TAXATION & REVENUE
NEW MEXICO

Michelle Lujan Grisham
Governor

Stephanie Schardin Clarke
Cabinet Secretary

DIVISIONS

Office of the Secretary
(505) 827-0341
Administrative Services
(505) 827-0369
Audit and Compliance
(505) 827-0900
Motor Vehicle
(505) 827-2296
Property Tax
(505) 827-0870
Revenue Processing
(505) 827-0800
Tax Fraud Investigation
(505) 841-5578

Office of the Secretary

January 26, 2021

Enclosed is the following proposal:

The New Mexico Taxation and Revenue Department hereby gives notice as required under Section 14- 4-5.2 NMSA 1978 and 1.24.25.11 NMAC that it proposes to amend, repeal and replace, and adopt the following rules as authorized by Section 9-11-6.2 NMSA 1978:

Purpose: The proposed rules are to reflect the 2019 legislative session changes in House Bill 6 to the Corporate Income Tax Act and the Uniform Division of Income for Tax Purposes Act and provide clarity to the public on both prior law and changes that are effective for the 2020 tax year.

Summary of Proposed Changes: The New Mexico Taxation and Revenue Department proposes to amend/repeal/replace the following rules:

Corporate Income and Franchise Tax Act

3.4.1.9 NMAC *(Net Operating Losses)*	Section 7-2A-2 NMSA 1978
3.4.1.10 NMAC *(Income from Obligations of Governments)*	Section 7-2A-2 NMSA 1978
3.4.1.11 NMAC *(Base Income for Filing as a Separate Corporate Entity)*	Section 7-2A-2 NMSA 1978
3.4.1.12 NMAC *(Foreign Source Dividends)*	Section 7-2A-2 NMSA 1978
[NEW] 3.4.1.13 *(Foreign Source Dividends After January 1, 2020)*	Section 7-2A-2 NMA 1978
[NEW] 3.4.1.14 NMAC *(Unitary Business)*	Section 7-2A-2 NMSA 1978
3.4.10.7 NMAC *(Definitions)*	Section 7-2A-8 NMSA 1978
3.4.10.8 NMAC *(Reporting Methods)*	Section 7-2A-8.3 NMSA 1978
3.4.10.9 NMAC *(Separate Accounting; Computation of Net Operating Losses)*	Section 7-2A-8 NMSA 1978
3.4.10.11 NMAC *(Combined Returns)*	Section 7-2A-8.3 NMSA 1978
[New] 3.4.10.12 NMAC *(Consolidated Filing Election)*	Section 7-2A-8.3 NMSA 1978
[NEW] 3.4.10.14 NMAC *(Computation of Base and Net Income – Applicable to Periods Beginning on or After January 1, 2020)*	Section 7-2A-2 NMSA 1978
[NEW] 3.4.10.15 NMAC	Section 7-2A-2 NMSA 1978

(Net Operating Losses of Filing Groups – Applicable to Tax Years Beginning on or After January 1, 2020)
[NEW] 3.4.10.16 NMAC Section 7-2A-3 NMSA 1978
(Obligations of Excluding Corporations to File a Return)

[NEW] 3.4.14.11 NMAC Section 7-2A-9.2 NMSA 1978
(Tax Credits; Applicability to Unitary Groups)

Uniform Division of Income for Tax Purposes Act

3.5.4.9 NMAC Section 7-4-4 NMSA 1978
(Taxable in Another State - When a Taxpayer is "Subject To" a Tax:)
3.5.4.10 NMAC Section 7-4-4 NMSA 1978
(Taxable in Another State - When a State has Jurisdiction to Subject a Taxpayer to a Net Income Tax)
[New] 3.5.4.11 NMAC Section 7-4-4 NMSA 1978
(Taxable in Another State - When a Taxpayer is "Subject to" a Tax - for Tax Periods Beginning on or After January 1, 2020)

3.5.10.8 NMAC Section 7-4-10NMSA 1978
(Apportionment Formula:)

[New] 3.5.16.11 NMAC Section 7-4-16 NMSA 1978
(Effect of Combined Filing on the Sales Factor)

3.5.18.8 NMAC Section 7-4-18 NMSA 1978
(Sales Factor - Sales Other Than Sales of Tangible Personal Property in This State:)
[New] 3.5.18.9 NMAC Section 7-4-18 NMSA 1978
(Sales Factor - Sales Other Than Sales of Tangible Personal Property in This State – Applicable to Tax Years Beginning on or After January 1, 2020)

Hearing Date: Notice of public rule hearing: A public hearing will be held on the proposed rule changes on Thursday, February 25, 2021, at 1:00 p.m. through the internet, email, and telephonic means in response to concerns surrounding COVID-19 and in accordance with Executive Order 2020-004, Declaration of a Public Health Emergency, and the March 12, 2020 Public Health Emergency Order to Limit Mass Gatherings Due to COVID-19.

Technical Information: No technical or scientific information was consulted in drafting these proposed rule changes.

Public Hearing Location: The Public Hearing will be accessible via WebEx by going https://nm-tax.webex.com/nm-tax/j.php?MTID=m54ada1b7d3b9821f418e965b12c66135 or by telephone by dialing 1-415-655-0001 and using the meeting number (access code) 132 999 0384 Password 02252021. Any oral comments made during this hearing will be recorded and any electronic written comments can be submitted during the hearing at policy.office@state.nm.us.

How to participate: Individuals with disabilities who need any form of auxiliary aid to attend or participate in the public hearing are asked to contact Bobbie Marquez at BobbieJ.Marquez@state.nm.us. The Taxation and Revenue Department will make every effort to accommodate all reasonable requests

but cannot guarantee accommodation of a request that is not received at least ten calendar days prior to the scheduled hearing.

Complete Copies of the proposed rule changes can be found at www.tax.newmexico.gov/proposed-regulations-hearing-notices.aspx or are available upon request by contacting the Tax Policy Office at policy.office@state.nm.us.

The copies of the proposed amended and repealed rules were placed on file in the Office of the Secretary on January 11, 2021. Pursuant to Section 9-11-6.2 NMSA 1978 of the Taxation and Revenue Department Act, the final rules, if filed, will be filed as required by law on or about March 12, 2021.

When are comments due: Written comments on the proposals can submitted by email to policy.office@state.nm.us or by mail to the Taxation and Revenue Department, Tax Information and Policy Office, Post Office Box 630, Santa Fe, New Mexico 87504-0630 or on or before February 25, 2021. All written comments received by the agency will be posted on www.tax.newmexico.gov no more than 3 business days following receipt to allow for public review.

Stephanie Schardin Clarke

Digitally signed by Stephanie Schardin Clarke
Date: 2021.01.13 16:07:23 -07'00'

Stephanie Schardin Clarke
Cabinet Secretary

3.4.1.9 [~~**NET OPERATING LOSSES**~~

~~A. Net operating losses; generated by deduction of income from United States obligations.~~

~~**(1)** If the exclusion of income from obligations of the United States of America results in a negative amount for New Mexico net income for a taxable year, the resulting negative amount may be deemed to be a net operating loss for that taxable year. The taxpayer must establish the loss from exclusion of income from obligations of the United States of America by filing a New Mexico return or amended return within the time period set forth in Section 7-2A-9 NMSA 1978 and Subsections B, C and E of Section 7-1-26 NMSA 1978. An amended return carrying back or forward any such net operating loss must be filed within the time period set forth in Subsection 7-1-26B NMSA 1978. The taxpayer shall apply relevant provisions of 26 U.S.C. Section 172 of the Internal Revenue Code to determine the years to which the net operating loss may be applied.~~

~~**(2)** Any net operating loss deemed created by this subsection (3.4.1.9A NMAC) may be carried back or forward in accordance with the provisions of Section 7-2A-2 NMSA 1978 and Subsections B through E of Section 3.4.1.9 NMAC. For taxable years beginning prior to January 1, 1991, the resulting taxable income shall then be allocated and apportioned in that year pursuant to the provisions of Section 7-2A-8 NMSA 1978.~~

~~**(3)** Example: For 1986, B Corporation reported $100,000 of federal taxable income on line 30 of its federal corporate income tax form 1120. During 1986, B corporation received $150,000 of interest income from United States obligations that was included in its federal taxable income. In preparing its 1986 New Mexico income tax form CIT-1, B corporation would report $100,000 of income on line 2 of page 1 of the form CIT-1 and would report $150,000 of interest from United States obligations on line 3 of page 1. Because the amount on line 3 of page 1 of the form CIT-1 is greater than the amount on line 2 of page 1, B corporation will report a negative amount of $50,000 as New Mexico net income. B corporation may carry the negative net income amount of $50,000 either back or forward as if that amount were a net operating loss being carried back or forward under the provisions of the Internal Revenue Code. B corporation reported $75,000 of New Mexico net income for 1983; therefore it could carry back the negative $50,000 amount of New Mexico net income from 1986 to reduce its 1983 New Mexico net income to $25,000. B corporation would be required to file an amended form CIT-1 for the year of 1983 to reflect the reduction of the federal taxable income for 1983 by the $50,000 negative net income for 1986. The federal taxable income on the amended form CIT-1 for 1983 would, therefore, reflect an adjusted amount of $25,000. In that amended return, B corporation would recompute its New Mexico net taxable income for 1983 based upon this adjustment.~~

