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Withholding Taxes in New Mexico

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What are Withholding Taxes?

- The Withholding Tax Act, Sections 7-3-1 through 7-3-14, NMSA 1978, relates to Personal Income Taxes, (“PIT”).
- The Withholding Tax Act requires employers to withhold an amount from each of their employees’ wages for payment of New Mexico personal income taxes.
  - The terms “employer” and “employee” have a special meaning for purposes of the Withholding Tax Act.
  - Because withholding tax relates to PIT, other definitions from the Income Tax Act, Sections 7-2-1 through 7-2-40, NMSA 1978, are also important.

Important Defined Terms

- Personal Income Tax defined terms:
  - The Income Tax Act distinguishes between residents and non-residents of New Mexico; taxable income is calculated differently for each category.
  - A "resident" of New Mexico is a person who is: (1) domiciled in New Mexico, or (2) physically present in New Mexico for 185 days or more during the taxable year. Section 7-2-2(S).
    - Residents are taxed on all their net income, whether earned in New Mexico or not.
    - Non-residents have their income apportioned or allocated, and only income apportioned or allocated to New Mexico is subject to income tax.
  - "Domicile" is defined by regulation, Section 3.3.1.9(C), NMAC; while the regulation is lengthy, a person's domicile is essentially the place they consider to be their home.

More Important Defined Terms

- Withholding Tax Act defined terms:
  - Withholding Tax Act applies to "employers" and "employees"; these definitions also incorporate residence and domicile concepts.
  - An "employee" is: (1) an individual <u>domiciled</u> in New Mexico who performs services <u>in New Mexico or outside of New Mexico</u> for an employer; <u>or</u> (2) an individual <u>not domiciled</u> in New Mexico who performs services <u>in New Mexico</u> for an employer. Section 7-3-2(B).
  - An "employer" is a person <u>doing business in or deriving income from sources within New</u> Mexico for whom an individual performs services as an employee for that person. Section 7-3-2(C).
  - "Person" for purposes of this act includes corporate- and partnership-type entities, as well as governmental entities. Section 7-3-2(H).

Application of the Withholding Tax Act

- An employer who deducts a portion of an employee's wages for federal income tax shall also deduct and withhold a portion of wages for state income tax. Section 7-3-3.
  - <u>Note</u>: an "employer" is a person who does business in New Mexico, or derives income from New Mexico sources. So, if a company has an employee located in New Mexico, including a teleworking employee, that company is likely an "employer" for purposes of the Withholding Tax Act.
  - Further exception: if the employee is <u>not a resident</u> and performs services in New Mexico <u>15 days or less</u>, there is no withholding requirement. Section 7-3-3(A)(2).

Different Withholding Scenarios

- There are six potential scenarios:
  1. New Mexico employer employing a person domiciled in New Mexico;
  2. New Mexico employer employing a non-domiciliary who works more than 15 days in New Mexico;
  3. New Mexico employer employing a non-domiciliary who works 15 days or less in New Mexico;
  4. Non-New Mexico employer employing a person domiciled in New Mexico;
  5. Non-New Mexico employer employing a non-domiciliary who works more than 15 days in New Mexico; and,
  6. Non-New Mexico employer employing a non-domiciliary who works 15 days or less in New Mexico.

Scenario 1

- New Mexico employer employing a New Mexico domiciliary.
  - Employer is doing business in New Mexico, or deriving income from New Mexico sources.
  - Employee is domiciled in New Mexico.
  - Employee owes income tax on all net income.
    - Employee will owe taxes on all income, including income derived from sources or performance of services outside of New Mexico.
  - Employer is required to withhold New Mexico income taxes on wages it pays to that employee.

Scenario 2

- New Mexico employer who employs a non-domiciliary who works more than 15 days in New Mexico.
  - Employer is doing business in New Mexico, or deriving income from New Mexico sources.
  - Employee is not domiciled in New Mexico. But may still be a resident of New Mexico, under the 185-day test.
  - Employee is an “employee” as defined under the Withholding Tax Act. Section 7-3-2(B).
- Employer must withhold New Mexico income tax.
  - Amount of wages subject to PIT depends on <u>residency status</u>. Section 7-2-11(A).
    - All net income of residents is subject to PIT.
    - For non-residents, income allocated to New Mexico is subject to PIT

Scenario 3

- New Mexico employer employing a non-domiciliary who works 15 days or less in New Mexico.
  - Employer is doing business, or deriving income from New Mexico sources.
  - Employee is not domiciled or a resident, and works 15 days or fewer in New Mexico.
  - Employee is <u>not</u> subject to New Mexico income tax. Section 7-2-11(A)(4)(a).
  - Employer is <u>not</u> required to withhold. Section 7-3-3(A)(2).

Scenario 4

- Non-New Mexico employer employing a New Mexico domiciliary.
  - Employer neither does business in New Mexico nor derives any income from New Mexico sources.
    - Note: if the employee is performing services for the employer in New Mexico, then the employer is a New Mexico employer, and Scenario 1 applies.
    - This scenario only applies when the employee is domiciled in New Mexico, but does not perform work for the employer in New Mexico. Therefore, this scenario does not apply to an employee teleworking from New Mexico for an employer located out of state.
  - Employee is domiciled in New Mexico; but may also be a non-domiciled resident.
- Employee is required to pay personal income tax on all net income.
  - Employer is <u>not</u> required to withhold, because it does not fit within technical definition of “employer” in Withholding Tax Act.
    - However, the Department recommends that employees request that their employers do withhold for New Mexico personal income tax. Otherwise, employees are required to pay estimated taxes, and may suffer penalties and interest for failure to do so.

