

March 12, 2014

SENATE EXECUTIVE MESSAGE NO. 119

The Honorable Mary Kay Papen, President Pro Tempore and
Members of the New Mexico State Senate
State Capitol Building
Santa Fe, New Mexico 87501

Honorable President Pro Tempore Papen and Members of the Senate:

Pursuant to the Constitution of the State of New Mexico, Article IV, Section 22, I hereby VETO and return SENATE BILL 117, enacted by the Fifty-First Legislature, Second Session, 2014.

I agree with the intent of Senate Bill 117, which would have required New Mexico to treat a limited liability company (LLC) whose sole owner is a tax exempt 501(c)(3) organization as a 501(c)(3) organization for purposes of gross receipts and compensating taxes. The Internal Revenue Service (IRS) is currently treating LLCs under these circumstances as 501(c)(3) organizations.

For purposes of the gross receipts tax and the compensating tax, New Mexico allows a 501(c)(3) organization to claim deductions and exemptions when its receipts are derived from trade or business that is related to the organization's tax exempt purpose. However, the organization's income that is unrelated to its tax exempt purpose is taxable. Treating an LLC as a 501(c)(3) when its sole member is a 501(c)(3) is good policy only if the LLC is a "disregarded entity" because, in that situation, all of the LLC's income would flow down to the 501(c)(3) sole member. To the extent that the LLC is engaged in business activity that is considered to be unrelated to the tax exempt activity of the 501(c)(3), that income is properly taxable.

Unfortunately, the language in Senate Bill 117 does not specify that the LLC must be a disregarded entity. Without the disregarded entity limitation, there is an opportunity for an organization to create an LLC that is not a disregarded entity, and engage in business activity that is unrelated to the tax exempt purpose of the 501(c)(3). If the LLC chooses to be taxable on that income, the IRS will no longer consider the income unrelated. As a result, under the provisions of Senate Bill 117, the LLC's income will not be considered unrelated for purposes of New Mexico's gross receipts tax, and the LLC will get the

SENATE EXECUTIVE MESSAGE NO. 119

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March 12, 2014

Page 2

benefit of exemptions and deductions as a 501(c)(3) on that income, even though this income should properly be taxable.

While I cannot sign legislation that would create an unintentional tax avoidance possibility, I agree with the intent of the legislation. If limited to the situation of a disregarded entity, the provisions of Senate Bill 117 appear to mirror the provisions of present law. Therefore, to clarify tax obligations under these circumstances, I am directing the Taxation and Revenue Department to promulgate rules to address this issue.

Respectfully yours,

Susana Martinez
Governor

RECEIVED FROM THE OFFICE OF THE GOVERNOR

Time: _____ a.m. p.m.

Date: _____, 2014

By _____
Secretary of State

Time: _____ a.m. p.m.

Date: _____, 2014

By _____
Chief Clerk of the Senate