~~**(4)** This version of Subsection 3.4.1.9A NMAC retroactively applies to taxable years beginning on or after January 1, 1991.~~

~~**B.** Net operating losses; time limitation.~~

~~**(1)** A net operating loss, including any net operating loss deemed created pursuant to Subsection 3.4.1.9A NMAC, for a taxable year may be excluded from the base income of any other taxable year only if the net operating loss for the taxable year is established by the filing of a return, either original or amended, within the time periods set forth in Subsections B, C and E of Section 7-1-26 NMSA 1978.~~

~~**(2)** Example: In 1997, a corporation that reports income tax on a calendar year basis discovers an error which relates to its state returns for 1990 and 1993. The original 1990 and 1993 returns were timely filed in 1991 and 1994, respectively. Absent the time limitations on filing amended returns, correcting the error through filing of amended returns would create net operating losses in both 1990 and 1993. An amended return may be filed only for 1993 and only the 1993 loss may be excluded from the base income of any other year.~~

~~**(3)** This subsection (3.4.1.9B NMAC) retroactively applies to taxable years beginning on or after January 1, 1991.~~

~~**C**. Net operating losses; must be deductible for federal income tax purposes.~~

~~**(1)** The net operating loss carryover of a corporation or corporations acquired by the taxpayer or otherwise included, as for example, through a change in reporting method, in the taxpayer's return for a taxable year may be excluded from New Mexico base income only to the extent the Internal Revenue Code and regulations issued thereunder would permit deduction of such loss carryovers for federal income tax purposes for that taxable year by that taxpayer.~~

~~**(2)** This subsection (3.4.1.9C NMAC) retroactively applies to taxable years beginning on or after January 1, 1991.~~

~~**D.** Net operating losses; carryover and carryback rules for taxable years beginning after 1990.~~

~~**(1)** For taxable years beginning on or after January 1, 1991, any corporate net operating loss for federal tax purposes and any net operating loss deemed created pursuant to Subsection 3.4.1.9A NMAC may be carried forward only. These loss carryovers may be excluded from base income only for five years or until the total amount of the loss carryover has been excluded, whichever occurs first. The first year in which the loss carryover may be excluded from base income is:~~

~~**(a)** in the case of a timely filed original return, the next taxable year; and~~

~~**(b)** in all other cases, the first taxable year after the date on which the return establishing the loss is filed, not the next taxable year following the taxable year in which the loss occurred.~~

~~**(2)** Example: Corporation B reports for tax purposes on a calendar year basis. In June, 1993, B files an amendment to its timely filed 1991 original New Mexico corporate income and franchise tax return. The 1991 original return showed a net operating profit. As a result of the amendment to the 1991 return, a net operating loss is generated for 1991. B may first apply the 1991 net operating loss generated by the amended return to B's New Mexico corporate income and franchise tax return for 1994. B may not apply this net operating loss to 1992 or 1993.~~

~~**(3)** For taxable years beginning on or after January 1, 1991, net operating loss carryovers must be applied in the following order:~~

~~**(a)** net operating loss carryovers from taxable years beginning prior to January 1, 1991, beginning with the carryover from the oldest taxable year; and~~

~~**(b)** net operating loss carryovers from taxable years beginning on or after January 1, 1991, beginning with the carryover from the oldest year.~~

~~**(4)** Example: Z corporation began operations January 1, 1988 and has timely filed (on a calendar year basis) its income tax returns every year. Z reported a net operating profit in 1988, a net operating profit of zero in 1989 and a net operating loss in 1990 which exceeded its 1988 profit by $5,000. Z sustains another net operating loss of $11,000 for 1991 but reports a net operating profit of $8,000 for 1992. In applying its loss carryovers, Z must first apply the net operating loss from 1990 to 1988. On its 1992 return, Z first applies the $5,000 carryover balance originating from 1990 and then the loss carryover deriving from 1991.~~

~~**(5)** For taxable years beginning on or after January 1, 1991, any corporation excluding a net operating loss carryover from a prior taxable year must attach to the New Mexico return for that taxable year a schedule showing the taxable year in which each net operating loss being carried forward occurred, the amount of each loss excluded in each taxable year following the taxable year in which the loss occurred and the amount of the loss being applied to the taxable year for which the return is being filed.~~

~~**(6)** For any taxable year beginning on or after January 1, 1991, the net operating loss for that taxable year may not be carried back to any preceding taxable year.~~

~~**(7)** This subsection (3.4.1.9D NMAC) retroactively applies to taxable years beginning on or after January 1, 1991.~~

~~**E.** Net operating losses; carryover and carryback rules for taxable years beginning before 1991.~~

~~**(1)** For taxable years beginning prior to January 1, 1991, any net operating loss, including any net operating loss deemed created pursuant to Subsection 3.4.1.9A NMAC, may be carried forward or carried back to any other taxable year beginning prior to January 1, 1991 in accordance with the provisions of the Internal Revenue Code unless contrary to the provisions of the Corporate Income and Franchise Tax Act and Title 3 Chapter 4 NMAC.~~

~~**(2)** For taxable years beginning prior to January 1, 1991, a net operating loss, including any net operating loss deemed created pursuant to Subsection 3.4.1.9A NMAC, may be carried back only to those prior taxable years for which a corporate income and franchise tax return was originally due, without regard to any extension, in the period beginning with the January 1 of the third calendar year preceding the calendar year in which began the taxable year for which the loss is established and ending with the day before the first day of the taxable year for which the loss is established.~~

~~**(3)** Example: D corporation files on a fiscal year basis. Its fiscal year ends April 30. In September, 1993, D files an amended corporate income and franchise tax return for its taxable year starting May 1, 1989 and ending April 30, 1990. The amendment establishes a net operating loss for that taxable year. The oldest year to which D may carry back the net operating loss is its taxable year beginning May 1, 1985 and ending April 30, 1986, the return for which was originally due July 15, 1986.~~

~~**(4)** This subsection (3.4.1.9E NMAC) retroactively applies to taxable years beginning on or after January 1, 1991.~~] **[RESERVED]**

[8/10/89, 1/7/92, 1/15/1997; 3.4.1.9 NMAC - Rn & A, 3 NMAC 4.1.9, 12/14/2000; R, xx/xx/xxxx]

3.4.1.10 INCOME FROM OBLIGATIONS OF GOVERNMENTS

A. Income from United States government obligations.

(1) Income from obligations issued by the United States are not includable in net income.

(2) Because they are not obligations of the United States, income from investment in the following is includable in net income:

(a) financial instruments guaranteed by the federal national mortgage association ("Fannie Maes"), the government national mortgage association ("Ginnie Maes"), the federal national home loan association ("Freddie Macs") and any similar organization whose income states are not prohibited by federal law from subjecting to income taxation;

(b) financial instruments issued by the college construction loan insurance corporation or the national consumer cooperative bank;

(c) agreements ("repo's") to sell and repurchase United States government obligations; and

(d) agreements ("reverse repo's") to purchase and resell United States government obligations.

[~~**(3)** This version of this subsection (3.4.1.10A NMAC) retroactively applies to taxable years beginning on or after January 1, 1991.~~]

B. Income from obligations of Puerto Rico and territories and possessions of the United States.

[~~**(1)**~~] Income from obligations of the commonwealth of Puerto Rico and of Guam, the Virgin Islands, American Samoa, Northern Mariana Islands and other territories or possessions of the United States are includable in net income only to the extent that inclusion is not prohibited by federal law. Income from such obligations which New Mexico is prohibited from taxing by the laws of the United States may be deducted from net income.

[~~**(2)** This subsection (3.4.1.10B NMAC) retroactively applies to taxable years beginning on or after January 1, 1992~~.]

