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

SPONSOR HTRC **ORIGINAL DATE LAST UPDATED** 3/15/2013 **HB** 182&507/HTRCS

SHORT TITLE Decrease Certain Corporate income Tax Rates **SB**

ANALYST van Moorsel

DRAFT

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY13	**FY14**	**FY15**	**FY16**	**FY17**		
$0.0	$9,584.6	($15,808.4)	($92,755.4)	($114,459.5)	Recurring	General Fund
$0.0	$8,468.7	$17,333.7	$13,184.3	$18,370.7	Recurring	Local Governments
$0.0	$11.0	$23.0	$31.0	$42.0	Recurring	Small County Assistance Fund
$0.0	$17.0	$34.0	$46.0	$63.0	Recurring	Small Cities Assistance Fund
$0.0	$6.0	$11.0	$15.0	$21.0	Recurring	Municipal Equivalent Distribution
$0.0	$18,087.3	$1,593.3	($79,479.1)	($95,962.8)	Recurring	Total

(Parenthesis ( ) Indicate Revenue Decreases)

Estimated General Fund Revenue Impacts					Bill Component
FY13	**FY14**	**FY15**	**FY16**	**FY17**	
$0.0	($7,257.0)	($25,503.0)	($43,406.0)	($62,833.0)	CIT Rate Reduction
$0.0	($62.0)	($28,056.0)	($66,094.0)	($76,712.0)	Optional SSF Apportioning
$0.0	$6,446.6	$19,571.6	($9,520.4)	($9,710.5)	HWJTC Changes
$0.0	$10,457.0	$18,179.0	$26,265.0	$34,796.0	GRT Manufacturing Changes
$0.0	$9,584.6	($15,808.4)	($92,755.4)	($114,459.5)	Total

SOURCES OF INFORMATION
LFC Files

Responses Received From
Taxation and Revenue Department (TRD)

SUMMARY

Synopsis of Bill

House Taxation and Revenue Committee Substitute for House Taxation and Revenue Committee Substitute for House Bill 182 and House Bill 507 makes several changes to the tax code. The bill lowers the corporate income tax (CIT) rate over five years and includes a "trigger clause" for the CIT rate based on general fund revenue growth and reserve fund percentage, permits single sales factor apportioning for certain manufacturing corporations phased in over three years, amends the gross receipts tax (GRT) deduction for tangible property consumed in the manufacturing process to narrow the qualifications for the deduction, and amends the high-wage jobs tax credit (HWJTC) to extend the credit and add criteria for the qualifications for the credit.

Section 1 amends the Corporate Income and Franchise Tax Act to provide for a corporate income tax (CIT) rate reduction contingent on "triggers" based on revenue growth and general fund reserve levels. Assuming the triggers are met, the rate reductions follow the rate schedules as follows:

<table>
<tr><th>Net Income</th><th>Schedule I</th><th>Schedule II</th><th>Schedule III</th><th>Schedule IV</th><th>Schedule V</th><th>Schedule VI</th></tr>
<tr><td>Less Than $500 thousand</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>Between $500 thousand and $1 million</td><td>$24,000 plus 6.4% of excess over $500k</td><td>$24,000 plus 6.4% of excess over $500k</td><td>$24,000 plus 6.4% of excess over $500k</td><td>$24,000 plus 6.4% of excess over $500k</td><td rowspan="2">$24,000 plus 6.2% of excess over $500k</td><td rowspan="2">$24,000 plus 5.9% of excess over $500k</td></tr>
<tr><td>Greater than $1 million</td><td>$56,000 plus 7.6% of excess over $1m</td><td>$56,000 plus 7.3% of excess over $1m</td><td>$56,000 plus 6.9% of excess over $1m</td><td>$56,000 plus 6.6% of excess over $1m</td></tr>
</table>

The bill requires that each year, the secretary of DFA certify to the secretary of TRD the revenue and reserves of the previous fiscal year. The TRD secretary must designate a CIT schedule for that calendar year. The secretary may not designate a CIT schedule for a calendar year at a lower numeric level than for the previous fiscal year.

If reserves at the end of the previous fiscal year were less than seven percent or if revenue in the previous fiscal year fell below a level required to designate a different CIT schedule, the secretary of TRS must designate the same CIT schedule as was in place for the previous calendar year. If revenue in the previous fiscal year was:

- Between $5.937 billion and $6.177 billion and reserves at the end of the fiscal year were at least seven percent, the secretary must designate CIT schedule III.
- Between $6.177 billion and $6.427 billion and reserves were at least seven percent, the secretary must designate CIT schedule IV;

- Between $6.427 billion and $6.687 billion and reserves were at least seven percent, the secretary must designate CIT schedule V;
- At least $6.687 billion and reserves were at least seven percent, the secretary must designate CIT schedule VI.

