

# Corporate Tax Reform Options in New Mexico:

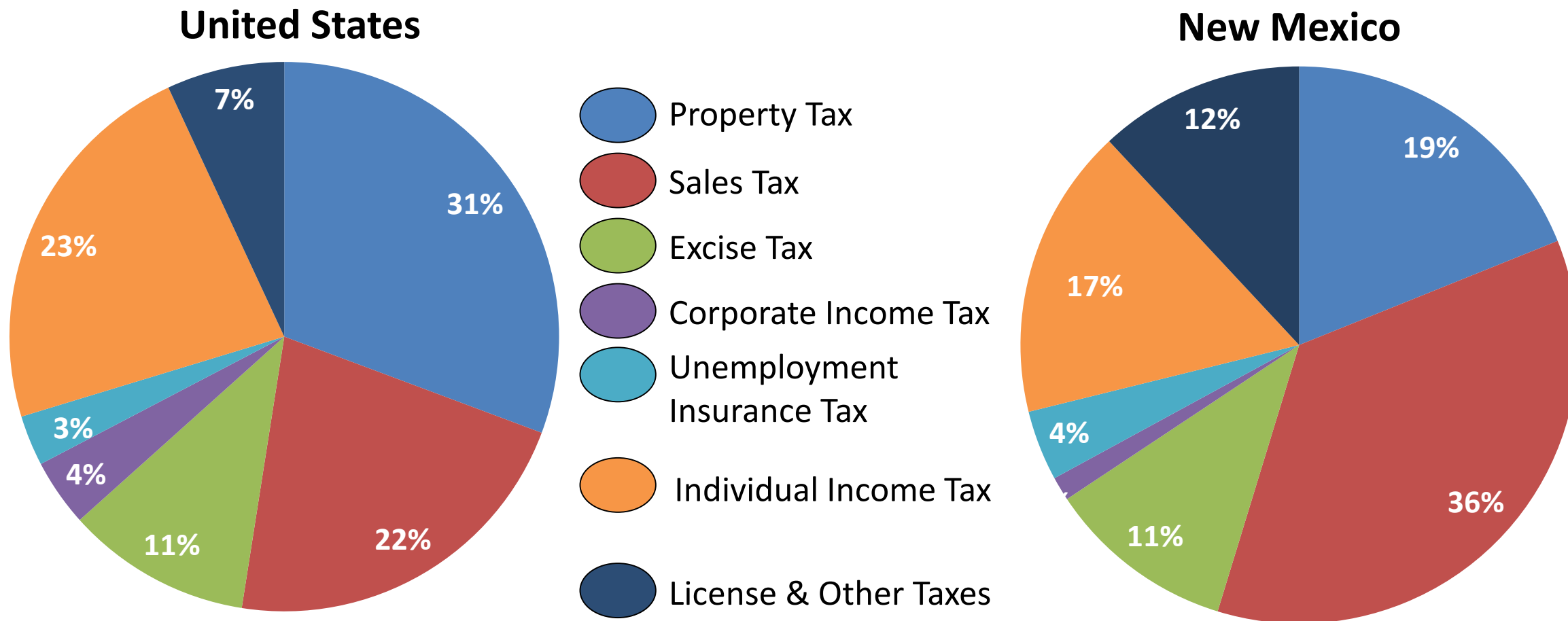
## Post-*Wayfair* Considerations; State-by-State Comparisons; Impact of Federal Tax Reform

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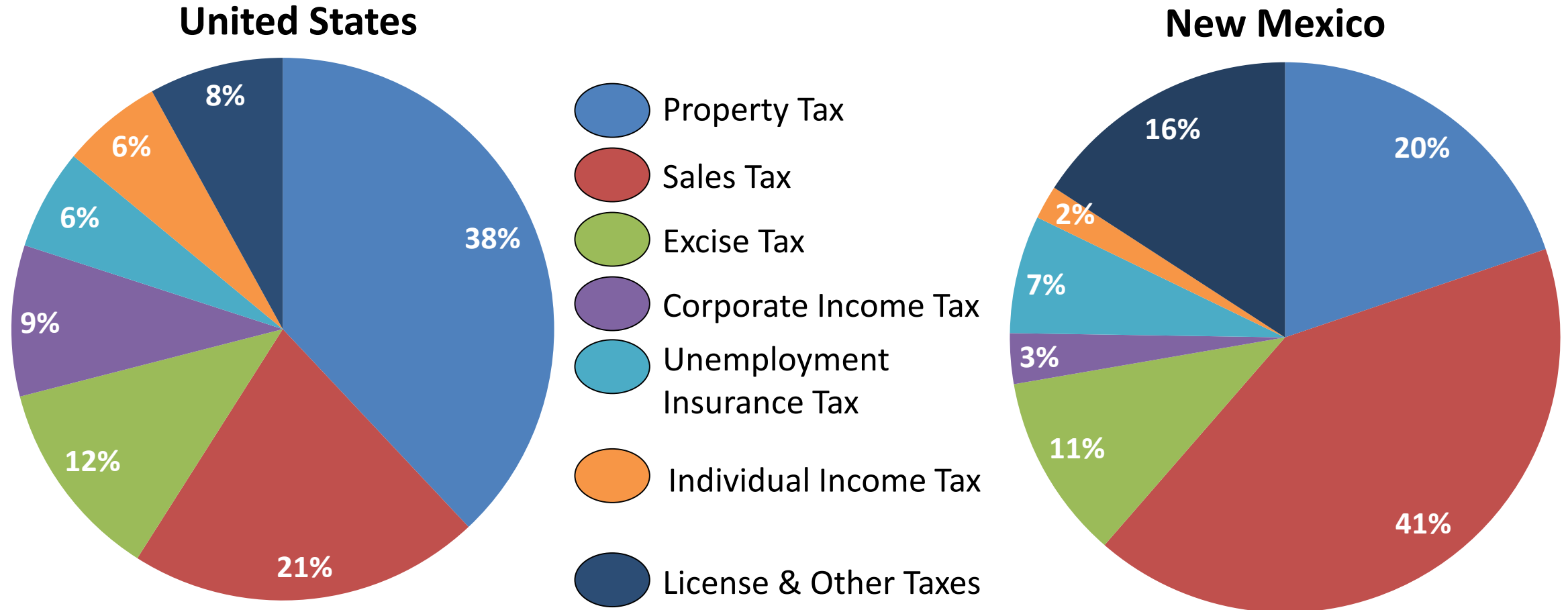
How Does New Mexico  
Compare?

# Total State & Local Taxes



Source: COST, STRI, Ernst & Young: "Total State and Local Business Taxes: State-by-State Estimates for Fiscal Year 2016"

# Total State & Local Business Tax Revenue



Source: COST, STRI, Ernst & Young: "Total State and Local Business Taxes: State-by-State Estimates for Fiscal Year 2016"

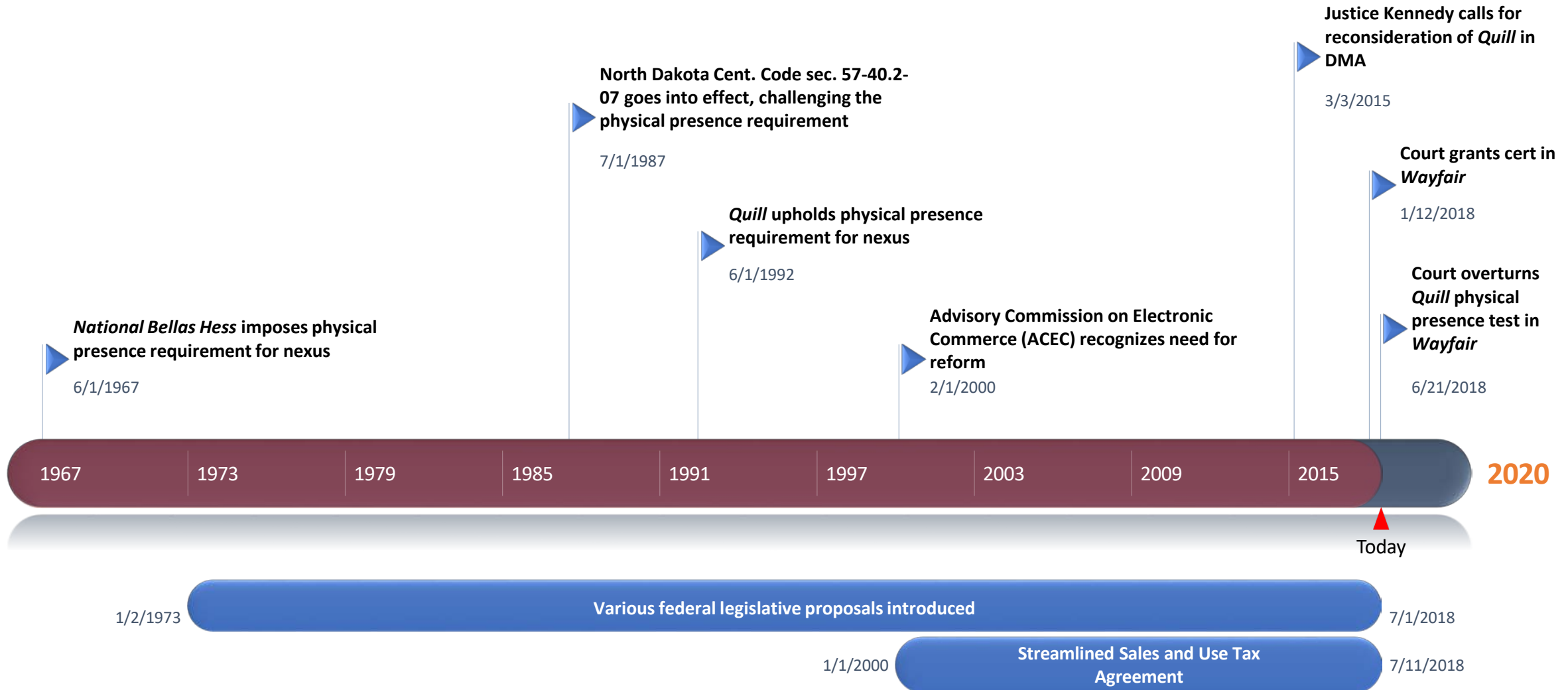
# State Tax Administration Scorecard

- Independent Tax Dispute Forum
  - New Mexico has an independent Administrative Hearings Office
- Pay-to-Play Requirement
  - Prepayment is not required to protest an assessment
- Even-Handed Statutes of Limitations
  - Equal – 3 years for both
- Even-Handed Interest Rates; **1-point**
  - Equal interest rates for under- and over-payment, however, NM does not calculate interest from comparable dates
- Number of Days to Protest an Assessment
  - Protests must be filed within 90 days of the date of the mailing to or service upon the taxpayer of the assessment
- Corporate Return Due Date and Extensions; **1-point**
  - Original due date is the Federal due date, not 30 days after
- Reporting Federal Corporate Tax Changes; **1-point**
  - Whether the state or taxpayers may adjust items beyond federal changes is unclear
- Transparency in Tax Guidance and Rulings
  - Rulings and decisions are available on website
- Retroactivity and Other Fairness Issues; **1-point**
  - Taxpayers seeking a refund must refile their refund claim within 90 days if the Department fails to act on the claim within 120 days of the original filing.