C. Exclusion of certain income from mutual funds or trusts.

(1) Income from investments in mutual funds, unit investment trusts or simple trusts which are invested in obligations of the United States, obligations of the state of New Mexico or its agencies, institutions, instrumentalities or political subdivisions or obligations of the commonwealth of Puerto Rico or territories or possessions of the United States may be deducted from net income to the extent that such investment income is nontaxable income provided that:

(a) for the purposes of this subsection (3.4.1.10C NMAC), "nontaxable income" means income from investments in obligations of:

(i) the United States;

(ii) the state of New Mexico or any of its agencies, institutions, instrumentalities or political subdivisions;

(iii) the commonwealth of Puerto Rico, the income from which obligations states are prohibited from taxing by the laws of the United States; and

(iv) Guam, the Virgin Islands, American Samoa, Northern Mariana Islands or other territories or possessions of the United States, the income from which obligations states are prohibited from taxing by the laws of the United States; and

(b) the mutual fund, unit investment trust or simple trust provides to the investor an annual statement of the income, by source, which was distributed to the individual investor.

(2) Only that amount of income may be deducted which is shown on the statement as flowing through to the investor from obligations of the United States, of the commonwealth of Puerto Rico, of Guam, the Virgin Islands, American Samoa, Northern Mariana Islands or other territories or possessions of the United States or of the state of New Mexico or any of its agencies, institutions, instrumentalities or political subdivisions.

[~~**(3)** This subsection (3.4.1.10C NMAC) applies to taxable years beginning on or after January 1, 1991.~~]

D. Expenses related to certain investment income.

(1) Because this investment income is exempt from income taxation by New Mexico, expenses of the taxpayer related to the earning of income from investments, directly or through mutual funds, unit

investment trusts or simple trusts, in obligations of the United States, obligations of the state of New Mexico or its agencies, institutions, instrumentalities or political subdivisions or obligations of the commonwealth of Puerto Rico or territories or possessions of the United States may not be deducted from net income. To the extent that such expenses have been deducted in determining federal taxable income, the amount must be added back to net income.

(2) Income from investment in state and local bonds is subject to New Mexico income taxation. Expenses of the taxpayer related to the earning of income from investments, directly or through mutual funds, unit investment trusts or simple trusts, in state or local bonds are deductible in determining net income. To the extent that such expenses have not been deducted in determining federal taxable income, these amounts may be subtracted from net income.

[~~**(3)** This version of this subsection (3.4.1.10D NMAC) applies to taxable years beginning on or after January 1, 1991.~~]

E. Income earned on "state or local bonds".

(1) Not included in the term "state or local bond" is any obligation of the commonwealth of Puerto Rico or of territories or possessions of the United States the income from which New Mexico is prohibited from taxing by the laws of the United States.

(2) For taxable years beginning on or after January 1, 1991, income from investing in any state or local bond, as that term is defined in Section 7-2A-2 NMSA 1978, is includable in base income.

(3) Income from investing in state or local bonds is to be included in base income in the year it is actually received without regard to federal tax treatment of the income, except that:

(a) the taxpayer may elect to report this income for New Mexico purposes on an accrual basis; and

(b) income from investing in state or local bonds earned or accrued before the first taxable year beginning on or after January 1, 1991, but which is received after that date is not includable in base income. Income is earned or accrued ratably, by assigning an equal amount of income to each day of the accrual period.

(4) Example 1: A, a New Mexico corporation, purchases a state of California municipal bond in [~~1992~~] 20X0 and receives semi-annual interest payments. A does not elect to report to New Mexico on an accrual basis. All income from this bond is included in base income. This income is included only as the interest payments are received.

(5) Example 2: B, a New Mexico corporation and calendar year filer, purchases a city of Los Angeles municipal bond in [~~1990~~] 20X0. This bond pays interest semi-annually on April 1 and October 1. B does not elect to report to New Mexico on an accrual basis. On April 10, [~~1991~~] 20X1, B receives $1,000 of interest. Since this payment includes interest earned or accrued before January 1, [~~1991~~] 20X1, this income is to be allocated between the period prior to the [~~tax~~] taxable year and the period following December 31, [~~1990~~] 20X0. The income accrual period is 182 days in length (October 1, [~~1990~~] 20X0, through March 31, [~~1991~~] 20X1), of which 90 days are in B's first taxable year beginning on or after January 1, [~~1991~~] 20X1. B's [~~1991~~] 20X1 base income includes $494.51 ($1,000 x 90/182). The remaining $505.49 is not subject to New Mexico corporate income tax.

(6) Example 3: C, a New Mexico corporation and calendar year filer, purchased a city of San Francisco municipal bond on January 1, 1981 for $1,400. C does not elect to report accrued income on this bond for New Mexico corporate income tax purposes. Although this bond pays interest semi-annually, C bought it stripped and at a discount. C has no right to the interest. On January 1, 1995, C receives the bond principal of $5,000. This is C's first and only payment on the bond. Since this payment includes income earned or accrued before January 1, 1991, the income is allocated between the period prior to January 1, 1991, and the period following December 31, 1990. The income accrual period is 5112 days, of which 1461 are after December 31, 1990. C's 1995 base income includes $1,028.87 ((1461/5112) x ($5,000 - $1,400)). The remaining $2,571.13 of income is not subject to New Mexico corporate income tax.

[~~**(7)** This subsection (3.4.1.10E NMAC) is applicable to taxable years beginning on or after January 1, 1991.~~]

[1/7/1992, 6/24/1993, 11/17/95, 1/13/1996, 1/15/1997; 3.4.1.10 NMAC - Rn & A, 3 NMAC 4.1.10, 12/14/2000; A, xx/xx/xxxx]

3.4.1.11 BASE INCOME FOR FILING AS A SEPARATE CORPORATE ENTITY

[~~**A.** When a corporation, which is a member of a group of corporations filing a consolidated income tax return for federal income tax purposes, files a New Mexico corporate income and franchise tax return as a~~

~~separate corporation, that corporation's base income shall be determined by completing a simulated federal corporate income tax return for the separate corporation. In completing the simulated federal return, only the income and expenses of the separate corporation will be allowed. The simulated return shall be prepared as if the corporate entity were filing a federal return as a separate corporation and not as a corporation included in a consolidated return. All provisions of the Internal Revenue Code which would apply to the filing as a separate corporation shall apply to the completion of the simulated return. Procedures and adjustments allowed by the Internal Revenue Code which apply to the filing of a federal consolidated return concerning the elimination of intercompany transactions or the sale or dissolution of one of the corporations within the federal consolidated group shall not be allowed when completing the simulated federal return for New Mexico income tax purposes. Net operating loss carryovers and carrybacks shall be in accordance with Subsections A through E of Section 3.4.1.9 NMAC but in no case shall a net operating loss established for the corporation reporting on a separate corporation basis be excluded from the base income of any other corporation or from the base income reported on any combined or consolidated return for any group of corporations.~~

~~**B.** This section (3.4.1.11 NMAC) applies to taxable years beginning on or after January 1, 1992.~~]

A. For taxable years beginning before January 1, 2020 or in a case where none of the corporations filing a federal consolidated return are unitary. A corporation, that files as part of a federal consolidated return may file a separate return for New Mexico corporate income tax purposes. In that case, that corporation's base income shall be determined by completing a simulated federal corporate income tax return for the separate corporation. In completing the simulated federal return, only the income and expenses of the separate corporation will be allowed. The simulated return shall be prepared as if the corporate entity were filing a federal return as a separate corporation and not as a corporation included in a consolidated return. All provisions of the Internal Revenue Code which would apply to the filing as a separate corporation shall apply to the completion of the simulated return. Procedures and adjustments allowed by the Internal Revenue Code which apply to the filing of a federal consolidated return concerning the elimination of intercompany transactions or the sale or dissolution of one of the corporations within the federal consolidated group shall not be allowed when completing the simulated federal return for New Mexico income tax purposes. In no case shall a net operating loss established for the corporation reporting on a separate corporation basis be excluded from the base income of any other corporation or from the base income reported on any combined or consolidated return for any group of corporations.

