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

SPONSOR: SCORC DATE TYPED: 3/10/03 HB

SHORT TITLE: Withhold Oil and Gas Payments to Nonresidents SB CS/621/aSFl#1

ANALYST: Neel

REVENUE

Estimated Revenue		Subsequent Years Impact	Recurring or Non-Rec	Fund Affected
FY03	**FY04**			
	$1,000.0	$1,000.0	Recurring	General Fund—Net increase in PIT from Withholding Requirement
	($1,600.0)	($2,400.0)	Recurring	General Fund—Distribution to Legislative Retirement Fund
	($600.0)	($1,400.0)	Recurring	Net General Fund
	$1,600.0	$2,400.0	Recurring	Legislative Retirement Fund

(Parenthesis ( ) Indicate Revenue Decreases)

Companion to:
SB 620, Legislative Retirement

SOURCES OF INFORMATION

LFC files

Responses Received From

Attorney General's Office (AG)
Taxation and Revenue Department (TRD)

SUMMARY

Synopsis of SFl#1 Amendment

Senate Floor Amendment #1:

- adds precision to the definition of "residents of New Mexico," who are excluded from the withholding requirements in the bill;
- is a technical amendment conforming language;
- requires the department to annually compile the reports filed by remitters and to compare them with records of individuals, estates or trusts filing income tax returns; and
- makes the first section of the bill—the new distribution to the Legislative Retirement Fund—effective November 1, 2003.

Synopsis of Original Bill

The Senate Corporations and Transportation Committee substitute for Senate Bill 621 imposes a withholding tax requirement on (1) all payments of oil and gas proceeds derived from wells located in New Mexico except for payments to individual residents of New Mexico or tax exempt entities, and (2) distributions to non-resident owners of profits not subject to the oil and gas proceeds withholding provisions from pass-through entities that do business in New Mexico. The rate of the withholding tax is initially set at 6.75% through December 31, 2004, and is thereafter to be set by the Department of Taxation and Revenue at an amount not to exceed the higher of the maximum individual income tax rate or the corporate income tax rate. The original bill imposed withholding only on oil and gas proceeds payable to non-resident individuals or to entities that failed to supply the payor with a New Mexico taxpayer identification number.

The Committee substitute bill also provides for a distribution from the general fund to the legislative retirement fund. However, unlike the original bill, the distribution to the legislative retirement fund provided in the committee substitute is not related to the amount collected from withholding tax collections under the other provisions of the bill.

CS/SB 621 is contingent on passage of SB620, *Legislative Retirement* that creates the Legislative Retirement Fund and amends the Public Employees Retirement Act by altering State Legislator Member Coverage Plan 1 and by adding a new State Legislator Member Coverage Plan 2.

Significant Issues

The AG makes the following comments:

1. This bill appears to target a tax toward non-residents (as opposed to taxing residents and non-residents uniformly). This may conflict with the Privileges and Immunities clause of the U.S. Constitution. The Clause gives a citizen of one state the right to conduct business in another state without having burdens greater than that state's own residents.

2. On the other hand, this bill appears to be modeled after an Oklahoma law (Okla. Stat. § 2352-2385). The Oklahoma Attorney General issued an opinion in 2000 (2000 WL 33155871) and ruled that the Oklahoma law did not violate the Clause. Its rationale was that the law did not actually require an additional tax for nonresidents, it just required payment at a different

time. Nonresidents paid as part of withholding. Resident paid when they filed their yearly returns.

FISCAL IMPLICATIONS

In determining the fiscal impact TRD made the following assumptions:

Due to the potential for legal challenge, there is a possibility that this bill would not take effect, and would therefore have no impact on state revenues. See the discussion under "OTHER ISSUES."

The department does not have information on the likely contributions needed for the Legislative Retirement Fund. The fiscal impact uses the $200 thousand per month floor amount for illustrative purposes.

The estimated increase in personal income tax ("PIT") collections is only a rough approximation. Numerous uncertainties affect the calculation. The following list gives an idea of the difficulty of deriving an estimate:

- Revenue from oil and gas operations is highly variable from year-to-year, thus annual collections will fluctuate widely.
- Oil and gas wells operated by pass-through entities are already subject to a withholding requirement on distributions to their out-of-state owners. Thus the proposal does not have a material impact on these operations, only on those operations by corporations that file federal tax returns under schedule C of the Internal Revenue Code.
- The department does not have reliable information on the typical financial arrangements between well operators and their working interest owners. The department also does not have reliable information on the amounts being distributed annually to out-of-state owners.
- Although the proposal would require withholding for all out-of-state interest owners, including individuals as well as pass-though entities, the latter could file a claim for refund of the tax paid since they are not taxable entities under New Mexico statutes. Thus, there would not be an enhanced compliance on the part of out-of-state individuals whose interests are held through pass-through entities.
- Most out-of-state shareholders are probably in compliance with the state's tax laws already. Income from oil and gas interests in this state are reported to the federal government, and are allocated to this state under the provisions of the Uniform Division of Income for Tax Purposes Act ("UDITPA"). Unlike some other types of business income, there is little ambiguity in the allocation rules concerning this type of income.

ADMINISTRATIVE IMPLICATIONS

Administrative impacts to TRD would be significant. According to TRD, the new withholding requirements would require new forms and systems for processing. In particular there would be major changes to the CRS-1 return. There would be significant cost for the department and increased compliance burdens for taxpayers. Initial costs of $100 thousand and recurring expenditures for one full-time equivalent