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SENATE BILL 7

50TH LEGISLATURE - STATE OF NEW MEXICO - FIRST SESSION, 2011

INTRODUCED BY

Peter Wirth

AN ACT

RELATING TO TAXATION; AMENDING THE CORPORATE INCOME AND
FRANCHISE TAX ACT TO REQUIRE DEDUCTIBLE INTANGIBLE EXPENSES AND
INTEREST TO BE ADDED BACK IN DETERMINING NET INCOME FOR CERTAIN
ENTITIES.

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF NEW MEXICO:

SECTION 1. Section 7-2A-2 NMSA 1978 (being Laws 1986,
Chapter 20, Section 33, as amended) is amended to read:

"7-2A-2. DEFINITIONS.--For the purpose of the Corporate
Income and Franchise Tax Act and unless the context requires
otherwise:

A. "affiliated group" means that term as it is used
in the Internal Revenue Code;

B. "aggregate effective rate of tax" means the sum
of the effective rates of tax imposed by a state or a United

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1 States possession or any combination thereof on a related
2 member;

3 [B-] C. "bank" means any national bank, national
4 banking association, state bank or bank holding company;

5 [G-] D. "base income" means that part of the
6 taxpayer's income defined as taxable income and upon which the
7 federal income tax is calculated in the Internal Revenue Code
8 for income tax purposes plus, for taxable years beginning on or
9 after January 1, 1991, the amount of the net operating loss
10 deduction allowed by Section 172(a) of the Internal Revenue
11 Code, as that section may be amended or renumbered, and claimed
12 by the taxpayer for that year; "base income" also includes
13 interest received on a state or local bond;

14 [D-] E. "corporation" means corporations, joint
15 stock companies, real estate trusts organized and operated
16 under the Real Estate Trust Act, financial corporations and
17 banks, other business associations and, for corporate income
18 tax purposes, partnerships and limited liability companies
19 taxed as corporations under the Internal Revenue Code;

20 [E-] F. "department" means the taxation and revenue
21 department, the secretary of taxation and revenue or any
22 employee of the department exercising authority lawfully
23 delegated to that employee by the secretary;

24 G. "effective rate of tax" means, as to any state
25 or United States possession, the maximum statutory rate of tax

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1 imposed by the state or possession on a related member's net
2 income multiplied by the apportionment percentage, if any,
3 applicable to the related member under the laws of that
4 jurisdiction. For purposes of this definition, the effective
5 rate of tax as to any state or United States possession is zero
6 where the related member's net income tax liability in the
7 jurisdiction is reported on a combined or consolidated return,
8 including both the taxpayer and the related member where the
9 reported transactions between the taxpayer and the related
10 member are eliminated or offset; provided that when computing
11 the effective rate of tax for a jurisdiction in which a related
12 member's net income is eliminated or offset by a credit or
13 similar adjustment that is dependent upon the related member
14 either maintaining or managing intangible property or
15 collecting interest income in that jurisdiction, the maximum
16 statutory rate of tax imposed by the jurisdiction shall be
17 decreased to reflect the statutory rate of tax that applies to
18 the related member as effectively reduced by the credit or
19 similar adjustment;

20 ~~[F.]~~ H. "fiscal year" means any accounting period
21 of twelve months ending on the last day of any month other than
22 December;

23 I. "intangible expense" means:

24 (1) an expense, loss and cost for, related to
25 or in connection directly or indirectly with the direct or

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1 indirect acquisition, use, maintenance or management,
2 ownership, sale, exchange or other disposition of intangible
3 property to the extent such amount is allowed as a deduction or
4 cost in determining taxable income before operating loss
5 deductions and special deductions for the taxable year under
6 the Internal Revenue Code;

7 (2) an amount directly or indirectly allowed
8 as a deduction under Section 163 of the Internal Revenue Code
9 for purposes of determining taxable income to the extent the
10 expense and cost is directly or indirectly for, related to or
11 in connection with the expense, loss and cost referenced in
12 Paragraph (1) of this subsection;

13 (3) a loss related to, or incurred in
14 connection directly or indirectly with, factoring transactions
15 or discounting transactions;

16 (4) a royalty, patent, technical and copyright
17 fee;

18 (5) a licensing fee; and

19 (6) any other similar expense and cost;

20 J. "intangible property" includes a patent, patent
21 application, trade name, trademark, service mark, copyright,
22 mask work, trade secret and similar type of intangible asset;

23 ~~[G.]~~ K. "Internal Revenue Code" means the United
24 States Internal Revenue Code of 1986, as amended;

25 ~~[H.]~~ L. "net income" means base income adjusted to

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1 exclude:

2 (1) income from obligations of the United
3 States less expenses incurred to earn that income;

4 (2) other amounts that the state is prohibited
5 from taxing because of the laws or constitution of this state
6 or the United States;

7 (3) for taxable years that began prior to
8 January 1, 1991, an amount equal to the sum of:

9 (a) net operating loss carryback
10 deductions to that year from taxable years beginning prior to
11 January 1, 1991 claimed and allowed, as provided by the
12 Internal Revenue Code; and

13 (b) net operating loss carryover
14 deductions to that year claimed and allowed; and

15 (4) for taxable years beginning on or after
16 January 1, 1991, an amount equal to the sum of any net
17 operating loss carryover deductions to that year claimed and
18 allowed, provided that the amount of any net operating loss
19 carryover from a taxable year beginning on or after January 1,
20 1991 may be excluded only as follows:

21 (a) in the case of a timely filed
22 return, in the taxable year immediately following the taxable
23 year for which the return is filed; or

24 (b) in the case of amended returns or
25 original returns not timely filed, in the first taxable year

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1 beginning after the date on which the return or amended return
2 establishing the net operating loss is filed; and

3 (c) in either case, if the net operating
4 loss carryover exceeds the amount of net income exclusive of
5 the net operating loss carryover for the taxable year to which
6 the exclusion first applies, in the next four succeeding
7 taxable years in turn until the net operating loss carryover is
8 exhausted; in no event may a net operating loss carryover be
9 excluded in any taxable year after the fourth taxable year
10 beginning after the taxable year to which the exclusion first
11 applies;

12 [~~F~~] M. "net operating loss" means any net
13 operating loss, as defined by Section 172(c) of the Internal
14 Revenue Code, as that section may be amended or renumbered, for
15 a taxable year as further increased by the income, if any, from
16 obligations of the United States for that year less related
17 expenses;

18 [~~J~~] N. "net operating loss carryover" means the
19 amount, or any portion of the amount, of a net operating loss
20 for any taxable year that, pursuant to Paragraph (3) or (4) of
21 Subsection [~~H~~] L of this section, may be excluded from base
22 income;

23 [~~K~~] O. "person" means any individual, estate,
24 trust, receiver, cooperative association, club, corporation,
25 company, firm, partnership, limited liability company, joint

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1 venture, syndicate or other association; "person" also means,
2 to the extent permitted by law, any federal, state or other
3 governmental unit or subdivision or agency, department or
4 instrumentality thereof;

5 P. "related entity" means:

6 (1) a stockholder who is an individual, or a
7 member of the stockholder's family as set forth in Section 318
8 of the Internal Revenue Code, if the stockholder and the
9 members of the stockholder's family own, directly, indirectly,
10 beneficially or constructively, in the aggregate, at least
11 fifty percent of the value of the taxpayer's outstanding stock;

12 (2) a stockholder, or a stockholder's
13 partnership, limited liability company, estate, trust or
14 corporation, if the stockholder and the stockholder's
15 partnerships, limited liability companies, estates, trusts and
16 corporations own directly, indirectly, beneficially or
17 constructively, in the aggregate, at least fifty percent of the
18 value of the taxpayer's outstanding stock; or

19 (3) a corporation, or a party related to the
20 corporation in a manner that would require an attribution of
21 stock from the corporation to the party or from the party to
22 the corporation under the attribution rules of the Internal
23 Revenue Code, if the taxpayer owns, directly, indirectly,
24 beneficially or constructively, at least fifty percent of the
25 value of the corporation's outstanding stock. The attribution

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1 rules of the Internal Revenue Code shall apply for purposes of
2 determining whether the ownership requirements of this
3 definition have been met;

4 Q. "related member" means a person that, with
5 respect to the taxpayer during all or any portion of the
6 taxable year, is:

7 (1) a related entity;

8 (2) a component member as defined in
9 Subsection (b) of Section 1563 of the Internal Revenue Code;

10 (3) a person to or from which there is
11 attribution of stock ownership in accordance with Subsection
12 (e) of Section 1563 of the Internal Revenue Code; or

13 (4) a person that, notwithstanding its form of
14 organization, bears the same relationship to the taxpayer as a
15 person described in Paragraph (1), (2) or (3) of this
16 subsection;

17 [~~H.~~] R. "secretary" means the secretary of taxation
18 and revenue or the secretary's delegate;

19 [~~M.~~] S. "state" means any state of the United
20 States, the District of Columbia, the commonwealth of Puerto
21 Rico, any territory or possession of the United States or
22 political subdivision thereof or any political subdivision of a
23 foreign country;