[1/7/92, 1/15/1997; 3.4.1.11 NMAC - Rn & A, 3 NMAC 4.1.11, 12/14/2000; Rp, xx/xx/xxxx]

3.4.1.12 [~~**FOREIGN SOURCE DIVIDENDS**~~

~~**A.** Foreign source dividends, received by a corporation reporting to New Mexico as a separate entity are wholly or partially excludable from the corporation's base income as follows:~~

~~**(1)** 70% of the dividends included on lines 13 and 14, schedule C, federal form 1120 received from corporations owned less than 20% by the reporting corporation but only if those dividends would have been subject to the 70% deduction under 26 U.S.C. Section 243(a)(1) had the payor of the dividends been a domestic corporation.~~

~~**(2)** 80% of the dividends included on lines 13 and 14, schedule C, federal form 1120 received from corporations owned 20% to 80% by the reporting corporation but only if those dividends would have been subject to the 80% deduction under 26 U.S.C. Section 243(c) had the payor of the dividends been a domestic corporation.~~

~~(3) 100% of the dividends included on lines 13 and 14, schedule C, federal form 1120 received from corporations owned more than 80% by the reporting corporation but only if those dividends would have been subject to the 100% deduction under 26 U.S.C. Section 243(a)(3) had the payor of the dividends been a domestic corporation.~~

~~B. The exclusion of foreign source dividends set forth in Section 3.4.1.12 NMAC applies only so long as New Mexico's method of taxing foreign source dividends is unconstitutional.~~

~~C. Section 3.4.1.12 NMAC applies to taxable years beginning on or after January 1, 1997.~~]

FOREIGN SOURCE DIVIDENDS – PRIOR TO JANUARY 1, 2020

A. Foreign source dividends, as the term is used under federal law, received by a corporation reporting to New Mexico as a separate entity are wholly or partially excludable from the corporation's base income as follows:

(1) seventy percent of the dividends included on lines 13 and 14, schedule C, federal form 1120 received from corporations owned less than twenty percent by the reporting corporation but only if those

dividends would have been subject to the seventy percent deduction under 26 U.S.C. Section 243(a)(1) had the payor of the dividends been a domestic corporation.

(2) eighty percent of the dividends included on lines 13 and 14, schedule C, federal form 1120 received from corporations owned twenty percent to eighty percent by the reporting corporation but only if those dividends would have been subject to the eighty percent deduction under 26 U.S.C. Section 243(c) had the payor of the dividends been a domestic corporation.

(3) One hundred percent of the dividends included on lines 13 and 14, schedule C, federal form 1120 received from corporations owned more than eighty percent by the reporting corporation but only if those dividends would have been subject to the one hundred percent deduction under 26 U.S.C. Section 243(a)(3) had the payor of the dividends been a domestic corporation.

B. The exclusion of foreign source dividends set forth in Section 3.4.1.12 NMAC applies only so long as New Mexico's method of taxing foreign source dividends is unconstitutional.

C. Section 3.4.1.12 NMAC applies to taxable years beginning on or after January 1, 1997 but prior to January 1, 2020.

[5/31/98; 3.4.1.12 NMAC - Rn & A, 3 NMAC 4.1.12, 12/14/2000; Rp, xx/xx/xxxx]

3.4.1.13 FOREIGN SOURCE DIVIDENDS AFTER JANUARY 1, 2020

For tax years beginning on or after January 1, 2020, "base income" under Section 7-2A-2 NMSA 1978 includes special deductions allowed under the Internal Revenue Code Sections 241 through 249 including the deduction for foreign source dividends under Section 245A.
[3.4.1.13 NMAC – N, xx/xx/xxxx]

3.4.1.14 UNITARY BUSINESS: The definition of a "unitary group" under Section 7-2A-2 NMA1978 rests on the underlying concept of "unitary business", which reflects the general constitutional principles that have been set out by the U.S. Supreme Court and is meant to be applied consistent with those constitutional principals. See, in particular, *Mobil Oil Corp. v. Comm'r of Taxes of Vt.*, 455 U.S. 425, 438 (1980) where the court noted that a "separate accounting, while it purports to isolate portions of income received in various states, may fail to account for contributions to income resulting from functional integration, centralization of management, and economies of scale." The court then characterized these as "factors of profitability" which "arise from the operation of the business as a while." See also, MeadWestvaco Corp. v. Ill. Dep't of Revenue, 553 U.S. 16, 18 (2008). There, the court reiterated past holdings that the unitary business principle as articulated applies generally to entities, not assets, and that "an asset can be a part of a taxpayer's unitary business even without a 'unitary relationship' between the 'payor and payee.'" The court went on to review its precedent saying, "where the asset is another business, a unitary relationship's 'hallmarks' are functional integration, centralized management, and economies of scale."

When a portion of a unitary business is conducted in New Mexico, the state has the constitutional authority to impose tax on that portion of the income derived from that business, provided that the tax is not discriminatory and is fairly apportioned. The primary factors indicating an economically interdependent business include centralized management, functional integration, and economies of scale, which may be demonstrated by substantial flows of value between components of the business as well as other similar indicia.
[3.4.1.14 NMAC – N, xx/xx/xxxx]

3.4.10.7 DEFINITIONS: [~~Separate accounting defined.~~

~~**A.** Under the separate accounting method of reporting formerly provided for in Paragraph 7-2A-8A(4) NMSA 1978 for taxable years beginning prior to January 1, 1996, a taxpayer accounts for that portion of business activity conducted within this state as if the business activities were conducted by a distinct and separate entity which operated solely within this state. A pro forma federal form 1120 reflecting such activity shall be prepared and included with the New Mexico report form. Only income generated and expenses incurred from business activities conducted within this state are to be included when calculating New Mexico tax liability.~~

~~**B.** Income and expenses reported under the separate accounting method must be determined in the same manner and through the same accounting method which was employed for reporting for federal income tax purposes.~~

~~**C.** The apportionment of indirect expenses to New Mexico business activities shall be determined in accordance with the application of the three factor apportionment formula defined by Section 7-2A-8 NMSA 1978 or the application of an alternative method which has previously been approved by the department.~~

~~**D.** The separate accounting method may not be used for any taxable year starting on or after January 1, 1996.~~] **[RESERVED]**

[5/12/1986, 9/16/1988, 1/7/1992, 1/15/1997; 3.4.10.7 NMAC - Rn & A, 3 NMAC 4.10.7, 12/14/2000; R. xx/xx/xxxx]

3.4.10.8 [~~**REPORTING METHODS:**~~

~~**A.** The net income of any taxpayer having income which is taxable both within and without New Mexico, prior to the application of corporate income tax rates provided in the New Mexico Corporate Income and Franchise Tax Act, shall be apportioned and allocated as provided in Section 7-2A-8 NMSA 1978.~~

~~**B.** For taxable years beginning on or after January 1, 1996, a taxpayer may elect to file the taxpayer's initial New Mexico corporate income tax return using any one of three reporting methods:~~

~~**(1)** 1st - separate corporate entity;~~

~~**(2)** 2nd - combination of unitary corporations;~~

~~**(3)** 3rd - federal consolidated group.~~

~~**C.** In succeeding taxable years, a taxpayer may elect to file on a different reporting method without written permission from the department as long as the reporting method chosen is ranked higher on this numbered list than the previous reporting method.~~

~~**D**. If a taxpayer, having reported under a higher-ranked method, desires to report in future taxable years using a lower-numbered method, the taxpayer must first obtain written permission from the secretary. The secretary will not approve requests under this section (3.4.10.8 NMAC) to elect a lower-numbered filing method except in some cases where a merger or other substantial change in the structure of the corporate group results in the creation of a new federal consolidated group. In all other cases if the taxpayer believes that the higher-ranked method does not fairly represent the extent of the taxpayer's business activity in this state, the taxpayer may petition for relief under Section 7-4-19 NMSA 1978.~~

~~**E.** No retroactive election of a different method for reporting New Mexico state income tax will be permitted. An election to report under a higher-ranked method or a request for permission to file under a lower-ranked method must be made no later than the last day on which the corporate income tax return may be timely filed for the taxpayer's taxable year to which the change in method applies.~~

~~**F.** This section (3.4.10.8 NMAC) applies to taxable years beginning on or after January 1, 1996.~~] **[RESERVED]**

[6/2/1987, 9/16/1988, 1/7/1992, 7/15/1996, 1/15/1997; 3.4.10.8 NMAC - Rn & A, 3 NMAC 4.10.8, 12/14/2000; R xx/xx/xxxx]

3.4.10.9 ~~**SEPARATE ACCOUNTING; COMPUTATION OF NET OPERATING LOSSES:**~~

~~**A.** A corporation which reported income to this state by means of separate accounting under former Paragraph 7-2A-8A(4) NMSA 1978 for taxable years beginning prior to January 1, 1996, may carry back or carry forward the net operating loss attributable to New Mexico activities in accordance with Subsections B through E of Section 3.4.1.9 NMAC, even though the corporation has no overall net operating loss which it can carry back or carry forward in the computation of federal taxable income for those years, provided that the five year limitation allowed by former Paragraph 7-2A-8A(4) NMSA 1978 has not expired. Any amount of net operating loss carryover remaining at the end of the five year period specified in former Paragraph 7-2A-8A(4) NMSA 1978 expires and may not be applied against base income of the corporation or any combined or consolidated group in which the corporation may be included for any subsequent taxable year.~~

~~**B.** This subsection is retroactively applicable to taxable years beginning on or after January 1, 1992.~~] **[RESERVED]**

[5/12/1986, 9/16/1988, 1/7/1992, 1/15/1997; 3.4.10.9 NMAC - Rn & A, 3 NMAC 4.10.9, 12/14/2000; R xx/xx/xxxx]

3.4.10.11 COMBINED RETURNS:

A. Members of a combined group:

(1) A group of unitary corporations may include both domestic corporations and foreign corporations other than foreign corporations which are incorporated in a foreign country and are not engaged in trade or business in the United States during the taxable year. Such a group may file a state corporate income and franchise tax return using the combination of unitary corporations method if it otherwise meets the requirements of the Corporate Income and Franchise Tax Act and regulations thereunder.

