

**Before the New Mexico Legislature  
Revenue Stabilization and Tax Policy Committee**

# **Tax Administrators' Perspectives on Tax Policy**

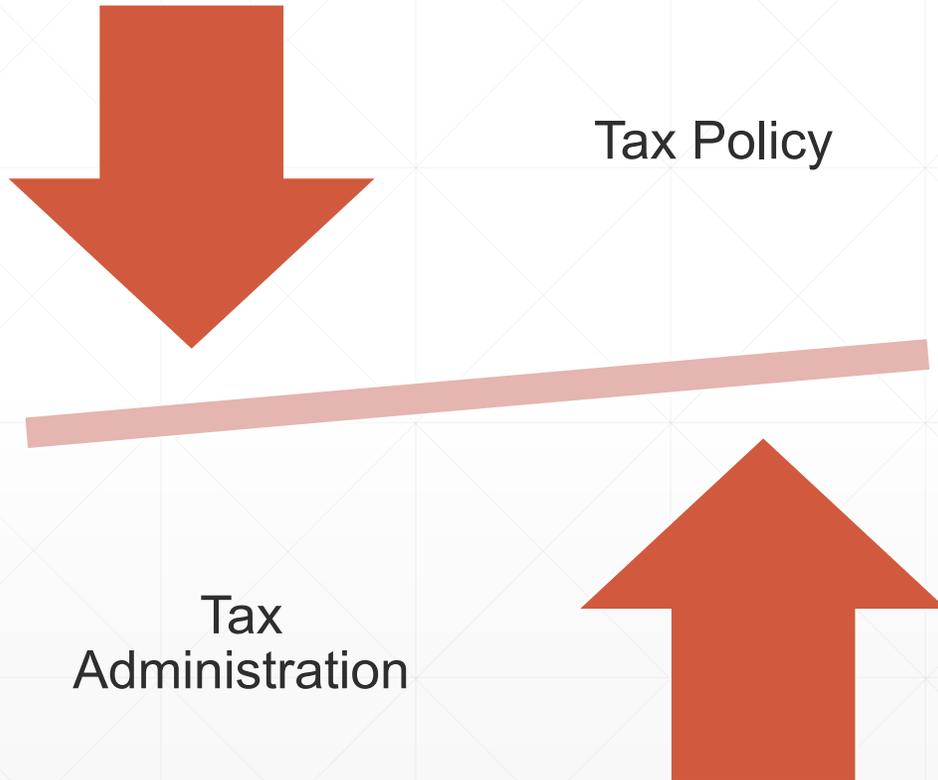
**Helen Hecht, Esq., C.P.A., Uniformity Counsel  
Multistate Tax Commission (MTC)**



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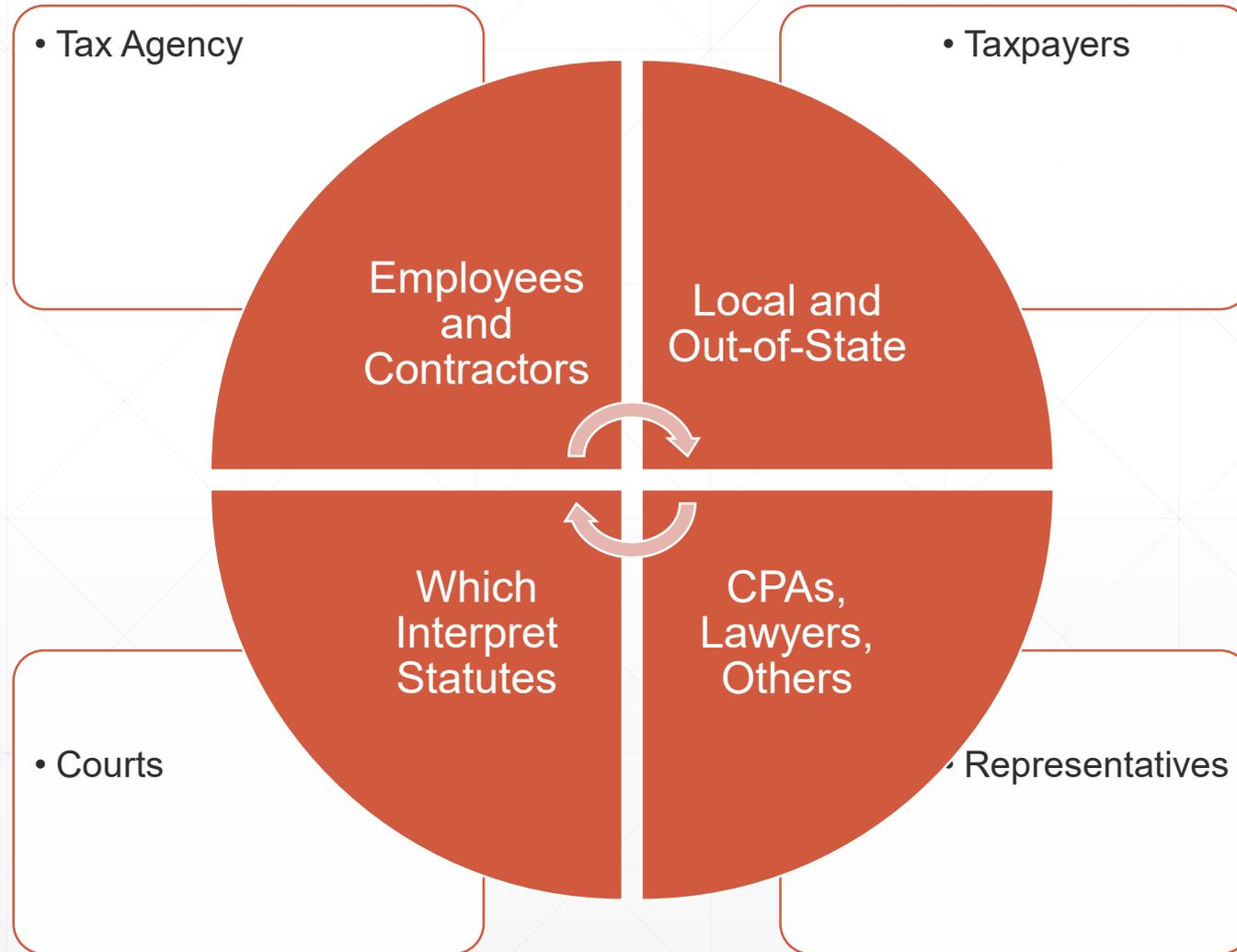
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# Tax Policy vs. Tax Administration



- Which is more important?

