May 21, 2013

NEW MEXICO 2013 TAX LEGISLATION UPDATE

The recently concluded 2013 regular session of the New Mexico Legislature resulted in legislation enacting several significant changes to New Mexico's tax programs, the majority of which are business friendly. Most of the legislation was promoted as making New Mexico more attractive to new investment that will retain and create new jobs for New Mexicans. The effect or potential effect of the legislative changes will vary depending on business-specific facts. New Mexico taxpayers or those considering investing in or doing business in New Mexico in the future should evaluate the changes outlined below to determine the impact, if any, on their business model.

I. INCOME/FRANCHISE TAXES

The 2013 New Mexico Legislature saw considerable activity intended to make New Mexico's corporate income tax more competitive with that imposed by other states. Much of the legislation passed was part of an economic development package advanced by Governor Martinez's administration found in what became an omnibus tax bill, House Bill 641, put together in a chaotic last 18 hours of the session in mid-March.

A. Rate Reduction

House Bill 641, § 3, provides for a phased-in reduction of the current top marginal corporate income tax rate of 7.6% to 5.9% over the course of five years. The initial reduction will be in 2014 to 7.3%, followed in successive years by 6.9%, 6.6%, 6.2% and 5.9% in 2018. The lowest marginal rate will remain at 4.8%. The reduction will make New Mexico more competitive with surrounding states from a rate perspective.

B. Single Weighted Sales Factor Apportionment for Manufacturers

House Bill 641, § 7, provides manufacturers an election to use a single weighted sales factor for income tax apportionment that will phase in over five years. States use income tax apportionment formulas to apportion a portion of the income of a business with multistate operations to an individual state. Historically, many states used very similar formulas, but over time states have enacted variants intended to promote business interests in their state.

The 2013 legislation is similar to that now found in many states with which New Mexico competes for capital investment. The single sales factor legislation is intended to retain and attract manufacturing investment in New Mexico by apportioning business income solely based upon an apportionment factor that is the amount of New Mexico sales divided by sales everywhere. This is advantageous for manufacturers whose customers are primarily outside of New Mexico.

The election is binding for a minimum of three years. The election is not available for utility power generation or natural resources processing, construction or farming. Another aspect of the single sales factor election is that the "throwback" rule found in New Mexico's current version of UDITPA does not apply to manufacturers making the election. The throwback rule places sales revenue not taxable in other states where sales occur in the New Mexico portion of the sales factor.

C. Mandatory Unitary Combined Filing for "Big Box" Retailers Only

While many states require mandatory combined unitary group filing, in 2013, New Mexico came up with

©2013 Brownstein Hyatt Farber Schreck, LLP
All Rights Reserved. Attorney Advertisement.

its own unique flavor that solely targets large national retailers. The Corporate Income and Franchise Tax Act has long provided for elective unitary combined filing of corporate income tax returns, along with separate entity filing and use of a federal consolidated group method. For about the last 10 years, some legislators have called for mandatory combined unitary filing for unitary groups as a way to combat perceived tax-planning advantages to large out-of-state businesses who file on a separate entity basis. That legislation was backed largely by public and private employee unions, and some social service advocacy organizations that demonized large retailers who in their opinion paid substandard wages and benefits.

After many years that saw a variety of proposals for mandatory unitary combined filing, House Bill 641, § 4, provides for mandatory unitary combined filing of corporate income tax returns starting January 1, 2014, for “a unitary corporation that provides retail sales of goods in a facility of more than thirty thousand square feet under one roof in New Mexico.” There is an exception to the “big box” requirement if the unitary corporation has nonretail operations in New Mexico that employ at least 750 employees. Potentially qualifying facilities may include distribution centers, call centers or back office operations.

There is some concern that the 2013 legislation may be only the beginning of a broader mandatory unitary combined filing regime in New Mexico, with attempts in later years to expand the requirement to other or all industries. Of note, Governor Martinez vetoed a very similar stand-alone mandatory unitary combined filing bill in 2012 as a “tax increase,” but accepted this version as part of a package containing many items that she wanted.