(2) This subsection is retroactively applicable to taxable years beginning on or after January 1, 1992.

B. Base income for members of a combined group.

(1) When a group of unitary corporations files a New Mexico corporate income and franchise tax return using the combination of unitary corporations method, the base income for the combined group of unitary corporations shall be determined by completing a simulated federal corporate income tax return. In completing the simulated federal return, only the income and expenses of the combined corporations will be allowed. The simulated return shall be prepared as if the combined group was filing a federal consolidated return including only the corporations in the unitary (combined) group.

(2) When completing the simulated federal return for New Mexico income tax purposes, all procedures and adjustments allowed by the Internal Revenue Code which apply to the filing of a federal consolidated return concerning the elimination of intercompany transactions or the sale or dissolution of one of the corporations within the federal consolidated group shall be allowed, but only for those transactions between members of the combined group of unitary corporations. No adjustments shall be made or allowed for transactions with any corporation that is not a member of the combined group of unitary corporations. Otherwise, all provisions of the Internal Revenue Code which would apply to the filing of a consolidated return shall apply to the completion of the simulated return for the combined group of unitary corporations.

(3) This subsection is retroactively applicable to taxable years beginning on or after January 1, 1992 but before January 1, 2020. For returns for taxable years beginning on or after January 1, 2020, see 3.4.10.14 NMAC.

[1/7/1992, 1/15/1997; 3.4.10.11 NMAC - Rn, 3 NMAC 4.10.11, 12/14/2000; A, xx/xx/xxxx]

3.4.10.12 [~~**CONSOLIDATED RETURNS: [RESERVED**~~]] **CONSOLIDATED FILING ELECTION;**

When a group of corporations has properly made an election to file on a consolidated basis for New Mexico corporate income tax purposes, the filing group must include all of the members of the group properly included in the filed federal consolidated return.

[3.4.10.12 NMAC – N, xx/xx/xxxx]

3.4.10.14 COMPUTATION OF BASE AND NET INCOME - APPLICABLE TO PERIODS BEGINNING ON OR AFTER JANUARY 1, 2020:

A. Each corporate member of a unitary filing group computes its "base income" by determining the federal taxable income or federal net operating loss of the corporation on a separate corporate basis as though the member was a separate domestic entity for the taxable year, applying the Internal Revenue Code and applicable regulations. This base income is computed after deductions provided for in Sections 241 through 249 of the Internal Revenue Code but before any deduction for net operating losses. Then, before the base income of the unitary group is determined, the members make the following adjustments to federal taxable income or net operating loss:

(1) adding to that income:

(a) interest received on a state or local bond exempt under the Internal Revenue Code;

(b) the amount of any deduction claimed in calculating taxable income for all expenses and costs directly or indirectly paid, accrued or incurred to a captive real estate investment trust; and

(c) the amount of any deduction, other than for premiums, for amounts paid directly or indirectly to a commonly controlled entity that is exempt from corporate income tax pursuant to Section 7-2A-4 NMSA 1978; and

(2) subtracting from that income:

(a) income from obligations of the United States net of expenses incurred to earn that income;

(b) other amounts that the state is prohibited from taxing because of the laws or constitution of this state or the United States net of any related expenses;

(c) an amount equal to one hundred percent of the subpart F income, as that term is defined in Section 952 of the Internal Revenue Code, as that section may be amended or renumbered, included in the income of the corporation; and

(d) an amount equal to one hundred percent of the income of the corporation under Section 951A of the Internal Revenue Code, after allowing the deduction provided in Section 250 of the Internal Revenue Code; and

(3) making other adjustments deemed necessary to properly reflect income of the unitary group, including attribution of income or expense related to unitary assets held by related corporations that are not part of the filing group.

B. The filing group's net income is computed by combining the member's base income, whether positive or negative, eliminating or deferring intercompany income and expense of the filing group members in a manner consistent with the consolidated filing requirements of the Internal Revenue Code and the Corporate Income and Franchise Tax Act; and without deducting any amount of net operating loss carryover.

[3.4.10.14 NMAC – N, xx/xx/xxx]

3.4.10.15 NET OPERATING LOSSES OF FILING GROUPS - APPLICABLE TO TAXABLE YEARS BEGINNING ON OR AFTER JANUARY 1, 2020:

A. In general, for taxable years beginning on or after January 1, 2020, New Mexico provides that net operating loss carryovers be computed on a post-apportioned basis and that the carryover be treated as an attribute of the unitary group, subject to the limitations under the Internal Revenue Code, including the consolidated filing regulations applied to the New Mexico unitary filing group as though it was the federal consolidated group.

B. A unitary filing group calculates its net operating loss carryover as follows:

(1) Determining the amount of "grandfathered net operating loss carryover," if any, by:

(a) Identifying the amount of net loss properly reported to New Mexico for taxable years beginning January 1, 2013 and prior to January 1, 2020 as part of a timely filed original return, or an amended return for those taxable years filed prior to January 1, 2020, that can be attributed to a corporation or corporations which are properly included in the taxpayer's return for the first taxable year beginning on or after January 1, 2020;

(b) Reducing each loss identified by:

(i) Adding back deductions for royalties or interest paid to any related corporation or group of corporations in computing the loss, but only to the extent that such adjustment would not create a net loss for that related corporation or group; and

(ii) Subtracting net operating loss deductions taken prior to January 1, 2020 that would be properly charged against those losses consistent with the Internal Revenue Code and provisions of the Corporate Income and Franchise Tax Act applicable to the year of the deduction; and

(c) Apportioning any remaining loss to New Mexico using the apportionment factors that can properly be attributed to the corporation or corporations for the year of the net loss.

(2) Computing the "net operating loss carryover" as follows:

(a) Add:

(i) The apportioned net loss properly reported on an original or amended tax return for taxable years beginning on or after January 1, 2020 by the taxpayer, including a filing group as properly determined under the Corporate Income and Franchise Tax Act;

(ii) The portion of an apportioned net loss properly reported to New Mexico for a taxable year beginning on or after January 1, 2020, on a separate year return, to the extent the taxpayer would have been entitled to include the portion of such apportioned net loss in the taxpayer's consolidated net operating loss carryforward under the Internal Revenue Code and consolidated filing rules if the taxpayer filed a consolidated federal return; and

(iii) The taxpayer's grandfathered net operating loss carryover; and

(b) Subtract:

(i) The amount of the net operating loss carryover attributed to an entity that has left the unitary filing group, computed in a manner consistent with the consolidated filing requirements of the Internal Revenue Code and applicable regulations, as if the taxpayer were filing a consolidated return; and

(ii) The amount of net operating loss deductions properly taken by the taxpayer.

C. For taxable years after January 1, 2020, a taxpayer may take a "net operating loss deduction" to the extent allowed under the Internal Revenue Code as of January 1, 2018 for the taxable year in which the deduction is taken, including the eighty percent limitation of Section 172(a) of the Internal Revenue Code as of January 1, 2018, calculated on the basis of the taxpayer's apportioned net income. In no case may the taxpayer's net operating loss deduction exceed eighty percent of the taxpayer's apportioned net income for the year in which the deductions taken.

[3.4.10.15 NMAC – N; xx/xx/xxxx]

3.4.10.16 OBLIGATION OF EXCLUDED CORPORATIONS TO FILE A RETURN: When a unitary group of corporations files a return, whether it is a worldwide, water's edge, or consolidated group return, if that return properly excludes one or more related corporations, those corporations are not relieved of the obligation to file tax returns and pay any tax owed on a separate entity basis. These corporations may separately elect to file a worldwide or water's edge return as a unitary group only if that return will include all corporations that are properly a part of that unitary group. In computing base income and net income, the corporation or corporations that properly file in a separate return from related corporations will not eliminate or defer intercompany transactions with those related corporations.

[3.4.10.16 NMAC – N, xx/xx/xxxx

3.4.14.11 TAX CREDITS; APPLICATION TO UNITARY GROUPS: With respect to taxable years beginning on or after January 1, 2020, when any corporation properly files as part of a worldwide, water's edge or consolidated return, if that corporation has qualified for and continues to hold an unused amount of New Mexico tax credit that it could properly take against its tax liability in a particular taxable year, then that unused amount of tax credit may be applied against the tax liability of the unitary group in accordance with the law applicable to that credit. Any other limitations on the credit apply in the same manner to the unitary group as they would apply to the corporation that holds the credit.

