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F I S C A L I M P A C T R E P O R T

SPONSOR Wirth **ORIGINAL DATE** 03/09/09 **LAST UPDATED** **HB**

SHORT TITLE Corporate Income Tax Rates and Payments **SB** 648

ANALYST Francis

REVENUE (dollars in thousands)

Estimated Revenue			Recurring or Non-Rec	Fund Affected
FY09	FY10	FY11		
	80,000.0 to $100,000.0	$60,000.0 to $80,000.0	Recurring	General Fund
	* See narrative			

(Parenthesis ( ) Indicate Revenue Decreases)

Relates to SB389

SOURCES OF INFORMATION
LFC Files

No Response Received From
Taxation and Revenue Department (TRD)

SUMMARY

Synopsis of Bill

Senate Bill 648 makes significant changes to the way corporations are taxed according to the Corporate Income and Franchise Tax Act by expanding the franchise tax from $50 to a rate of 0.084 % of the sum of the value above certain thresholds of sales, property and payroll, similar to the way corporate income is allocated. The modified tax is reduced by the corporate income tax.

Section 1 **Adds definitions:**
"business industry" is a corporation other than a sole proprietorship, estate, or trust
"ownership share" means all interests, direct and indirect, owned or leased in a business entity
"related business entity" is a business entity for which a corporation's ownership share is more than 20 percent

Section 2 Changes CIT rates

	Current Law	SB 648
Less than 250,000	4.8%	0.0%
250,000-500,000	4.8%	7.6%
500,000 to 1,000,000	6.4%	7.6%
!,000,000 or more	7.6%	7.6%

Section 3 Increases franchise tax from $50.00 to $50 plus a graduated rate less the CIT rate

	property share	payroll share	sales share
0	$5 million or less	$1.2 million or less	$9.3 million or less
0.084%	Over $5 million	Over $1.2 million	Over $9.3 million
Apportionment	If a corporation owns more than 80 percent of a business entity, then property, sales and payroll share is 100%		

If the changes increases the amount of estimated payments made prior to June 15th, 2010, the increased amount is not required to be paid until the first quarterly payment on or after September 15th, 2010.

The changes are for tax year 2010 and beyond.

FISCAL IMPLICATIONS

TRD has not responded to a request for information but it is estimated that because this addresses many of the issues regarding out of state “passive investment companies” it is expected that the change will increase corporate income tax revenue by a similar amount as mandating combined reporting. The fiscal impact for SB389 which mandates corporate income is shown below:

	FY10	FY11	FY12	FY13
General fund	94.72	69.80	77.60	85.40

TRD has reported in other contexts that approximately 1,500 taxpayers would be affected from all sectors.

SIGNIFICANT ISSUES

Under current law, a company is taxed $50 for the franchise tax plus the amount of corporate income tax (CIT) determined by the companies allocable share of income multiplied by the appropriate rate. A concern that has been raised in recent years is that some companies are able to transfer NM income to subsidiaries in states that do not tax income. Only multi-state companies are able to do this efficiently and so to the extent that this activity is for tax minimization only and not for legitimate business reasons it places local companies at disadvantage.

SB389, a related bill, attempts to address this by mandating combined reporting which would capture these transactions but the business community and the New Mexico Tax Research Institute have expressed opposition to this and believe it will not increase revenue and will be detrimental to economic development in the state.

SB648 comes at the issue from a different angle, sidestepping the combined reporting issue, by expanding the franchise tax in such a way that the method of reporting is not an issue. SB648 calculates a tax based on payroll, sales and property amounts (rather than income) and than subtracts the amount calculated for CIT. The new franchise tax, which cannot be less than zero, is added to CIT for the total tax liability (The $50 per company tax still applies as well). This way, a company with a significant presence manifested by property, payroll and sales will still have a liability if the company is able to significantly decrease the CIT owed.

The bill adds the following definitions in the Corporate Income and Franchise Tax Act:

- “business entity” means a corporation or any other business association except sole proprietorship, estate or trusts.
- “ownership share” means all interests, direct and indirect, held in a business entity;
- “related business entity” means a business entity for which a corporation’s ownership share exceeds twenty percent; provided that business entities with common ownership, direct plus indirect, of more than twenty percent are related business entities and are each deemed to have the direct plus indirect ownership share of the common owner in each of the other commonly owned business entities.

TRD, responding to a proposal but which is pertinent to this discussion, reports that this new methodology will reduce economic distortions:

> State corporate income taxes also largely incorporate the other economic distortions due to provisions in the federal corporate income tax, although some states avoid the effect of some provisions by “decoupling” from portions of the federal tax. In addition to economic distortions due to conformity with the federal tax, other distortions arise from state corporate income tax provisions that determine the appropriate amount of tax for a state to impose on the income of multi-state businesses. These businesses are typically part of a large number of related entities that may have multiple transactions among them, including sales, asset transfers, cost sharing arrangements, charges for services, and royalties for the use of intangibles. The number and complexity of these transactions make the determination of the income attributable to each state very difficult, giving rise to the multiple state income tax provisions that attempt to properly match the income and expenses of a multi-state corporation to the activities in a state. These provisions include mandatory combined reporting; authority to reallocate income, deductions, and other items between related entities; “add-back” and “anti-passive investment company” legislation; minimum taxes; and significant franchise taxes. These rules tend to be complex, requiring significant compliance resources from both corporations and state tax agencies. They also have generated significant litigation. In addition, the actual or perceived “business climate” of a state may be heavily influenced by presence and nature of such rules.

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

Relates to SB389 which mandates combined reporting.

NF/mc

The Legislative Finance Committee has adopted the following principles to guide responsible and effective tax policy decisions:

1. ***Adequacy:*** *revenue should be adequate to fund government services.*
2. ***Efficiency:*** *tax base should be as broad as possible to minimize rates and the structure should minimize economic distortion and avoid excessive reliance on any single tax.*
3. ***Equity****: taxes should be fairly applied across similarly situated taxpayers and across taxpayers with different income levels.*
4. ***Simplicity****: taxes should be as simple as possible to encourage compliance and minimize administrative and audit costs.*
5. ***Accountability/Transparency:*** *Deductions, credits and exemptions should be easy to monitor and evaluate and be subject to periodic review.*

More information about the LFC tax policy principles will soon be available on the LFC website at www.nmlegis.gov/lcs/lfc