Federal Impacts and Trends Affecting State Taxation

Before the New Mexico Legislature
Federal Funding Stabilization & Affordability Subcommittee
Presented – Taos, New Mexico, August 3, 2026

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Richard Anklam, President and Executive Director, New Mexico Tax Research Institute

Our Organizations & Backgrounds

- **Helen Hecht, Uniformity Counsel, Multistate Tax Commission** –
  The MTC is an intergovernmental state tax agency whose mission is to promote uniform and consistent tax policy and administration among the states, assist taxpayers in achieving compliance with existing tax laws, and advocate for state and local sovereignty in the development of tax policy. New Mexico has been an MTC member since 1967.

- **Richard Anklam, Executive Director, New Mexico Tax Research Institute** –
  The NMTRI is a nonprofit, nonpartisan, member-supported organization dedicated to providing fact based principled research and analysis to the tax policy debate in New Mexico.

Caveat

- **Unless otherwise indicated, the views expressed are our own and not the official positions of our organizations.**

BACKGROUND

U.S. Tax System

Major Tax Revenue Sources - Direct

Federal

- Income
- Payroll
- Excise
- Tariffs

State

- Sales Tax
- Income
- Excise

Major Tax Revenue Sources - Indirect

Federal

- Income
- Payroll
- Excise
- Tariffs

State

- Sales Tax
- Income
- Excise

Tax Systems

Federal

- Income
- Payroll
- Excise
- Tariffs

State

- Sales Tax
- Income
- Excise

Tax Systems - Connection

Federal

- Income
- Payroll
- Excise
- Tariffs

State

- Sales Tax
- Income
- Excise

State Conformity to Federal System

- **States generally conform to important aspects of the federal tax system.**

- **What does that mean?**
  - **The federal rules or incentives are built in.**
  - **The federal problems are also built in.**

Two Reasons Why States Need the Federal Income Tax System to Work

- **The revenue from that system funds much of what the federal government is expected to do.**

- **States conform to the system and its rules. Therefore, they need to make sure that the system works so that their own income tax systems will also work.**
  - **OR . . . States may de-conform.**

But De-conforming is Complex

- **Example – some states (including New Mexico) have de-conformed with current rules for expensing certain business assets (rather than using depreciation).**
- **This raises complex issues for administrators and practitioners since this requires:**
  - **Calculating different amounts of expense.**
  - **Sourcing the state-related expense correctly.**
  - **Adjusting the basis in the underlying asset for state purposes over time (using state-adjusted/sourced expense).**
- **And in NM's case—it de-conformed only for corporate income tax, not for personal income tax, which means the treatment for partnerships will be even more complex.**

Tax on Business Income

Much more complicated than tax on wages—because of the components that make up the tax calculation.

Income Tax - Generally

Imposed on income – which is . . .

Certain receipts

- Exemptions and exclusions

= Taxable receipts

- Allowable expenses & deductions

= Tax base

x Tax rate

= Tax amount before credits

- credits

= Tax liability

Income Tax - Generally

Imposed on income – which is:

Certain receipts

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x Tax rate

= Tax amount before credits

- Credits

= Tax liability

States generally conform to federal base.

Influence of Trade on Income Taxes

- **Income can be earned through business activities in multiple countries or states.**
- **The big questions then become:**
  - **Does the country or state have jurisdiction to impose tax?**
  - **How do you avoid multiple taxation?**
  - **Ho do you avoid "income shifting"—that is—the ability of taxpayers to use artificial structures and transactions to source their income to a no or low-tax jurisdiction.**

Income Taxes

A little history.

Income Taxes

- Internationally, developed countries began adopting income taxes in the 19th Century.
- In the U.S., states began adopting them in the early 20th Century.
- Federal government could not adopt a general income tax until the Constitution was amended – 16th Amendment – 1913.

Traditional Federal / International Systems

- **Limited taxing jurisdiction – permanent establishment.**
- **Don’t consolidate all global companies**
- **Use transfer pricing for related-entity transactions**
- **Waited till repatriation to tax income of multi-national entities (MNEs)**

Federal and State Tax Systems Evolved in Different Directions

- **Federal government's system (built on the international system) has used a much more complex approach to sourcing multi-national income:**
  - **Uses transfer pricing rather than aggregation for related-entity transactions.**
  - **Provides credits for foreign taxes paid.**
  - **Uses sourcing of income to determine the amount of credit allowable.**
- **States' systems**
  - **Look to aggregation and apportionment.**

Systems built in the early 20th Century

The economy then -

The economy now –

The Old System is Gone

Now, everything has changed.

Recent Federal and International Shifts

- **At the international level–**
  - **The OECD has developed a plan to which countries are now expected to conform:**
    - **The country where the parent is domiciled can impose a minimum pick-up tax on undertaxed income (sourced using the traditional system).**
    - **The tax is generally imposed on an entity / country basis and not on a net basis.**

Recent Federal and International Shifts

- **At the federal level –**
  - **2017 –**
    - **Began taxing U.S. corporations' "global intangible low-taxed income" (GILTI) calculated along with a standard deduction (50%) to achieve a reduced effective tax rate.**
    - **Got rid of the tax on foreign dividends (with a one-time deemed repatriation tax).**
  - **2025 –**
    - **Expanded this tax on GILTI to what is now called net controlled foreign corporation tested income (NCTI) which is an aggregated amount of the income of foreign subs.**
    - **Again – the effective tax rate for federal purposes is reduced by a standard deduction (40%).**

Next Steps for States

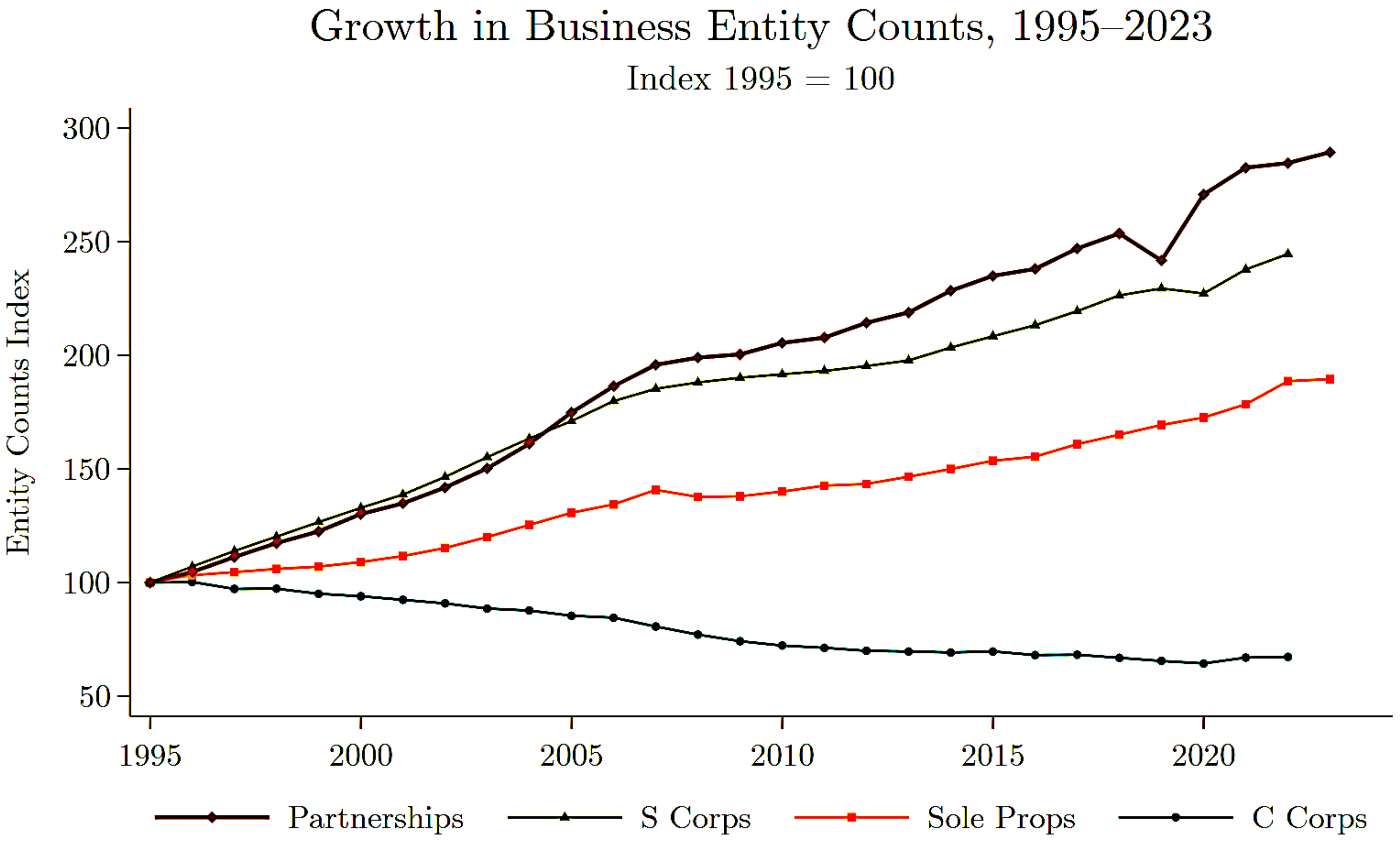
- States are considering whether to conform to the federal tax rules for including NCTI in the tax base.
- Because state and federal systems vary in terms of how they address duplicative taxation—the states would then determine the source of that NCTI using their own systems rather than providing a credit for taxes paid.
- New Mexico has decided to include NCTI in the tax base and will provide apportionment.
- One alternative is worldwide combined filing—where the major difference is that loses of foreign subsidiaries (as well as income) would be included in the apportionable base.

But All that is Fighting the Last War

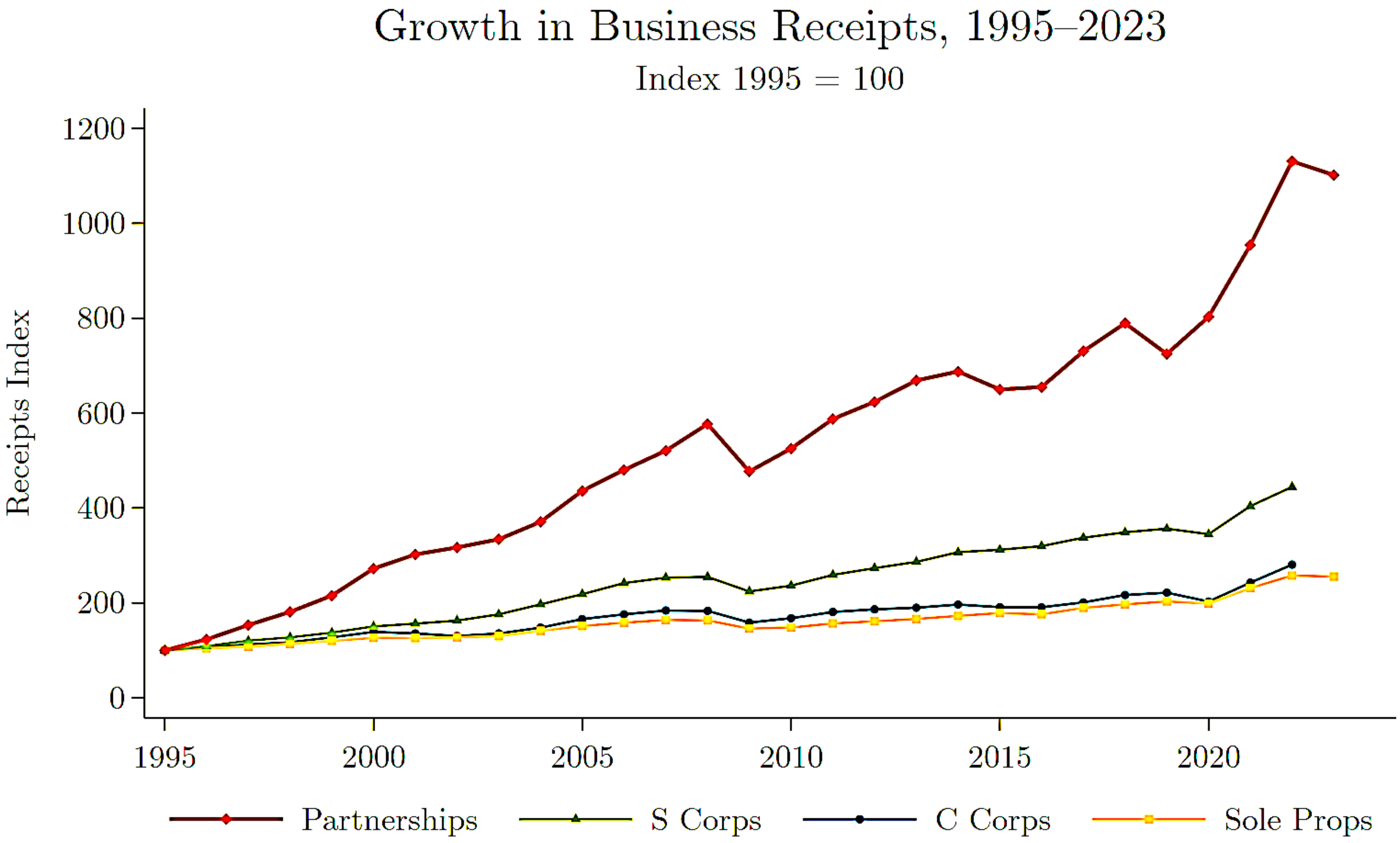
The next struggle is not with tax on corporate income – but with tax on partnership income.

The MTC's Work

- The MTC has had a project to clarify state rules on the taxation of partnership income.
- This income is taxed on a pass-through basis.
- This pass-through system is the most complex part of the federal tax system.
- A recent presentation at our meetings by Michael Love of the Columbia Law School illustrates why this is so important.