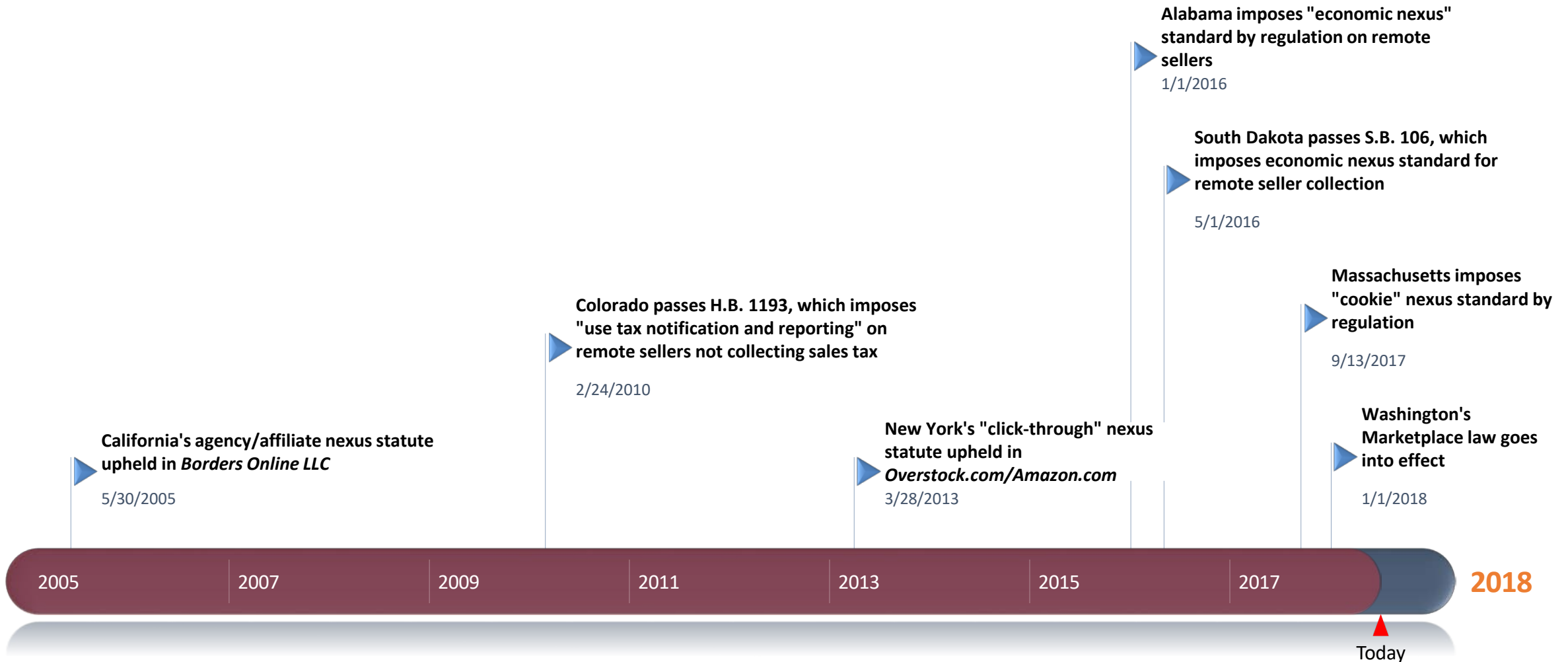
**New Mexico's Overall Grade = B+**

# Post-*Wayfair* State Tax Considerations

# National Bellas Hess to Wayfair



# States take things into their own hands . . .





# Holding (June 21, 2018):

- In a 5-4 Decision, Justice Kennedy (joined by Thomas, Gorsuch, Ginsburg, Alito) held that:
  - *Quill* and *National Bellas Hess* are overruled. “Physical Presence test is replaced with “economic and virtual” presence test
  - The physical presence rule is unsound, is an incorrect interpretation of the Commerce Clause, and restricts the states’ authority to “collect taxes and perform critical public functions”
- The Physical Presence rule only impacts the first (nexus) prong of *Complete Auto*. Query – might some other principle in the Court’s Commerce Clause doctrine invalidate the Act?
- Majority concluded that the following features of South Dakota’s law minimized the burdens on interstate commerce:
  - Included a transactional safe harbor
  - Did not apply retroactively
  - South Dakota was a full member of the Streamlined Sales and Use Tax Agreement (SSUTA)

# Transactional safe harbor

- South Dakota's transaction safe-harbor of an annual threshold of 200 sales or \$100,000 in sales was sufficient
- States argued that the first sale triggered the collection responsibility and Justice Kennedy did not respond
- Should the threshold be the same for California as South Dakota?
- Can states require small businesses making few sales collect in all cases?

# Retroactivity

- Not really dealt with, despite emphasis in oral argument
- South Dakota law foreclosed retroactive application
- Although generally speaking a determination by the U.S. Supreme Court about the meaning of the U.S. Constitution can be applied retroactively, consider whether such an application in a particular set of facts (and considering prior positions of the state) could violate Due Process as a retroactive application of a state statute (*See United States v. Carlton*, 512 U.S. 26 (1994))

# Other views

- Justices Thomas and Gorsuch in separate concurrences rejected the dormant commerce clause
- Justice Roberts (joined by Breyer, Sotomayor, and Kagan) dissented based on *stare decisis* and noted that any alteration of the Court's prior rule should be left to Congress

# Will Congress Step in?

- What should Federal Legislation look like?
- S. 976 — *Marketplace Fairness Act*
- H.R. 2193—*Remote Transaction Parity Act*
- *Online Sales Simplification Act* (hybrid origin-based system)
- S. 3180 — *Stop Taxing Our Potential (STOP) Act (S. Res. 433)*
  - Reinforces the standard in *Quill*: sponsored by Senators from Montana, New Hampshire, and Oregon
- Implications for Income and other Business Activity Taxes?
  - More urgency for BATSA now that *Quill* is gone
- House Judiciary Committee on July 24 explored advisability of a moratorium on implementing the *Wayfair* decision