The provisions of the section apply to taxable years beginning on or after January 1, 2013.

Sections 2 and 3 amend Section 7-2F-1 NMSA 1978, to allow for an additional five percent film credit for direct production expenditures:

1. On series television productions intended for commercial distribution with a budget per episode of $50,000;
2. That are attributable to wages and fringe benefits paid to a NM resident directly employed in an industry crew position, excluding a performing artist;
    a. with a total budget of at least $30 million that shoots at least 10 principal photography days at a qualified production facility in NM or
    b. $30 million or more that shoots at least 15 principal photography days at a qualified production facility in NM.

Additionally, language is added to allow for the carry-over of any amounts under the fifty million dollar annual limit not expended in a fiscal year but not to exceed $10 million, and these amounts will not count toward a subsequent years' annual limitation. Section 7-2F-2 NMSA 1978, is amended to alter the definitions of "direct production expenditure" and "physical presence." It also tightens the income tax provisions on performing artists by requiring withholding when the artist has an equity interest in the production. The bill also excludes expenditures from qualifying for the credit that are supplied by nonresidents whether hired or subcontracted by an in-state vendor.

The bill also adds language to:

- allow the film production tax credit to be claimed on an information return filed by a pass-through entity;
- adds a definition of a "qualified production facility"; and
- amends the definition of "vendor" to exclude director, writer, producer, an associate producer, a co-producer, an executive producer, a production supervisor, a director of photography, a motion picture driver, a production or personal assistant, a designer, a still photographer, and a carpenter and utility technician.

Section 2 and 3 are applicable to direct production expenditures and postproduction expenditures made on or after April 15, 2013 and to principal photography on or after January 1, 2014.

Section 4 of the bill amends the Uniform Division of Income for Tax Purposes Act (UDITPA) to phase in over three years an optional single sales apportionment factor for businesses engaged in manufacturing. To elect the apportionment formula created in the bill, the taxpayer must notify the TRD in writing before first filing a return using the new apportionment formula. Once opting into this apportionment formula, the taxpayer must use the formula for three years before being able to opt back out. The single sales factor would be phased in over three years as follows:

Tax Year	Apportionment Formula
2013 (current law)	$\frac{(\text{sales factor})+(\text{property factor})+(\text{payroll factor})}{3}$
2014	$\frac{(2\text{Xsales factor})+(\text{property factor})+(\text{payroll factor})}{4}$
2015	$\frac{(8\text{Xsales factor})+(\text{property factor})+(\text{payroll factor})}{10}$
2016	$\frac{(\text{total sales in New Mexico})}{(\text{total sales})}$

The effective date of section 4 is January 1, 2014, and the provisions of the section apply to taxable years beginning on or after January 1, 2014.

Section 5 also amends the UDIPTA to exclude certain sales from being apportioned as sales in New Mexico. The effective date of section 3 is January 1, 2014, and the provisions of the section apply to taxable years beginning on or after January 1, 2014.

Section 6 amends the Gross Receipts and Compensating Tax Act to amend the provisions governing the deduction of receipts from selling tangible personal property that is consumed in the manufacturing process. The amendments specify that the tangible personal property must be a consumable. The bill defines "consumable" as tangible personal property that is incorporated into, destroyed, depleted or transformed in the process of manufacturing a product, including electricity, fuels, water, manufacturing aids and supplies, chemicals, gases, repair parts, spares and other tangibles used to manufacture a product. The definition excludes tangible personal property used in power generation, the processing of natural resources, including hydrocarbons, and the preparation of meals for immediate consumption on- or off-premises.

The effective date of section 6 is July 1, 2013, and the provisions of the section apply to gross receipts received on or after July 1, 2013.

Section 7 amends the provisions governing the high-wage jobs tax credit to tighten a host of high wage tax credit definitions and to extend the sunset to the end of FY20. The most important changes to the law are:

- Requiring taxpayers to apply for the credit within one year of the end of the calendar year in which the taxpayer's final qualifying period closes. Currently there is no limitation;
- Providing that that eligible jobs cannot be recycled through mergers or acquisitions;
- Limiting eligible employers to those certified by the Economic Development Department to be eligible for job training program assistance, commonly known as "JTIP". Eligible employers must also have made more than 50 percent of its sales of goods and services produced in New Mexico to persons outside New Mexico during the applicable qualifying period.
- Clarifying that wages are calculated exclusive of benefits or the employer's share of payroll taxes.

