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

ORIGINAL DATE 1/29/19
SPONSOR Chandler **LAST UPDATED** ____ **HB** 247

SHORT TITLE Increase Corporate Income Tax Rates **SB** ____

ANALYST Clark

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY19	FY20	FY21	FY22	FY23		
\$0 – (\$80,000.0)	\$0 – (\$83,000.0)	~\$25,000.0	~\$42,000.0	~\$44,000.0	Recurring	General Fund

Parenthesis ( ) indicate revenue decreases

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY19	FY20	FY21	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
Total	Likely Minimal				Nonrecurring	TRD Operating Budget

Parenthesis ( ) indicate expenditure decreases

SOURCES OF INFORMATION
LFC Files

Responses Received From
Taxation and Revenue Department (TRD)
Economic Development Department (EDD)

SUMMARY

Synopsis of Bill

House Bill 247 revises corporate income tax (CIT) rates and brackets, increasing upper bracket rates beyond current levels and phasing in a new top bracket and rate of 7.6 percent instead of the current highest 5.9 percent.

For taxable years beginning on or after January 1, 2020 and prior to January 1, 2021:
- If the net income is over \$500 thousand but not over \$1 million the tax shall be \$24 thousand plus 6.4 percent of excess over \$500 thousand

- If the net income is over $1 million the tax shall be $56 thousand plus 6.9 percent of excess over $1 million

For taxable years beginning on or after January 1, 2021:
- If the net income is over $500 thousand but not over $1 million the tax shall be $24 thousand plus 6.4 percent of excess over $500 thousand
- If the net income is over $1 million the tax shall be $56 thousand plus 7.6 percent of excess over $1 million

There is no effective date of this bill. It is assumed that the effective date is 90 days after this session ends. However, there appears to be a technical issue with the effective dates for the phased-in tax structure.

The bill repeals all the existing language establishing rates and brackets for taxable years beginning prior to January 1, 2020. If this bill is signed into law, it could be interpreted to effectively eliminate the corporate income tax for the remainder of FY19 and the first half of FY20.

FISCAL IMPLICATIONS

It is important to note that film credit rebates are paid out of the CIT revenue stream, so any changes to CIT affect a revenue base that is larger than the general fund receipts by the $50 million of the annual film cap. This can make losses and gains appear larger than would otherwise seem reasonable just looking at the general fund revenues shown in the consensus revenue estimates.

Although CIT rates and brackets would be in effect until this bill becomes law, taxpayers might argue that payments made for taxable years ending on or after the effective date of the bill and prior to January 1, 2020 should be refunded. Therefore, the impact for FY19 could be the loss of up to half the value of CIT payments during the fiscal year. The range shows a minimum of zero and up to half the CIT revenue estimated for FY19.

If taxpayers persist with this possible interpretation, there might be no payments for the remainder of 2019, so the first half of FY20 could see no CIT revenue, and revenues for the remainder of FY20 could also be reduced if companies have taxable years starting later in the year than January 1. However, the estimate just shows an estimated half-year impact as the maximum end of the range, again with zero as the minimum end if this is deemed an invalid interpretation.

The estimates for FY21 through FY23 are rounded figures from TRD (rounded because it is exceedingly difficult to estimate CIT revenues), and the agency supplied the following analysis.

> TRD used GenTax data to estimate the fiscal impact. The new rates were applied to prior year tax liability calculations; the estimate is the average of the differences. Consensus Revenue Estimating Group growth rates were applied to out years.
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> It is important to note corporate income tax liabilities for a specific tax year do not align well to collections during a fiscal year. This is due to delays, amendments, retroactive

> applications for business credits, and other regime mechanics. The legislation is a tax rate increase, and will, over the short term, generate additional revenue, all else equal.

SIGNIFICANT ISSUES

It is unknown what, if any, effect the gradual reduction in CIT rates that was fully phased-in for taxable years beginning on or after January 1, 2018 had on business decisions to expand in or relocate to New Mexico. However, the justification for the rate reduction had a reasonable basis: CIT rates were higher in New Mexico than in surrounding states, and being an outlier can be an upfront disincentive for businesses looking at multiple states when deciding where to locate operations.