**COST Scorecard:  
THE BEST AND WORST OF STATE  
SALES TAX SYSTEMS**

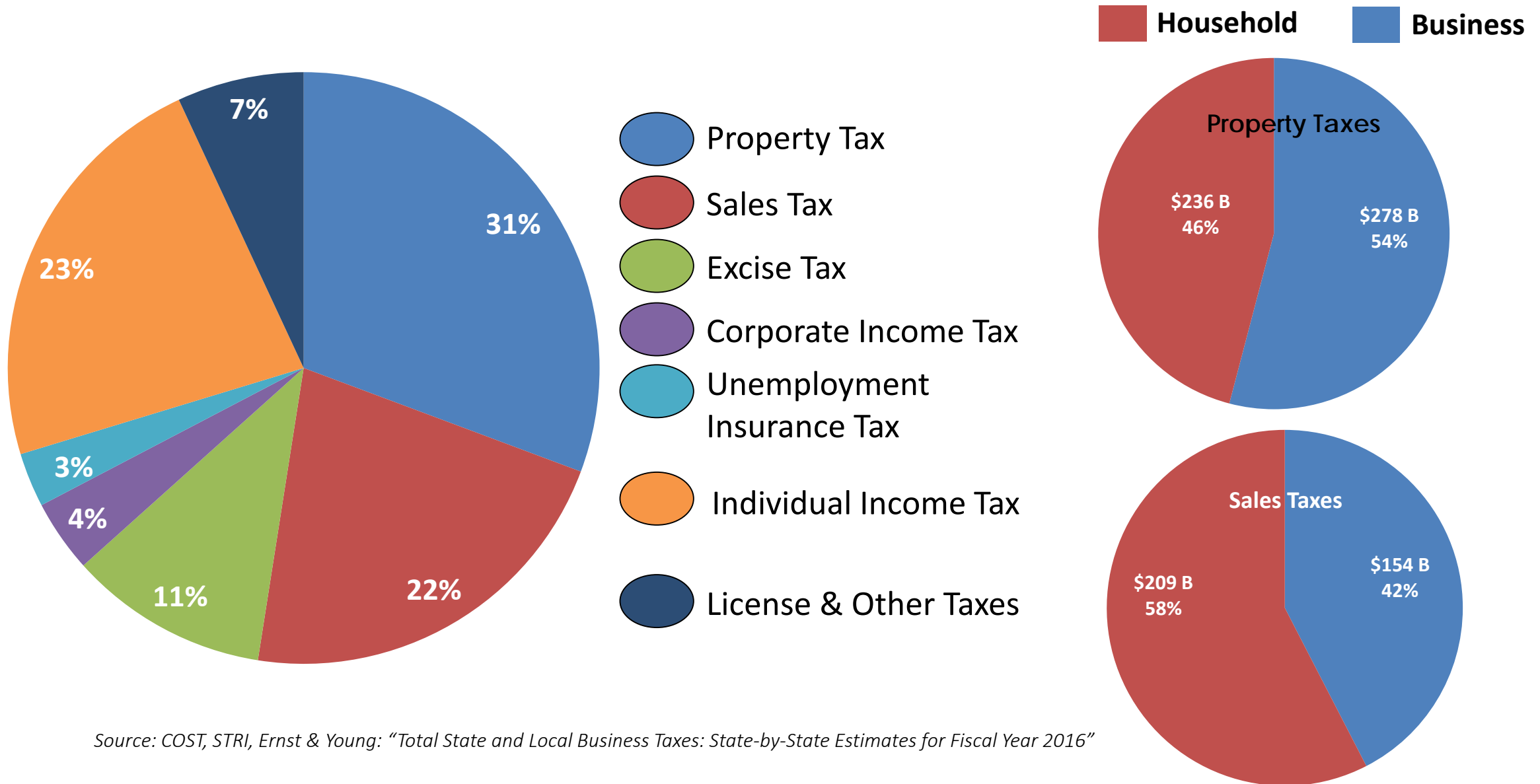
# Background on COST's Scorecards

- **Purpose** of Scorecards is to grade the state tax systems on an objective basis, guided by sound tax policy principles, and to work with the states' policy makers – both executive and legislative – to improve state and local tax administration for multijurisdictional businesses.

COST's Scorecards (Available at [www.cost.org](http://www.cost.org))

- **State Administrative Scorecard**
  - Increase in independent tribunals & appeal period from 30 to 60 days
- **Unclaimed Property Scorecard**
  - Increase in states exempting gift cards and b2b transactions
- **Property Tax Administration Scorecard**
  - International and improvement of some states appeal processes
- **Scorecard on State Sales Tax Systems**
  - First Edition released April, 2018
  - New Mexico, along with Colorado and Louisiana, received the lowest grade, an “F”

# Sales Tax and Overall State & Local Revenue



Source: COST, STRI, Ernst & Young: "Total State and Local Business Taxes: State-by-State Estimates for Fiscal Year 2016"



# The Sales Tax Scorecard Categories

- **Scorecard Categories**

- Exemption for Business-to-Business Transactions
- Fair Sales Tax Administration
- Centralized Sales Tax Administration
- Simplification & Transparency
- Reasonable Tax Payment Administration
- Fair Audit/Refund Procedures
- Other Issues Impacting Fair Tax Administration

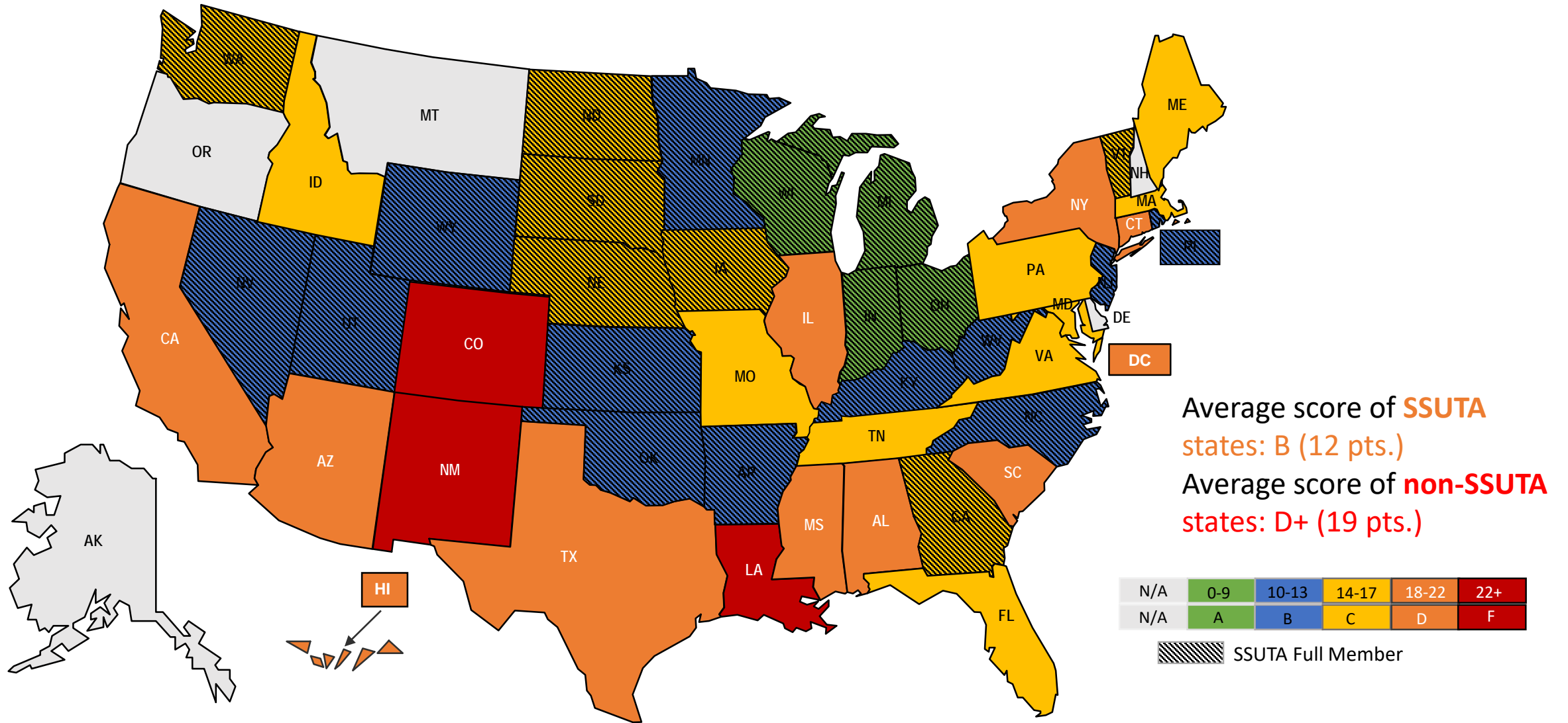
- **What the Scorecard Does Not Grade**

- Tax Rate Differences
- Tax Base Breadth (other than Taxing Business Inputs)

# State Remote Seller Collection Versus Efficient Sales Tax Administration

While the U.S. Supreme Court overturned the longstanding *Quill* precedent in the *Wayfair* case, **attaining a level of sales tax simplification that satisfies a constitutional “commerce clause” requirement should not be confused with constructing an efficient and fair modern-day sales tax system.**

# States' Overall Scorecard Grades

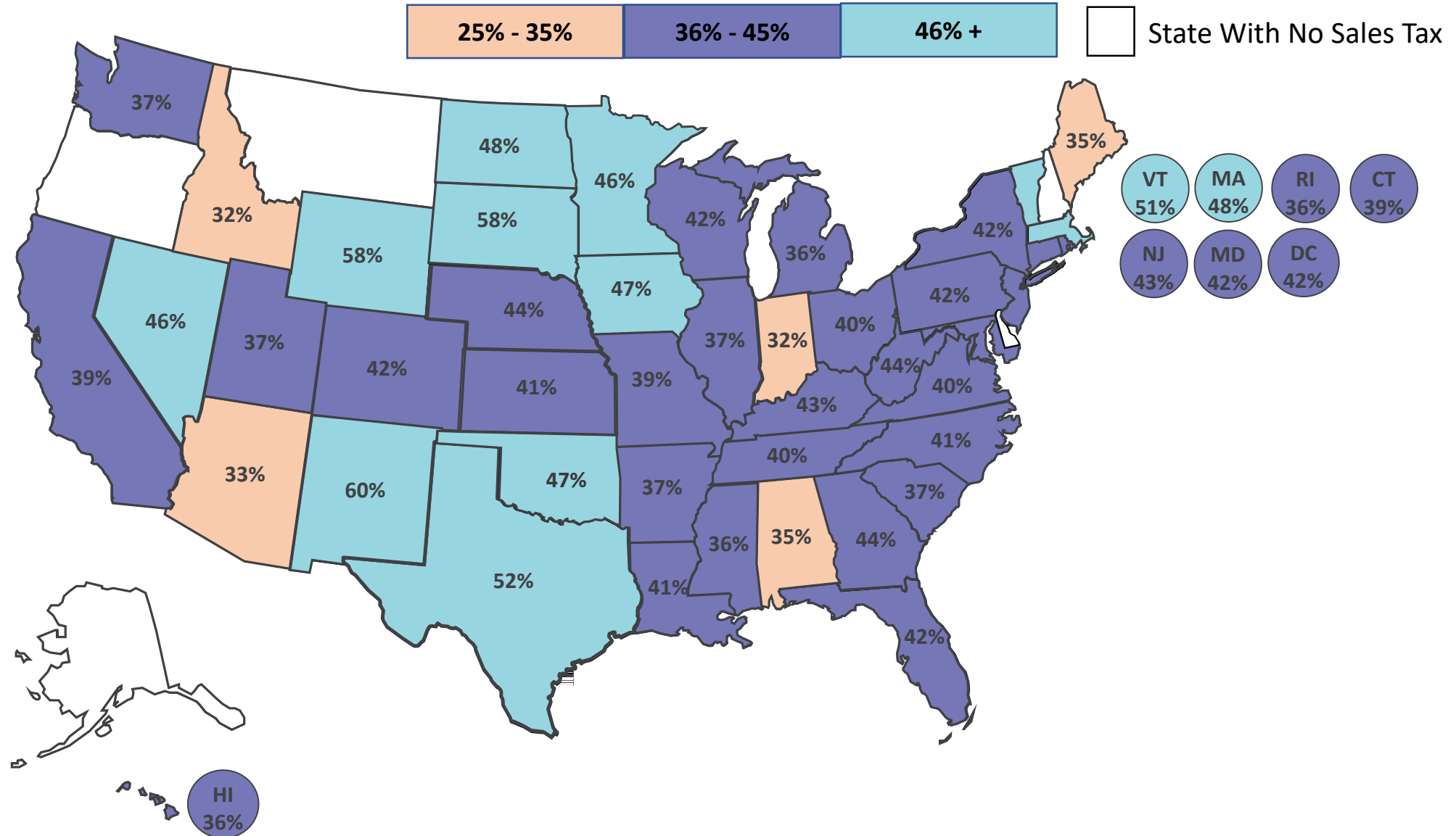


# Exemption for Business-to-Business Transactions

- COST/EY Study highlighting overall tax on business inputs – 2 points; (NM 2 pts)
- Manufacturing exemption – 3 points; (NM 3 pts)
  - Manufacturing equipment exemption – 2 points; (NM 2 pts)
  - Manufacturing inputs exemption – 1 point; (NM 1 pt)
- Pyramiding tax of service industries – 3 points; (NM 3 pts)
  - Double tax on equipment to provide service and tax on service when sold to consumers
- New Mexico: 8 out of 8 points