Source: IRS Statistics of Income



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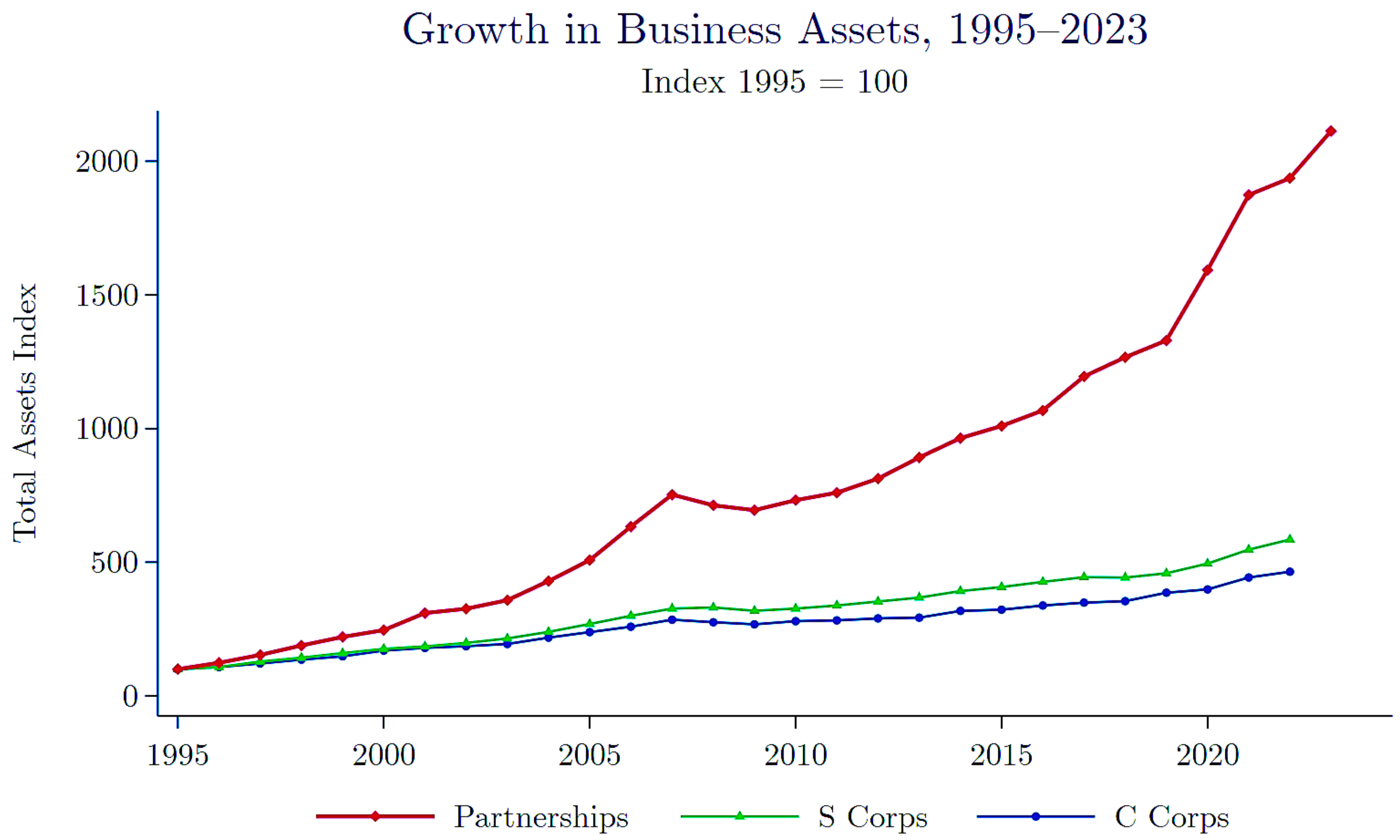

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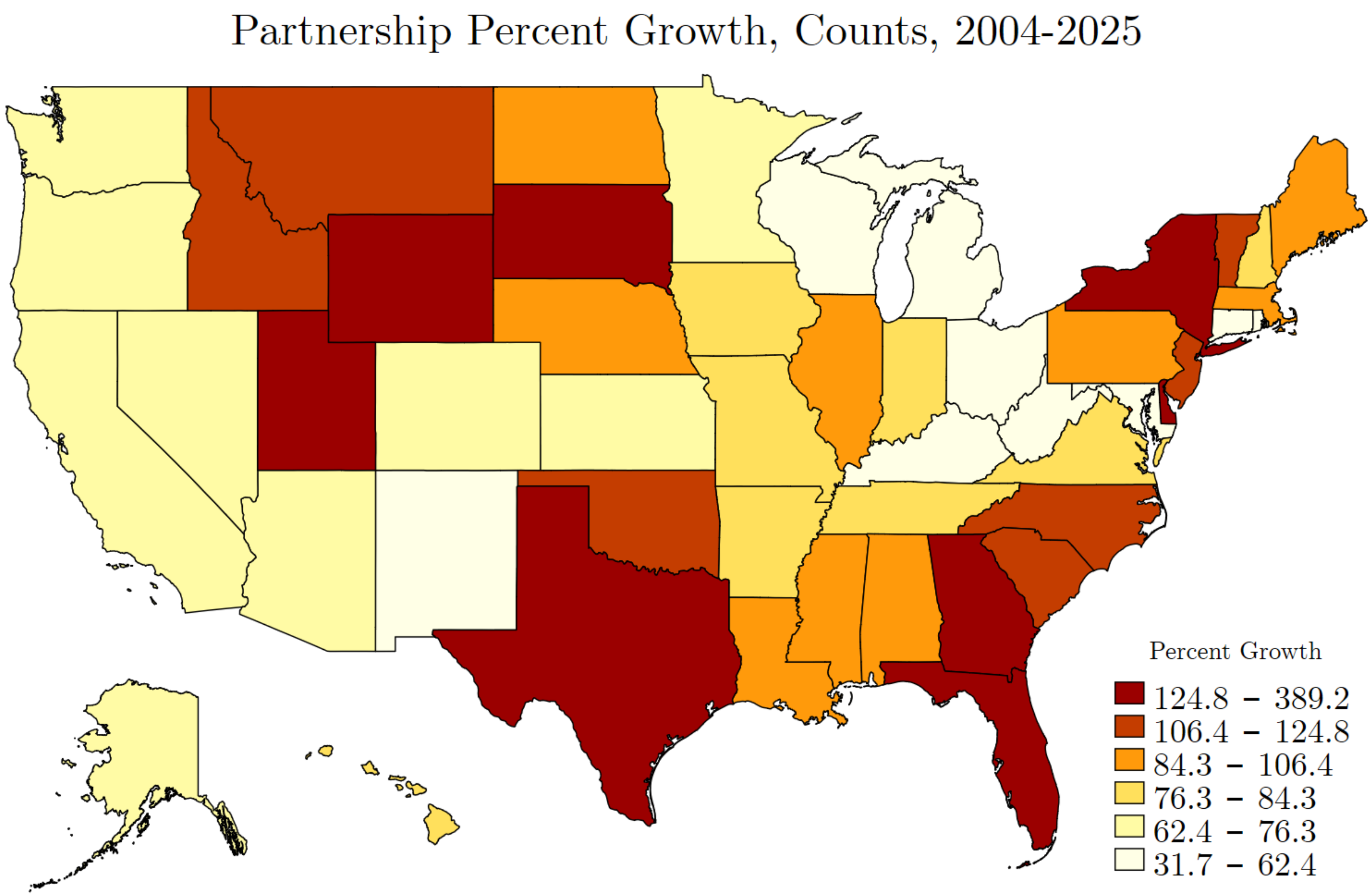
Growth is widespread…



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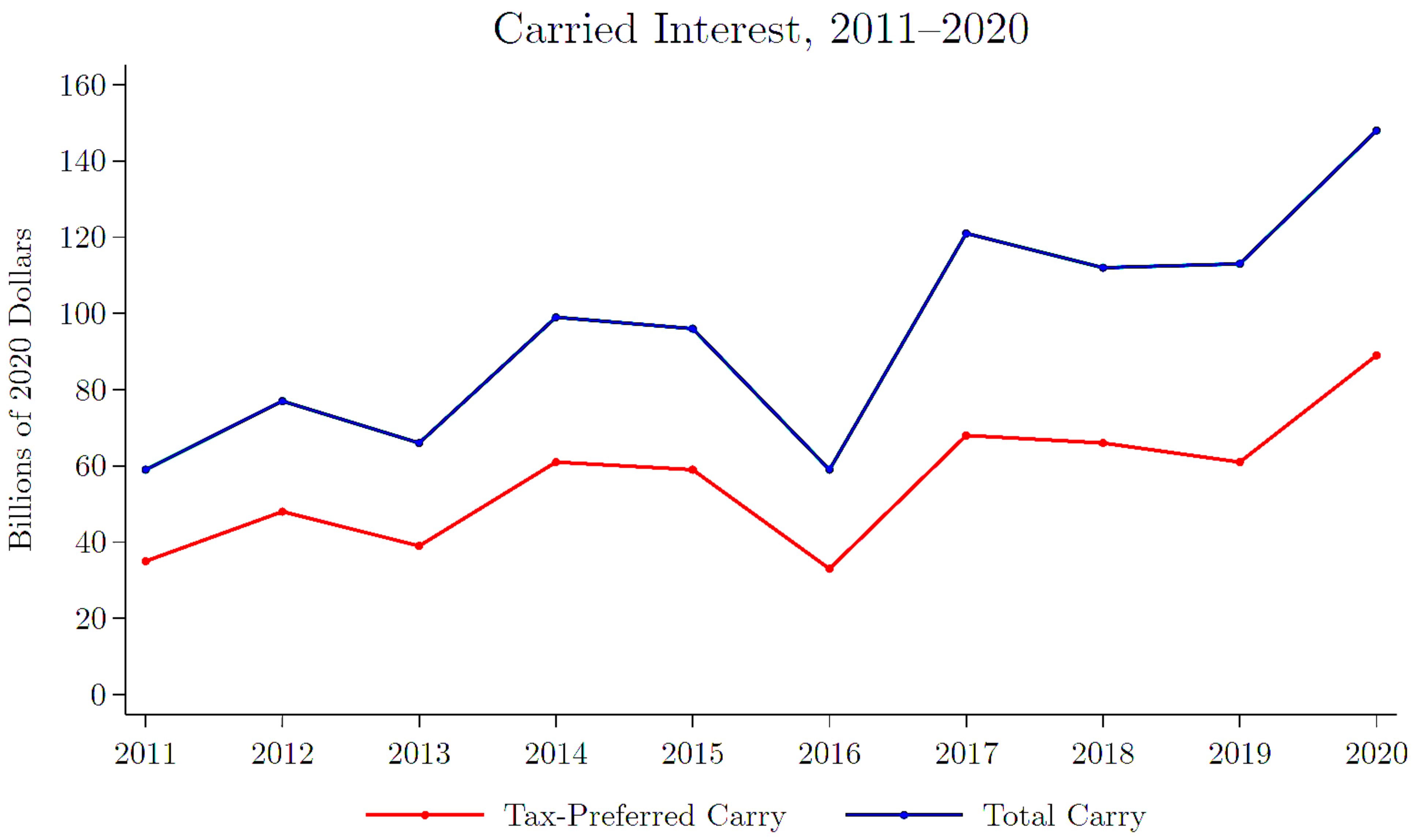
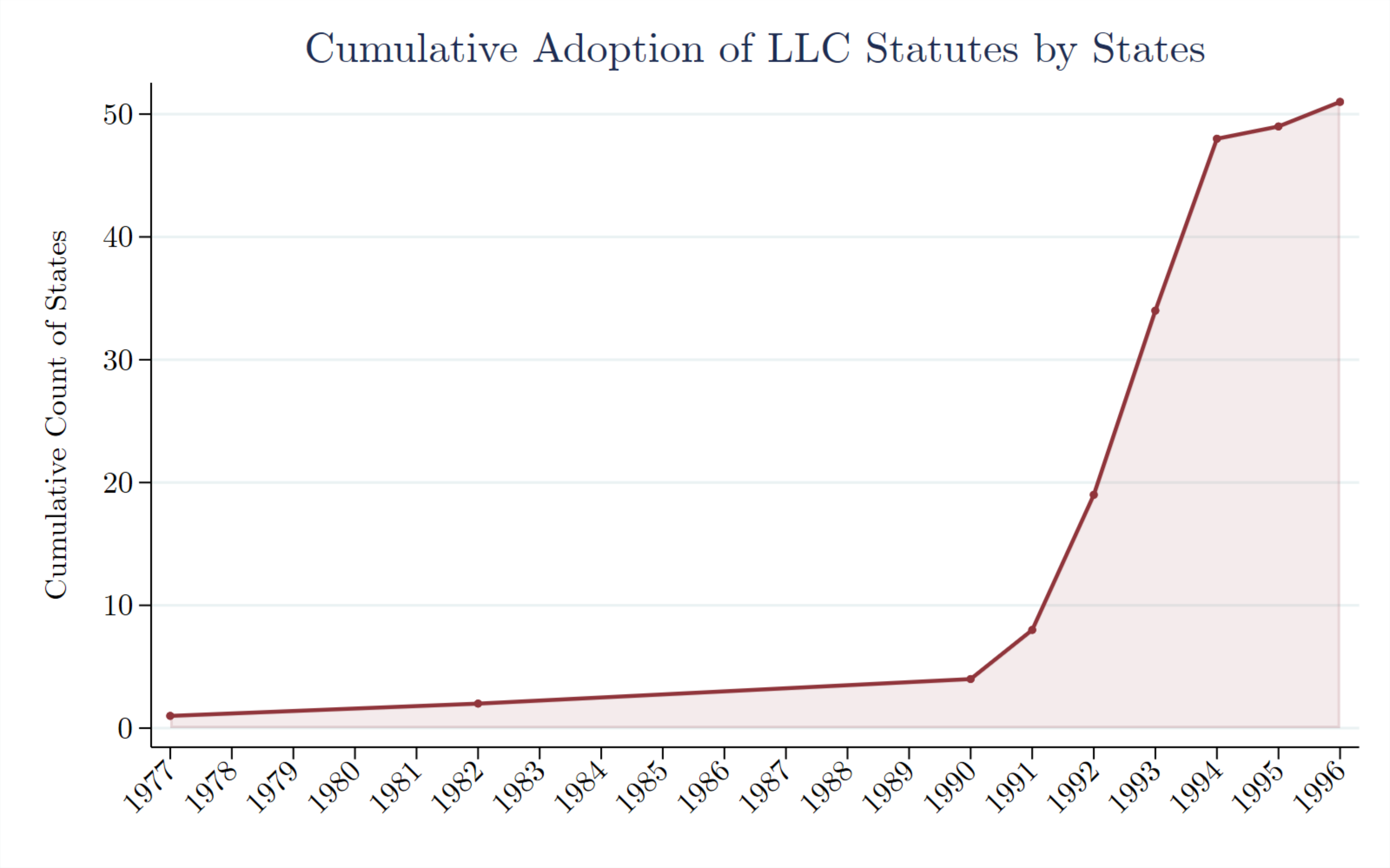


Source: Love, "Who Benefits from Partnership Flexibility," *Journal of Public Economics*, 2025


