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

**SPONSOR** Sapien/ Lujan, B. **ORIGINAL DATE** 02/20/11 **LAST UPDATED** **HB**

**SHORT TITLE** Weighted Sales Factor For Income Tax **SB** 443

**ANALYST** Golebiewski

## REVENUE (dollars in thousands)

| Estimated Revenue | | | Recurring or Non-Rec | Fund Affected |
|---|---|---|---|---|
| **FY11** | **FY12** | **FY13** | | |
| | ($1,400.0)-($6,000.0) | ($2,300.0)-($12,300.0) | Recurring | General Fund |

(Parenthesis ( ) Indicate Revenue Decreases)

Relates to SB 6 and SB 7

**SOURCES OF INFORMATION**
LFC Files

Responses Received From
Taxation and Revenue Department (TRD)

**SUMMARY**

Synopsis of Bill

Senate Bill 443 would allow a corporate income taxpayer whose principal business activity is manufacturing to elect to use “single-weighted sales” (SWS) apportionment to determine their New Mexico taxable income provided they have invested more than specified amounts in New Mexico plant and equipment during specified time periods. A taxpayer investing over $1 billion within a single year could use SWS apportionment for an 8-year period. A taxpayer investing at least $500 million could use SWS for a 4-year period, and a taxpayer investing at least $250 million could use SWS for a two-year period. A taxpayer making the SWS election could not claim the investment tax credit for the same capital equipment.

Effective January 1, 2012. Applicable to tax years beginning on or after January 1, 2012 but provisions are limited to investments occurring by December 31, 2020.

## FISCAL IMPLICATIONS

TRD:

| Estimated Revenue Impact* | | | | | R or NR** | Fund(s) Affected |
|---|---|---|---|---|---|---|
| **FY2011** | **FY2012** | **FY2013** | **FY2014** | **FY2015** | | |
| 0 | (1,400)-(6,000) | (2,300)-(12,300) | (2,800)-(12,900) | (3,000)-(13,100) | R | General Fund |

* In thousands of dollars. Parentheses ( ) indicate a revenue loss. ** Recurring (R) or Nonrecurring (NR).

Fiscal impacts are highly uncertain. The measure would be likely to reduce corporate income tax revenue because it allows taxpayers an election that could potentially reduce the amount of their income that is taxable in New Mexico. However, to qualify for the election, taxpayers would have to invest significant amounts in New Mexico, and they would also have to forego the investment credit they might otherwise be eligible to claim on those investments.

The estimate was based on 2008 corporate income tax paid and apportionment factors used by manufacturing firms in New Mexico. Also, firms taking advantage of the current double weighted sales factor apportionment formula were identified. Investment credit data was reviewed to identify past investment activity. Investment credit claims have varied between $1.8 million and $15 million per year. Qualified equipment purchases would be approximately 20 times the investment credit amounts.

Whether a manufacturer would prefer the SWS election or the investment credit will depend on specific characteristics of their business which are difficult to predict from available data. For example, the investment credit is limited by the number of employees being added to a firm’s payroll. An additional uncertainty is the possibility the proposal will stimulate new investment in the state’s economy, creating an offsetting positive impact on state revenues. This effect is not included in the table due to the difficulty of estimating it with any precision.

## SIGNIFICANT ISSUES

There is a substantial amount of economic research regarding the use of heavier weights for sales in the Corporate Income Tax – the single-weighted (SWS) sales factor represents a weight of 100% on sales. The results, however, are inconclusive regarding the revenue effects. Understanding that the SWS is an election in SB 443, only those companies that would benefit would choose to use the SWS and considering its independent effect, the Corporate Income Tax revenue would decrease.

In terms of economic policy, the reason for allowing the election to a SWS factor following a substantial investment in buildings and employees is that these investments would not be taxed under a SWS factor. If the company had to weigh sales, property and payroll equally, the company would be charged Corporate Income Tax directly on their investment.

The SWS factor runs contrary to the benefits principle of taxation - a large company consuming a significant amount of public services does not necessarily pay tax that reflects this usage. This is better addressed using three-factor apportionment since large companies will pay tax on property at the same rate as sales.

TRD:

The proposal appears intended to stimulate economic development in New Mexico by reducing corporate income tax liabilities for manufacturers making significant new investments in the state. Single-weighted sales apportionment – as compared with traditional three-factor apportionment based on payroll, property and sales – reduces New Mexico tax liability for businesses with large shares of total sales outside the state. This is often the case for manufacturers. Several other western states with corporate income taxes allow the SWS election for certain taxpayers. Thus, allowing the election would make New Mexico more competitive with other states. Manufacturers currently have the option of using "double-weighted sales" to reduce the portion of their income taxable in New Mexico. However, because of several conditions that must be met to qualify for the double-weighted sales election, it has not been used often.

## ADMINISTRATIVE IMPLICATIONS

SB 443 would have minimal impact on TRD.

## TECHNICAL ISSUES

TRD:

- Under present law, taxpayer's making the double-weighted sales election are required to notify the Department in writing when they make the election and also to notify the Department in writing when they terminate the election. The same process should be used for the proposed new single-weighted sales election in the new subsection C.
- On page 3, line 13, "or" should be changed to "and" to make it clear that the denominator of the SWS apportionment factor includes total sales of the corporation.
- The definition of capital equipment in section 1(F)(1) references section 179 of the Internal Revenue Code. Because that section applies to certain classes of taxpayers, using it as a point of reference for this bill may limit the eligible expenditures in unintended ways. A broader definition of eligible equipment expenditures, such as the one in the present law investment credit, section 7-9A-3(B), may be preferable.

JAG/mew

***The Legislative Finance Committee has adopted the following principles to guide responsible and effective tax policy decisions:***

1. ***Adequacy:*** *revenue should be adequate to fund government services.*
2. ***Efficiency:*** *tax base should be as broad as possible to minimize rates and the structure should minimize economic distortion and avoid excessive reliance on any single tax.*
3. ***Equity****: taxes should be fairly applied across similarly situated taxpayers and across taxpayers with different income levels.*
4. ***Simplicity****: taxes should be as simple as possible to encourage compliance and minimize administrative and audit costs.*
5. ***Accountability/Transparency:*** *Deductions, credits and exemptions should be easy to monitor and evaluate and be subject to periodic review.*

***More information about the LFC tax policy principles will soon be available on the LFC website at www.nmlegis.gov/lcs/lfc***