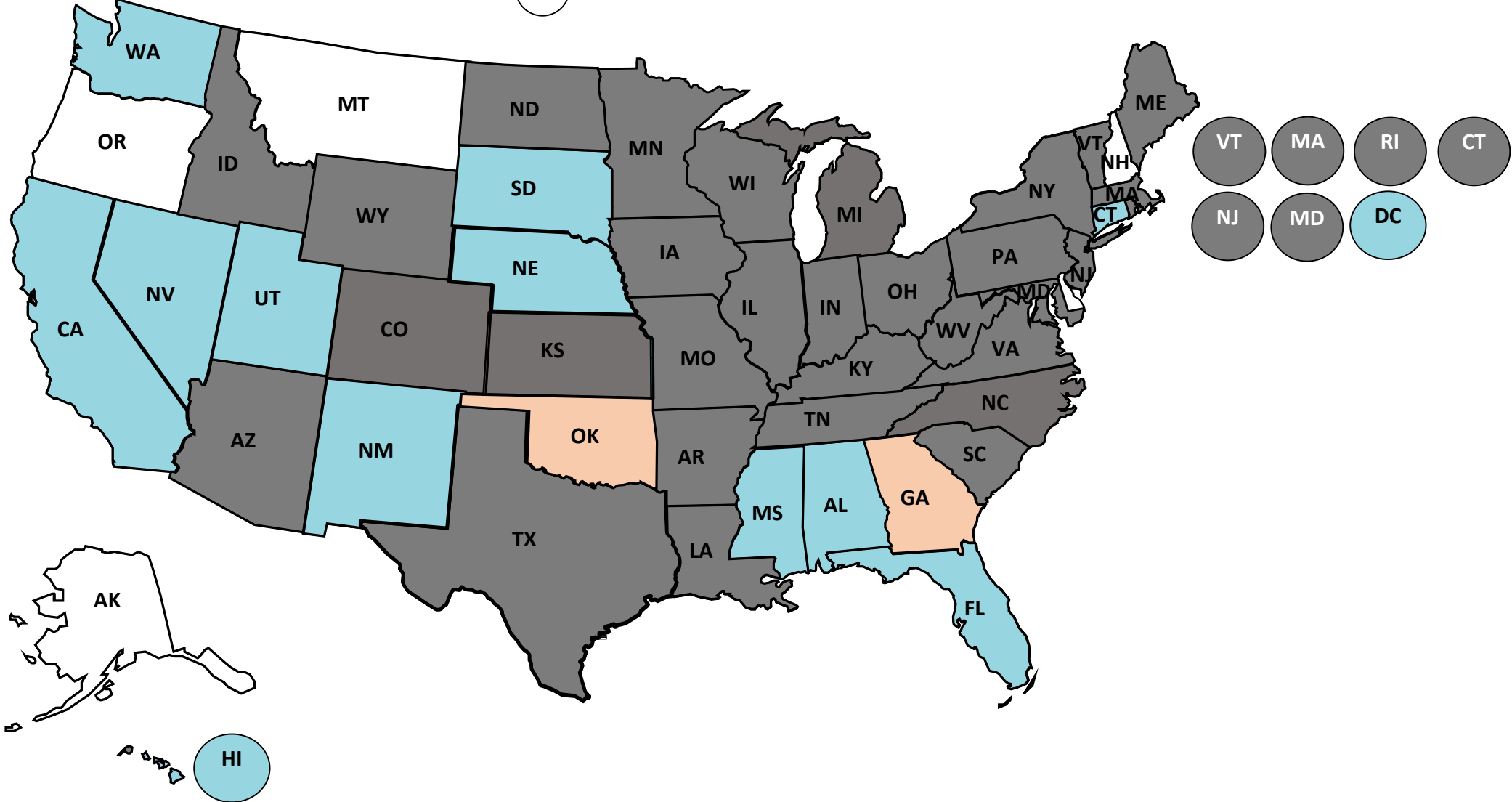
# State and Local Sales Taxes Imposed on Business Inputs

## Business Inputs Share of Total Sales Tax Collected



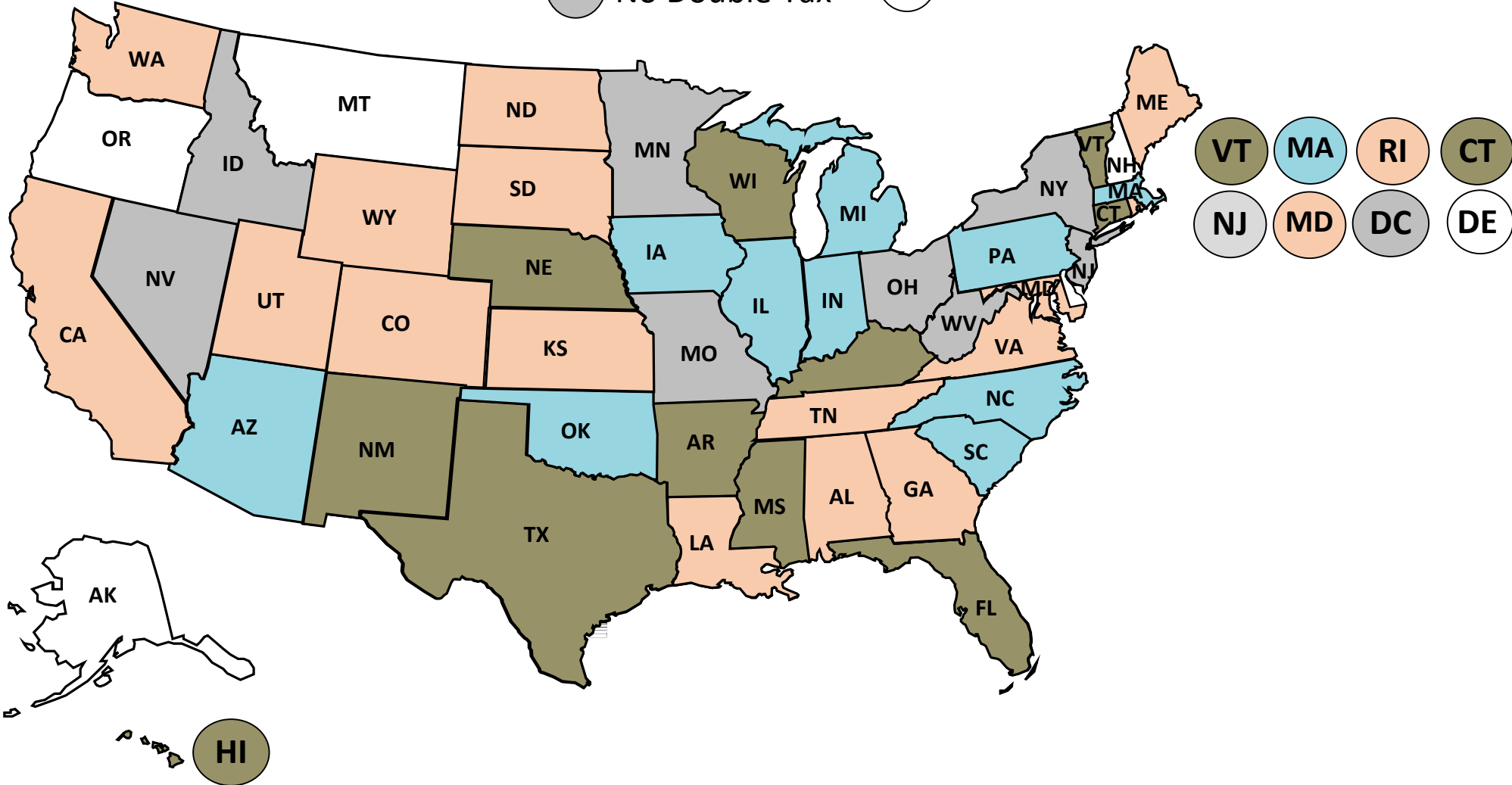
# Breadth of States' Manufacturing Equipment Exemptions

- None or Restricted Exemption
- Direct or Primary Use Exemption
- Integrated Plant Exemption
- State With No Sales Tax



# Double Taxation of Select Service Providers: Wired/Wireless, Cable, Electric + Gas

● 1 Service Industry Double Taxed  
 ● 2 Service Industries Double Taxed  
 ● 3 Service Industries Double Taxed  
● No Double Tax  
  State With No Sales Tax



