414923
- (Cal. App. 2d Dist. Dec. 14, 2016)
- This case discusses the different standards or tests that the U.S. Supreme Court has applied to determine if a unitary business exists and how those tests relate to each other.
 - Tests Include:
 - “Three Unities” test – which may be phrased in various ways
 - “Flow of Value” test

CIT CHANGES – COMBINED FILING



- New Mexico's approach is a "single-entity" approach, which is sometimes referred to as the "Finnigan" approach after a California administrative case.
- Under this approach, all the income (or losses) of the separate entities, and all the factors, are combined, regardless of whether a particular entity has nexus in the state or is protected from state tax under federal law (P.L. 86-272).

RECENT ACTIVITY AT THE MTC

- Combined Filing Project:
 - The MTC combined filing model has long taken the so-called Joyce approach. (Also named after a California administrative case.)
 - Under that approach, all of the unitary income of the group is apportioned separately, by each entity, and only group members with nexus (or who are not protected) include their sales in the sales factor.
 - The U.S. Supreme Court has never weighed in on which approach—Joyce or Finnigan—is correct.
 - The MTC now has a project to do an alternative Finnigan combined filing model.

RECENT ACTIVITY AT THE MTC

- Updating Statement on P.L. 86-272:
 - The federal statute provides that a person that has only certain solicitation activity in the state is protected from income tax.
 - But where does activity that takes place over the internet happen?
 - And what activity is “solicitation” in the modern economy?
- The MTC also had a factor presence model (similar, but more detailed, than the thresholds that are currently being used on the sales tax side) –
 - Dollar thresholds for property, payroll and sales – OR
 - More than 25% of property, payroll or sales in the state – OR
 - Having a business domicile in the state.

COMBINED FILING AVOIDS MANY (BUT NOT ALL) TRANSFER PRICING ISSUES

- *Utah State Tax Comm'n v. See's Candies, Inc.*, 2018 UT 57, 435 P.3d 147
 - See's Candies transferred its trademarks to a related insurance company that Utah law excludes from the combined group
 - Utah tax commission argued that the royalty deduction paid by See's should be disregarded under its version of IRC Sec. 482
 - Utah supreme court held that the deduction was valid—but upheld an adjustment to the amount of that deduction
- New Mexico's House Bill 6 defines "base income" with (among other things) the following provision:
 - "(3) making other adjustments deemed necessary to properly reflect income of the unitary group, including attribution of income or expense related to unitary assets held by related corporations that are not part of the filing group;"
 - Other provision



CIT CHANGES - MARKET - BASED SOURCING

- So that sales, leases, licenses of services and intangibles are sourced to the market (rather than based on income producing activity/cost of performance).
- Based on “delivery” of services and “use” of intangibles
- The Multistate Tax Commission and Professor Pomp were involved in the development of the approach that New Mexico has adopted.

NEW MEXICO'S SOURCING RULES:

7-4-18 "(3) in the case of sale of a service, if and to the extent the service is delivered to a location in this state; and

(4) in the case of sale, rental, lease or license of intangible property, if and to the extent the intangible property is used in this state.

B. If the state or states of assignment under Subsection A of this section cannot be determined, the state or states of assignment shall be reasonably approximated.

C. If the taxpayer is not taxable in a state to which a sale is assigned . . . or if the state of assignment cannot be determined or reasonably approximated . . . that sale shall be excluded from the numerator and denominator of the sales factor.

D. The department may promulgate rules as necessary or appropriate to carry out the purposes of this section."

ISSUES WITH MARKET SOURCING:

- Special industries – may need special rules – example - broadcasting
- Special types of receipts may need special rules – example – investment receipts
- Consideration of taxpayer information/records available
- “Look-through” sourcing of receipts from certain intangibles (e.g. tradenames)
- Worldwide sourcing – when is a taxpayer “taxable” in another state
- Possible “whip-sawing” of taxpayers as states move from using location of income producing activity to using market-based sourcing

MARKET SOURCING – STATUTES ARE BETTER

- A number of states that retain income producing activity/cost of performance statutes have, nevertheless, argued that certain types of sales/receipts should be sourced to the state on a market basis, based on :
 - UDITPA's equitable/alternative apportionment statute
 - A transactional approach to determining the location of income producing activity and costs of performance, or
 - Special industry regulations
- With varying degrees of success.

MARKET SOURCING – CABLE TV CASES

- Where does a cable TV company do its income producing activities and what costs of performance should be included?
 - Recent Massachusetts Comcast case – based decision on the separate entity as opposed to the group
 - South Carolina DirecTV case – determined that the income producing activity was the sending of the signal to the customer's location – which happened within the states
 - Oregon Comcast case – special statutory rule

POSSIBLE WHIP-SAWING

- *Corp. Exec. Bd. Co. v. Va. Dep't of Taxation*, 822 S.E.2d 918 (Va. 2019)
 - Applying the income producing activity/costs of performance approach, a Virginia based company had to source nearly 100% of its receipts to Virginia because the service it provided, and all the related costs, were in Virginia.
 - But because a number of states had moved to market-based sourcing, the company also sourced some of these receipts to other states, as well.
 - Virginia has a statutory relief provision, but it applies only if the VA method applied is shown to be unconstitutional.
- MTC adopted a mediation provision as part of its uniform model market sourcing regulations.

NEW MEXICO AVOIDS THESE ISSUES:

- By adopting market sourcing by statute.
- Adopting the “delivery” approach rather than the – “benefit received” – method which California is having difficulties implementing
- Considering the adoption of the MTC model uniform regulations (safety in numbers)



- Utah – *Steiner* case – pending in front of Utah supreme court
 - Resident taxpayer with pass-through income argues that a credit for taxes paid to other states is not sufficient and, instead, Utah must allow for apportionment of business income (domestic and foreign).
- NM is one of the few states that actually apportions non-compensation income rather than taxing 100% to residents.
 - This is also why the trust cases pending at the U.S. Supreme Court are likely to have less effect on New Mexico (since, in those cases, states are asserting authority to tax 100% of resident trusts income).



- Recent *Dawson v. Steager*, 139 S. Ct. 698 , 203 L. Ed. 2d 29 (2019)
 - Under intergovernmental immunity and 4 U.S.C. 111, states cannot tax federal employees more than state employees that do similar jobs.
- See also *United States v. California*, No. 18-16496, 2019 BL 137706, 2019 Us App Lexis 11275 (9th Cir. Apr. 18, 2019) .
 - Citing *Dawson*, the court said: “. . . the prohibition against discriminatory taxes in § 111 "is coextensive with the prohibition against discriminatory taxes embodied in the modern constitutional doctrine of intergovernmental tax immunity.”
- This is consistent with the case of *U.S. v. New Mexico* where the state was allowed to tax the federal government consistent with taxes imposed on state government entities.
- New Mexico SB 11 – as passed – applies tax to 501(c)(3)s if they act as prime contractors for both federal and state labs.