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

SPONSOR Munoz
ORIGINAL DATE 02/11/13
LAST UPDATED
HB

SHORT TITLE Single Sales and Reduce Corporate Sales Tax
SB 277

ANALYST van Moorsel

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY13	**FY14**	**FY15**	**FY16**	**FY17**		
	($49,000.0)	($153,000.0)	($230,000.0)	($255,000.0)	Recurring	General Fund

(Parenthesis ( ) Indicate Revenue Decreases)

Duplicate to HB 182

Relates to SB 13, Corporate Income Tax Rates and Reporting, and SB 59, Corp. Tax Reporting, Single Sales & Repeals.

SOURCES OF INFORMATION
LFC Files

Responses Received From
Department of Finance and Administration (DFA)
Taxation and Revenue Department (TRD)

SUMMARY

Synopsis of Bill

Senate Bill 277 (SB 277) amends the Corporate Income and Franchise Tax Act phase in a corporate income tax (CIT) rate reduction between tax years 2014 and 2016. The bill also permits corporate income taxpayers to opt into a different apportionment formula that transitions toward a single-sales factor between tax years 2014 and 2016. The bill also amends the act to and to exclude certain sales from being apportioned as sales in New Mexico.

The effective date of this bill is January 1, 2014, and the provisions are applicable to taxable years beginning on or after January 1, 2014.

The bill phases in the CIT rate reductions as follows:

<table>
<tr><th>Net Income</th><th>Tax Year 2013</th><th>Tax Year 2014</th><th>Tax Year 2015</th><th>Tax Year 2016</th></tr>
<tr><td>Less Than $500 thousand</td><td>4.8%</td><td>4.8%</td><td>4.8%</td><td>4.8%</td></tr>
<tr><td>Between $500 thousand and $1 million</td><td>$24,000 plus 6.4% of excess over $50k</td><td>$24,000 plus 5.9% of excess over $500k</td><td>$24,000 plus 5.4% of excess over $500k</td><td rowspan="2">$24,000 plus 4.9% of excess over $500k</td></tr>
<tr><td>Greater than $1 million</td><td>$56,000 plus 7.6% of excess over $1m</td><td>$53,500 plus 6.7% of excess over $1m</td><td>$51,000 plus 5.8% of excess over $1m</td></tr>
</table>

SB 277 allows taxpayers to opt into the following apportionment formula schedule that increasingly weights the salesfactor over the property and the payroll factor:

Tax Year	**Apportionment Formula**
2013	$\dfrac{\text{(sales factor)X(property factor)X(payroll factor)}}{3}$
2014	$\dfrac{\text{(2Xsales factor)X(property factor)X(payroll factor)}}{4}$
2015	$\dfrac{\text{(8Xsales factor)X(property factor)X(payroll factor)}}{10}$
2016	$\dfrac{\text{(total sales in New Mexico)}}{\text{(total corporate sales)}}$

FISCAL IMPLICATIONS

According to the Taxation and Revenue Department (TRD), 2010 New Mexico corporate income tax data was used to analyze the fiscal impact. According to this data, there are 13,571 corporations that pay no income tax. Another 3,545 corporations have New Mexico taxable income under the $500 thousand threshold and hence will not be impacted by the proposed rate change. Therefore, the remaining 2,973 corporations (with a non-apportioned New Mexico taxable income of $374,088,021,423) will see a tax decrease due to the rate decreases.

There are 1,276 corporations whose sales factor is less than the average factor that pay New Mexico tax according to the 2010 corporate income tax data. It was assumed that all these corporations would elect to go towards the single sales factor apportionment as proposed. For these corporations, it was assumed that "throwback" rule would not apply.

In order to estimate the fiscal impact, the new rates were applied to (non-apportioned) New Mexico taxable income for each corporation, to calculate the non-apportioned tax for each corporation under the new rate regimes as proposed. The proposed apportionment factors were applied to the non-apportioned tax, for the applicable tax years, for the impacted corporations (as assumed above) in order to estimate the apportioned tax paid to New Mexico under the proposed law. Consensus revenue forecast estimates were used to estimate the tax under proposed law at the forecasted level (calculated in proportion from the 2010 tax year level). The difference between the two (consensus forecasts and the estimated tax under the proposed law for all corporations) for each fiscal year, was used to estimate the fiscal impact.

The corporate income tax is currently structured according to net income. The lowest rate (for net income below $500 thousand is taxed at 4.8 percent. Net income between $500 thousand and $1 million is taxed at 6.4 percent, and net income over $1.0 million is taxed at 7.6 percent.

The magnitude of the estimated revenue impact of the rate reduction results from the large percentage of CIT payments made at the top rate of 7.6 percent. The table below presents a breakdown of CIT payments received at each of the three rates in the current schedule – 97.4 percent of CIT payments were made at 7.6 percent of net income.