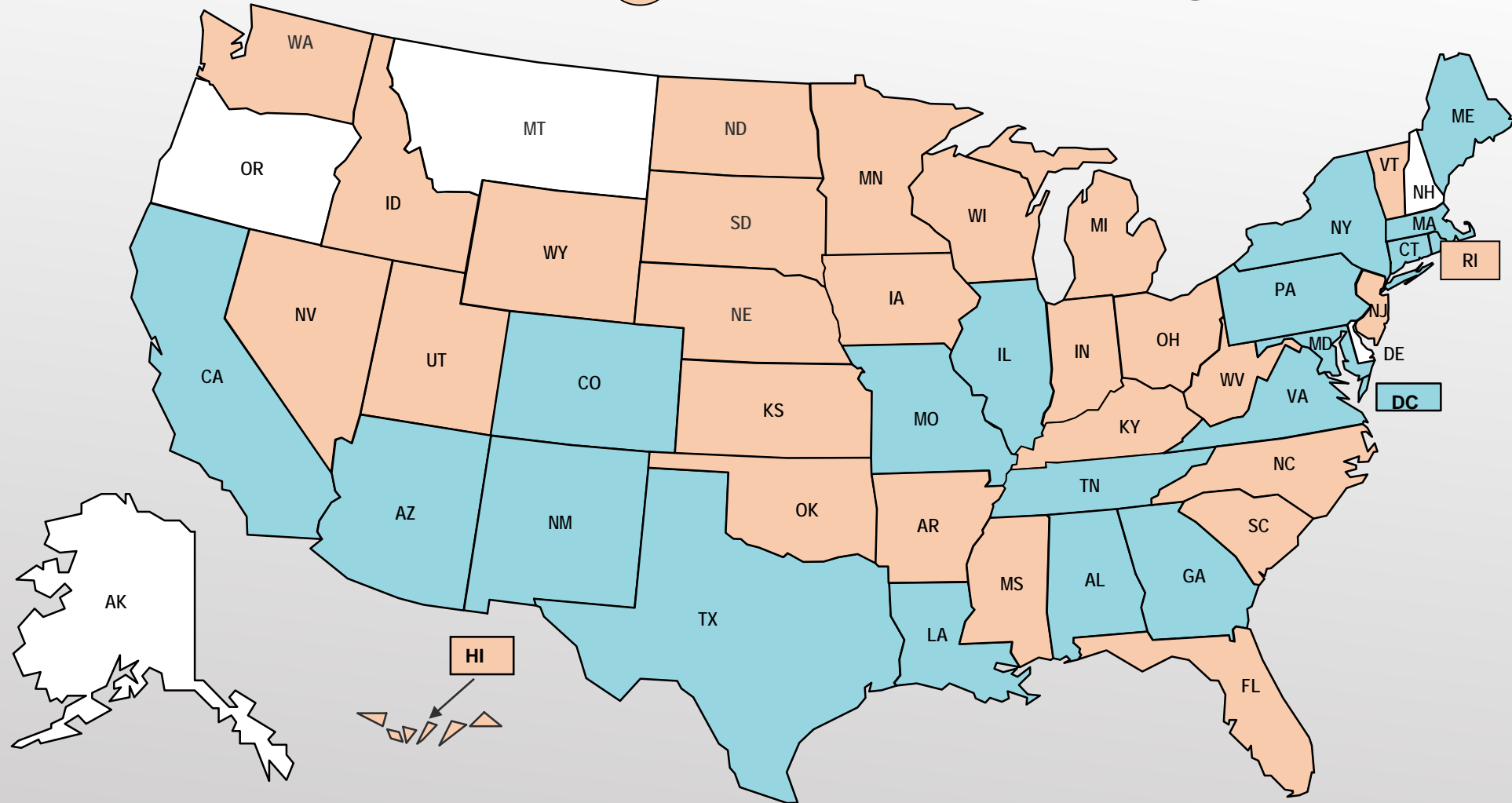
# Fair Sales Tax Administration

- Exemption Certificate Procedure - 2 points; (NM 2 pts)
  - NM requires Good faith on acceptance
  - Only 60 day (not 120-days) period on audit to perfect
  - Allows limited use of MTC or SSUTA exemption certificates
  - No verification, but must use exemption/account number
- Vendor Compensation – 2 points; (NM 2 pts)
  - No vendor comp. or less than \$12,000 per year (de minimis) - 2 points
  - At least 0.5% for one-rate state or 0.75% for states with local rates – no points
- Broad Direct Pay – 1 point; (NM 1 pt)
  - Not overly restrictive – no thresholds over \$1 million per year
- **New Mexico: 5 out of 5 points**

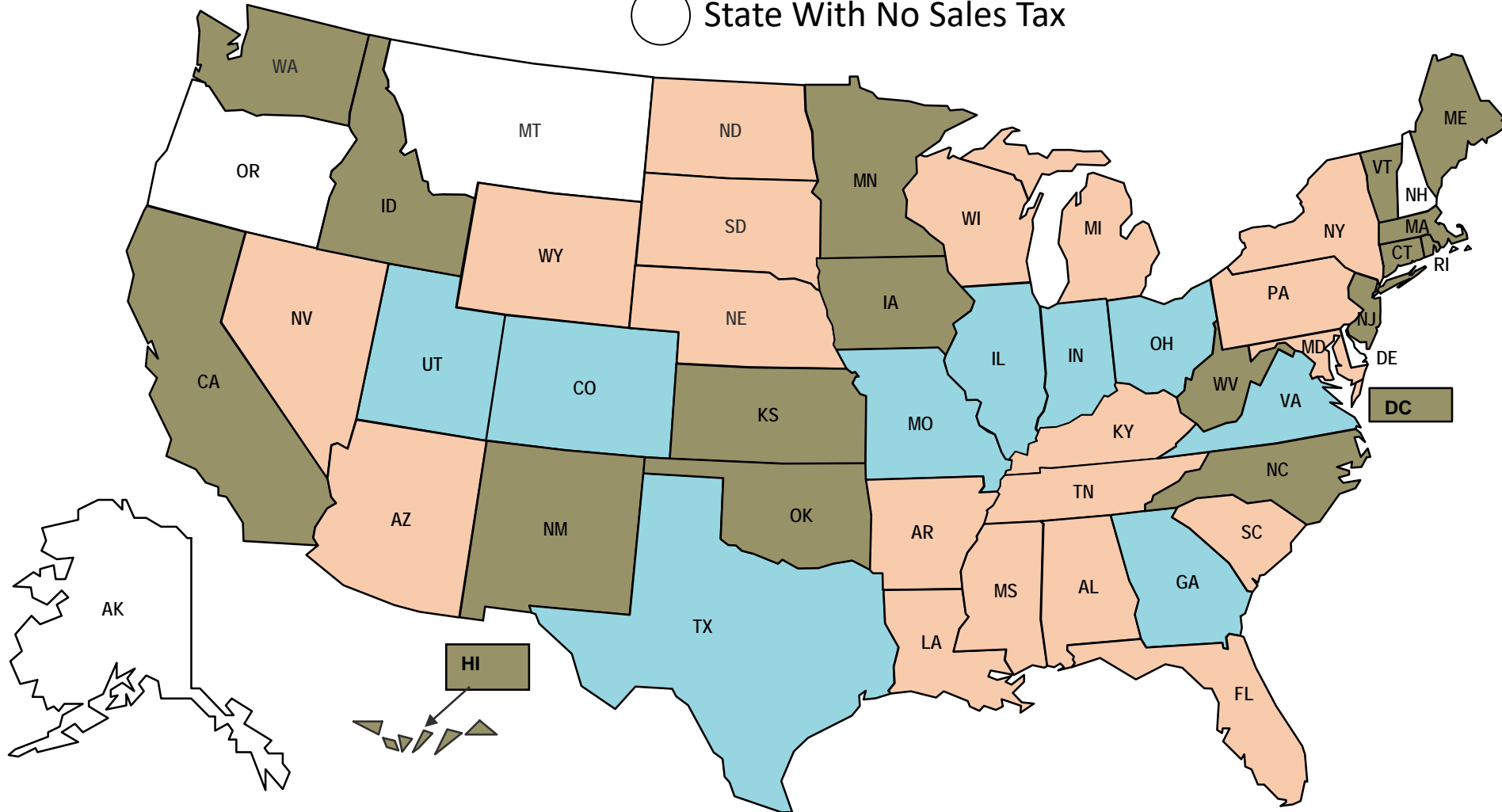
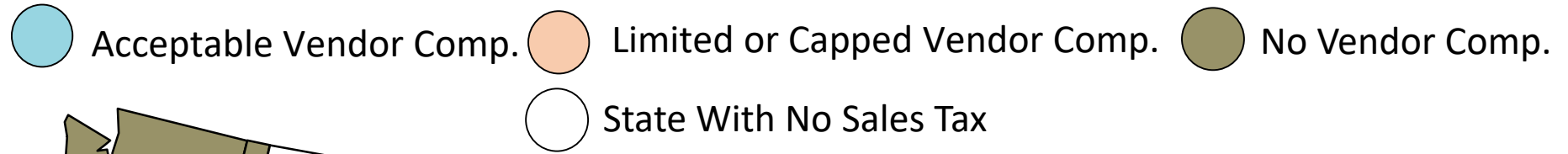


# Good Faith Requirement

- Good Faith Requirement Imposed
- No Good Faith Requirement
- State With No Sales Tax