Scenario 5

- Non-New Mexico employer employing a non-domiciliary who works more than 15 days in New Mexico.
  - Employer neither does business in New Mexico nor derives any income from New Mexico sources.
  - Employee is not domiciled in New Mexico, but works more than 15 days in New Mexico.
    - Employee may be a New Mexico resident without being domiciled in the state.
  - Note: this scenario is unlikely, as the employee could not be performing services for the employer in New Mexico under it.
- Employee is required to pay personal income tax on income derived from employment in New Mexico; i.e., income must be apportioned. Section 7-2-11(A)(4).
    - But if employee is a non-domiciled resident, the employee is required to pay income tax on all net income.
- Employer is <u>not</u> required to withhold, because it does not fit within technical definition of “employer” within the Withholding Tax Act.
    - But again note that if the employee is performing services in New Mexico for that employer, this scenario does not apply – Scenario 2 would apply.
    - Residents may still want their employers to withhold tax, however, as non-domiciled residents are still liable for personal income tax on all their net income.

Scenario 6

- Non-New Mexico employer employing a non-domiciliary who works 15 days or less in New Mexico.
  - Employer neither does business in New Mexico nor derives any income from New Mexico sources.
  - Employee is not a domiciliary, but works 15 days or fewer in New Mexico.
  - Employee is not required to pay personal income tax in New Mexico. Section 7-2-11(A)(4).
  - Employer is not required to withhold tax. Section 7-3-3(A)(2).

Credit for Taxes Paid to Another State

- Residents only may get a credit for taxes paid to another state. Section 7-2-13.
  - Other state's tax must be on income derived from work performed outside of New Mexico.
  - Income must be included in net income as income allocated or apportioned to New Mexico under Section 7-2-11.
  - Taxpayer must provide evidence that tax was paid to another state.
  - Credit cannot exceed amount of taxpayer's New Mexico income tax liability on income allocated or apportioned to New Mexico.

Some Specific Examples: 1

- The most common scenario.
- X Corporation, a company doing business in New Mexico, employs Y.
- Y is domiciled in New Mexico, and performs work for X Corporation in New Mexico.
- All of Y's net income is subject to personal income tax, and X Corporation must withhold tax.
- If Y starts teleworking from home in New Mexico, there is no change to either personal income tax liability or withholding responsibility.

Some Specific Examples: 2

- Same situation as Example 1. But during their employment with X Corporation, Y moves out of New Mexico, and begins teleworking for X Corporation.
- Y is no longer domiciled in New Mexico; but Y may still be a resident of New Mexico if they spend 185 days or more physically present in New Mexico. Note: they do not need to be working in New Mexico to be physically present here. They can be physically present for other reasons.
  - Residents are subject to personal income tax on all their net income.
  - Non-residents are subject to personal income tax on their apportioned income.
- X Corporation must withhold taxes.
  - If Y is still a resident of New Mexico, then Y has wages against which tax must be withheld.
  - If Y is a non-resident, then no income from X Corporation is subject to withholding. So there is a duty to withhold, but no actual amounts are withheld.

Some Specific Examples: 3

- Z Corporation is a Texas business that does not derive income from New Mexico.
- Y is a person domiciled in New Mexico.
- Y commutes to Texas, and performs all work for Z Corporation in Texas.
- Y is subject to personal income tax on all their net income.
- Z Corporation does not withhold; Z Corporation is not an “employer” as defined by the Withholding Tax Act.
  - This is true, even though Y <u>is</u> an “employee” as defined by that Act.
  - Y may request that Z Corporation withhold taxes, in order to avoid the need to pay estimated tax, and the risk of incurring penalty for failure to do so.

Some Specific Examples: 3 (continued)

- During the course of their employment, Y begins teleworking from New Mexico for Z Corporation.
- No change to Y's liability for personal income tax. Y is still a resident of New Mexico, and must pay personal income tax on all net income.
- But now Z Corporation <u>does</u> have a duty to withhold.
  - Because Z Corporation now has an employee performing services for it in New Mexico, it is now "doing business in or deriving income from sources within" New Mexico. Section 7-3-2(C).
  - Z Corporation may now also have to report and pay New Mexico corporate income tax.

Some Specific Examples: 4

- Z Corporation is a Texas corporation that derives income from New Mexico sources.
- Y is not domiciled in New Mexico, but performs services for Z Corporation in New Mexico more than 15 days in the year.
  - If Y is physically present in New Mexico (whether working for Z Corporation or not when present) 185 days or more, then Y is a resident of New Mexico. Otherwise, Y is not a resident.
- Y is responsible for paying personal income tax.
  - If Y is a resident, then Y is taxed on all their net income.
  - If Y is a non-resident, then Y is taxed on income allocated to New Mexico.
- Z Corporation is responsible for withholding.
  - Z Corporation is an "employer" because it is doing business in or deriving income from sources within New Mexico.
  - Y is an "employee" because they are domiciled outside of New Mexico, but are performing services within the state for Z Corporation.

Questions?

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