# Tax Administrators – Who Are They



# Tax Administrators – What Do They Agree About

- The legislature needs to speak clearly.
- Complexity in the tax law imposes higher administrative and compliance costs—so the tax system is less efficient.
- Complexity also imposes higher relative costs and risks on lower income families and small businesses.
- Failure to deal with complexity undermines respect for government.

# Perspective - State Agencies

- For each page of statutory law, implementation may take dozens or hundreds of pages of –
  - Regulations
  - Rulings
  - Instructions
  - Case Law
  - Other Guidance
- These take time and resources to develop and communicate to taxpayers.
- In addition – information technology and processing systems must be created and maintained.

# Perspective - State Agencies

- Lower income taxpayers and small businesses often need special assistance with understanding and complying with tax requirements.
- High income taxpayers and multinational enterprises often pose tax enforcement challenges.
- These two extremes require very different approaches to tax administration generally and very different resources.
- There is virtually no tax administrator in this country who, if answering honestly, would say that their administrative agency has anything close to adequate resources—especially expertise.

# Perspective – Taxpayers

- All –
  - Need to be able to get reliable answers to questions in a timely fashion.
  - Need time to adjust to changes in the tax law.
- Multistate businesses –
  - Need more uniformity or consistency between state tax laws.
  - Need parity when it comes to treatment of competing businesses.

# Ongoing Challenges

- Tax agencies are feared and disliked.
- They can become “political footballs.”

# Recent Challenges

- Competition for expertise puts agencies at a significant disadvantage.
- Tax agencies are being tasked with other duties.
- Under-resourced IRS means that state taxes, which are often tied to federal taxes, are undermined.

## Example – Partnership Taxation

- Income reported by partnerships has been growing over recent decades whereas income reported by taxable corporations has been shrinking.
- Most states have tied their taxation of partnerships to the federal pass-through treatment.
- This pass-through system (Subchapter K) is widely regarded as one of the most complex systems imposed under the federal tax law.
- Partnership structures can be very complex and complex partnerships have reported a greater share of total partnership income.
- For decades, the IRS has been unable to audit and assess tax where the income comes from complex partnership structures.

## Example – Partnership Taxation

- 2015 – Congress – controlled by the Republicans – decided to enact provisions that would allow the IRS to audit and assess tax on partnership income at the partnership level.
- These audit provisions are also complex and it took three years for the IRS to implement regulations.
- Audits began in 2021 and the IRS recently admitted that even with the new authority, it lacks the resources (auditors) who have sufficient expertise.
- States have had to amend their laws so that they can assess tax at the partnership level whenever there are federal adjustments that affect state taxes.

## Example – Partnership Taxation

- State taxation of partnerships is even more complicated because in addition to the federal complexity, states must divide (apportion) partnership income and enforce tax on non-residents.
- Only two states that use the federal pass-through system have enacted laws allowing tax agencies to audit and assess tax at the partnership level.
- States face the same challenges to attracting expertise that are faced by the IRS.
- In addition, many states, including New Mexico, now provide partnerships with the option to pay tax at the partnership level—which may be simpler—but does not do away with the separate pass-through system.

# Example – Partnership Taxation

- The Multistate Tax Commission has taken up a project to assist states in clarifying their shared tax rules.
- This project has been referred to by experts as:
  - “Ambitious” (Bloomberg, Jun. 30, 2021)
  - “Complex” (Law360, Mar, 28, 2022)
  - “Enormous” (Tax Notes State, Oct.21, 2021)
  - “So massive” (Forbes tax podcast with Tax Notes, Sep. 9, 2021)
  - “This could be a lifetime project.” (Tax Notes State, Feb. 7, 2021)
  - “One of the largest projects the MTC has ever attempted.” (Bloomberg, Jun. 30, 2021)
  - “Members said they expect this to be a very large project that will take up a good amount of the Uniformity Committee’s time and resources.” (Tax Notes State, May 3, 2021)

## Example – Digital Products

- This is another project recently taken up by the Multistate Tax Commission.
- Focusing on sales taxation of digital products.
- Most states tax only tangible personal property and certain enumerated services.
- New Mexico is one of a handful of states that has long had the advantage of a broad-based sales tax (the gross receipts tax).
- But New Mexico is also faced with one of the biggest challenges facing all states—which is the sourcing of digital products.
- The Streamlined project has been working on this sourcing issue for years.

# New Mexico – Recent Issues

- Change from separate corporate filing to mandatory combined filing.
- Change from origin-based to destination-based sourcing of gross receipts.
- Enacting pass-through entity level tax.
- New tax on cannabis.

# What can the legislature do?

- Make sure the law is as clear as it can be – which is an ongoing process.
- Make sure the Taxation and Revenue Department has resources to issue timely guidance and respond to taxpayer questions.
- Resist changes that make the law more complicated—or look for the least complicated approach to tax policy.
- Look for ways to make New Mexico law more consistent with other states.

**The End**

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