# Vendor Compensation

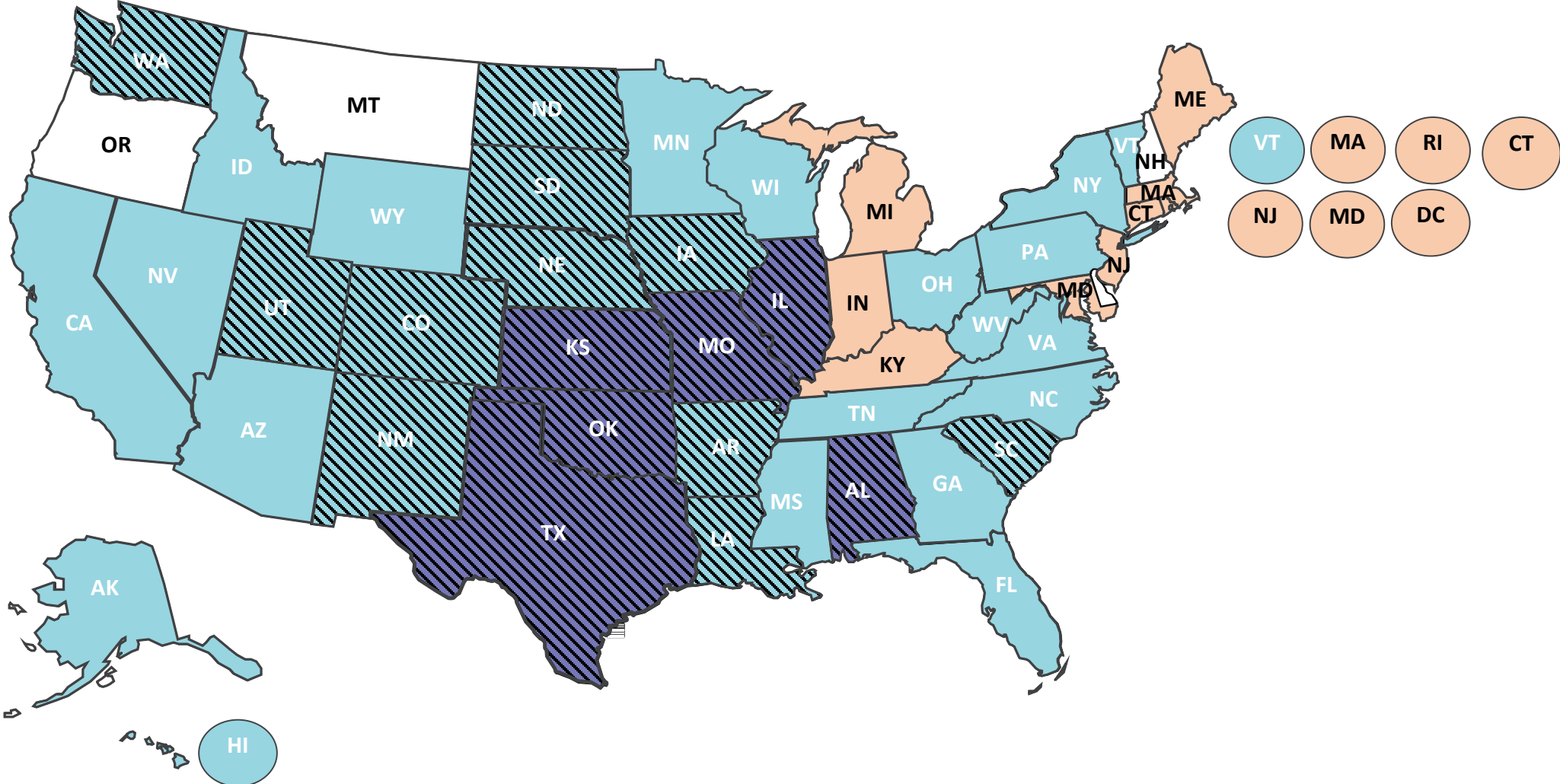


# Centralized Sales Tax Administration

- Population of state as compared to number of local jurisdictions - 1 point
  - Less than 20,000 – 1 point; **NM 1 pt**
- Central administration – 3 points; **NM 0 pts**
  - Uniform tax base
  - Centralized filing and auditing
  - Centralized appeals
- Website lacks current & historical tax rates and boundaries – 1 point; **NM 1 pt**
- **New Mexico: 2 out of 5 points**

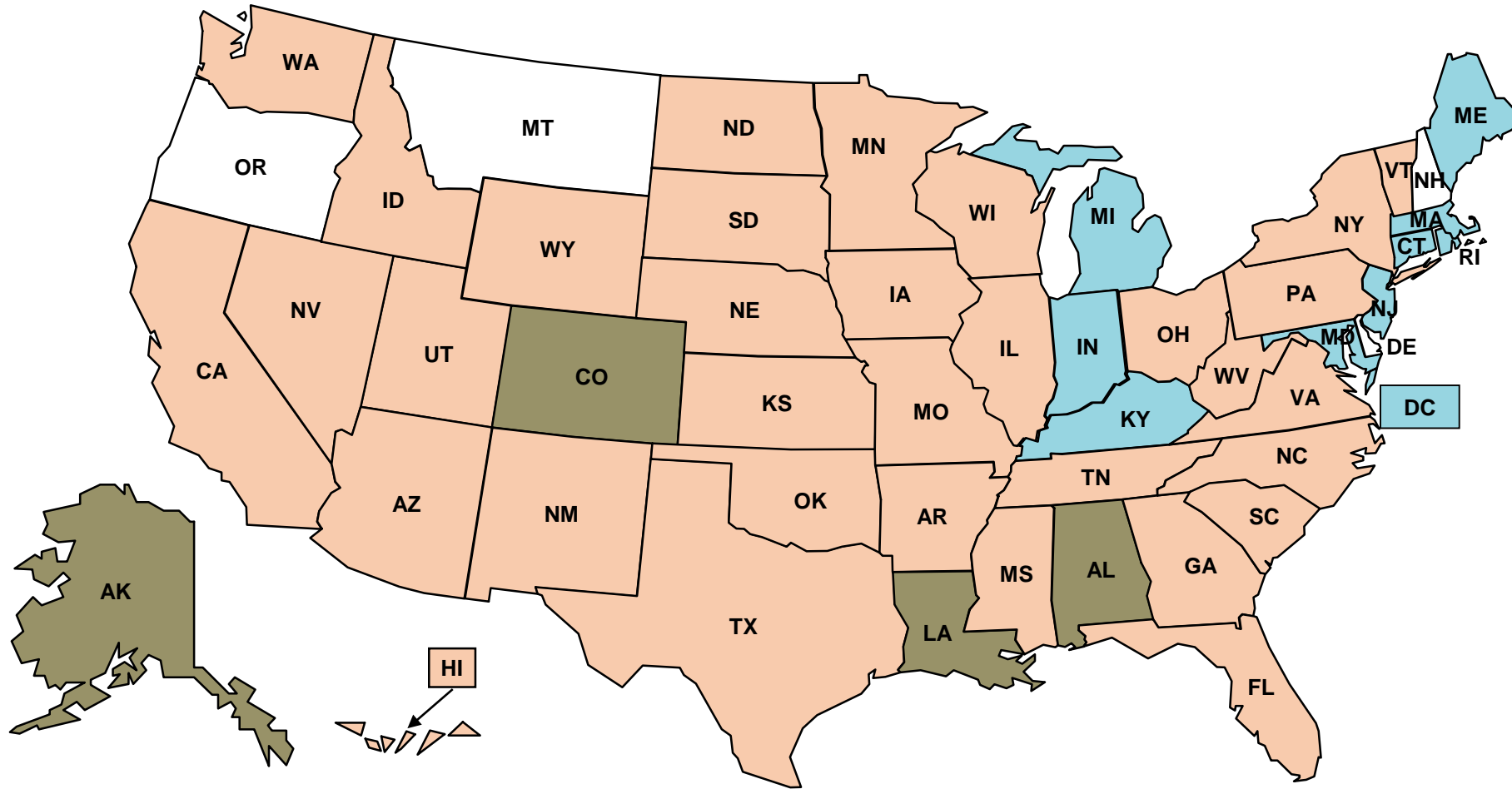
# Number of Taxing Jurisdictions

- 1 Taxing Jurisdiction
- 2-500 Taxing Jurisdictions
- 500+ Taxing Jurisdictions
- 50+ Jurisdictions With a Population Ratio of Under 20,000
- State With No Sales Tax



# States with Local Sales Tax Jurisdictions

- States With Local Administration of Sales Tax
- States With Centralized Administration of Local Sales Taxes
- States With No Local Sales Taxes
- State With No Sales Tax