[3.4.14.11 NMAC – N, xx/xx/xxxx]

3.5.4.9 TAXABLE IN ANOTHER STATE - WHEN A TAXPAYER IS "SUBJECT TO" A TAX - FOR TAXABLE YEARS BEGINNING PRIOR TO JANUARY 1, 2020

A. A taxpayer is "subject to" one of the taxes specified in Subsection A of Section 7-4-4 NMSA 1978 if it carries on business activity in such state and such state imposes or has the ability to impose such a tax thereon. Any taxpayer which asserts that it is subject to one of the taxes specified in Subsection A of Section 7-4-4 NMSA 1978 in another state shall furnish to the department upon its request evidence to support such assertion. The department may request that such evidence include proof that the taxpayer has filed the requisite tax return in such other state and has paid any taxes imposed under the law of such other state; the taxpayer's failure to produce such proof may be taken into account in determining whether the taxpayer in fact is subject to one of the taxes specified in Subsection A of Section 7-4-4 NMSA 1978 in such other state.

B. If the taxpayer voluntarily files and pays one or more of such taxes when not required to do so by the laws of that state or pays a minimal fee for qualification, organization or for the privilege of doing business in that state, but

(1) does not actually engage in business activity in that state; or

(2) does actually engage in some business activity, not sufficient for nexus, and the minimum tax bears no relation to the taxpayer's business activity within such state, the taxpayer is not "subject to" one of the taxes specified within the meaning of Subsection A of Section 7-4-4 NMSA 1978.

C. The concept of taxability in another state is based upon the premise that every state in which the taxpayer is engaged in business activity may impose an income tax even though every state does not do so. In states

which do not, other types of taxes may be imposed as a substitute for an income tax. Therefore, only those taxes enumerated in Subsection A of Section 7-4-4 NMSA 1978 which may be considered as basically revenue raising rather than regulatory measures shall be considered in determining whether the taxpayer is "subject to" one of the taxes specified in Subsection A of Section 7-4-4 NMSA 1978 in another state.

D. When determining whether a taxpayer is taxable in another state, the term "taxpayer" shall apply to each separate member of a combined or consolidated filing group and shall not apply to the group as a single taxpaying entity, unless the taxpayer can demonstrate that application of this rule will subject it to multiple taxation based on the application of a contrary rule in the other state.

E. This version of this section applies to taxable years beginning prior to January 1, 2020. For tax periods beginning on or after January 1, 2020 see 3.5.4.11 NMAC.

[1/15/1974, 9/15/1988, 9/20/1993, 1/15/1997; 3.5.4.9 NMAC - Rn & A, 3 NMAC 5.4.9, 6/29/2001; A, xx/xx/xxxx]

3.5.4.10 TAXABLE IN ANOTHER STATE - WHEN A STATE HAS JURISDICTION TO SUBJECT A TAXPAYER TO A NET INCOME TAX FOR TAXABLE YEARS BEGINNING PRIOR TO JANUARY 1, 2020: The second test, that of Subsection B of Section 7-4-4 NMSA 1978, applies if the taxpayer's business activity is sufficient to give the state jurisdiction to impose a net income tax by reason of such business activity under the constitution and statutes of the United States. Jurisdiction to tax is not present where the state is prohibited from imposing the tax by reason of the provisions of Public Law 86-272, 15 U.S.C.A. Sections 381-385. In the case of any "state" as defined in Section 7-4-2 NMSA 1978 other than a state of the United States or political subdivision of such state, the determination of whether such "state" has jurisdiction to subject the taxpayer to a net income tax shall be made as though the jurisdictional standards applicable to a state of the United States applied in that "state". If jurisdiction is otherwise present, such "state" is not considered as without jurisdiction by reason of the provisions of a treaty between that "state" and the United States.

This section applies to taxable years beginning prior to January 1, 2020. For taxable years beginning on or after January 1, 2020 see 3.4.11 NMAC.

[1/15/1974, 9/15/1988, 9/20/1993, 1/15/1997; 3.5.4.10 NMAC - Rn & A, 3 NMAC 5.4.10, 6/29/2001; A. xx/xx/xxxx]

3.5.4.11 TAXABLE IN ANOTHER STATE; WHEN A TAXPAYER IS "SUBJECT TO" A TAX – FOR TAXABLE YEARS BEGINNING ON OR AFTER JANUARY 1, 2020: For periods beginning on or after January 1, 2020. New Mexico follows the so-called Finnigan approach. This approach determines when a corporation will be deemed to be taxable in New Mexico as well as to the question of when a taxpayer is "taxable in another state" for purposes of Section 7-4-4 NMSA 1978, and sourcing of sales under Sections 7-4-17 and 7-4-18 NMSA 1978. In general, under the Finnigan approach, New Mexico looks to the activities of the unitary group, or if the group has elected to file a consolidated return, to the activities of the consolidated group, to determine if any member of the group is taxable in New Mexico or in another state. If the group, or any member of the group, could be subjected to New Mexico corporate income tax under both constitutional principles and any applicable federal statutory law, then all members of the group are taxable in New Mexico. Similarly, when determining if a member of the group is "taxable in another state," if the state has jurisdiction to impose such a tax on the unitary business in whatever form it may allow that unitary business to file, whether or not it does impose such a tax, then all members of that unitary group are taxable in that state. This version of this section applies to taxable years beginning on or after January 1, 2020.

[3.5.4.11 NMAC – N, xx/xx/xxxx]

3.5.10.8 ~~[APPORTIONMENT FORMULA:~~

~~A. Except for taxpayers who are manufacturers and taxpayers using a special apportionment formula under Section 7-4-19 NMSA 1978, all business income of the trade or business of the taxpayer shall be apportioned to this state by use of the single-weighted sales apportionment formula set forth in Section 7-4-10 NMSA 1978.~~

~~B. For taxable years beginning on or after January 1, 1995, manufacturers who have elected to apportion in accordance with the double-weighted sales apportionment formula set forth in Section 7-4-10 NMSA 1978 shall apportion in accordance with that double-weighted sales apportionment formula for every taxable year covered by the election. A taxpayer who files a combined or consolidated return and who elects to use the double-~~

~~weighted sales apportionment formula for any eligible manufacturer included in the return must use the double-weighted sales apportionment formula for all eligible manufacturers included in the return.~~

~~C. The elements of both apportionment formulae set forth in Section 7-4-10 NMSA 1978 are the property factor, the payroll factor and the sales factor of the trade or business of the taxpayer.~~] **[RESERVED]**

[1/15/1974, 9/15/1988, 9/20/1993, 1/15/1997, 10/29/199999; 3.5.10.8 NMAC - Rn & A, 3 NMAC 5.10.8, 6/29/2001; R, xx/xx/xxxx]

3.5.16.11 EFFECT OF COMBINED FILING ON THE SALES FACTOR: For corporations that file on a combined or consolidated basis, the sales factor for the filing group is calculated without the inclusion of intercompany sales that would otherwise be deferred or eliminated under federal consolidated filing rules when calculating net income for the group.

[3.5.16.11 NMAC – N; xx/xx/xxxx]

3.5.18.8 SALES FACTOR - SALES OTHER THAN SALES OF TANGIBLE PERSONAL PROPERTY IN THIS STATE – APPLICABLE TO TAXABLE YEARS BEGINNING PRIOR TO JANUARY 1, 2020:

A. In general. Section 7-4-18 NMSA 1978 provides for the inclusion in the numerator of the sales factor of gross receipts from transactions other than sales of tangible personal property (including transactions with the United States government). Under Section 7-4-18 NMSA 1978 gross receipts are attributed to this state if the income producing activity which gave rise to the receipts is performed wholly within this state. Also, gross receipts are attributed to this state if, with respect to a particular item of income, the income producing activity is performed within and without this state but the greater proportion of the income producing activity is performed in this state, based on costs of performance.

B. Income producing activity: defined:

(1) The term "income producing activity" applies to each separate item of income and means the transactions and activity directly engaged in by the taxpayer in the regular course of its obtaining gains or profit. Such activity does not include transactions and activities performed on behalf of a taxpayer such as those conducted on its behalf by an independent contractor. Accordingly, income producing activity includes but is not limited to the following:

(a) the rendering of personal services by employees or the utilization of tangible or intangible property by the taxpayer in performing a service;

(b) the sale, rental, leasing, licensing or other use of real property;

(c) the rental, leasing, licensing or other use of tangible personal property; or

(d) the sale, licensing or other use of intangible personal property.