D. Refundable Film and Television Production Tax Credit
House Bill 641, §§ 5 and 6, increased the existing film and television production tax credit by 5% from 25% to 30% for television series productions intended for commercial distribution for: 1) a television series production with an order for at least six episodes in a single season with a budget of at least $50,000 per episode; 2) a production with a total budget for salaries and wages, excluding performing artists, of not more than $30 million that shoots at least 10 principal photography days at a qualified production facility in New Mexico; or, 3) a production with a total budget for salaries and wages, excluding performing artists, of more than $30 million that shoots at least 15 principal photography days at a qualified production facility in New Mexico. The bill also allows for the carry over and payout of unused credits below the $50 million annual aggregate credit cap imposed two years ago in fiscal years 2013 through 2015.

The concept behind the bill was that multiyear television productions tend to create longer-term jobs in New Mexico, for New Mexico residents, than one-time film productions that come and go. Governor Martinez campaigned for election in 2010 in part by bashing the film production tax credit as a cozy giveaway to Hollywood and the entertainment unions by her Democratic predecessor, Bill Richardson. Since she signed the 2013 legislation, Governor Martinez has made several statements in strong support of the film and television industry in New Mexico. There seems to be some fence mending with the entertainment industry that may indeed contribute substantially to New Mexico’s economy.

©2013 Brownstein Hyatt Farber Schreck, LLP
All Rights Reserved. Attorney Advertisement.

E. High Wage Jobs Tax Credit
House Bill 641, § 10, narrowed the High Wage Jobs Tax Credit by: 1) excluding reorganized businesses from the credit; 2) clarifying that exported goods providing the basis for the credit must be "produced" within New Mexico; and, 3) increasing the new job salary and benefit thresholds for credit qualification.

F. Potential Issues for the Future
One issue to keep an eye on is treatment of foreign dividends for entities filing not on a separate entity basis, but either unitary combined or federal consolidated. At least to date, the Taxation and Revenue Department has taken the position that the Kraft decision of the United States Supreme Court applying the Foreign Commerce Clause only bars taxation of foreign dividends received by separate entity filers.

II. GROSS RECEIPTS TAX
New Mexico's primary transactional taxes are the gross receipts tax, similar in many ways to sales taxes in most states, though with some material differences, and the compensating tax, a use tax. The gross receipts tax is different than most sales taxes in several ways, including the fact that it is much more broadly based and is imposed on most services performed in New Mexico. The 2013 New Mexico Legislature saw some activity on the gross receipts tax front, though far less than in 2012.

A. Manufacturing Consumables, Round 2
The primary 2013 gross receipts tax legislative development was amendment of the gross receipts tax deduction in NMSA 1978, § 7-9-46, enacted in 2012 for receipts from selling consumables to manufacturers. After enactment of the deduction in 2012, closer analysis revealed that as drafted, it would have a far greater fiscal impact on gross receipts tax revenue than understood at the time of passage. The 2013 Legislature set out to narrow its scope, but some items arguably not covered by the 2012 legislation were added. The primary exclusions were tangible personal property consumed to generate electricity (primarily coal and natural gas), process natural resources and to prepare food in restaurants and similar facilities. The express statutory additions were repair parts and spares used in a manufacturing process.

B. Additional Local Option Gross Receipts Tax Authority
In part to "pay for" some of the income tax reforms outlined above, the Legislature phased out "hold harmless" payments currently made from the state general fund to counties and municipalities. When the Legislature enacted deductions for receipts from selling groceries and medical services in 2004, part of the package was reimbursement out of the state general fund to local governments for revenue lost due to those two deductions. House Bill 641, § 1, phases out that reimbursement over the course of 15 years starting in 2015, but, at the same time, House Bill 641, §§ 11 and 12, provides municipalities and counties authority to impose up to 0.375% of additional local option gross receipts tax to replace the lost reimbursement.