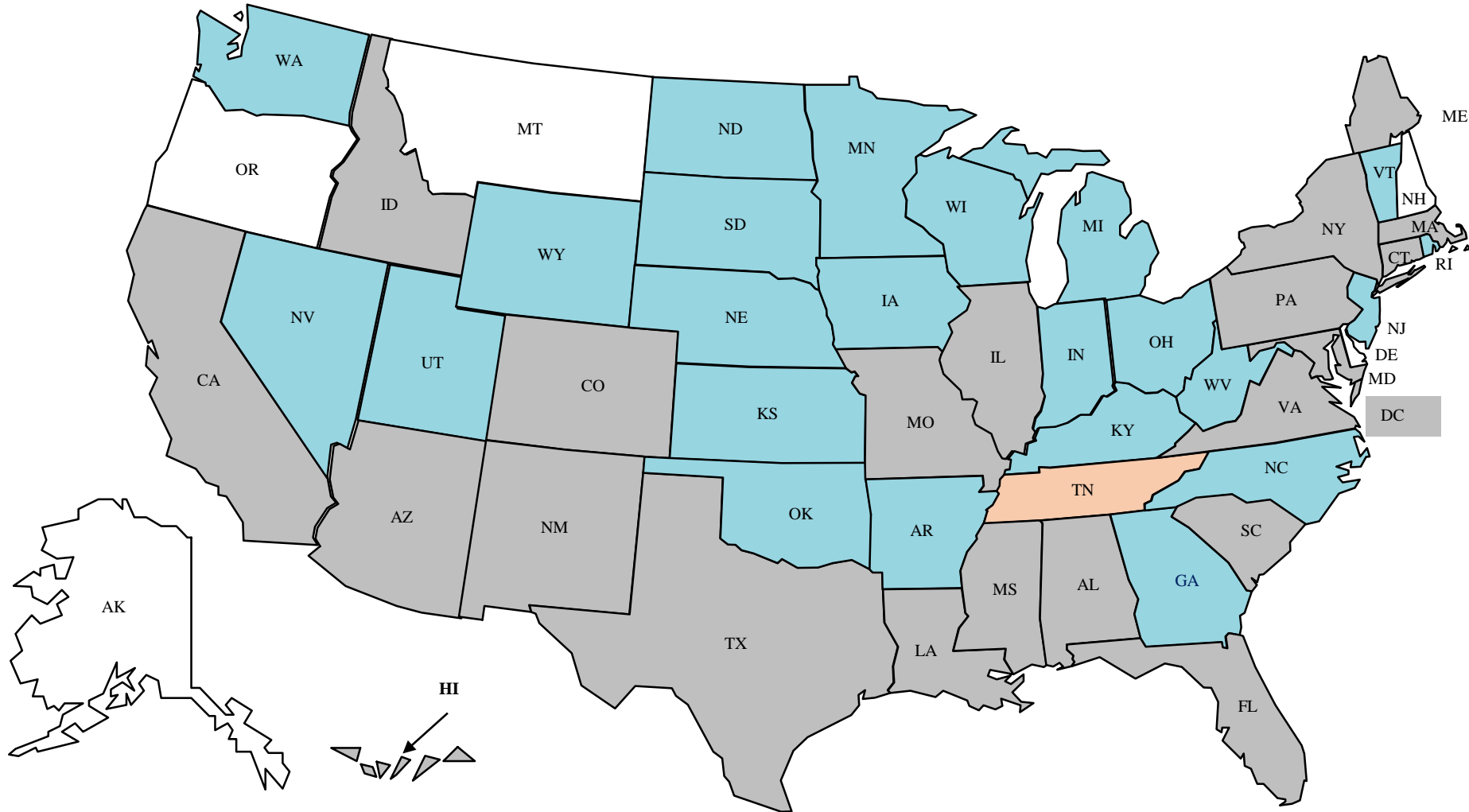


# Simplification & Transparency

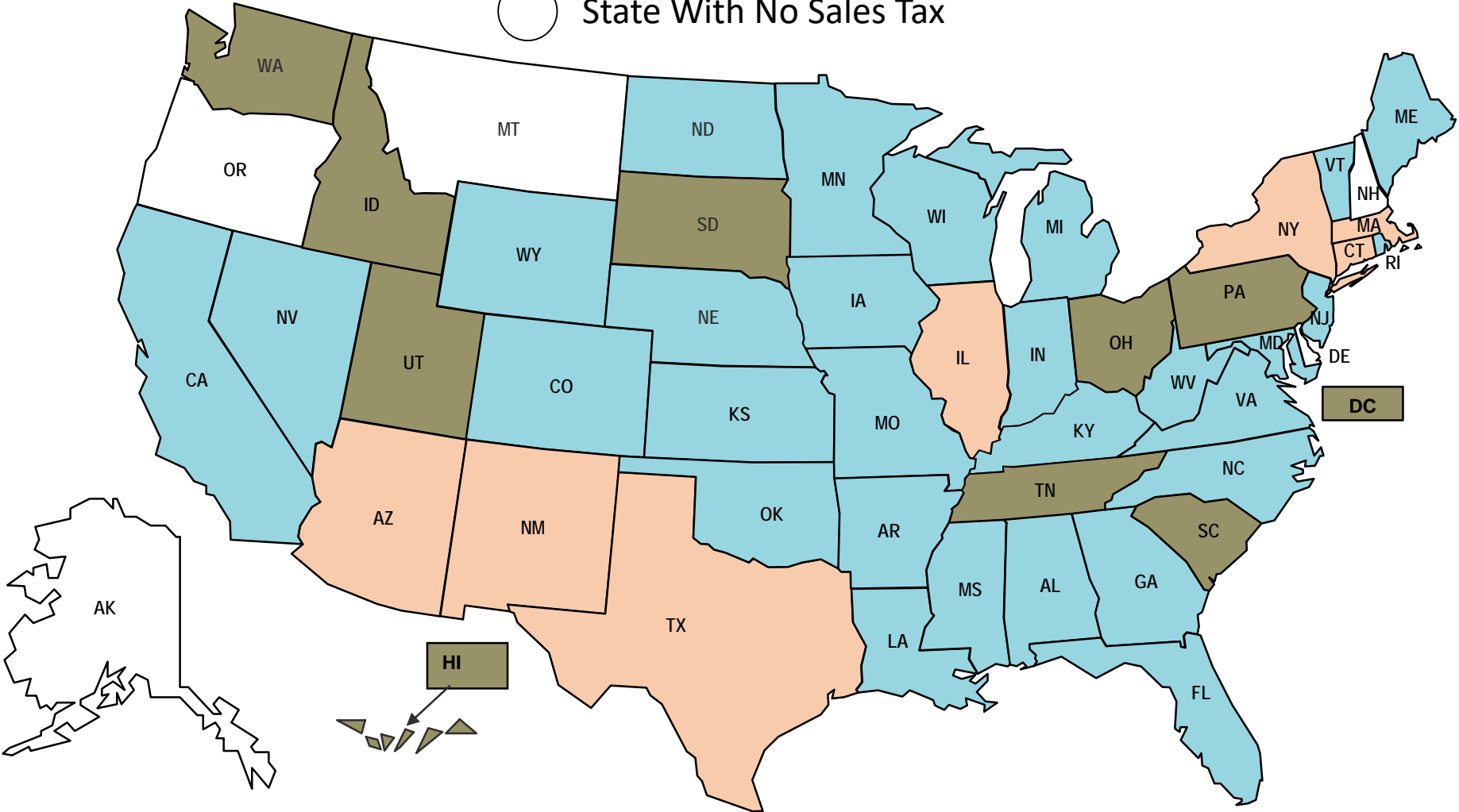
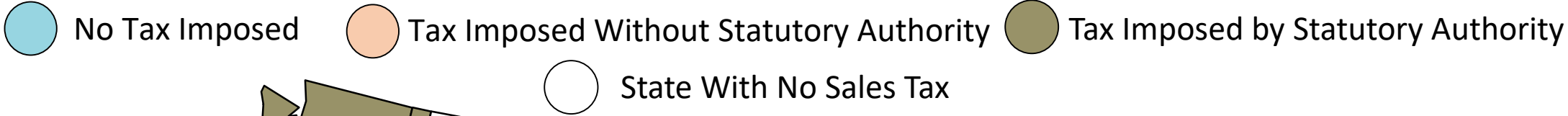
- SSUTA State? - 2 points; **NM 2 pts**
- Unclear tax on digital products and access to prewritten software
  - 2 points; **NM 1 pt**
    - Is by legislation or administrative rule/policy position?
    - NM no clear legislation on taxing access to software – **1 pt**
- Liability relief – 1 point; **NM 1 pt**
  - Relief should broadly apply to most written correspondence
- **New Mexico: 4 out of 5 points**

