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

		ORIGINAL DATE	2/11/15		
SPONSOR	James	**LAST UPDATED**		**HB**	286
SHORT TITLE	Single Sales Factor for Corporate Income			**SB**	
				ANALYST	van Moorsel

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY15	**FY16**	**FY17**	**FY18**	**FY19**		
($4.7)	($9.6)	($12.7)	($17.7)	($25.7)	Recurring	General Fund

(Parenthesis ( ) indicate revenue decreases

SOURCES OF INFORMATION

LFC Files

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

SUMMARY

Synopsis of Bill

House Bill 286 amends the Uniform Division of Income for Tax Purposes Act (UDITPA) to phase in optional single-sales income apportioning for corporate income tax (CIT) for taxpayers whose principal business activity in the state is a headquarters operation as follows:

HB 286 - Apportionment Formula Schedule

Tax Yr	Apportionment Formula
Current Law	$\frac{\text{(sales)+(property)+(payroll)}}{3}$
2015	$\frac{\text{(3Xsales)+(property)+(payroll)}}{5}$
2016	$\frac{\text{(7Xsales)+(1.5Xproperty)+(1.5Xpayroll)}}{10}$
2017	$\frac{\text{(7Xsales)+(1.5Xproperty)+(1.5Xpayroll)}}{10}$
2018	$\frac{\text{(total sales in New Mexico)}}{\text{(total sales)}}$

The bill defines "headquarters operation" as:

- the center of operations of a business:
  - where corporate staff employees are physically employed;
  - where centralized functions are performed, including administrative, planning, managerial, human resources, purchasing, information technology and accounting, but not including operating a call center;
  - the function and purpose of which is to manage and direct most aspects and functions of the business operations within a subdivided area of the United States;
  - from which final authority over regional or sub regional offices, operating facilities and any other offices of the business are issued; and
  - including national and regional headquarters if the national headquarters is subordinate only to the ownership of the business or its representatives and the regional headquarters is subordinate to the national headquarters; or
- the center of operations of a business:
  - the function and purpose of which is to manage and direct most aspects of one or more centralized functions; and
  - from which final authority over one or more centralized functions is issued.

The bill provides that all elections to apportion income using a single-sales apportioning formula apply to the separately filed return of the taxpayer or the combined or consolidated return the taxpayer has elected to be included pursuant to provisions of law requiring combined returns for some corporations and permitting consolidated returns.

The provisions of the bill are applicable to taxable years beginning on or after January 1, 2015.

FISCAL IMPLICATIONS

TRD indicates the sample of companies that would be eligible to take this income apportioning option and that would benefit from the election is very small, comprising only $8.7 million in gross income, based on tax year 2012 data. TRD states here are as few as 200 current New Mexico corporations which file under the non-manufacturing NAICS codes and have headquarters in New Mexico. The impact was estimated by apportioning these firms' income under the current and proposed formulae and assuming corporations elect to choose the apportioning formula that minimizes their tax liability.

DFA also states the fiscal impact is expected to be small as there are few existing businesses that qualify for this election. However, DFA adds that to the extent that the provisions allowed through this legislation attract headquarters to the state, the economic impact to the New Mexico economy through the creation of relatively high-salaried jobs would be positive.

This bill may be counter to the LFC tax policy principle of adequacy, efficiency and equity. Due to the negative revenue impact of this bill revenues may be insufficient to cover growing recurring appropriations.

SIGNIFICANT ISSUES

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. Legislation phasing in a CIT rate reduction was enacted in 2013.

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 created 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, does not punish firms for investing or employing workers within a state. The same legislation that reduced the CIT rate phased in an optional single-sales factor income apportionment formula for manufacturing corporations.

DFA reports many states currently offer headquarters incentives, including Alabama, Florida, Georgia, Indiana, South Carolina, and Tennessee, among others.

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

PvM/bb