C. Payment of Gross Receipts Tax by Third Party
For tax periods beginning on or after May 1, 2013, House Bill 315 provides the Taxation and Revenue Department authority to allow a gross receipts taxpayer to assign its payment obligation to a third party pursuant to an agreement. Under the agreement, the third party agrees to assume all the rights and responsibilities of the taxpayer for a stated period of time except application for tax credits and refunds against the tax. The third party must: 1) be in a business relationship with the taxpayer; 2) a

©2013 Brownstein Hyatt Farber Schreck, LLP
All Rights Reserved. Attorney Advertisement.

manufacturer paying gross receipts tax on behalf of a utility as to electricity consumed in manufacturing processes; or, 3) a "direct sales company" paying on behalf of its distributors. The bill in effect codifies a little known form used by the Taxation and Revenue Department for many years, Form TS-22, that has allowed one to pay tax of another. If such an agreement is not in place, the Department takes the position that the taxpayer owes tax even if paid on its behalf by another, causing an assessment for the taxpayer and at times a refund claim by the payor.

D. Locomotive Fuel
House Bill 120 expanded the deduction for receipts from selling locomotive fuel to a common carrier railroad in NMSA 1978, § 7-9-110.3, to all railroads engaging in new construction, renovations or infrastructure improvements in New Mexico above stated investment thresholds. The bill made the deduction available to railroads other than the Union Pacific, which was the beneficiary of the initial statutory language intended to attract it to build an intermodal freight facility in far southeastern New Mexico near El Paso where Union Pacific had a similar facility.

III. TAX ADMINISTRATION
House Bill 299 made several changes to the Tax Administration Act that governs administration of most New Mexico taxes other than the property tax. The bill was largely intended to clarify prior ambiguities and make the act more taxpayer friendly. The changes are effective July 1, 2013.

A. Time to File Protest Extended to 90 Days
Sections 2 and 6 simplify the current statutory scheme that requires a protest within 30 days for assessment or demand for payment, unless an additional 60 days is requested, to simply provide for a full 90 days without the need to request the 60-day extension. Section 6 also clarifies triggering dates for the 90-day period.

B. Protest Hearing Dates to Be Set Within 90 Days of Protest Filing
Section 7 requires a Department administrative hearing officer to set a hearing date within 90 days of the filing of a protest. The Chief Hearing Officer advises that in matters in which an attorney represents a taxpayer, there will be a telephonic scheduling conference within 90 days of the protest filing, with reasonable extensions provided upon request. Her thought is that most protests can be set for hearing within six to nine months of filing.

C. Grounds for Administrative Protest
Section 6 clarifies that one may file an administrative protest of a denial of a credit or rebate. The current version of the Administration Act is arguably ambiguous as to whether denial of a credit or rebate may be challenged by administrative protest or can only be challenged in court.

D. Administrative Protest Process
Section 7 outlines the administrative protest process in detail not previously found in statute or regulation.

E. Credit Claim Added to Refund Statute
Section 8 amends NMSA 1978, § 7-1-26, that previously governed solely claims for refund to also address credit claims, including the right to file suit in district court to contest denial of a credit.

©2013 Brownstein Hyatt Farber Schreck, LLP
All Rights Reserved. Attorney Advertisement.

201 Third Street NW, Suite 1700
Albuquerque, NM 87102,4386

F. Payment of Gross Receipts Tax by Someone Other Than Taxpayer
Section 9, among other things, allows the Taxation and Revenue Department to abate assessed tax if it was paid by a third party on behalf of a taxpayer "provided that the requirements of equitable recoupment are met." The concept of equitable recoupment is found in New Mexico case law and applies in narrowly defined circumstances. The Department and its hearing officers had previously taken the position that only the courts, not the Department or hearing officers, could grant equitable relief.

Tim Van Valen
Shareholder
Albuquerque
tvanvalen@bhfs.com
505.724.9582

This document is intended to provide you with general information regarding New Mexico Tax Updates. The contents of this document are not intended to provide specific legal advice. If you have any questions about the contents of this document or if you need legal advice as to an issue, please contact the attorney listed above or your regular Brownstein Hyatt Farber Schreck, LLP attorney. This communication may be considered advertising in some jurisdictions.

©2013 Brownstein Hyatt Farber Schreck, LLP
All Rights Reserved. Attorney Advertisement.