24 [~~N.~~] T. "state or local bond" means a bond issued
25 by a state other than New Mexico or by a local government other

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1 than one of New Mexico's political subdivisions, the interest
2 from which is excluded from income for federal income tax
3 purposes under Section 103 of the Internal Revenue Code, as
4 that section may be amended or renumbered;

5 [Ø-] U. "taxable year" means the calendar year or
6 fiscal year upon the basis of which the net income is computed
7 under the Corporate Income and Franchise Tax Act and includes,
8 in the case of the return made for a fractional part of a year
9 under the provisions of that act, the period for which the
10 return is made;

11 [P-] V. "taxpayer" means any corporation subject to
12 the taxes imposed by the Corporate Income and Franchise Tax
13 Act; [~~and~~

14 [Ø-] W. "unitary corporations" means two or more
15 integrated corporations, other than any foreign corporation
16 incorporated in a foreign country and not engaged in trade or
17 business in the United States during the taxable year, that are
18 owned in the amount of more than fifty percent and controlled
19 by the same person and for which at least one of the following
20 conditions exists:

21 (1) there is a unity of operations evidenced
22 by central purchasing, advertising, accounting or other
23 centralized services;

24 (2) there is a centralized management or
25 executive force and centralized system of operation; or

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1 (3) the operations of the corporations are
2 dependent upon or contribute property or services to one
3 another individually or as a group; and

4 X. "valid business purpose" means one or more
5 business purposes, other than the avoidance or reduction of
6 taxation, which alone or in combination constitute the primary
7 motivation for a business activity or transaction, which
8 activity or transaction changes in a meaningful way, apart from
9 tax effects, the economic position of the taxpayer. The
10 economic position of the taxpayer includes an increase in the
11 market share of the taxpayer or the entry by the taxpayer into
12 new business markets."

13 SECTION 2. Section 7-2A-3 NMSA 1978 (being Laws 1981,
14 Chapter 37, Section 36, as amended) is amended to read:

15 "7-2A-3. IMPOSITION AND LEVY OF TAXES.--

16 A. A tax to be known as the "corporate income tax"
17 is imposed at the rate specified in the Corporate Income and
18 Franchise Tax Act upon the net income of every domestic
19 corporation and upon the net income of every foreign
20 corporation employed or engaged in the transaction of business
21 in, into or from this state or deriving any income from any
22 property or employment within this state.

23 B. A tax to be known as the "corporate franchise
24 tax" is imposed in the amount specified in the Corporate Income
25 and Franchise Tax Act upon every domestic corporation and upon

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1 every foreign corporation employed or engaged in the
2 transaction of business in, into or from this state or deriving
3 any income from any property or employment within this state
4 and upon every domestic or foreign corporation, whether engaged
5 in active business or not, but having or exercising its
6 corporate franchise in this state.

7 C. For purposes of determining net income subject
8 to the tax imposed pursuant to this section, a taxpayer shall
9 add back otherwise deductible intangible expenses directly or
10 indirectly paid, accrued or incurred in connection with one or
11 more direct or indirect transactions with one or more related
12 members. For purposes of this subsection:

13 (1) if the related member was subject to tax
14 in this state, another state, a possession of the United States
15 or a foreign nation or some combination thereof on a tax base
16 that included the intangible expense paid, accrued or incurred
17 by the taxpayer, the taxpayer shall receive a credit against
18 tax due in this state in an amount equal to the higher of the
19 tax paid by the related member with respect to the portion of
20 its income representing the intangible expense paid, accrued or
21 incurred by the taxpayer, or the tax that would have been paid
22 by the related member with respect to that portion of its
23 income if that portion of its income had not been offset by
24 expenses or losses, or the tax liability had not been offset by
25 a credit; provided that:

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1 (a) the credit determined to be due
2 shall be multiplied by the apportionment factor of the taxpayer
3 in this state; and

4 (b) in no case shall the credit exceed
5 the taxpayer's liability in this state attributable to the net
6 income taxed as a result of the adjustment required by this
7 subsection; and

8 (2) the adjustment required by this subsection
9 and the credit allowed in Paragraph (1) of this subsection
10 shall not apply:

11 (a) to the portion of the intangible
12 expense that the taxpayer establishes by clear and convincing
13 evidence meets both of the following requirements: 1) the
14 related member during the same taxable year directly or
15 indirectly paid, accrued or incurred that portion to a person
16 that is not a related member; and 2) the transaction giving
17 rise to the intangible expense between the taxpayer and the
18 related member was undertaken for a valid business purpose;