Cumulative Adoption of LLC Statutes by States
Cumulative Count of States
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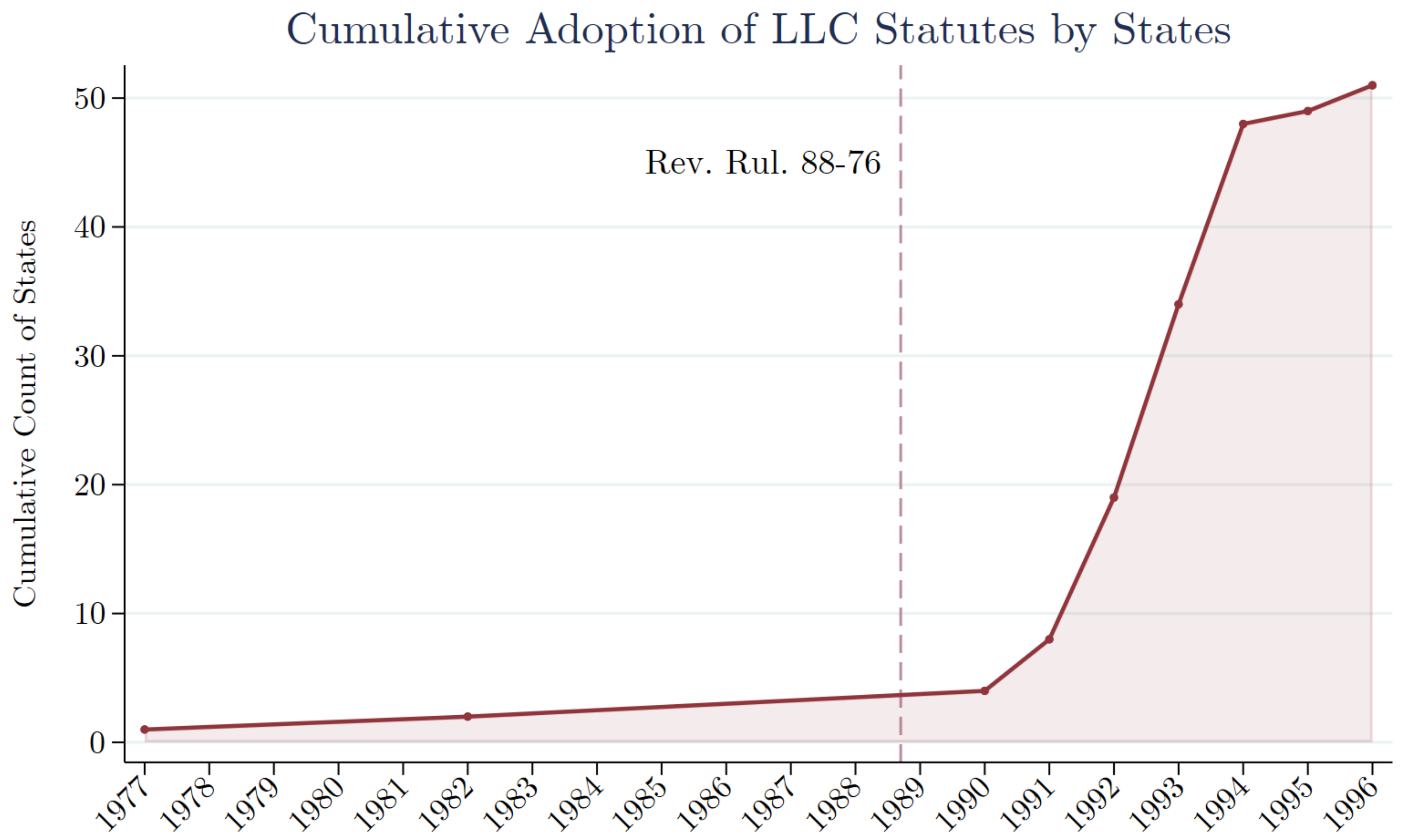
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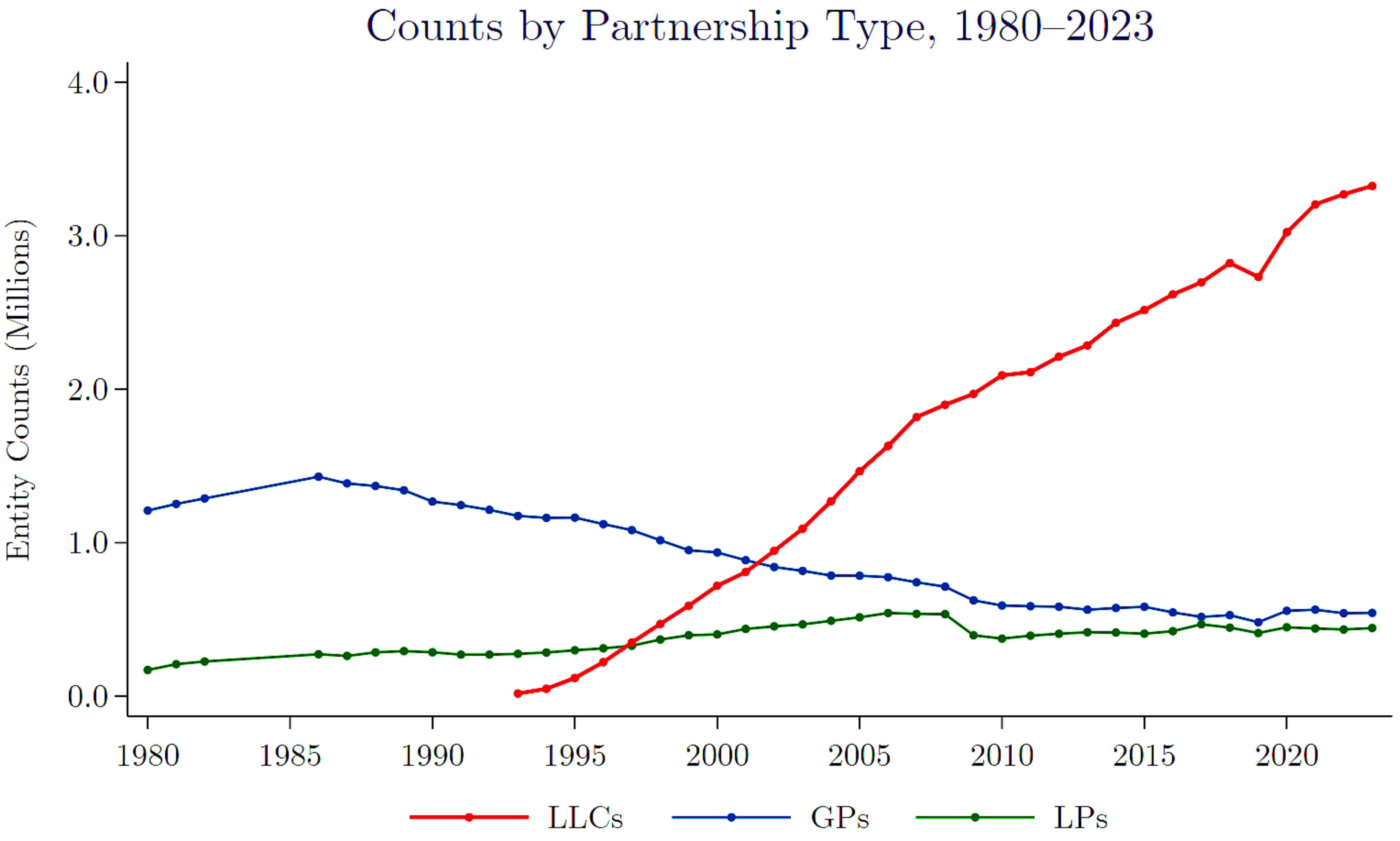
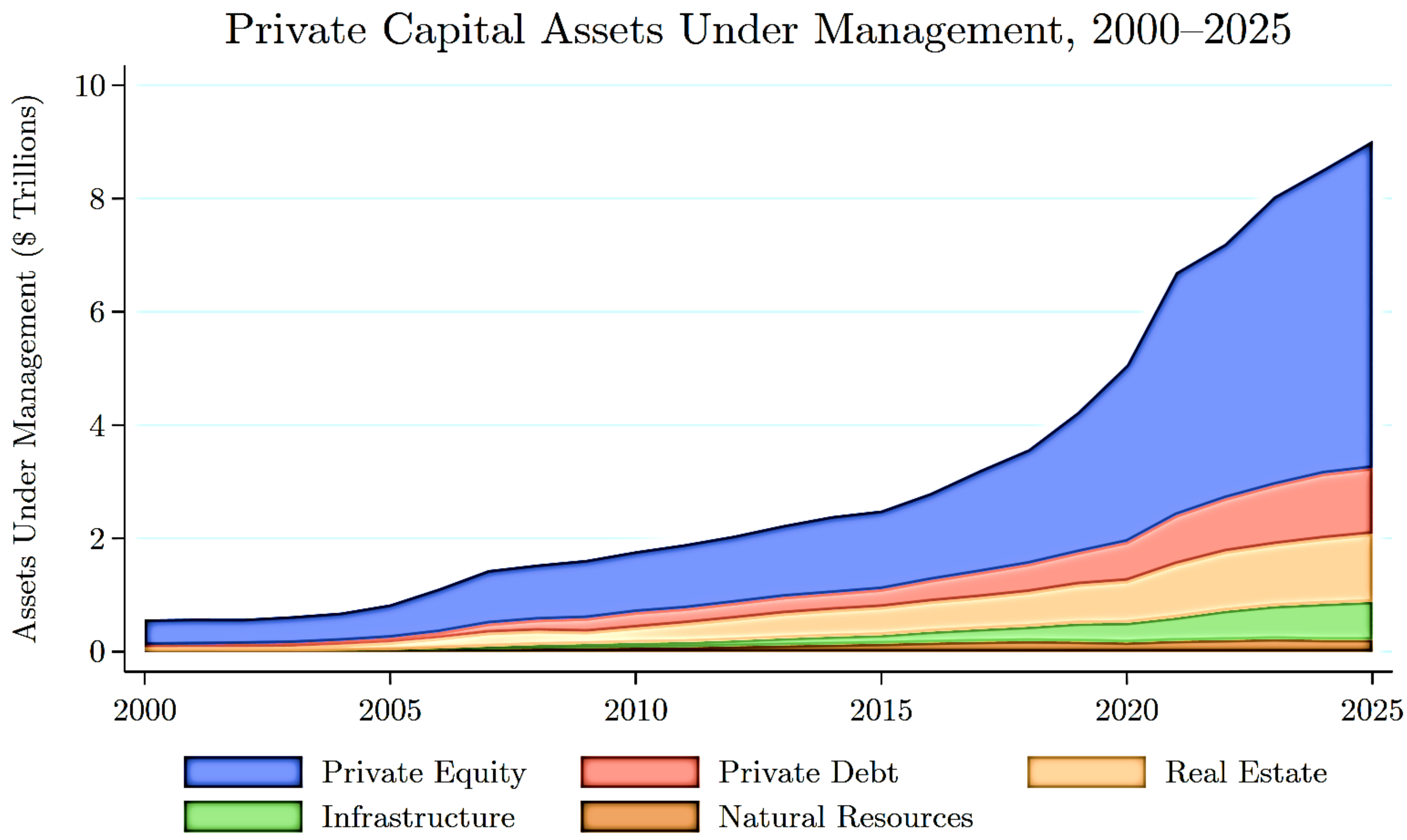


Source: IRS Statistics of Income



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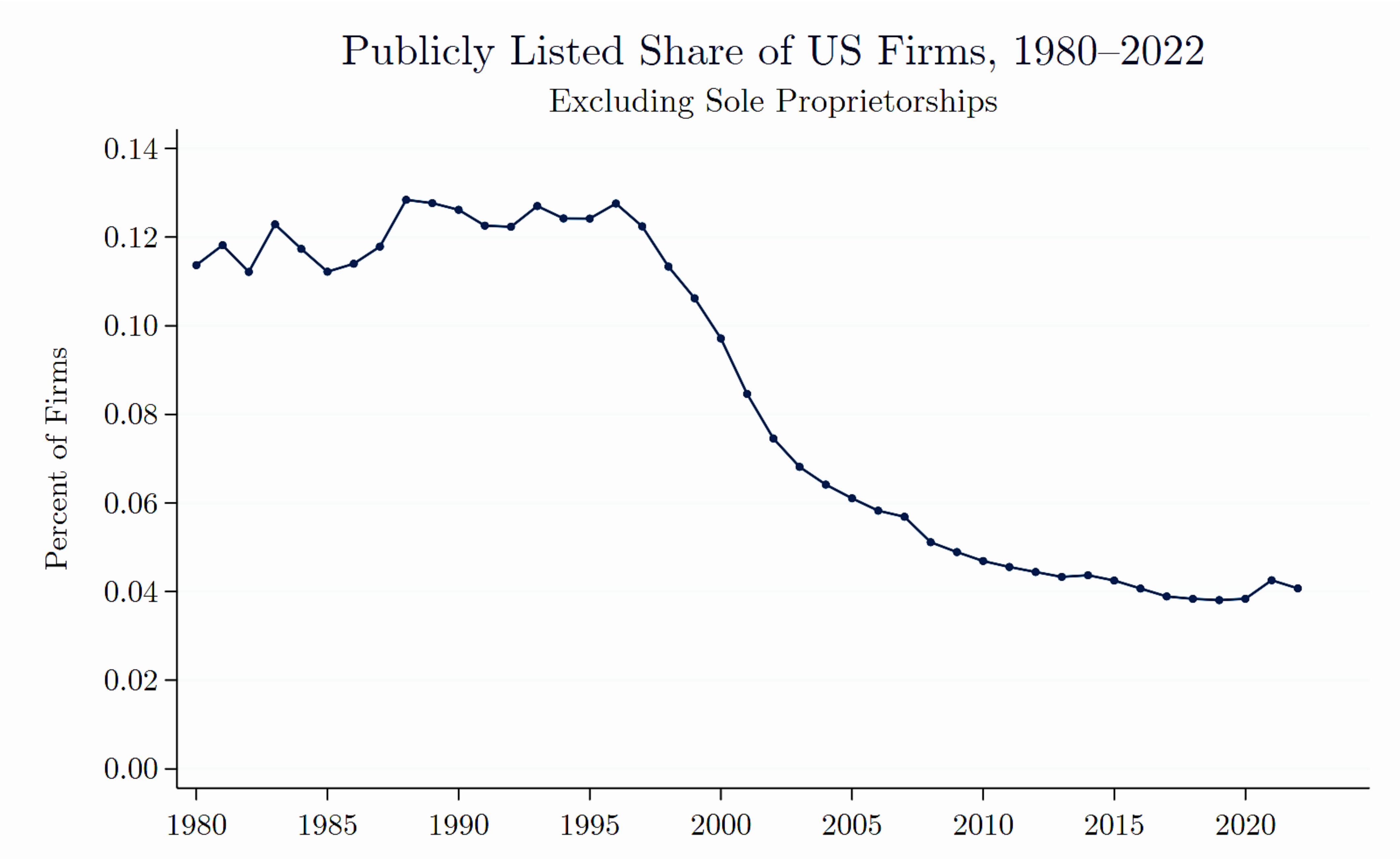
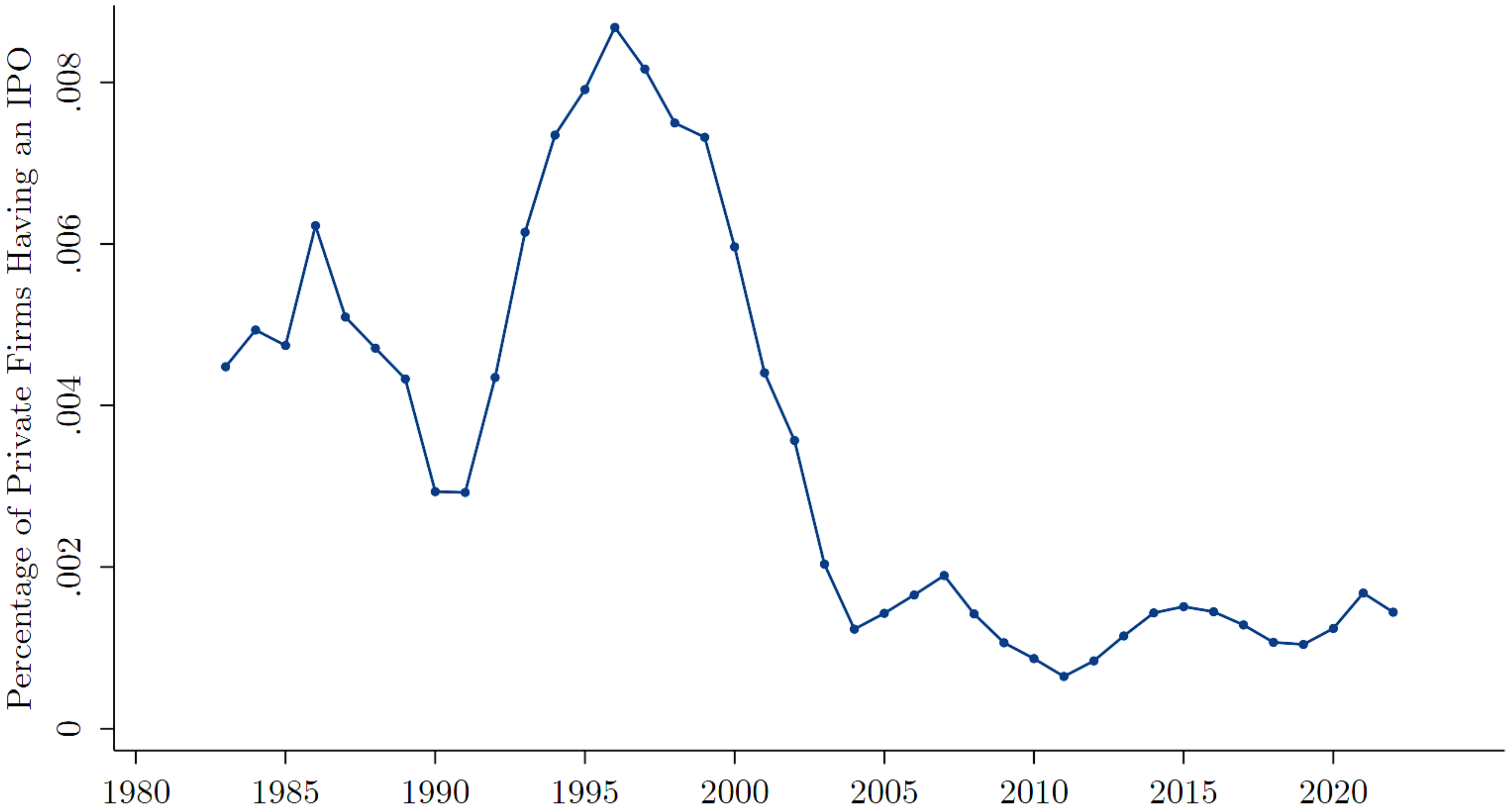


