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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** **LAST UPDATED**	02/04/14	**HB**	
SHORT TITLE	Unitary Corporate Bank Combined Tax Reporting			**SB**	17
				ANALYST	Graeser

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY14	**FY15**	**FY16**	**FY17**	**FY18**		
	$560.0	$1,250.0	$780.0	$300.0	Recurring	General Fund (CIT)

(Parenthesis ( ) Indicate Revenue Decreases)

* See Fiscal Issues Below for detail of this estimate.

Neither RLD nor TRD report significant administrative or compliance efforts will be needed to implement and administer the provisions of this bill.

SOURCES OF INFORMATION
LFC Files

Responses Received From
Taxation and Revenue Department (TRD)
Regulation and Licensing, Financial Institutions Division (RLD/FID)
Economic Development Department (EDD)

SUMMARY

Synopsis of Bill

Senate Bill 17 amends the corporate income tax statute (Section 7-2A-8.3 NMSA 1978) to add a requirement that financial institutions must utilize combined reporting if that financial institution is part of a bank or other financial institution unitary group. Combined reporting for this type of entity is to be done with other unitary corporations as though the entire combined net income were that of one corporation.
The effective date of this bill is January 1, 2015 and applicable for corporate taxable years beginning on or after January 1, 2015.

FISCAL IMPLICATIONS

Tax Year (TY) 2010 Corporate Income Tax (CIT) collections in NAICS 521-523 and 525 totaled $9.0 million. For TY 2011, the same total was $14.4 million. For previous years, financial

corporations contributed from 3 percent to 6 percent of total receipts (prior to credits), with an average for TY06 through FY10 of 4 percent. NAICS 521-523 may be more expansive than necessary, since many corporations file as separate entities that are not part of a unitary group.

TRD reports:

> Tax Year 2011 New Mexico corporate income tax data was used in this analysis. Income tax paid by the banking sector is about $7M of which approximately $6M is paid by separate corporate entity (SCE) filers and the rest by filers using Unitary Combined and Federal Consolidated methods. A review of several experiences and studies on combined reporting provided a range of estimates from a zero change or no increase in revenue up to a 20 percent increase in revenue. It was assumed that in the case of "banks" switching to combined reporting would increase revenue by 20 percent. However, this initial rate of increase is expected to diminish as taxpayers adjust their operations and corporate structures to minimize taxation. Consensus corporate income tax growth rates were used to estimate the impact in the subsequent years. The first fiscal year impact is a partial impact.

Estimating the cost of tax changes is difficult. TRD analysts have access to confidential data, and while this is usually important information, it by no means answers all questions about the future.

SIGNIFICANT ISSUES

This will be the second mandatory corporate combined requirement. The first, enacted in Laws 2013, Chapter 160 (HB 641), required some "big box" retailers to file combined corporate income tax returns.

TRD describes the issues as follows, "…unitary combined reporting is often presented as a way to ensure that multistate corporate taxpayers pay their 'fair share'. However, unitary combined reporting does not necessarily ensure that the proper amount of income is attributed to the state when compared to the actual level of a corporate taxpayer's real economic activity in the state because it assumes that all businesses within the unitary entity are equal in their profitability. This is almost certainly not the case. Furthermore, mandatory combined reporting may discourage corporations with profitable operations in other states from locating in New Mexico since profits from existing operations would be partially-taxable in New Mexico, even though their New Mexico start-up operation was not profitable.

Mandatory combined reporting generates revenue for New Mexico when the property, payroll and sales ratios are quite different from one another and or when the New Mexico contributions to corporate profit are quite different from the average factors of other state contributions to corporate profit. For financial corporations, this requirement is likely. Banks make profit by investing deposits in loans and in the financial markets. Large unitary national financial institutions invest otherwise unvested cash at the corporate level, since money is completely fungible. These investments generate a great deal of income per dollar of property or payroll compared to the amount of income per dollar of property or payroll involved in servicing consumer accounts or initiating and servicing commercial or consumer loans at the state or local level. Thus, the New Mexico separate financial corporate entity would have 100 percent allocation of lower amounts of profit generated from in-house/in-state loans and fees compared

to the amounts of profit per dollar of property or payroll of a lucrative investment operation. It is not clear how the investment earnings are booked to the branch banks, but it is likely that not all of the earnings are booked back to the state. Banks will allocate significant resources to headquarters property and payroll, but each branch bank is structured with an eye to balancing sales, payroll and property. This balance will be quite uniform among branches within the state and in other states, but be wildly different for the investment division. This imbalance creates the likelihood that requiring local banks that are part of a large national unitary group to file as combined will generate revenue for the State. Whether 20 percent of current taxes paid is an appropriate estimate, an underestimate or overestimate remains to be seen.

In many previous discussions of mandatory consolidated CIT filing, little attention has been paid to financial corporations. What is clear from perusing the complexity of State taxation of financial institutions, there is little consensus on how to impose state corporate or excise taxes on financial institutions. Of the 45 states that impose a corporate income tax, 31 tax financial corporations on the same basis that they tax non-financial corporations. The other 14 either impose in-lieu-of-CIT taxes based on deposits or impose surtaxes or, in the case of Delaware, impose declining marginal rates as income rises. This is a difficult industry to tax fairly because of the risk of non-performing loans and pro-cyclical gains and losses. Banks are allowed to maintain untaxed reserves to cover losses from non-performing loans. There are other subtle tax and regulatory rules for the financial industry. (http://www.taxadmin.org/fta/rate/corp_inc.pdf)

The ladder from separate entity to combine to federal consolidated is elective. However, moving back down from combined to separate entity requires approval of the Secretary of TRD and is unlikely to be granted unless the composition of the combined group changes. It is reported that some corporations would benefit in most years from the combined status, but file as separate to preserve the right to file as separate entity in the years in which that is the appropriate election. However, it is unlikely that financial corporations would pay less tax as New Mexico separate entities than as a member of the unitary group filing combined.

PERFORMANCE IMPLICATIONS

The LFC tax policy of accountability is not applicable to the provisions of this bill.

OTHER SUBSTANTIVE ISSUES

In the wake of the 2008 financial collapse, financial institutions are still reeling from the increase in regulation and oversight. The State should be somewhat wary of imposing additional stresses on these banks until the new federal rules have settled down and whatever mergers that are going to take place have take place. The bill has a delayed implementation date, such that the first revenue from the proposal will not be forthcoming until March of 2016 and will not be fully implemented until FY17.