19 (b) if the taxpayer establishes by clear
20 and convincing evidence of the type and in the form determined
21 by the secretary that: 1) the related member was subject to
22 tax on its net income in this state or another state or a
23 possession of the United States or some combination thereof; 2)
24 the tax base for that tax included the intangible expense paid,
25 accrued or incurred by the taxpayer; and 3) the aggregate

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1 effective rate of tax applied to the related member is no less
2 than the rate imposed pursuant to Section 7-2A-5 NMSA 1978;

3 (c) if the taxpayer establishes by clear
4 and convincing evidence of the type and in the form specified
5 by the secretary that: 1) the intangible expense was paid,
6 accrued or incurred to a related member organized under the
7 laws of a country other than the United States; 2) the related
8 member's income from the transaction was subject to a
9 comprehensive income tax treaty between that other country and
10 the United States; 3) the related member's income from the
11 transaction was taxed in that other country at a tax rate at
12 least equal to that imposed by this state; and 4) the
13 intangible expense was paid, accrued or incurred pursuant to a
14 transaction that was undertaken for a valid business purpose
15 and using terms that reflect an arm's-length relationship; or

16 (d) if the taxpayer and the secretary
17 agree in writing to the application or use of alternative
18 adjustments or computations provided that the secretary agrees
19 to the use or application of alternative adjustments or
20 computations only after the secretary has concluded that, in
21 the absence of the agreement, the income of the taxpayer would
22 not be properly reflected.

23 D. For purposes of determining net income subject
24 to the tax imposed pursuant to this section, a taxpayer shall
25 add back otherwise deductible interest paid, accrued or

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1 incurred to a related member during the taxable year. For the
2 purposes of this subsection:

3 (1) if the related member was subject to tax
4 in this state, another state, a possession of the United States
5 or a foreign nation or some combination thereof on a tax base
6 that included the interest expense paid, accrued or incurred by
7 the taxpayer, the taxpayer shall receive a credit against tax
8 due in this state in an amount equal to the higher of the tax
9 paid by the related member with respect to the portion of its
10 income representing the interest expense paid, accrued or
11 incurred by the taxpayer, or the tax that would have been paid
12 by the related member with respect to that portion of its
13 income if that portion of its income had not been offset by
14 expenses or losses, or the tax liability had not been offset by
15 a credit; provided that:

16 (a) the credit determined to be due
17 shall be multiplied by the apportionment factor of the taxpayer
18 in this state; and

19 (b) in no case shall the credit exceed
20 the taxpayer's liability in this state attributable to the net
21 income taxed as a result of the adjustment required by this
22 subsection; and

23 (2) the adjustment required by this subsection
24 and the credit allowed in Paragraph (1) of this subsection
25 shall not apply:

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1 (a) if the taxpayer establishes by clear
2 and convincing evidence of the type and in the form determined
3 by the secretary that the transaction between the taxpayer and
4 the related member giving rise to the interest expense was
5 undertaken for a valid business purpose and the interest
6 expense was paid, accrued or incurred using terms that reflect
7 an arm's-length relationship;

8 (b) if the taxpayer establishes by clear
9 and convincing evidence of the type and in the form determined
10 by the secretary that: 1) the related member was subject to
11 tax on its net income in this state, another state or a
12 possession of the United States or some combination thereof; 2)
13 the tax base for the tax included the interest expense paid,
14 accrued or incurred by the taxpayer; and 3) the aggregate
15 effective rate of tax applied to the related member is no less
16 than the tax rate imposed pursuant to Section 7-2A-5 NMSA 1978;

17 (c) if the taxpayer establishes by clear
18 and convincing evidence of the type and in the form specified
19 by the secretary that: 1) the interest expense was paid,
20 accrued or incurred to a related member organized under the
21 laws of a country other than the United States; 2) the related
22 member's income from the transaction was subject to a
23 comprehensive income tax treaty between that other country and
24 the United States; 3) the related member's income from the
25 transaction was taxed in that other country at a tax rate at

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1 least equal to that imposed by this state; and 4) the interest
2 expense was paid, accrued or incurred pursuant to a transaction
3 that was undertaken for a valid business purpose and using
4 terms that reflect an arm's-length relationship; or

5 (d) if the taxpayer and the secretary
6 agree in writing to the application or use of alternative
7 adjustments or computations; provided that the secretary agrees
8 to the use or application of alternative adjustments or
9 computations only after the secretary has concluded that, in
10 the absence of the agreement, the income of the taxpayer would
11 not be properly reflected."

12 SECTION 3. APPLICABILITY.--The provisions of this act are
13 applicable to taxable years beginning on or after January 1,
14 2012.