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

		LAST UPDATED	
SPONSOR	Wirth/Chandler	**ORIGINAL DATE**	02/20/23
SHORT TITLE	Flat Corporate Income Tax Rate	**BILL NUMBER**	Senate Bill 189
		ANALYST	Faubion

REVENUE*
(dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY23	FY24	FY25	FY26	FY27		
--	--	$16,000 - $37,000	$16,500 - $38,500	$17,100 - $39,700	Recurring	General Fund

Parenthesis ( ) indicate revenue decreases
*Amounts reflect most recent version of this legislation.

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT*
(dollars in thousands)

	FY23	FY24	FY25	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
		$11.1	$0.5	$11.6	Nonrecurring	TRD

Parentheses ( ) indicate expenditure decreases.
*Amounts reflect most recent version of this legislation.

Conflicts with HB322.

Sources of Information
LFC Files

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

SUMMARY

Synopsis of Senate Bill 189

Senate Bill 189 creates a single corporate income tax rate of 6.9 percent.

The provisions in this bill apply to taxable years beginning on or after January 1, 2024.

FISCAL IMPLICATIONS

LFC used the corporate income tax tables in the 2021 Tax Expenditure Report to estimate the fiscal impact of the tax increase on businesses in tax year 2020. LFC grew the figures by the gross corporate income tax growth rate estimated in the December 2022 Consensus Revenue Estimating Group through the forecast period. This assumes CIT growth is equal throughout the income distribution.

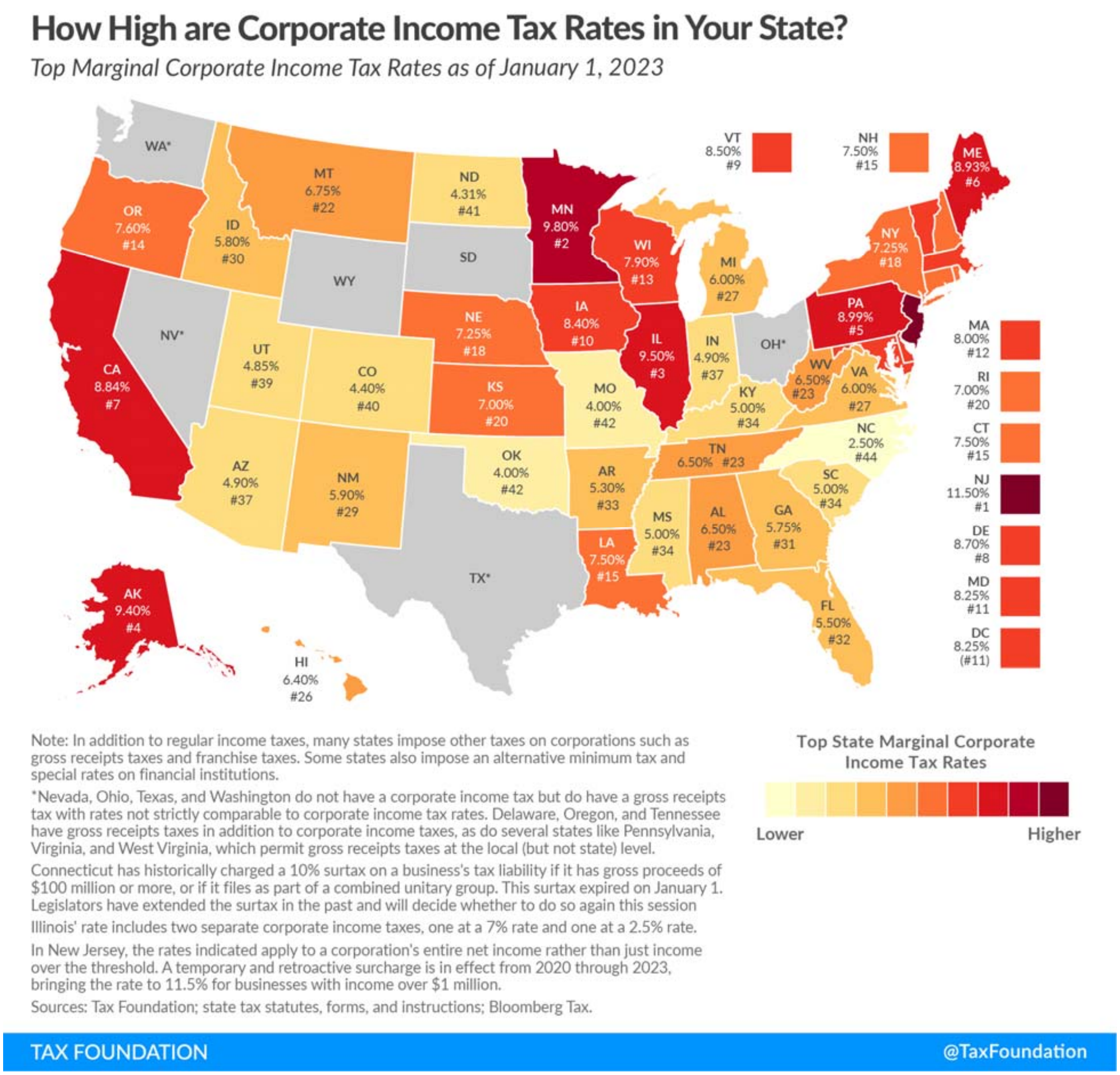
The Taxation and Revenue Department notes the following methodology for their fiscal impact analysis:

> The fiscal impact for corporate income tax (CIT) filers is based on reviewing CIT tax return data from tax years 2019 through 2021. The new taxpayer liability was modeled applying the single tax rate of 6.9 percent. An average tax liability impact was assumed from the three tax years. In any fiscal year, corporate income tax revenue has multiple years of final return payments and estimated payments. The modeling of the increase of the tax rate is challenging due to the multiple tax years layered in any given fiscal year. CIT is an extremely challenging revenue to forecast in times of relatively stability. Given the current economic instability due to consumer demand, supply-chain bottlenecks, energy market uncertainty and inflation, the estimate has been presented as a positive range to emphasize the uncertainly of the magnitude of the impact and the uncertainty of taxpayer behavior for return extensions and final payments. Using the December 2022 Consensus Revenue Estimating Group (CREG) forecast, the average range impact is grown by the current growth rate for gross CIT.
>
> The new entity-level tax was enacted in 2022 to addresses the federal Tax Cuts and Jobs Act (TCJA) $10 thousand limitation on the deduction of state and local taxes for taxpayers that itemize federal deductions. The proposed change in this bill to increase the Corporate Income Tax (CIT) tax rate to one rate of 6.9 percent will increase the tax rate and therefore the amount of tax due for owners of PTEs that elect the new entity-level tax, whether those owners are corporations or individuals. TRD assumes that the increased rate will still not offset the gain that taxpayers will achieve in state taxes versus federal taxes. As it is still unknown how many taxpayers will elect the entity-level tax and what is their taxable income, TRD cannot estimate the fiscal impact of raising the entity-level tax rate to 6.9 percent.

SIGNIFICANT ISSUES

Currently, there are two corporate income tax rates: 4.8 percent for corporations making less than $500 thousand; and 5.9 percent for corporations making more than $500 thousand. According to the 2022 Tax Expenditure Report, there were approximately 71,242 corporate income taxpayers in tax year 2020 and 67,359 of those taxpayers have $0 or less in income and did not pay any corporate income tax. Approximately 91 percent of taxpayers with liability, made less than $500 thousand in income and paid the 4.8 percent rate currently in statute. The remaining taxpayers made over $500 thousand in income and therefore paid the 5.9 percent rate currently in statute. All corporate income taxpayers will experience a tax increase under this bill, with those making less than $500 thousand experiencing a larger increase.

According to the Tax Foundation, 44 states levy a corporate income tax in 2023. New Jersey levies the highest top statutory corporate tax rate at 11.5 percent, followed by Minnesota (9.8 percent) and Illinois (9.5 percent). North Carolina has the lowest CIT rate at 2.5 percent, followed by rates in Missouri and Oklahoma (both at 4 percent). Seven other states impose top rates at or below 5 percent. New Mexico is currently ranked 29th in corporate income tax, as measured by the top marginal rate and ranked highest tax rate to lowest (see map below). Twenty-nine states and the District of Columbia have single-rate corporate tax systems. There is no meaningful progressivity, or "ability to pay," concept in corporate taxation, in contrast to personal income taxation, as the size of a corporation could have no relation to the income levels of the individual owners.



TRD notes the following policy issues:

> Corporations and the economy like certainty and that applies to the tax code. Changing the tax code and in this case the tax rates would be the sixth change to the CIT brackets in

10 years as detailed in the table below. This uncertainty is seen by corporations as creating a less favorable business environment; on the other hand, the majority of states with CIT are moving to a single tax rate.