(2) The mere holding of intangible personal property is not, of itself, an income producing activity.

C. Costs of performance: defined. The term "costs of performance" means direct cost determined in a manner consistent with generally accepted accounting principles and in accordance with accepted conditions or practices in the trade or business of the taxpayer.

D. Application:

(1) In general. Receipts (other than from sales of tangible personal property) in respect to a particular income producing activity are in this state if:

(a) the income producing activity is performed wholly within this state; or

(b) the income producing activity is performed both in and outside this state and a greater proportion of the income producing activity is performed in this state than in any other state, based on costs of performance.

(2) Special rules: The following are special rules for determining when receipts from the income producing activities described below are in this state:

(a) Gross receipts from the sale, lease, rental or licensing of real property are in this state if the real property is located in this state.

(b) Gross receipts from the rental, lease or licensing of tangible personal property are in this state if the property is located in this state. The rental, lease, licensing or other use of tangible personal property in this state is a separate income producing activity from the rental, lease, licensing or other use of the same property while located in another state; consequently, if property is within and without this state during the rental

lease or licensing period, gross receipts attributable to this state shall be measured by the ratio which the time the property was physically present or was used in this state bears to the total time or use of the property everywhere during such period.

(c) Gross receipts for the performance of personal services are attributable to this state to the extent such services are performed in this state. If services relating to a single item of income are performed partly within and partly without this state, the gross receipts for the performance of such services shall be attributable to this state only if a greater portion of the services were performed in this state, based on costs of performance. Usually where services are performed partly within and partly without this state the services performed in each state will constitute a separate income producing activity; in such case the gross receipts for the performance of services attributable to this state shall be measured by the ratio which the time spent in performing such services in this state bears to the total time spent in performing everywhere. Time spent in performing services includes the amount of time expended in the performance of a contract or other obligation which gives rise to such gross receipts. Personal service not directly connected with the performance of the contract or other obligation, as for example, time expended in negotiating the contract, is excluded from the computations.

E. This section applies to taxable years beginning before January 1, 2020.

[1/15/74, 9/15/88, 9/20/93, 1/15/1997; 3.5.18.8 NMAC - Rn & A, 3 NMAC 5.18.8, 6/29/2001; A, xx/xx/xxxx]

3.5.18.9 SALES FACTOR - SALES OTHER THAN SALES OF TANGIBLE PERSONAL PROPERTY IN THIS STATE - APPLICABLE TO TAXABLE YEARS BEGINNING ON OR AFTER JANUARY 1, 2020:

A. Sales Factor: Sales Other Than Sales of Tangible Personal Property in this State: General Rules.

(1) Definitions. For the purposes of this section (3.5.18.9 NMAC) these terms have the following meanings:

(a) "Billing address" means the primary mailing address relating to a customer's account as of the time of the transaction as kept in good faith in the normal course of business and not for tax avoidance purposes.

(b) "Business customer" means a customer that is a business or organization operating in any form and generally includes customers other than individual customers.

(c) "Customer" means the person with which the taxpayer has a contract for the transaction, regardless of who pays for or may benefit from the transaction.

(d) "IRC" means the Internal Revenue Code as currently written and subsequently amended.

(e) "Individual customer" means a customer that is a natural person.

(f) "Intangible property" means property that is not physical or whose representation by physical means is merely incidental.

(g) "Place of order" means the physical location from which a customer places an order resulting in a contract with the taxpayer.

(h) "Population" means the most recent population data maintained by the U.S. Census Bureau for the year in question as of the close of the taxable period.

(i) "Related party" means any person who may exercise control of the taxpayer, or is generally controlled by the taxpayer, directly or indirectly, whether through ownership or agreement.

(j) "Sale," in the context of Section 7-4-18 NMSA 1978 means a transaction described in that section, including a lease or license and depending on the context also means the receipts from that transaction.

(k) "Source" means, in general, attributing a sale to a state using the rules under Section 7-4-18 NMSA, 1978 and this regulation.

(l) "State or location where a contract of sale is principally managed by the customer," means the primary location from which a customer's employee or agent interacts with the taxpayer and oversees the taxpayer's activities under the contract.

(m) "Use" means use for the intended purpose of the intangible property.

(2) Hierarchical Rules. Where a hierarchical rule applies under this regulation, a taxpayer must make a reasonable effort to apply each rule, in order, before defaulting to any subsequent rule.

(3) Rules of Reasonable Approximation as Provided for in Subsection B of Section 7-4-18 NMSA 1978. This regulation includes various rules of reasonable approximation for determining when a sale should be included in the New Mexico sales factor numerator. These rules apply when the proper inclusion of sales in sales factor numerator cannot be determined. The method of reasonable approximation should make use of reliable information and be applied consistently.

(4) Exclusion of Sales from the Sales Factor. As provided in Subsection C of Section 7-4-18 NMSA 1978, sales should be excluded from the sales factor if:

(a) Using the same rules applicable under Subsection A of Section 7-4-19 NMSA 1978 or a method of reasonable approximation under Subsection B of Section 7-4-18 NMSA 1978 used by the taxpayer to determine if sales are included in the New Mexico sales factor numerator, the sales would be sourced to a state in which the taxpayer is not taxable, as defined under Section 7-4-4 NMSA 1978 and applicable regulations; or

(b) The taxpayer is unable to determine where sales are sourced under Section 7-4-18(A) NMSA 1978 or a proper method of reasonable approximation under Subsection B of Section 7-4-18 NMSA 1978.

(5) Related-Party Transactions – Information Imputed from Customer to Taxpayer. Where a taxpayer has receipts subject to this section (3.5.18.9 NMAC) from transactions with a related-party customer, any information necessary to apply the rules under Subsection A Section 7-4-18 NMSA 1978. will be imputed to the taxpayer and the taxpayer may not use a rule of reasonable approximation to determine if those sales should be included in the New Mexico sales factor numerator or should be excluded from the sales factor under Subsection C Section 7-4-18 NMSA 1978.

(6) No Limitation on Section 7-4-19 NMSA 1978. Nothing in this regulation limits the authority granted to the department under Section 7-4-19 NMSA 1978. Regulations adopted pursuant to Section 7-4-19 NMSA 1978 control to the extent they conflict with provisions of this regulation.

B. Sale, Rental, Lease or License of Real Property. In the case of a sale, rental, lease or license of real property, the receipts from the sale are in New Mexico if and to the extent that the property is in New Mexico.

C. Rental, Lease or License of Tangible Personal Property. In the case of a rental, lease or license of tangible personal property, the receipts are from the sale of tangible personal property in New Mexico if and to the extent that the tangible personal property is located in New Mexico. If property is mobile property that is located both within and without New Mexico during the period of the lease or other contract, the receipts are assigned to New Mexico in the same percentage as the time the property is used in the state.

D. Sale of a Service. General Rule – Determining the Category of a Service. The receipts are from a sale of a service in New Mexico if and to the extent that the product of the service or the service is delivered to a location in New Mexico. These rules in this subsection define three general categories of services and set out rules for when a service in that category is delivered in New Mexico. A service may fall into more than one category. If a service could be characterized as both an in-person service and a professional service, it will be deemed an in-person service. The third category of service—other services—excludes services that can be categorized and assigned based on the rules for in-person or professional services.

(1) In-Person Services. An in-person service is a service that is physically performed by the taxpayer, whether through employees, agents, or by third parties on behalf of the taxpayer, while in the same location as the customer or on the customer's real or tangible personal property. Examples include: heath care services; in-person training or entertainment; child care services; repair, installation, cleaning or maintenance services; and construction and similar services.

(a) Determining the New Mexico Sales Factor Numerator. Sales of in-person services are included in the New Mexico sales factor numerator if those services are performed on a customer or the customer's property in the state.

(b) Reasonable Approximation. If the taxpayer has insufficient information to determine where its in-person services are performed, the taxpayer shall reasonably approximate where those sales are sourced using general information on customers' locations or other similar information.

(2) Professional Services. In General. Professional services are services performed for customers by the taxpayer's employees or agents, or by third parties on behalf of the taxpayer, which require the application of specialized knowledge or skill to the customer's particular facts and circumstances, but exclude in-person services. Examples include: management, consulting and similar services; financial and investment services not subject to 3.5.19.17 NMAC; technology and data processing services; legal services; and architectural, engineering and design services.

(a) Determining the New Mexico Sales Factor Numerator. The following hierarchy of rules apply:

(i) Architectural and Engineering Services with respect to Real or Tangible Personal Property. If the service is an architectural or engineering service, it is included in the New Mexico sales factor numerator if the service relates to real estate improvements or tangible personal property located, or expected to be located, in the state.