Source: IRS Statistics of Income + Doidge et al., “Are There Too Few Publicly Listed Firms in the US?,” 2025

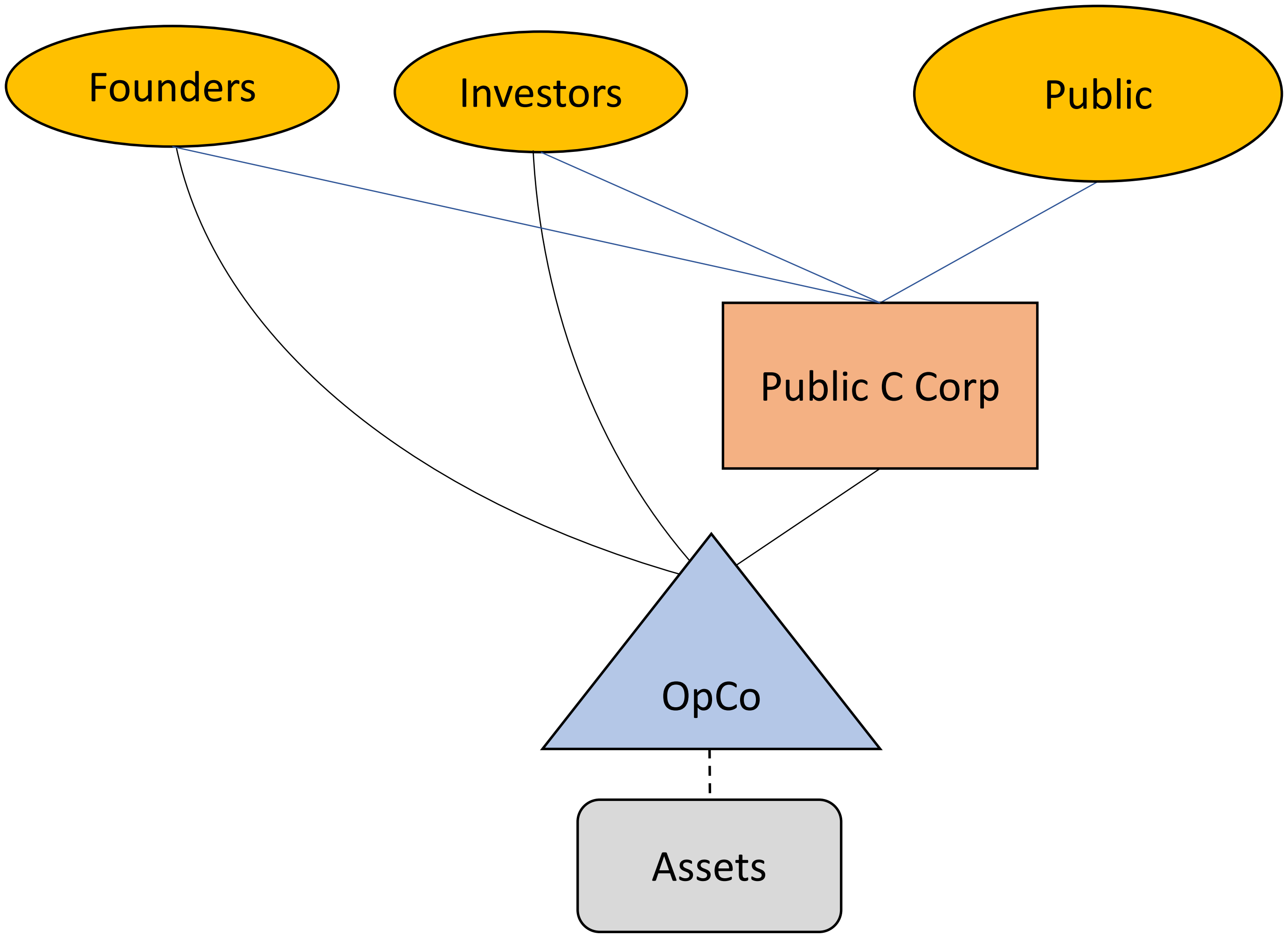
Share of Private Firms with IPOs, 1983–2022

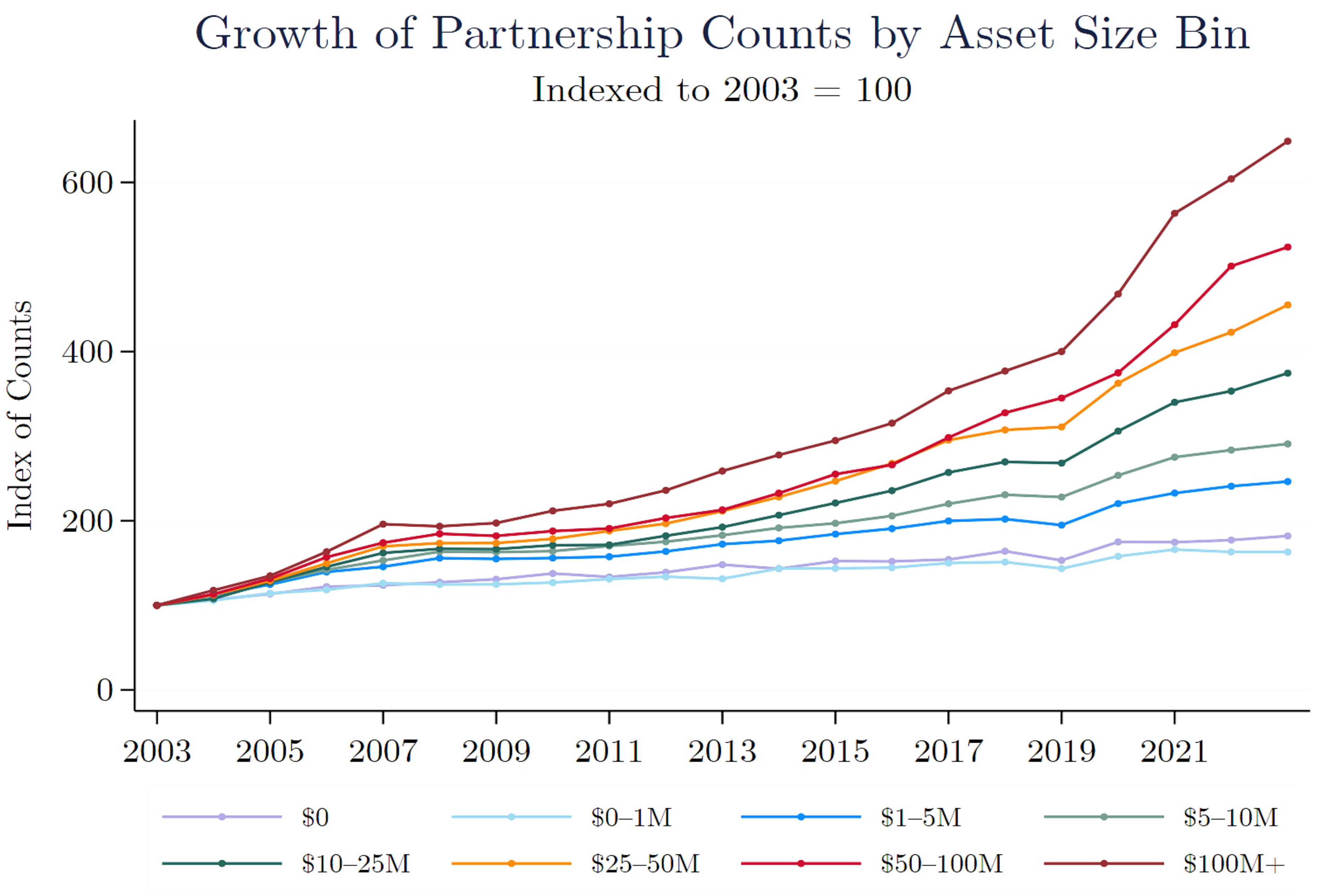
4-Year Rolling Average



Source: IRS Statistics of Income + Ritter and Brigham, “Initial Public Offerings: Updated Statistics,” 2026

UP-C Structures





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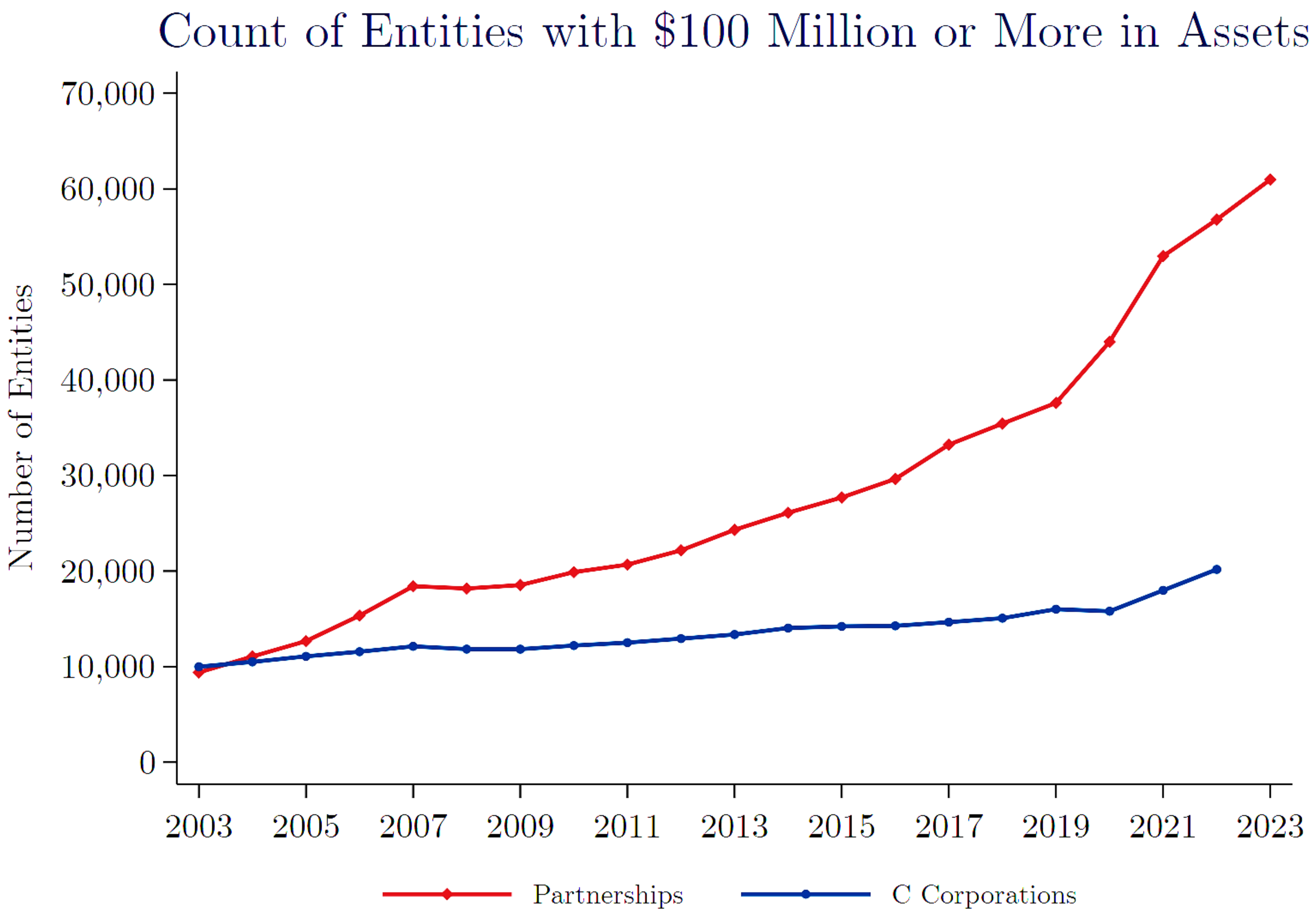