<table>
<tr><th colspan="7">Table 1 – Historical and Current New Mexico CIT rates</th></tr>
<tr><th>Taxable Income</th><th>1987-2013</th><th>2014</th><th>2015</th><th>2016</th><th>2017</th><th>2018-present</th></tr>
<tr><td>Up to $500,000</td><td>4.8%</td><td>4.8%</td><td>4.8%</td><td>4.8%</td><td>4.8%</td><td>4.8%</td></tr>
<tr><td>$500,000.01 to $1,000,000</td><td>6.4%</td><td>6.4%</td><td>6.4%</td><td>6.4%</td><td rowspan="2">6.2%</td><td rowspan="2">5.9%</td></tr>
<tr><td>Over $1,000,000</td><td>7.6%</td><td>7.3%</td><td>6.9%</td><td>6.6%</td></tr>
</table>

One tax rate also reduces the complexity of the CIT code. This change would support the tax policy principle of simplicity. Taxpayers incur compliance burdens as they prepare, submit, and keep records about tax returns. Likewise, TRD incurs administrative costs to collect taxes, review the accuracy of tax returns and tax payments, and bring taxpayers into compliance.

The reduction of the CIT rates to one rate moves the majority of taxpayers who have tax liability to the higher tax rate. In Tax Year 2020, of those that had tax liability, the majority, approximately 94 percent, incurred that liability with taxable income less than $500 thousand placing them at the 4.8 percent current tax rate. This now places smaller income companies on par with larger corporations. But while for personal income time (PIT) there is progressivity tied to the 'ability to pay" and fairness with vertical equity, that association of ability to pay is not readily applied to corporate income tax policy. The Tax Foundation quotes Jeffrey Kwall, a professor of law at Loyola University Chicago School of Law that 'Graduated corporate income rates are inequitable – that is, the size of a corporation bears no necessary relation to the income levels of the owners.'[1] Additional arguments that the Tax Foundation puts forth for a single-rate, is that it minimizes the effort by corporations to avoid the tax liability at the higher marginal tax rates. New Mexico would join 29 other states who have a corporate income tax and the District of Columbia in enacting a single-rate corporate income tax.

By statute, 7-3A-10 NMSA 1978, those electing the entity-level tax will pay the maximum tax rate of either the highest tax bracket for Personal Income Tax (PIT) or the highest tax bracket for CIT. Currently the rates are equal; this bill will automatically increase the tax rate taxpayers electing the entity-level tax.

While essentially treating these taxpayers as corporate filers may not be a question of fairness, as noted above by the Tax Foundation, it will be assumed that these taxpayers will expend resources to calculate at the federal and state level the advantages to filing under different entities and under different state tax acts.

The Economic Development Department notes the following:

This bill may raise revenues in the short term due to the increase in the rate. However, it may decrease revenues in the long term due to the possibility some businesses may choose to leave the state. It could also significantly deter new businesses from moving to

[1] https://taxfoundation.org/publications/state-corporate-income-tax-rates-and-brackets/

New Mexico because the rate is much higher than those of surrounding states. The proposed tax increase and the associated rate percentage is likely to make businesses look elsewhere. Even though most economic base businesses face an effective tax rate which is much lower than the current rate, this will drive a narrative that could immediately remove our state off the list for companies looking to expand and relocate.

Businesses, especially businesses that file corporate income taxes, favor predictability. New Mexico currently has a phased in rate, that was recently changed in 2019 for the 2020 tax year. By changing the corporate tax rates again, but in the opposite direction, the state is sending a message to current and future businesses that our tax code is unpredictable. This may negatively impact economic diversification and future revenues.

ADMINISTRATIVE IMPLICATIONS

TRD will need to make information system changes and update forms, instructions and publications. These changes will be incorporated into annual tax year implementation for tax year 2024. Implementation of this bill will have a moderate impact on TRD's Information Technology Division (ITD) of approximately 200 hours or about 1.5 months and $11,108 of staff workload costs. The Administrative Services Division (ASD) of TRD will test the changes and will incur eight hours of staff workload costs.

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

This bill conflicts with HB322, which creates a flat corporate income tax credit at a rate of 5.9 percent.

TECHNICAL ISSUES

TRD notes rate changes also impact rates for Section 7-1-13(G) NMSA 1978 Federal adjustments other than the distributive share of federal adjustments; Section 7-3-14 NMSA 1978. Composite returns; and Section 7-3A-10 NMSA 1978, Election of entity-level tax. As noted in policy issues above, the CIT rate increase to 6.9 percent will place CIT above the highest tax bracket for PIT. By statute, Section 7-3A-10 (C) NMSA 1978, those electing the entity-level tax will then pay a higher tax rate at 6.9 percent.

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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