(ii) Related Party Transactions. If the customer is a related party, then the taxpayer's sale of the services to that customer are included in the New Mexico sales factor numerator to the extent of that customer's New Mexico apportionment factor as properly determined under Section 7-4-1, et seq. NMSA 1978 and applicable regulations.

(iii) Large Individual or Business Customers: If the sale is to an individual or business customer to which the taxpayer sells five percent or more of its total professional services in a single year, then the sale is included in the New Mexico sales factor numerator: (1) if the customer is an individual customer whose residence is New Mexico, or (2) if the customer is a business customer and the place where the contract for professional services is primarily managed by the customer is in New Mexico.

(iv) Other Individual Customers: If the taxpayer has information to accurately determine where an individual customer takes delivery of the sale of the professional service, then that sale is included in the New Mexico sales factor numerator if the customer took delivery of the service in New Mexico. Otherwise, the sale is included in the New Mexico sales factor numerator if the customer's primary billing address is in the state.

(v) Other Business Customers: If the taxpayer has information to accurately determine the location from which the contract for professional services is principally managed by a business customer, then the sale is included in the New Mexico sales factor numerator if that location is in New Mexico. Otherwise, the sale is included in the sales factor numerator if the customer's billing address is in New Mexico.

(b) Reasonable Approximation: If, in applying the rules under (iv) and (v) above, the taxpayer lacks information to determine the customer's primary billing address (for example, if someone other than the customer is paying for the service) the taxpayer may use a method of reasonable approximation to determine whether the sales for which the information is lacking are included in the New Mexico sales factor numerator and to determine the sourcing of those sales for purposes of Section 7-4-18(C) NMSA 1978.

(3) Other Services. Services other than in-person or professional services are sourced under this Paragraph 3 of Subsection D of 3.5.18.9 NMAC. The rules in this paragraph may distinguish services based on whether they are delivered physically or electronically, whether they are delivered to a customer or to a third party (including the customer's customer), and whether the customer is an individual or business customer. If a rule depends on whether the customer is an individual or a business customer, and the taxpayer acting in good faith

cannot reasonably determine whether the customer is an individual or business customer, the taxpayer shall treat the customer as a business customer.

(a) Services Delivered by Physical Means to a Customer or a Third Party. Services delivered by physical means to a customer or third party exclude in-person and professional services, but generally include delivery services, themselves, and services that produce a physical product which is then delivered by the taxpayer. In addition to delivery services, examples include: items designed and printed by the taxpayer to the order of the customer that are delivered to the customer's customers by mail; and customized software services where the software is physically installed on the customer's computer.

(i) Determining the New Mexico Sales Factor Numerator. The sale of services delivered by physical means to a customer or third party are delivered are included in the New Mexico sales factor numerator if the delivery takes place in New Mexico.

(ii) Rule of Reasonable Approximation. If the taxpayer cannot determine where services are actually delivered, the taxpayer may use a method of reasonable approximation determine sales that will be included in the New Mexico sales factor, and for purposes of 7-4-18(C) NMSA 1978, including the use of population or other information.

(b) Services Delivered Electronically to a Customer. Services delivered electronically include services that are transmitted by any electronic medium whether or not the service provider owns, leases or otherwise controls medium.

(i) Determining the New Mexico Sales Factor Numerator. In the case of the sale of a service delivered electronically, the following hierarchy of rules apply:

(I.) If the sale is to a related party, the sale is included in the New Mexico sales factor numerator to the extent of that customer's New Mexico apportionment factor as properly determined under Section 7-4-1, et seq. NMSA 1978 and applicable regulations;

(II.) If the sale is to an individual or business customer to which the taxpayer sells five percent or more of its total other services in a single year, the sale is included in the New Mexico sales factor numerator: (1) if the customer is an individual customer whose residence is New Mexico, or (2) if the customer is a business customer and the place where the contract for professional services is primarily managed by the customer is in New Mexico; and

(III.) If the sale is to a customer other than a customer described in I or II, the sale is included in the New Mexico sales factor numerator if the customer's primary billing address is in the state.

(ii) Reasonable Approximation: If, in applying the rule under III above, the taxpayer lacks information to determine the customer's primary billing address (for example, if someone other than the customer is paying for the service) the taxpayer may use a method of reasonable approximation to determine whether the sales for which the information is lacking are included in the New Mexico sales factor numerator and to determine the sourcing of those sales for purposes of Subsection C of Section 7-4-18 NMSA 1978.

(c) Services Delivered Electronically On Behalf of a Customer to a Third Party. A service delivered electronically "on behalf of" a customer is one in which a customer contracts for the service to be delivered electronically directly by the taxpayer or through one or more intermediaries, provided the service does not change its form, to one or more third parties who are the customer's intended recipients of the service. Examples include: delivery of electronic advertising to a customer's intended audience and subcontracted services performed electronically for the customer's customers.

(i) Determining the New Mexico Sales Factor Numerator. The sale of a service delivered electronically to third-party recipients on behalf of the customer is delivered in New Mexico if and to the extent that the third-party recipients are in New Mexico.

(ii) Rule of Reasonable Approximation. If the taxpayer cannot determine the state or states where the sales of a service delivered electronically are actually delivered to the customer's

intended third-party recipients, the taxpayer may use a method of reasonable approximation to determine whether the sales are included in the New Mexico sales factor numerator and to determine the sourcing of those sales for purposes of Subsection C of Section 7-4-18 NMSA 1978.

E. Sale, Lease, or License of Intangible Property. General Rule. Sourcing of receipts from the sale, lease or license of intangible property depends primarily on the nature of the intangible property and the method by which receipts are determined, rather than on whether the transaction is a true sale, lease or license.

(1) Contract Right or Government License that Authorizes Activity in Specific Geographic Area. In the case of a sale, lease or license of a contract right, government license or similar intangible property that authorizes the holder to conduct a activity in a specific geographic area, the receipts from the sale are included in the New Mexico sales factor numerator to the extent that the intangible property is used or is authorized to be used within the state.

(2) Marketing Intangible. The receipts from granting a right to use intangible property in connection with the sale, lease, license, or other marketing of goods or services to a consumer are included in the New Mexico sales factor numerator to the extent of the sale or provision of those goods or services is located or occurs in New Mexico. Examples of marketing intangibles include trademarks, service marks and trade names.

(3) Production Intangible. The receipts from granting a right to use intangible property, other than a marketing intangible, used in manufacturing (a "production intangible") are included in the New Mexico sales factor numerator to the extent that the use for which the fees are paid takes place in New Mexico.

(4) Mixed Intangible. The receipts from a sale, lease or license transaction that involves a mixture of a marketing and production intangible may be included in the New Mexico sales factor as provided in Subsection E of Paragraphs 2 or 3 of 3.5.18.9 NMAC on the basis of the taxpayer's separate statement of these rights, and the related receipts, to the customer as part of the contract with the customer. Otherwise, the receipts will be treated as receipts from a marketing intangible.

(5) Intangible Property that Resembles a Sale of Goods or Services, Including Digital Goods and Services. If receipts from the sale, lease or license of intangible property resembles the sale of a goods or services such that other rules under Section 7-4-17-18 NMSA 1978, or these or other regulations of the department can accurately and appropriately be used to source those receipts, including rules of reasonable approximation, the receipts are included in the New Mexico sales factor numerator as provided in those rules.

(6) Sublicenses. If the receipts from the sale, lease or license of intangible property is to a customer that the taxpayer is aware will grant a sublicense to others, regardless of the form that sublicense may take, and if the taxpayer's own receipts are determined based on its customer's sublicensing of the intangible property, then the taxpayer shall use the rules under this regulation, including rules of reasonable approximation, that would apply to the sourcing of its customer's receipts to determine the sales to be included in the New Mexico sales factor numerator. It is not necessary for the application of this paragraph for the taxpayer to use the same method actually used by its customer to source the sublicensing receipts.

(7) Software Transactions - Generally. Receipts from the sale, lease or license of software, whether "canned" or custom, is treated as the sale, lease or license of tangible personal property, rather than intangible property or the performance of a service, except that, to the extent necessary, the taxpayer may use a method of reasonable approximation under these rules if the taxpayer lacks information to determine where the software is delivered.

F. Mediation: Whenever a taxpayer is subjected to different sourcing methodologies regarding intangibles or services, by the department and one or more other state taxing authorities, the taxpayer may petition for, and the department may participate in, and encourage the other state taxing authorities to participate in, non-binding mediation in accordance with the alternative dispute resolution rules promulgated by the Multistate Tax Commission from time to time, regardless of whether all the state taxing authorities are members of the Multistate Tax Compact.

[3.5.18.9 NMAC – N, xx/xx/xxxx]