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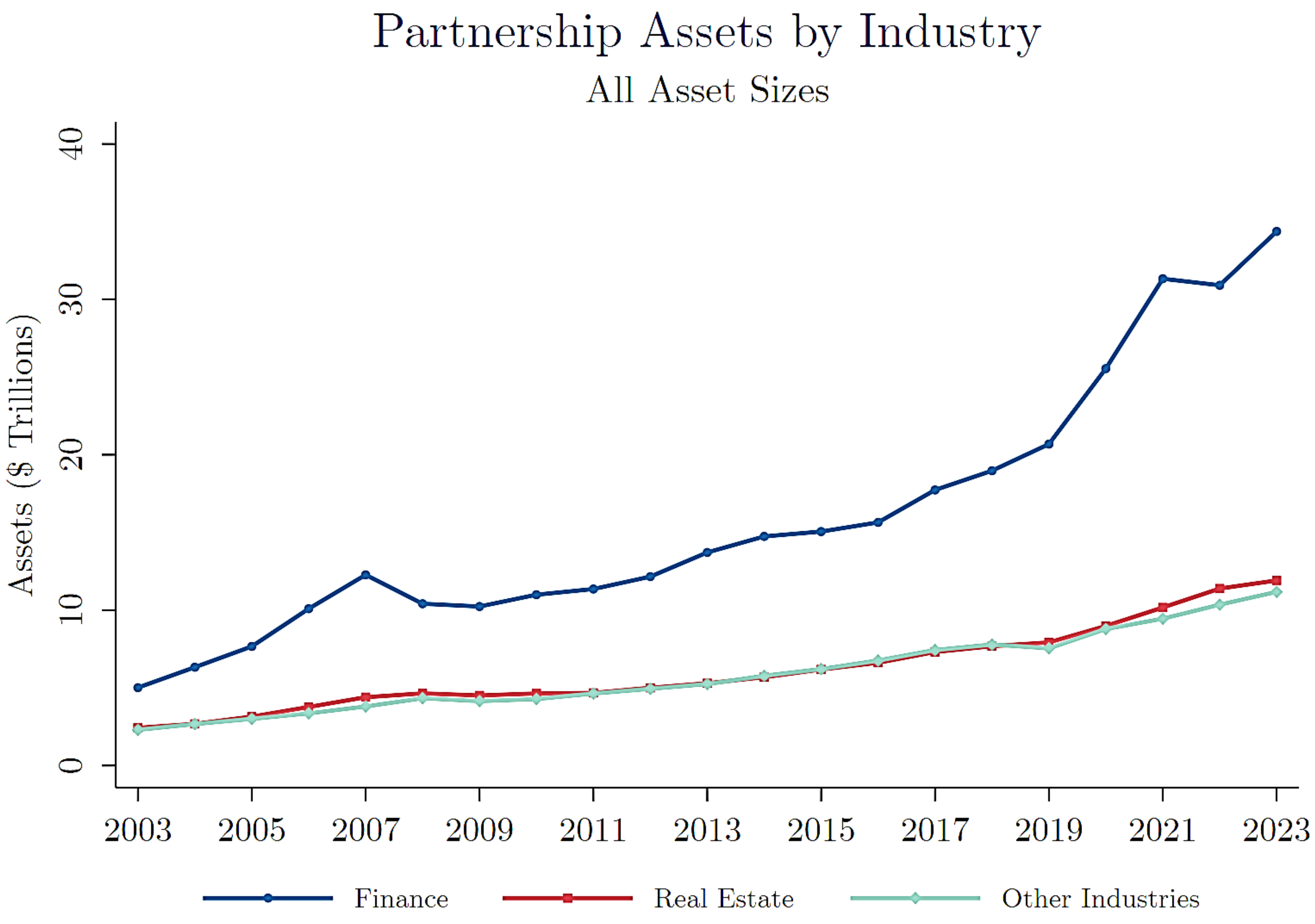
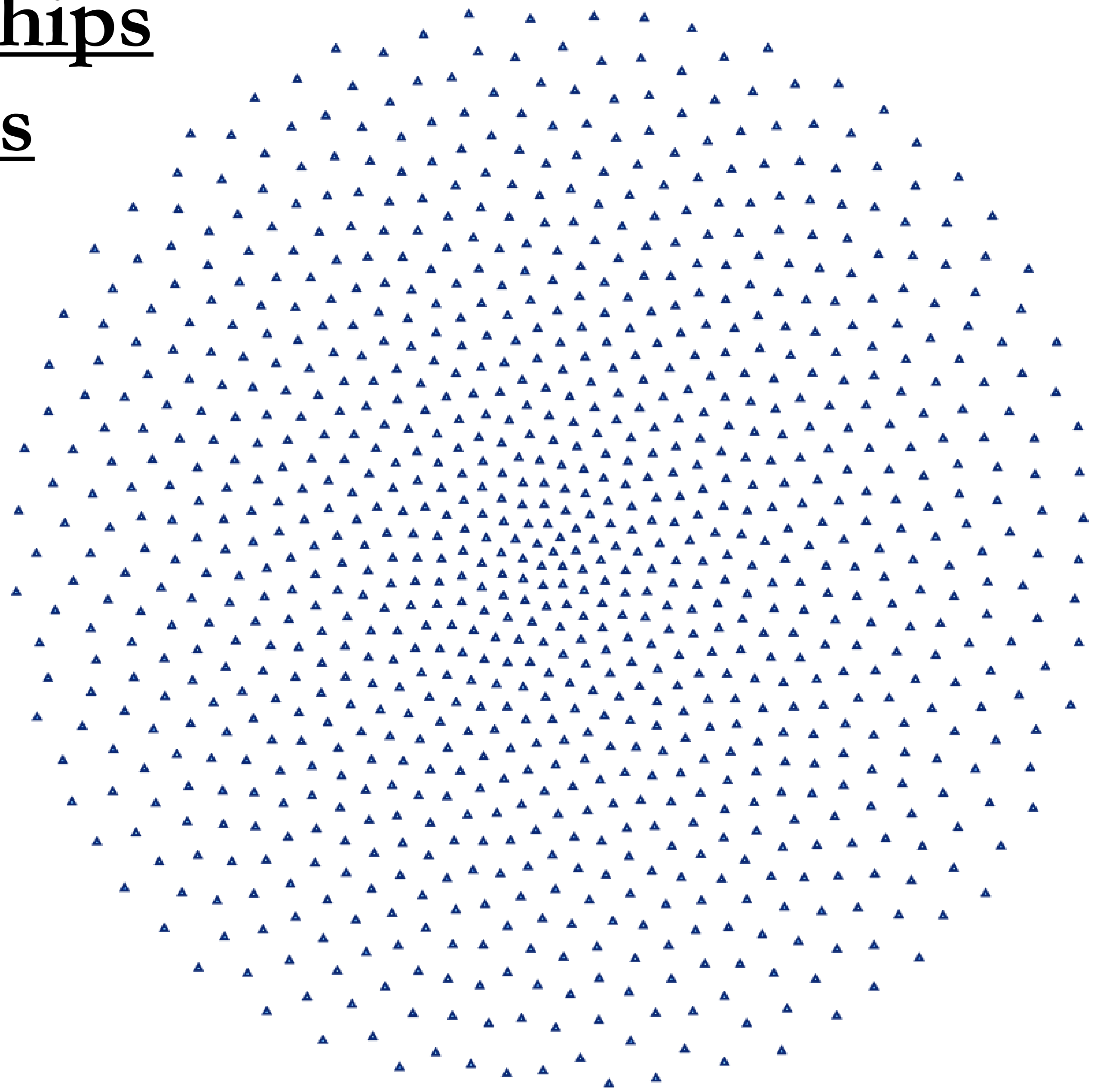