- Increasing wage requirements for jobs created after July 1, 2015 to qualify for the HWJTC. These jobs must pay wages of $60 thousand (if in an urban area) and $40 thousand (if in a rural area). Currently, the requirements are that the jobs pay $40 thousand and $28 thousand, respectively; and
- Providing specific definitions of "wages" and "benefits."

The provisions of section 7 of the bill apply to credit claims received on or after the effective date of the bill. Because the bill contains an emergency clause, it would become effective immediately upon signature by the governor.

Section 8 of the bill repeals the section of the Film Tax Credit Act that makes a series of definitions.

FISCAL IMPLICATIONS

Corporate Income Tax Rate Reduction: The first step in this analysis is to estimate the change in revenue from lowering the top CIT rate from 7.6% to 5.9%, over five years, as illustrated in the table below. The fiscal impact of the rate changes is in the table below. The January 1, 2014, effective date for this portion creates an impact that is 60 percent of the full-year impact in FY2014. The analysis assumes that the revenues and balances are sufficient to move down one CIT schedule per year, starting with schedule I in tax year 2013.

	FY2013	FY2014	FY2015	FY2016	FY2017
Forecast Net CIT	280,000	327,000	383,000	400,000	410,000
Impact, Rate Changes	0	($7,257.0)	($25,503.0)	($43,406.0)	($62,833.0)

Film Tax Credit Changes: The bill mandates that the film credit to be constrained by the $50 million annual cap. However, the richer credits for television and the $10 million carry-over virtually guarantee that the credit would be greater than otherwise over a multiyear period. For example, there is some indication that the credit will not be fully expended in FY13 which will result in increased General Fund revenue of $12 million. Given the provisions in this substitute, the FY 14 cap will be increased from $50 million to $60 million and General Fund revenue will decrease by $10 million.

The Taxation and Revenue Department (TRD) researched the share of total approved and pending approval New Mexico film credits since FY11 that can be identified as relating to eligible television series. On that basis, it is estimated that approximately 20 percent of the film credits approved or pending approval since FY11 are related to television series that could qualify for the enhanced credit. The New Mexico Film Office and the Consensus Revenue Estimating Group are forecasting that the $50 million cap will be reached in each of the forecast period fiscal years. This would imply that approximately $10 million of the total credits earned (determined based on 25 percent of production expense), or an addition $2 million in film credits would be added to these television productions as a result of the enhanced credit opportunity. However, the $50 million cap would still constrain the film credits offered, so no additional fiscal impact is forecast.

Table 1: SUMMARY OF FILM CREDITS — MATRIX OF YEAR AWARDED VERSUS YEAR CREDIT DISTRIBUTED

FY FILM CREDIT DISTRIBUTED (in thousands of dollars)

FY FILM CREDIT AWARD APPROVED	FY03	FY04	FY05	FY06	FY07	FY08	FY09	FY10	FY11	FY12	Grand Total
FY03	$1,116.2	$103.3									$1,219.5
FY04		$1,633.3	$1,771.6								$3,405.0
FY05			$333.0	$1,446.9	$285.5						$2,065.3
FY06				$4,274.2	$4,320.4	$6.3					$8,600.8
FY07					$13,917.8	$2,250.5	$477.2				$16,645.6
FY08						$40,312.5	$5,248.1	$6.4			$45,567.1
FY09							$76,336.8	$86.6		$1.1	$76,424.4
FY10								$45,274.5	$20,632.6	$0.2	$65,907.3
FY11									$75,559.6	$1,411.5	$76,971.2
FY12										$8,081.6	$8,081.6
Grand Total	$1,116.2	$1,736.7	$2,104.6	$5,721.1	$18,523.7	$42,569.3	$82,062.1	$45,367.4	$96,192.3	$9,494.5	$304,887.8

<u>Manufacturing Single Sales Factor</u>: The TRD used 2010 New Mexico CIT data for manufacturing corporations (NAICS code 31 through 33) to analyze the impact the phase in of the single sales apportionment formula. The TRD notes there are approximately 1,750 corporations which file under the manufacturing NAICS codes with a total gross NM CIT of $75 million. The impact was estimated assuming that all manufacturing corporations whose sales factor is less than an average factor would make the election. Since not all eligible corporations will make this election due to the 36 consecutive month election requirement, the impact was reduced by 10 percent. February consensus forecast estimates were used to estimate the fiscal impacts from FY14 through FY17. These estimated effects assume the modified tax rates in the bill are in effect.