	NM CIT Paid (in millions of dollars) where taxable income is . . .			
Tax Rate	Less Than $500K	Between $500 thousand and $1 million	Greater than $1 million	Percentage of Total
4.8%	$5.9	$1.5	$2.4	1.1%
6.4%	n/a	$0.8	$3.2	1.5%
7.6%	n/a	n/a	$209.2	97.4%
Total Taxes Paid	$5.9	$2.3	$214.8	
# of Taxpayers	4,210	463	3,339	

This bill may be counter to the LFC tax policy principle of adequacy, efficiency and equity. According to the LFC staff General Fund Recurring Appropriation Outlook for FY15 and FY16, after the revenue impact of the bill, forecasted revenues may be insufficient to cover growing recurring appropriations.

SIGNIFICANT ISSUES

New Mexico's top corporate income tax rate of 7.6 percent is high, compared with the national average of 6.4 percent. New Mexico's CIT rate is especially high when considering a corporation can be taxed at the 4.9 percent personal income tax rate simply by organizing under another section of the IRS code. This violates the principle of tax equity. In 2011, the Council on State

Taxation (COST) commissioned Ernst & Young to perform a 50-state study of effective tax rate/after-tax return on investment over a 30-year investment, New Mexico ranked last. The study found that tax rates and a complex tax credit incentive system are a burden on firms considering investments in New Mexico and are "almost certainly impeding economic growth." Among other options, the New Mexico Tax Research Institute (NMTRI) noted a reduction in the top corporate rate would make New Mexico more appealing to business investment.

The NMTRI also addressed the option of allowing corporations to apportion income with a single- or double-weighted sales factor. All states parse a multistate corporation's income into a state taxable base. New Mexico uses an "apportionment formula" that averages the percentage of a corporation's sales occurring in New Mexico, the percentage of payroll in New Mexico, and the percentage of property (or assets or investment) domiciled in New Mexico. The equally weighted corporate income apportionment formula creates a disincentive to expansion in New Mexico; if a company increases its operations in New Mexico, its taxes in New Mexico would increase, even without the benefit of additional sales, creating a disincentive to growth. Firms can lower exposure to New Mexico tax by firing workers and closing plants.

The "single sales" factor, by which income is apportioned only on the percentage of sales made in the state, is the alternative in favor nationally. This formula does not punish firms for investing or employing workers within a state. In New Mexico, a single sales formula would likely benefit extractive and manufacturing industries while penalizing direct sellers of goods and services and multistate banks. Mining and manufacturing pay well over half of New Mexico CIT, however, and this formula could result in lower revenues.

A corporate subsidiary doing business in New Mexico can pay taxes on a "separate corporate entity" basis or the entire corporation can pay on a "combined reporting" basis. Separate reporting brings up concerns about charges between related companies. For example, a company domiciled outside of New Mexico might provide management services or legal services to one domiciled in New Mexico and receive a payment for those services. The company making the payment would incur an expense. If the paying company is reporting on the separate entity basis, this expense will reduce its taxable income. The company not domiciled in New Mexico receiving the payment increases its income, and if it is located in a state with no income tax it might avoid the tax. Although it is hard to estimate the impact of this activity, combined reporting eliminates any chance of "gaming the system" because the income of all members of the corporate group is included. Because of the sales factor, combined reporting could have unintended consequences because a corporation could pay more tax based on the profits of its affiliates nationwide, regardless of whether the in-state subsidiary is profitable.

ADMINISTATIVE IMPLICATIONS:

According to the TRD, the phase out for the payroll and property factors could be burdensome for the taxpayer because they would need to calculate their CIT returns for the next 3 years using a different method of apportionment. The TRD suggests it would be taxpayer friendly to allow the taxpayer to elect the single sales factor effective tax year January 1, 2014.

Also, the TRD would have some difficulty in administering this phase out. The department would need to reprogram their systems to accept these returns for the 3-year phase out of the payroll and property factors. The forms and instructions would need to be revised every year and the audit staff and the Multistate Tax Commission that audits CIT on the state's behalf would need to adjust procedures for the years in question.

TECHNICAL ISSUES

The TRD notes that because Section 2 of the bill deletes Subsection B (page 3, line 22 through page 5, line 3) and makes the single sales factor election apply to all taxpayers, Subsection D-defining "manufacturing" is not necessary and should be deleted also.

DUPLICATION, RELATIONSHIP

Duplicate to HB 182. Relates to SB 13, Corporate Income Tax Rates and Reporting, and SB 59, Corp. Tax Reporting, Single Sales & Repeals.

Does the bill meet the Legislative Finance Committee tax policy principles?

1. **Adequacy**: Revenue should be adequate to fund needed government services.
2. **Efficiency**: Tax base should be as broad as possible and avoid excess reliance on one tax.
3. **Equity**: Different taxpayers should be treated fairly.
4. **Simplicity**: Collection should be simple and easily understood.
5. **Accountability**: Preferences should be easy to monitor and evaluate

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