# Streamlined Sales Tax States

 Full Member    Associate Member    State With No Sales Tax    Non-Member State



# Taxation of a Person Merely Accessing Pre-Written Software





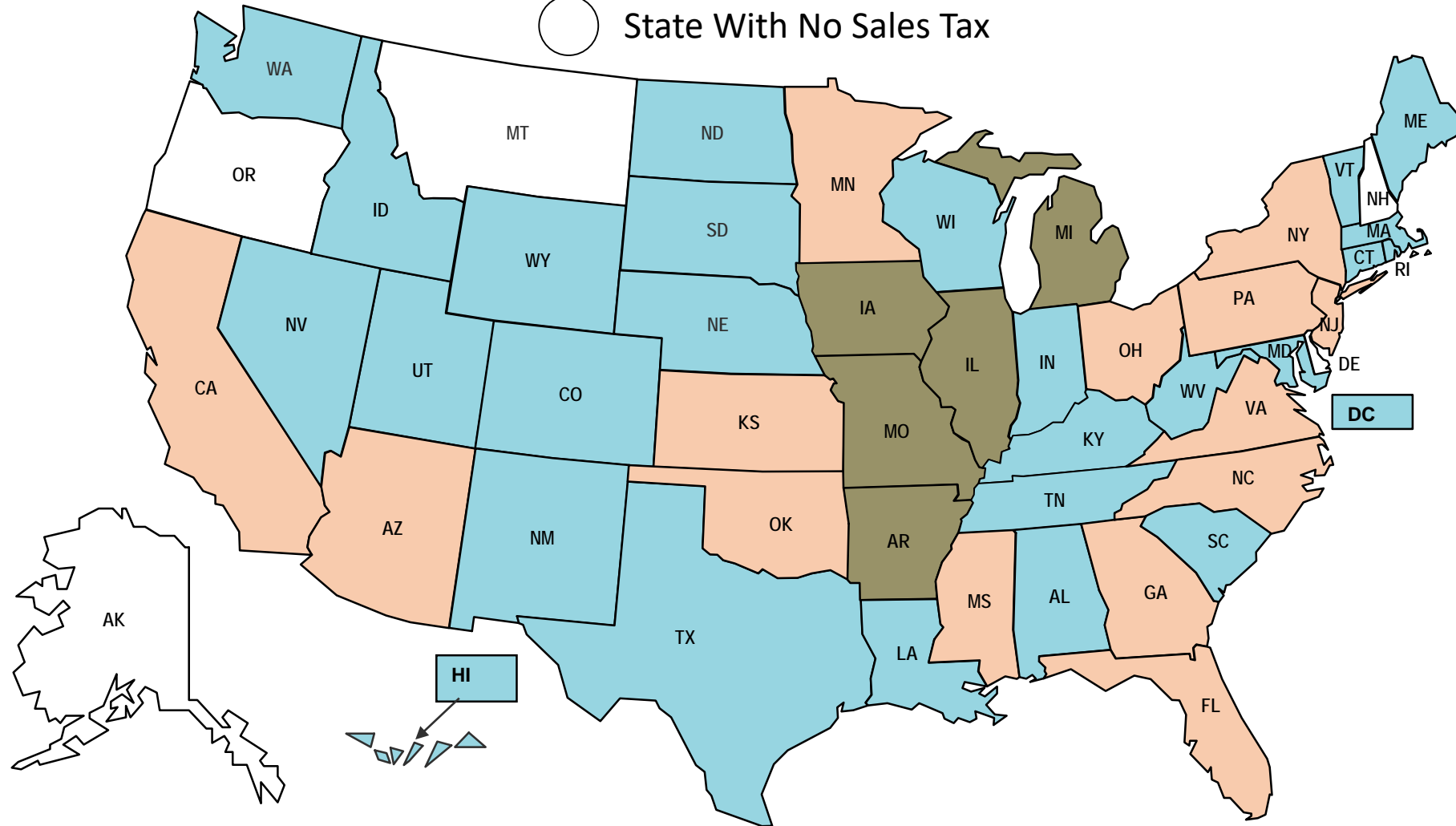
# Reasonable Tax Payment Administration

- Advance Payments - 2 points; **NM 0 Pts**
  - One per year or month – 1 point
  - Two or more per month – 2 points
- Full credit other states sales/use taxes – 2 points; **NM 1 pt**
  - Credit sales and use tax – 1 point; **NM 1 pt**
  - Credit other states' state and local taxes – 1 point; **NM 0 pts**
- Periodic leases tax based on each lease payment – 2 points; **NM 1 pt**
  - State accelerating or continuing tax on leases when property no longer in the state – 1 point; **NM 0 pts**
  - Credit for tax paid in other states on such leases- 1 point; **NM 1 pt**
- Bad debt deduction applies to third-party private label credit card – 1 point; **NM 1 pt**
- **New Mexico: 3 out of 7 points**

# Advance Payments

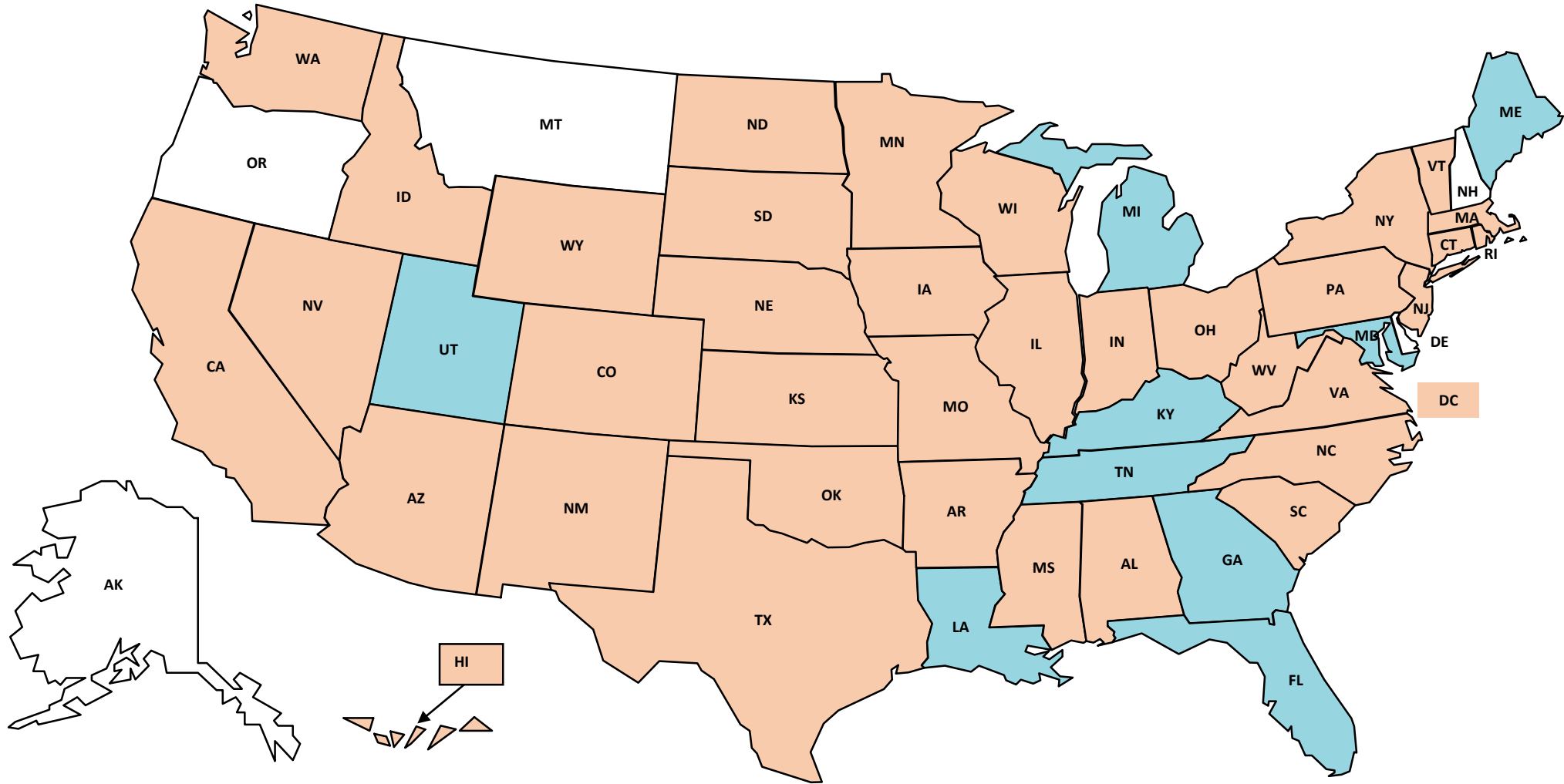
● No Advance Payments   ● 1 Advance Payment Per Month or Year   ● More Than 1 Advance Payment Per Month

○ State With No Sales Tax



# Tax Credit Against Sales and Use Tax

- Credit Only Against Use Tax
- Credit Against Both Sales and Use Taxes
- State With No Sales Tax



# Fair Audit/Refund Procedures

- Purchasers ability to obtain refunds directly from the state - 1 point; **NM 1 pt**
  - New Mexico has limited process
- False claims act & class action suits – 2 points; **NM 0 pts**
  - Allow either – 1 point each
- Contingent fee or private auditing – 1 point; **NM 0 pts**
  - Allow either – 1 point
- **New Mexico: 1 out of 4 points**

# State Impact of Federal Tax Reform

# Key Tax Law Changes in the TCJA and Differences from the Tax Reform Act of 1986

## — Transformational Changes

- Over 10 years provides for \$6 trillion of tax cuts offset by \$4.5 trillion of tax increases.
- 40 percent corporate tax rate cut to sync up with OECD norms.
- Lower PIT rate for pass through businesses.
- Bonus depreciation and immediate expensing coupled with new limitations on interest deductions.
- \$10k limitation on state and local tax deductions for individuals.

## — International Tax Reform

- Moves the U.S. from a worldwide to a quasi-territorial tax system consistent with U.S. trading partners.
- New foreign source tax provisions intended to raise and tilt the playing field to favor domestic commerce over foreign commerce (e.g. GILTI; BEAT, FDII).

# State Partial Conformity with the Tax Cuts and Jobs Act

- Impact of the TCJA on corporations:
  - **A federal tax cut of about 10%.**
  - **A state tax increase of about 12%.**
    - COST/ EY study “The Impact of Federal Tax Reform on State Corporate Income Taxes (based on 2018 update and pre-federal tax reform (FTR) linkage to IRC).
- This outcome is **inadvertent and arbitrary**: If states simply conform to the TCJA, either automatically or by updating the conformity date and do nothing more they will link to federal corporate base-broadening measures but not to federal rate reduction.
- As a general principle, conformity with federal laws can facilitate taxpayer compliance and reduce taxpayer burdens.
  - However, many of the provisions relating to international tax reforms and the interest limitations raise unique issues that states need to consider as part of their responses.

# Quantifying the impacts of TCJA on state corporate taxes

- New EY/COST/STRI study provides estimates of the impacts of TCJA on state corporate tax bases.
- Study examines the impact of all states updating their corporate tax codes to the TCJA, but remaining coupled to specific provisions as they have in the past.
- The estimated percentage change in the state corporate tax base from TCJA is about 12% over the first 10 years (2018-2027), with significant variation among the states.





## Top Increases and Decreases in Federal Corporate Tax Base with TCJA and Potential State Conformity

Business Tax Provision	% Change in Federal Corporate Tax Base	State Conformity
One-time transition tax on unrepatriated foreign earnings	+ 9 %	Partial conformity (but typically of 25% or less)
Net interest expense limitation (30% of ATI)	+ 6.4%	Mostly conformity
Global intangible low-taxed income (GILTI)	+ 5.5 % (gross amount)	Mostly conformity
Modification of net operating loss deduction	+ 5.3%	States have own provisions
Base Erosion and Anti-Abuse Tax (BEAT)	+ 4.0%	Non-conformity
Amortization of research and experimental expenditures	+ 2.9%	Conformity
Repeal of domestic production activities deduction	+ 1.9%	Partial conformity
Foreign derived intangible income (FDII) deduction	- 1.7%	Mostly conformity (but Section 250 issue)
Expensing provided under Section 168(k) bonus depreciation	- 1.8%	Partial conformity
Global intangible low-taxed income (GILTI) deduction	- 2.6%	Mostly conformity (but Section 250 issue)
100% foreign DRD	- 5.9%	States have own provisions

# COST Conformity Principles

- Manage conformity to achieve revenue neutrality and avoid increasing the state's business tax burden
- Do not selectively conform to revenue-increasing federal tax reform changes only
  - Example: GILTI but not IRC Section 250 deduction.
  - Example: Interest deduction limitation but not 100% expensing
- Do not conform to new foreign source income provisions that would expand the state tax base beyond the water's edge
  - Examples: GILTI; BEAT
- States should provide guidance to facilitate state income tax compliance with complex new federal tax reform provisions.