	FY2013	FY2014	FY2015	FY2016	FY2017
Impact, Manufacturing SSF Apportioning	0	($62.0)	($28,056.0)	($66,094.0)	($76,712.0)

<u>Manufacturer Consumables Changes:</u> The TRD notes its estimates for this portion of the analysis include a high degree of uncertainty for several reasons which make it difficult to estimate the baseline level of the deduction, as well as the impacts from the proposed changes:

- The deduction is not separately stated, and the historical size of the deduction is not known.
- 2012 amendments to the law governing the deduction are expected to greatly increase the size of the deduction; the changes have not been in effect long enough to assess their impact.
- Given the current and proposed definitions of manufacturing, it is difficult to identify with certainty the pool of firms that will be eligible for the credit.

To establish a baseline level of the manufacturers' consumables deduction, the TRD relied on the Department of Finance and Administration's revised analysis of a REMI Input-Output model of manufacturer consumption. This model estimates the size of the deduction under current law as described in the table below.

Current Law	FY13	FY14	FY15	FY16	FY17
Deduction	($16,545.0)	($30,748.0)	($53,304.0)	($77,846.0)	($104,324.0)

With the baseline established, the TRD identified the proposed changes that are expected to have a significant revenue impact. The effect of each of these changes is to tighten the qualifying standards for businesses receiving this deduction.

GRT Manufacturing Changes	**FY13**	**FY14**	**FY15**	**FY16**	**FY17**
General Fund (GRT)	0	$10,378.0	$18,020.0	$26,050.0	$34,501.0
Local Governments	0	$6,444.0	$11,187.0	$16,174.0	$21,419.0
Net GRT Impact	0	**$16,822.0**	**$29,207.0**	**$42,224.0**	**$55,920.0**
General Fund (Comp)	0	$79.0	$159.0	$215.0	$295.0
Small County Assistance Fund	0	$11.0	$23.0	$31.0	$42.0
Small City Assistance Fund	0	$17.0	$34.0	$46.0	$63.0
Municipal Equivalent Distrib.	0	$6.0	$11.0	$15.0	$21.0
Net Comp Tax Impact	0	**$113.0**	**$227.0**	**$307.0**	**$421.0**
Total Impact	**0**	**$16,935.0**	**$29,434.0**	**$42,531.0**	**$56,341.0**

High Wage Jobs Tax Credit: The changes to the HWJTC have the effect of tightening the eligibility requirements for both employers and employees. Much of this analysis reflects the TRD analyses of similar legislation that makes other HWJTC changes.

The 17 companies filing the greatest number of the HWJTC applications had those claims approved in recent years (FY11 and part of FY12). These companies account for about 75 percent of all credits by dollar amount during the period analyzed. Growth in new qualified jobs was estimated using BBER FOR-UNM forecast employment growth for the applicable sectors (-0.3 percent for FY13, 1.2 percent for FY14, 1.6 percent for FY15, and 2.0 percent for FY16).

Applications for the HWJTC surged in FY12 and in FY13 (to-date), apparently due to a "mining" of potential claims by several consulting accounting firms, and due to an increasing awareness of the potential claims under the existing HWJTC statutes. At present, approximately $110 million in pending HWJTC claims are under evaluation by the TRD. In other FIRs, the TRD has estimated the "normal" applications per year under the current law to be approximately $65 million. Assuming one third of claims are not approved, the total amount approved would be $43.3 million per year.

Senate Bill 538 also extends the sunset of the HWJTC from July 1, 2015, to July 1, 2020, reflected as a reduction in revenues in FY16 and FY17. The $120 million in the HWJTC applications that are pending would be processed under the current provisions of law. The proposed legislation would only be applicable to applications received after April 1, 2013.

The extension of the definition of urban jobs to within ten miles of a municipality with a population of 60,000, or in Los Alamos County would have a minimum impact because the wage limit of a qualified job in Los Alamos County and ten miles of its external boundaries would be $40,000 under the proposed law, which would potentially reduce the number of qualified jobs. However, the wage limit of a qualified job in other municipalities, for example Roswell (population: 48,366) and Farmington (population: 45,877) would be reduced from $40,000 to $28,000, causing a potential increase in the number of qualified jobs.