Additionally, stability in the tax code is very important to a wide array of businesses, and raising CIT rates almost immediately after the previous rate reduction was fully phased-in can create unpredictability for corporations. Businesses that located here in recent years may not have made their location decisions because of the rate reduction, but they would have included it in their financial projections.

The Economic Development Department (EDD) provided the following analysis.

> The higher tax rate will generate more state revenue from existing taxpayer corporations but may discourage new corporations from starting in the state or impede growth for existing companies.
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> According to TaxFoundation.org:
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> - The current (2019) state CIT rate for net income over $500,000 is higher than 14 states (six of whom have no corporate tax at all).
> - In 2013, the top New Mexico CIT rate for net income over $1 million was higher than the rate in 29 states.
> - The proposed rate is higher than the current CIT rate in 31 states.
>
> If corporations consider the CIT rate in their location decision, New Mexico may be less competitive in attracting or retaining them.

The Taxation and Revenue Department (TRD) provided the following analysis related to a technical issue of graduated CIT rates leading to a policy concern.

> TRD recommends that the policy behind this structure be carefully considered. Progressive tax rates may serve two main policy functions. First, higher-income taxpayers may have a greater "ability to pay" a higher tax rate. Second, higher taxes on higher-income taxpayers may reduce so-called regressivity in a tax structure, especially personal income taxes, by reducing the relative cost of the tax on lower-income households and increasing the relative cost of the tax on higher-income households.
>
> Progressive corporate or tax rates are far less likely to serve the same purposes. First, corporate net taxable income bears little relationship to the ability of corporations to pay taxes since corporations have access to funds from public investment and other means of financing. Second, both small start-up and large established corporations may report

relatively low amounts of taxable income for a host of reasons—including the fact that the tax code allows substantial deductions for business expenses.

More importantly, it is exceedingly difficult to determine who bears the actual economic cost of a corporate tax, whether employees or shareholders or customers or suppliers of the business. So a tax imposed on a particular corporation may result in the corporation lowering wages paid to executives, or instead, to its lowest-paid employees, or the tax cost may be passed along to customers through higher prices for goods and services sold.

Furthermore, most small businesses do not organize as taxable corporations, but are set up as pass-through entities that do not pay tax at the entity level. So the progressive corporate rates would have no effect on these small businesses.

New Mexico, like all states, can only tax a portion of the total income of a multistate corporation and uses an apportionment formula to do this—which looks to the percentage of property, payroll, and sales in New Mexico. States generally apply this apportionment formula to corporate income or loss each year. But because New Mexico chooses to impose a progressive tax rate structure on corporate income, it has also chosen to apply those progressive tax rates to the corporation's total income, before it is apportioned to New Mexico. This complicates the reporting of corporate tax in -the state. See Section 7-2A-8 NMSA 1978, which uses a credit mechanism for this purpose.

But it can also negatively impact New Mexico based companies. Assume that a New Mexico corporation has 100 percent of its apportionment factors in the state in its first two years of operation and, in each year, has a $500,000 loss. In years three and four, the company grows but also has substantial sales outside New Mexico, so that it has only a 50 percent average apportionment factor in the state, but earns $1 million in taxable income in each year. Because New Mexico apportions the tax, and not the income or loss, the company would first offset its $1 million loss carryover from years 1 and 2 against 100 percent of its income in year 3, using up the entire loss in that year. And it would pay no tax that year, but the following year, the company would pay tax its income, with no benefit of any loss carryover.

Assume, instead, New Mexico apportioned income and loss, rather than the tax, each year. The company would still have $1 million in loss carryovers (because in those the loss years it had 100 percent of its factors in New Mexico) but would have only $500,000 of New Mexico income in years 3 and 4 (because its average factor in those years was 50 percent). So it would use up only $500,000 of the $1 million loss carryover in year 3 and would have $500,000 remaining to offset apportioned income in year 4. And rather than owing tax in year 4, the company would still get the benefit of the losses it incurred in New Mexico.

ADMINISTRATIVE IMPLICATIONS

The Taxation and Revenue Department would need to revise forms and make minor software adjustments.

TECHNICAL ISSUES

The technical issue is noted in the summary and fiscal implications sections.

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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