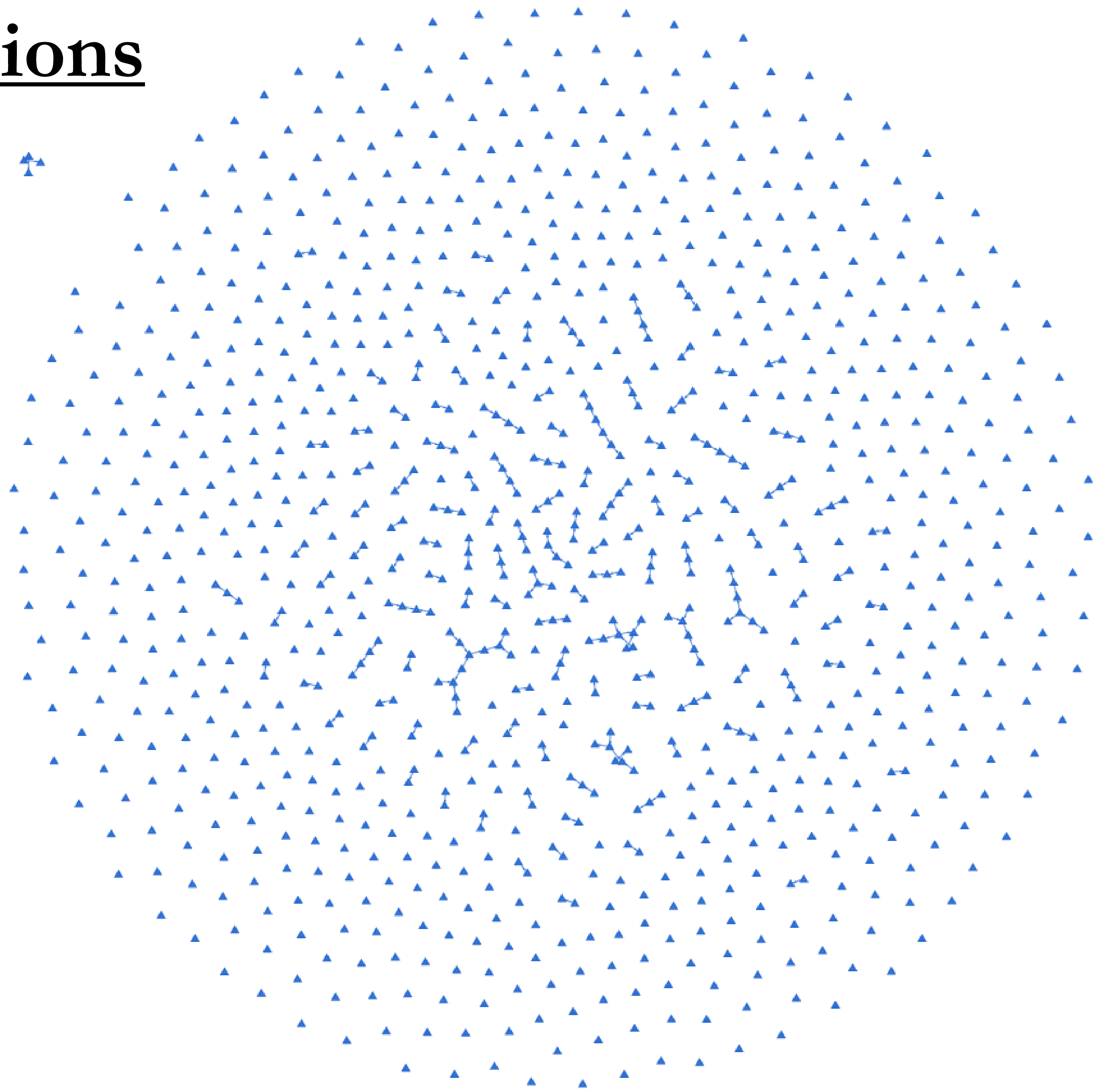
Source: IRS Statistics of Income

1000 Partnerships
0 Connections



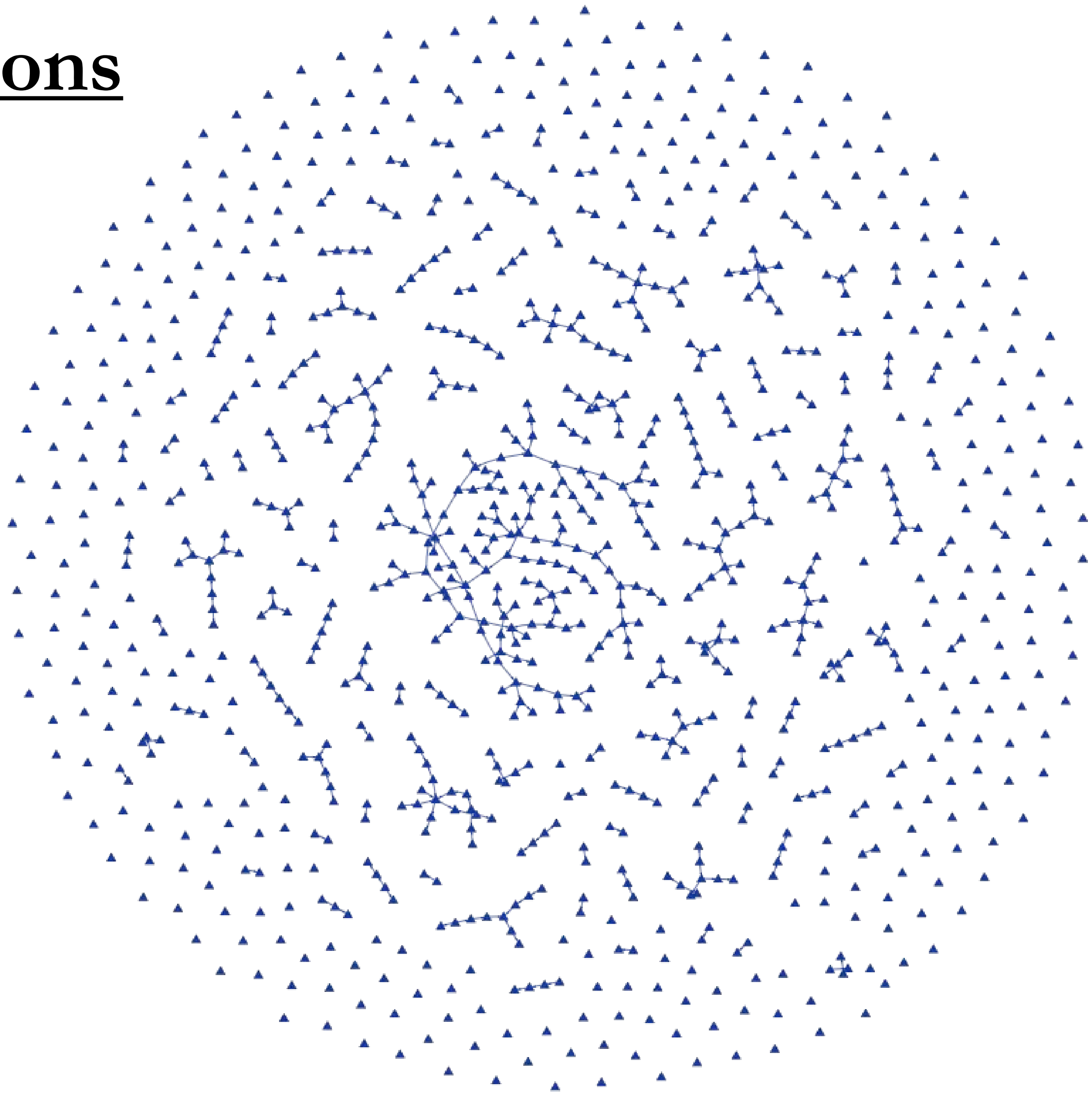
Python simulation

200 Connections



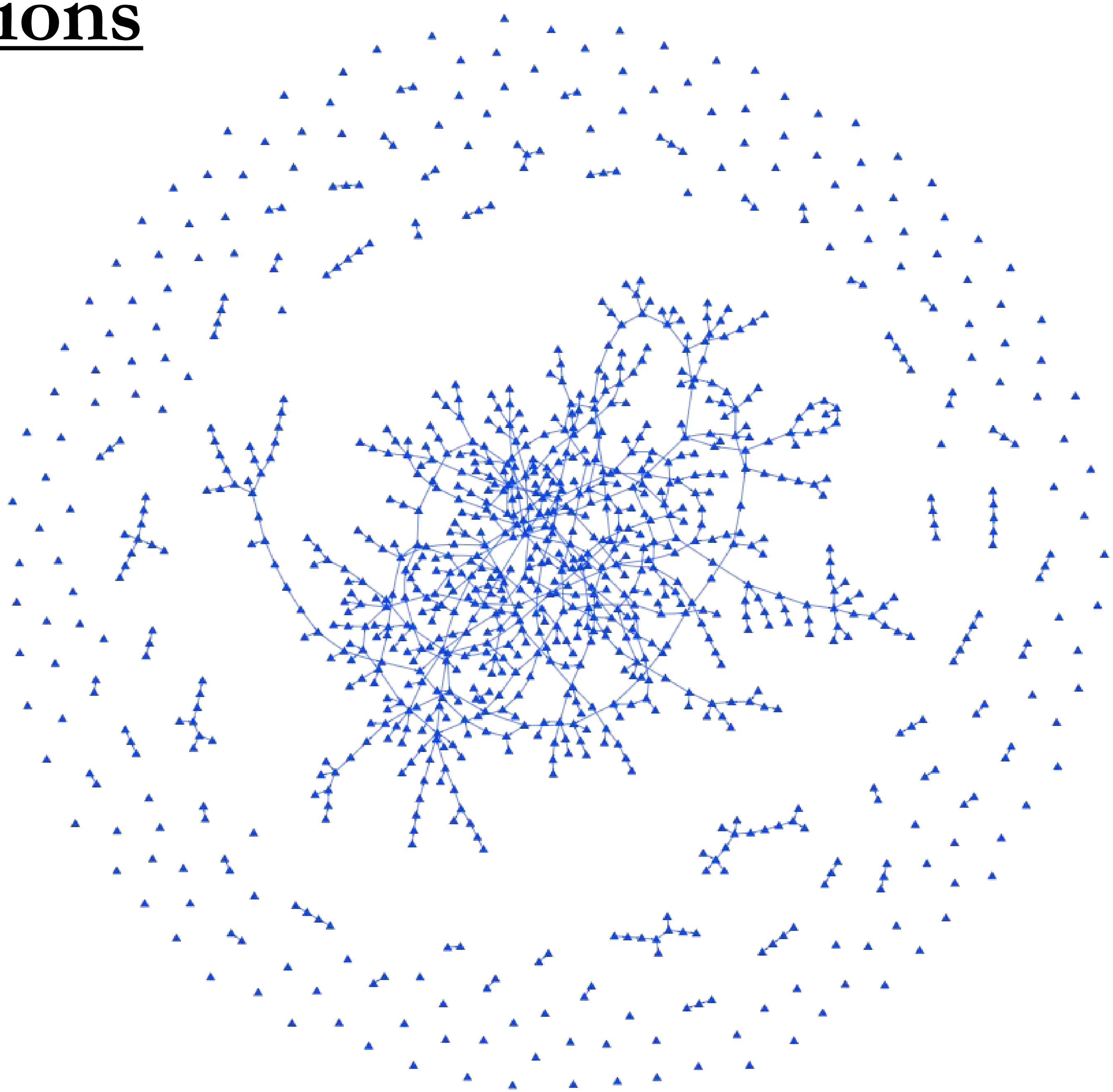
Python simulation

500 Connections



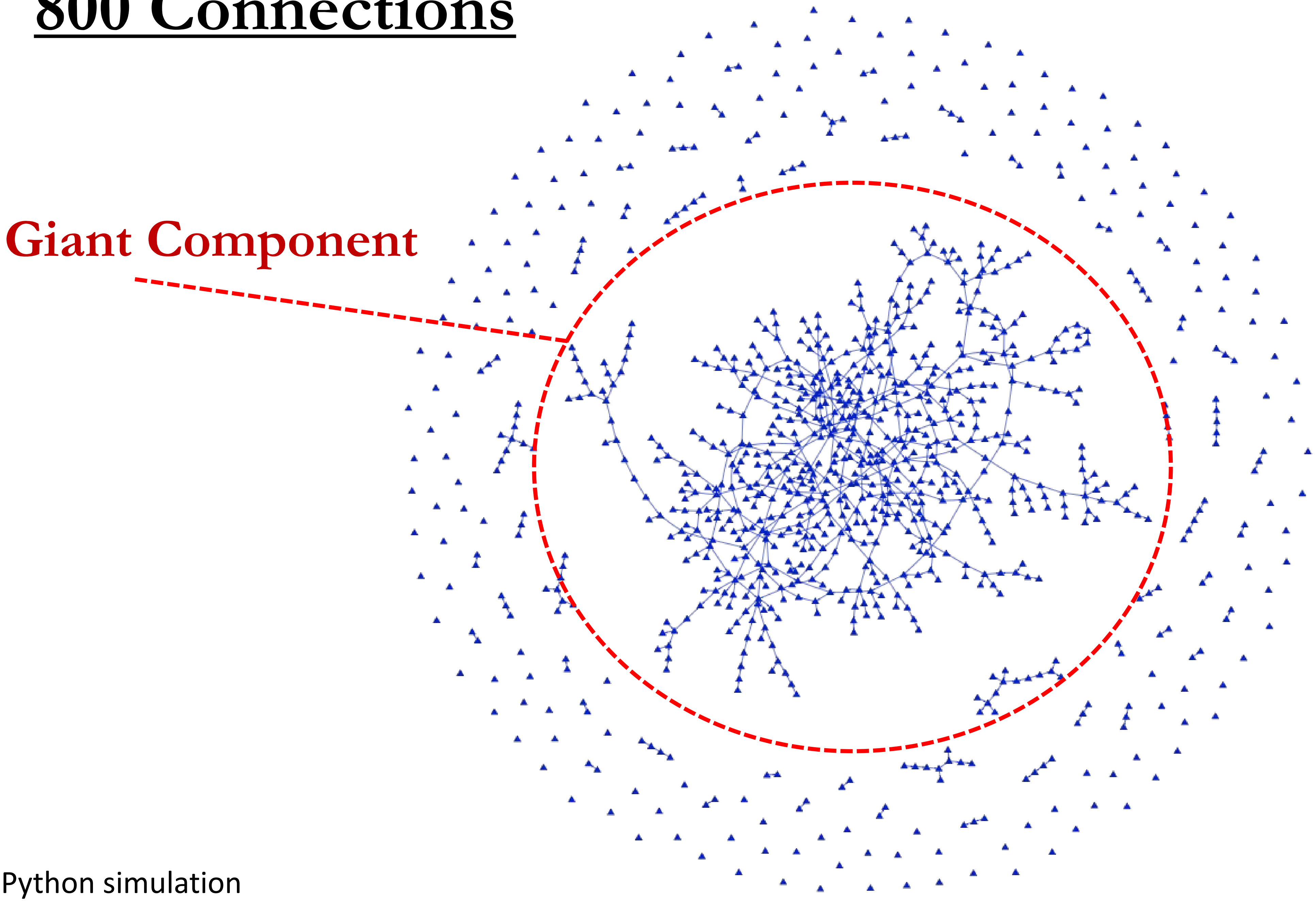
Python simulation

800 Connections



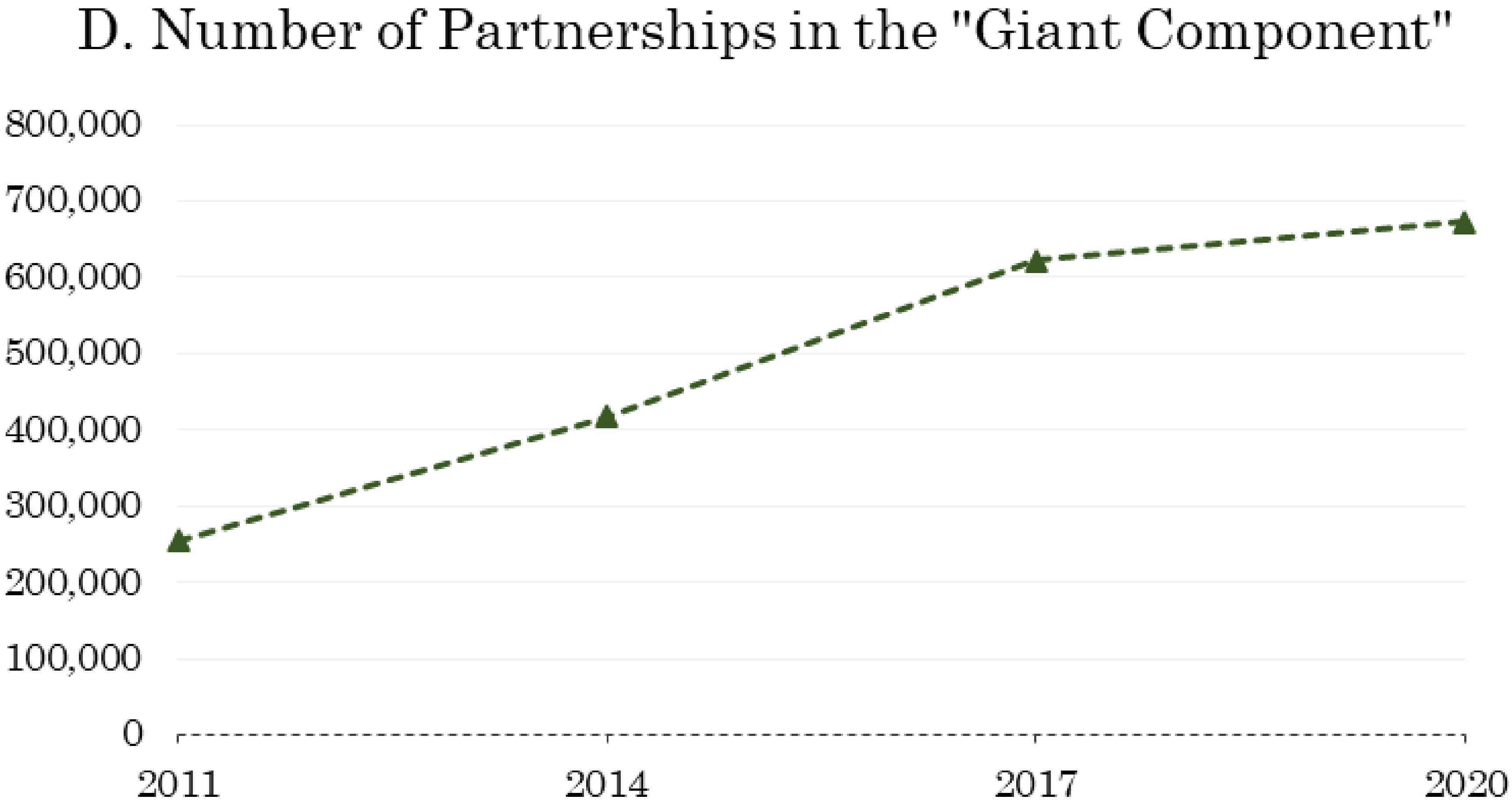
Python simulation

800 Connections



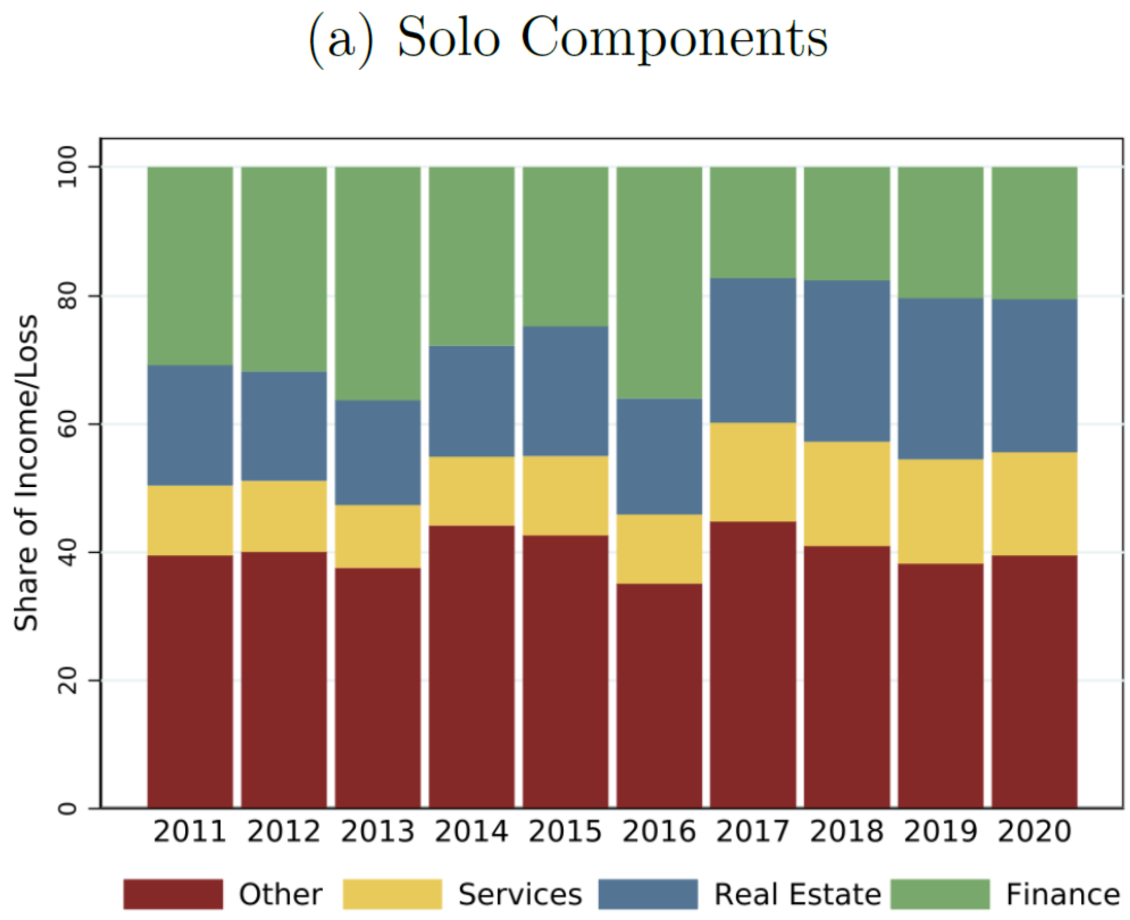
Python simulation

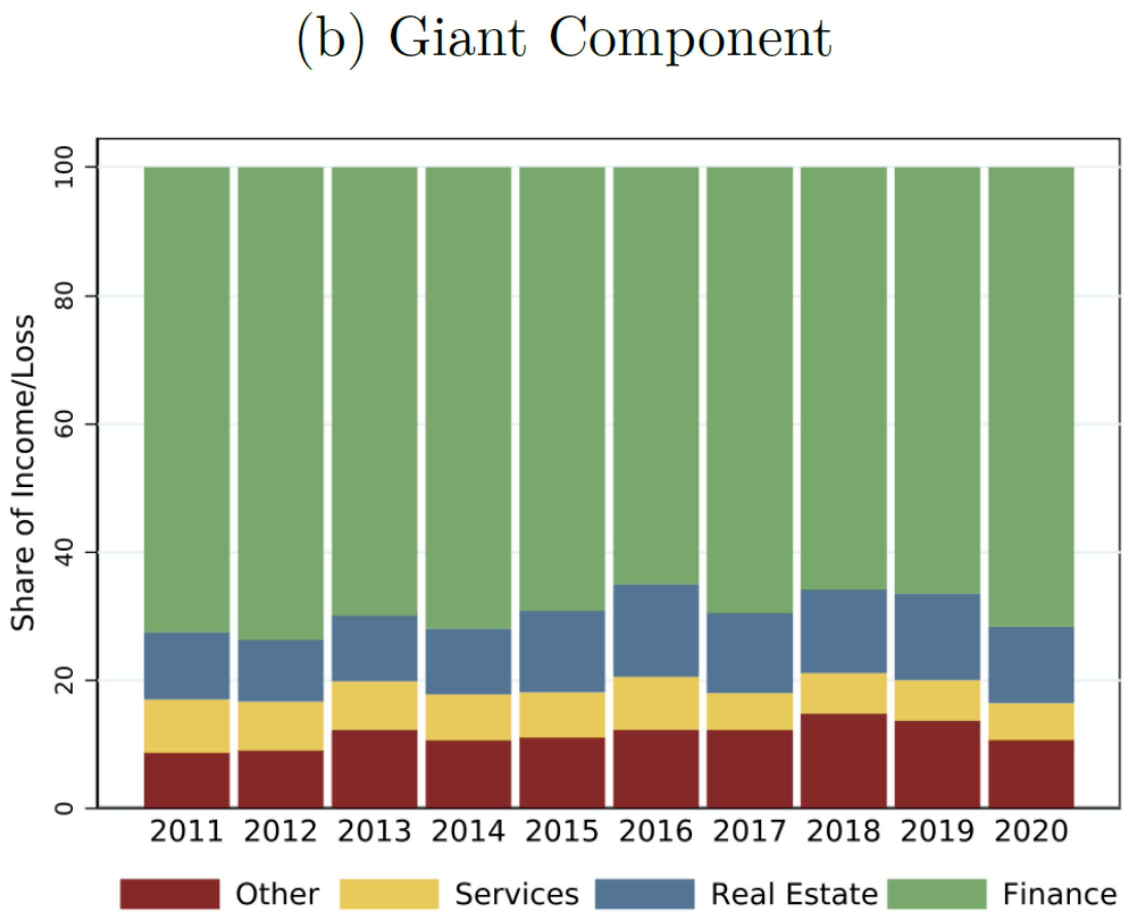
Growth of the Giant Component



Source: Fox et al., “How to Tax Business? Economic Rents, Legibility, and the Corporate–Pass-Through Divide,” 2026

What's in the Giant Component?