Beginning in FY2016, the proposal raises the threshold wages to $40,000 in rural jobs and $60,000 for urban jobs, from $28,000 and $40,000 respectively. This would cause a 20 percent

reduction in the amount of the credit (5 percent of credits issued are tied to jobs below $40,000 that would be eliminated, and 15 percent of credits issued are estimated to arise from urban jobs between $40,000 and $60,000 that would be eliminated.). The total estimated revenue impact of the HWJTC portion of this bill is in the table below.

HWJTC Changes	FY13	FY14	FY15	FY16	FY17
General Fund	$0.0	$6,447.0	$19,572.0	($9,520.0)	($9,711.0)
Local Government	$0.0	$2,025.0	$6,147.0	($2,990.0)	($3,048.0)
Total Impact, HWJTC Changes	$0.0	$8,472.0	$25,719.0	($12,510.0)	($12,759.0)

This bill may be counter to the LFC tax policy principle of adequacy, efficiency and equity. Due to the increasing cost of tax expenditures revenues may be insufficient to cover growing recurring appropriations.

Estimating the cost of tax expenditures is difficult. Confidentiality requirements surrounding certain taxpayer information create uncertainty, and analysts must frequently interpret third-party data sources. The statutory criteria for a tax expenditure may be ambiguous, further complicating the initial cost estimate of the expenditure's fiscal impact. Once a tax expenditure has been approved, information constraints continue to create challenges in tracking the real costs (and benefits) of tax expenditures.

SIGNIFICANT ISSUES

New Mexico's top corporate income tax rate of 7.6 percent is high, compared with the national average of 6.4 percent. New Mexico's CIT rate is especially high when considering a corporation can be taxed at the 4.9 percent personal income tax rate simply by organizing under another section of the IRS code. This violates the principle of tax equity. 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.

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 creates 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, is the alternative in favor nationally. This formula does not punish firms for investing or employing workers within a state. In New Mexico, a mandatory single sales formula would likely benefit extractive and manufacturing industries while penalizing direct sellers of goods

and services and multistate banks. Mining and manufacturing pay well over half of New Mexico CIT, however, and this formula could result in lower revenues.

The high-wage jobs tax credit provides qualifying employers with a 10 percent tax credit, up to $12 thousand, for each employee with annual wages and benefits totaling more than $28 thousand if in a rural area and more than $40 thousand if in an urban area. Eligible employers include those eligible for the Job Training Incentive Program (JTIP) or that earned more than 50 percent of their sales from out-of-state entities in the prior year. The cost of the credit is higher than initially estimated, with FY12 claims exceeding $48 million, and FY13 projected at $50 million. The credit is intended to create new jobs, but data suggests most of the claims are for jobs created from previous business activity. The TRD estimates as little as 19 percent of all FY12 credit applications were for jobs created during the current qualifying period. In the last two fiscal years, employers claimed credit for creating roughly 3,000 jobs. However, it should be noted that the UNM's Bureau of Business and Economic Research estimates employment actually declined by 258 jobs during that time.

Legislation enacted in 2012 expanded the GRT deduction for tangible personal property to include property consumed in the manufacturing process. The deduction was intended to exempt the cost of electricity used in the manufacturing process, but it can be construed to cover refining, processing, restaurants, and even art. Further, the electric utilities report it will be difficult to identify electricity "consumed" during manufacturing. These issues doubled the original estimate of the deduction's general fund impact to $4.7 million in FY13, rising to $80 million when fully phased in by FY17.

ADMINISTATIVE IMPLICATIONS:

According to TRD, the phase out for the payroll and property factors could be burdensome for the taxpayer because they would need to calculate their CIT returns for the next 3 years using a different method of apportionment. TRD suggests it would be taxpayer friendly to allow the taxpayer to elect the single sales factor effective tax year January 1, 2014.

Also, TRD would have some difficulty in administering this phase out. The department would need to reprogram their systems to accept these returns for the 3-year phase out of the payroll and property factors. The forms and instructions would need to be revised every year and the audit staff and the Multistate Tax Commission that audits CIT on the state's behalf would need to adjust procedures for the years in question.

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

The bill is similar to SFC/SB 538 & 540 & SCORCS 13 & 277.

Several other bills make one or more such changes to the tax code.

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/sec