Source: Love, "Who Benefits from Partnership Flexibility," *Journal of Public Economics*, 2025

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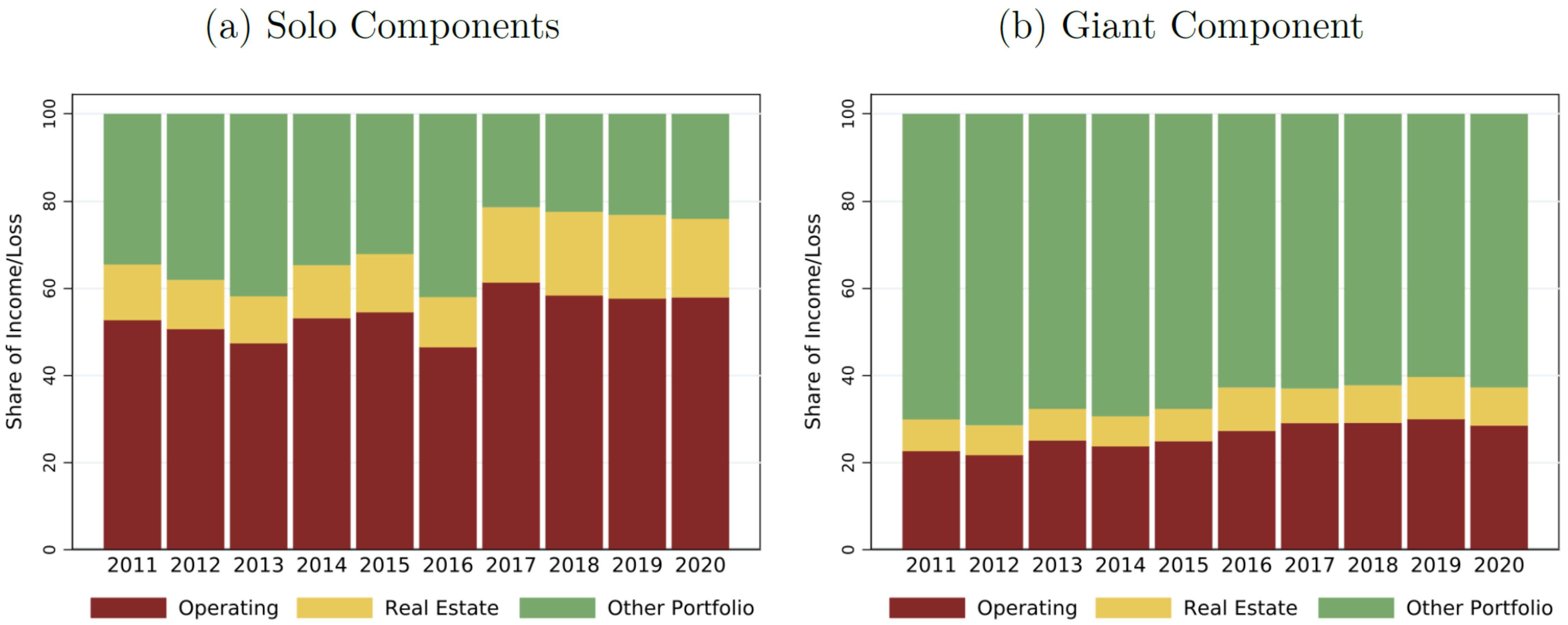
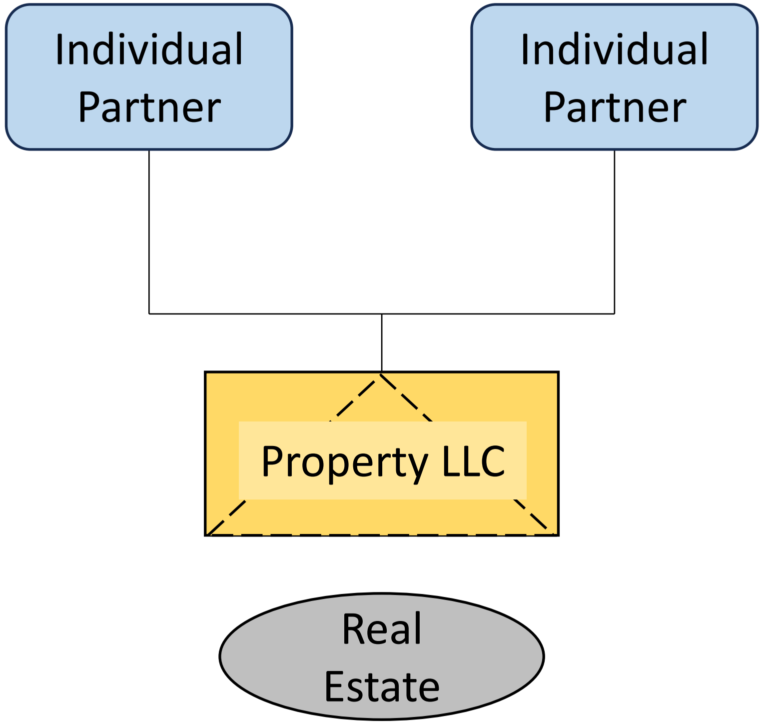
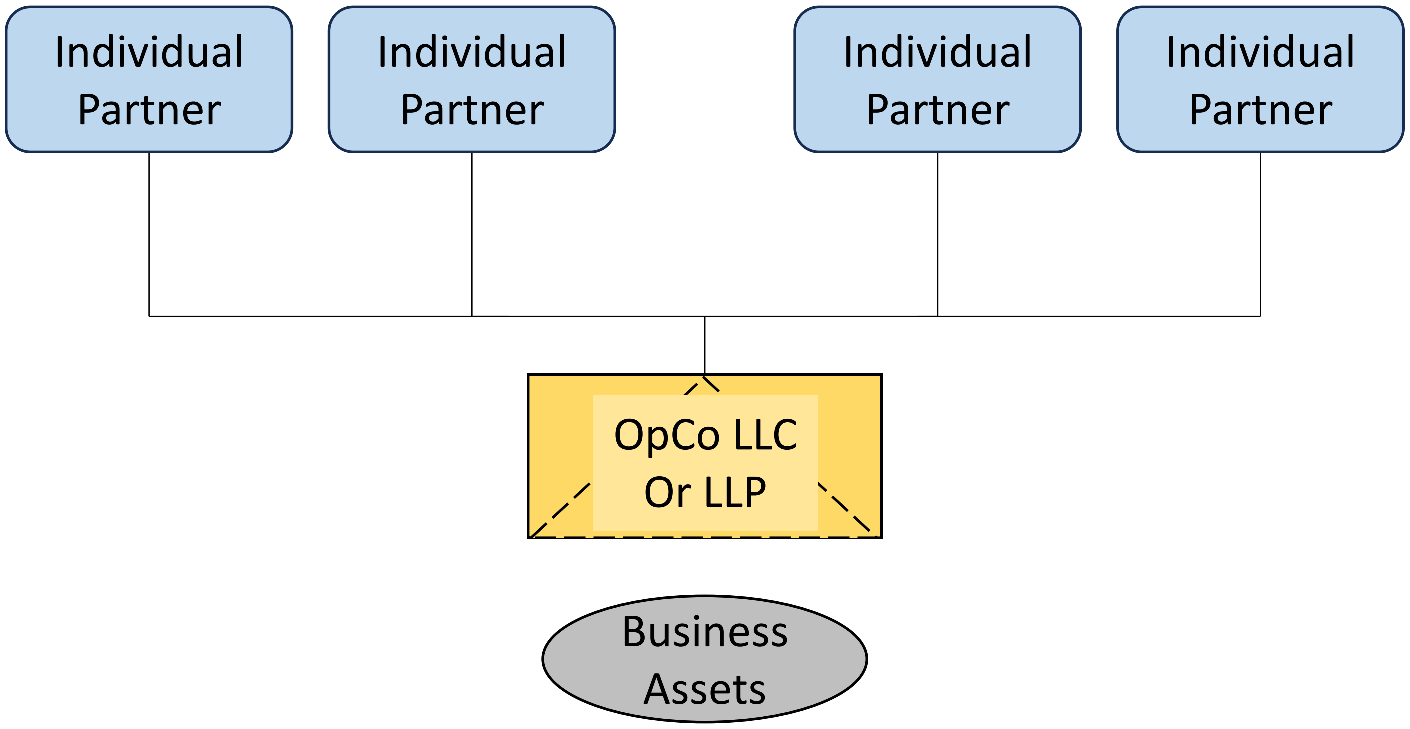


Source: Love, "Who Benefits from Partnership Flexibility," *Journal of Public Economics*, 2025

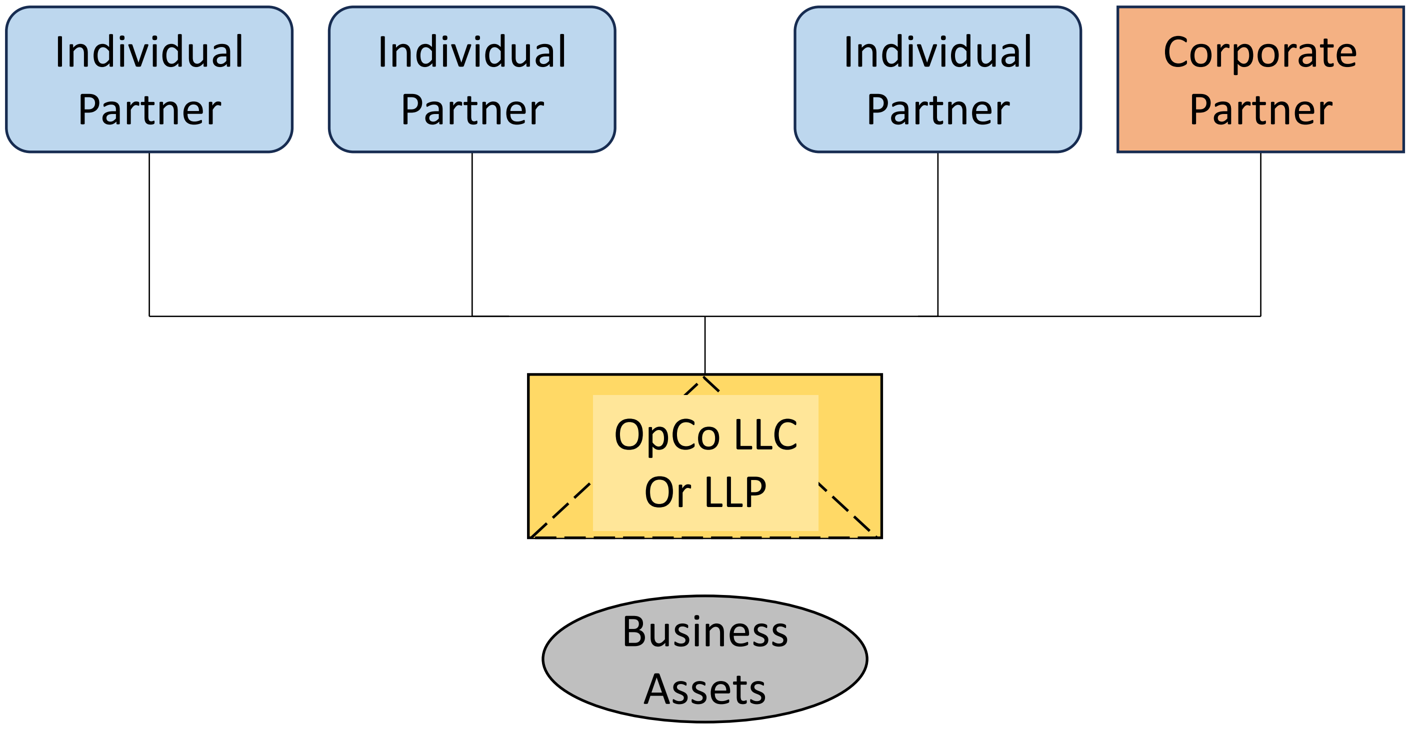
The most common partnership…

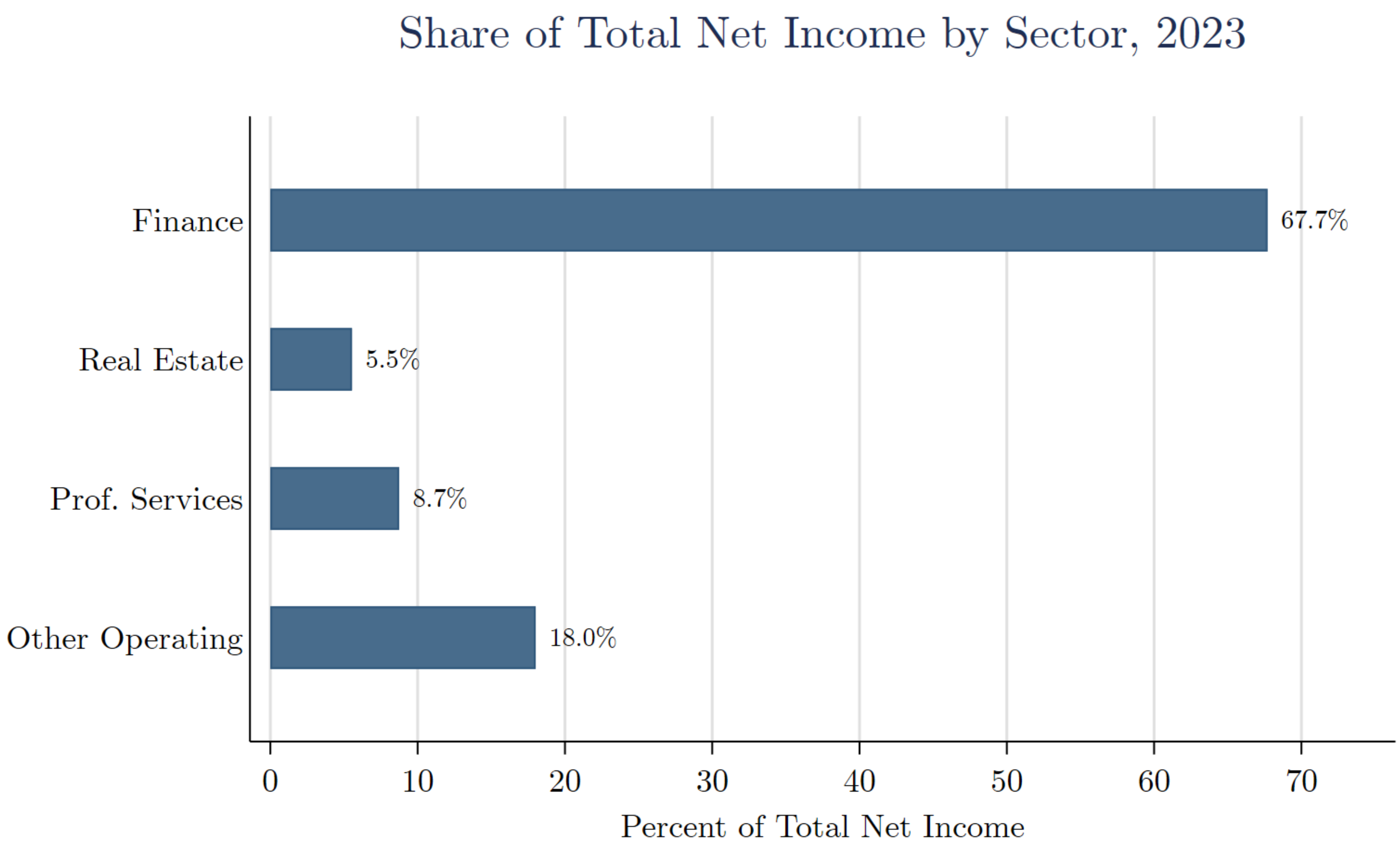


Service Firm…

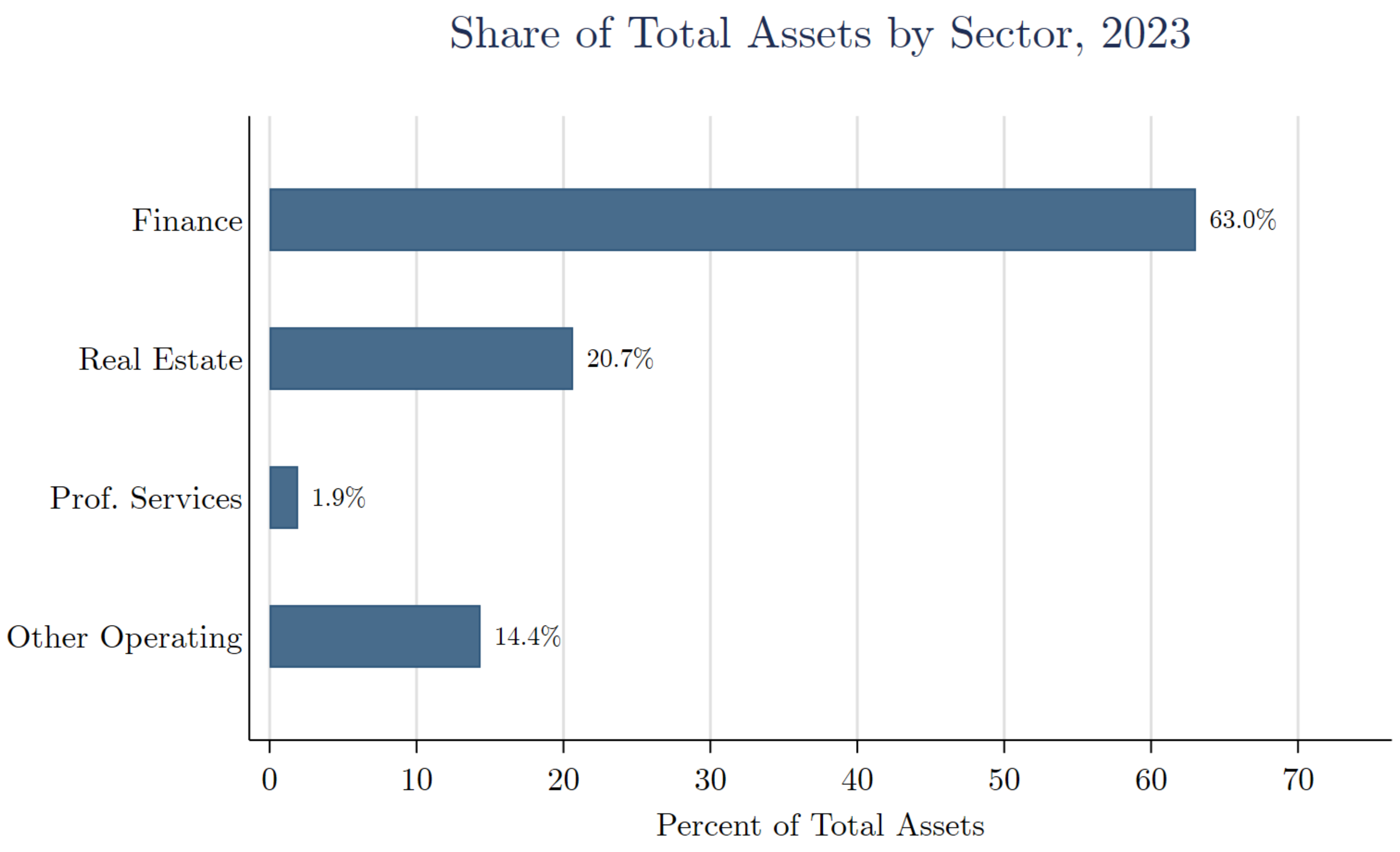


Simple Operating Firm…



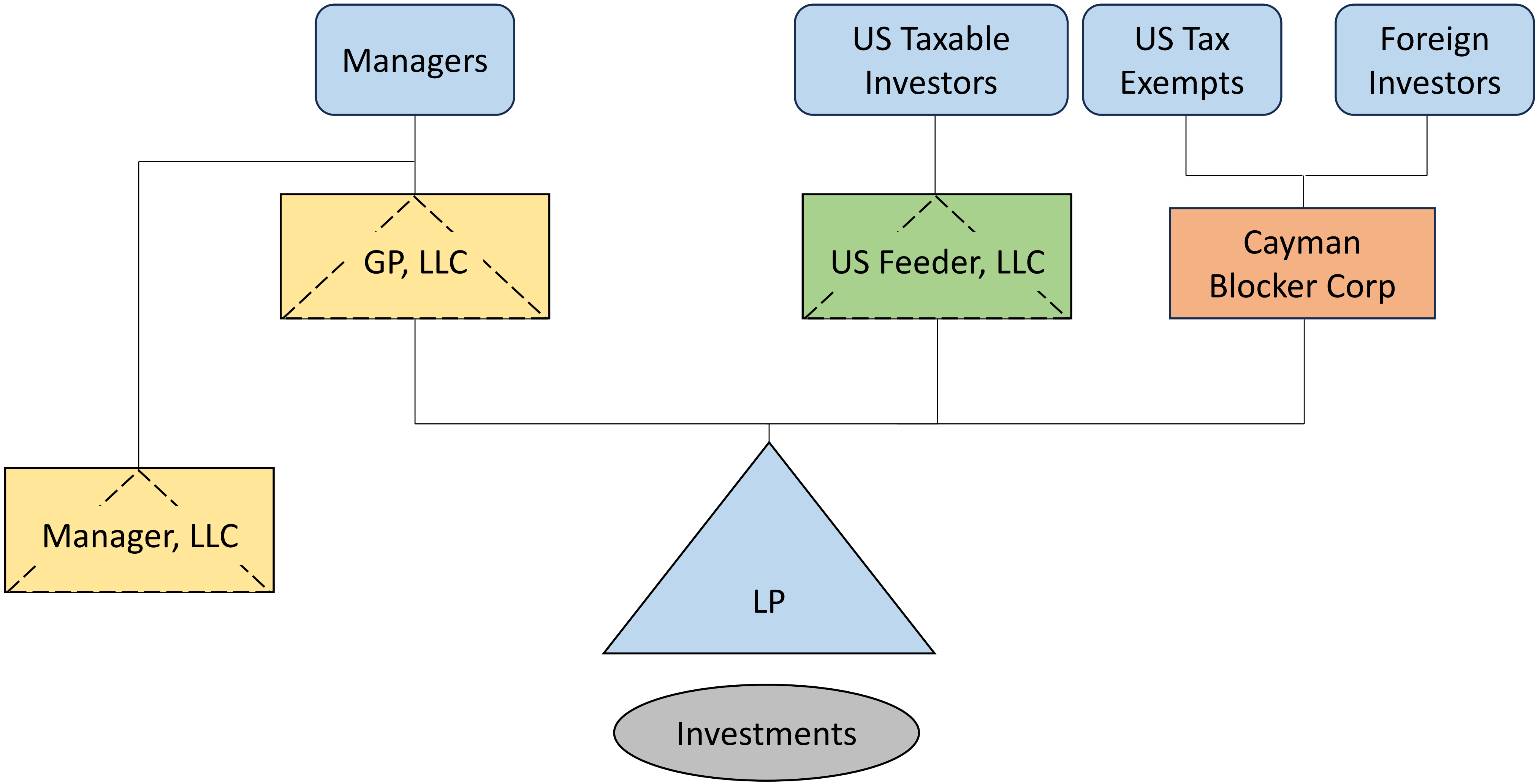


Source: IRS Statistics of Income

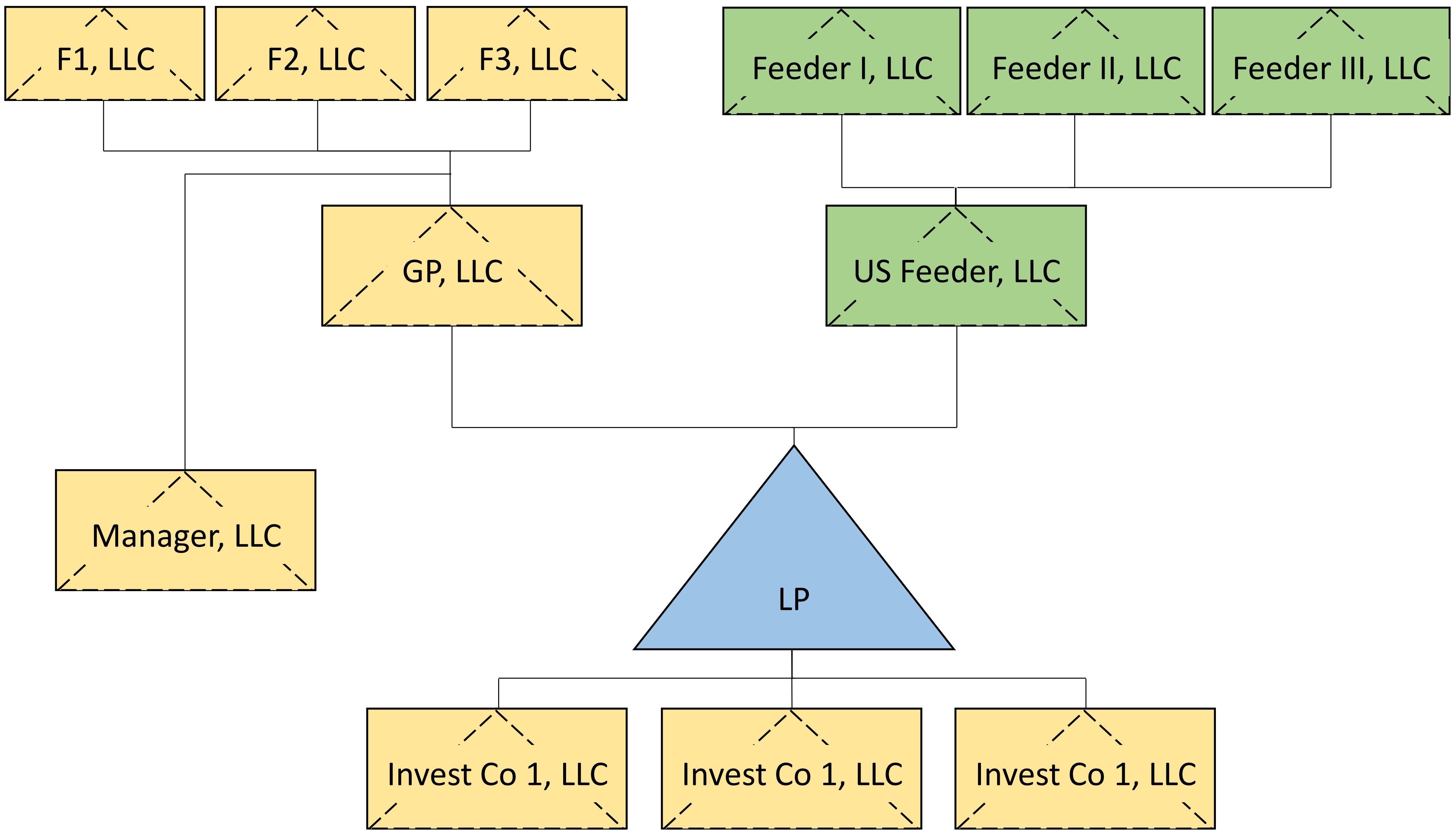


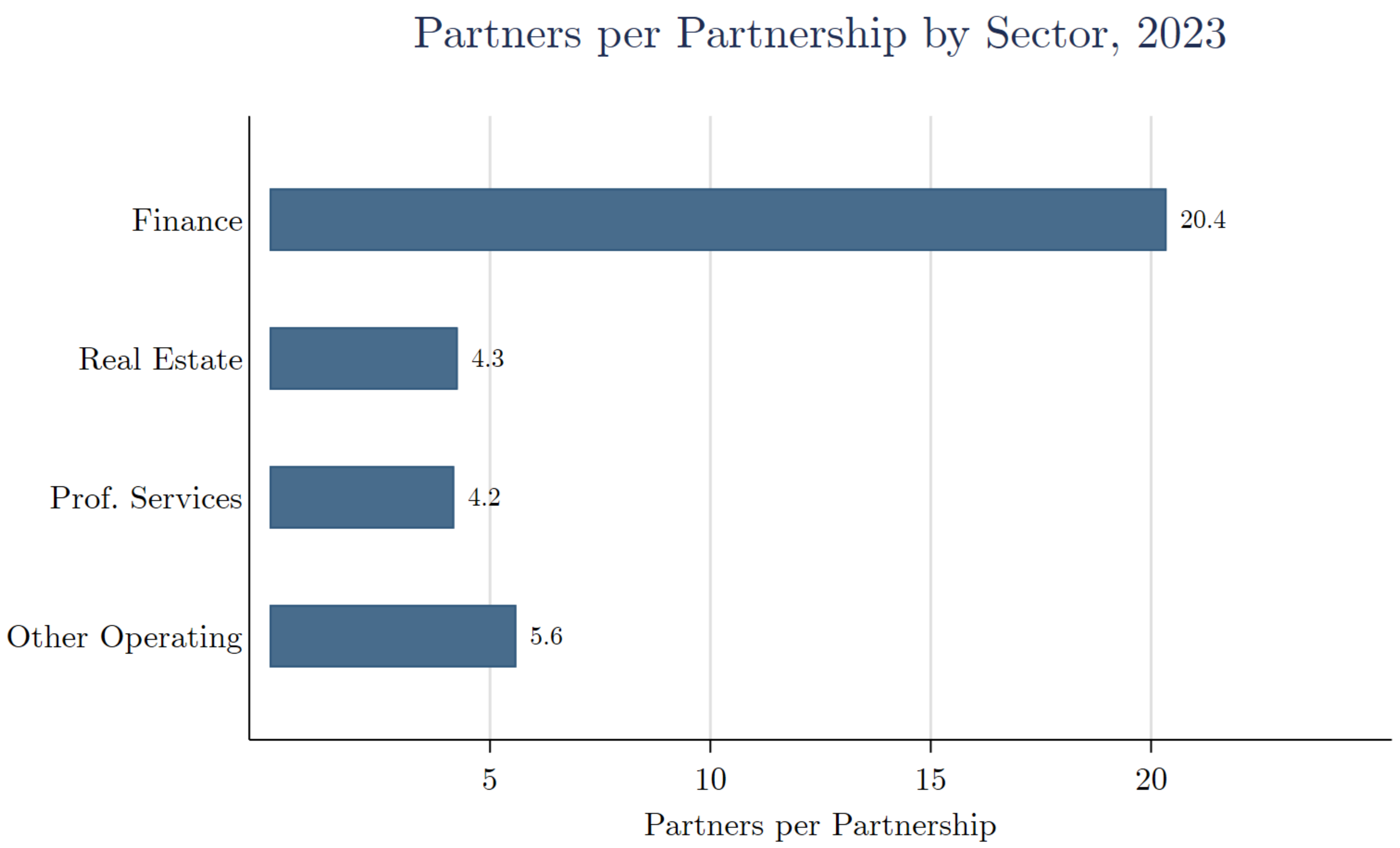
Source: IRS Statistics of Income

Most common weighted by income/assets…



With entity tiering…





Source: IRS Statistics of Income

Most partnerships are small and simple

Roughly <u>two-thirds</u> of partnerships are those with…

→ Less than $5 million annual profit or loss

→ Three or fewer interconnected partnerships

→ All other partners are human

→ At least 75 percent of income is operating

BUT….these small partnerships only constitute <u>10 percent</u> of income

Source: Love, "Who Benefits from Partnership Flexibility," *Journal of Public Economics*, 2025

2015 Federal Bipartisan Budget Act

- **Gave the IRS the power to audit partnerships at the entity level and make certain presumptions that would have to be rebutted by the partnership and the partners.**
- **But the idea that the IRS could implement this new centralized partnership audit regime was based on providing sufficient resources.**
- **The IRS had received some funding and additional resources, but that funding and the added personnel and systems have been scaled back.**

MTC Project on Taxation of Partnerships

- The MTC has a project to help states determine their share of the income of partnerships operating in multiple states (including large complex structures.
- The project page with the research, white papers, and proposed model provisions is here: https://www.mtc.gov/uniformity/project-on-state-taxation-of-partnerships/
- The two keys for states –
  - Clarify rules so that taxpayers and practitioners know what is required.
  - Provide agencies with the resources to develop specialized expertise.

Questions

Thank you.