BILL ANALYSIS AND FISCAL IMPACT REPORT
Taxation and Revenue Department

February 6, 2024

Bill: HB-216 **Sponsor:** Representative Jason C. Harper

Short Title: Flat Corporate Income Tax

Description: This bill amends Section 7-2A-5 NMSA 1978 to set a flat corporate income tax rate of 5.9%. Section 7-4-10 NMSA 1978 is amended to provide that the apportionment of business income be done by multiplying the income by the sales factor, known as “single sales factor” apportionment, in distinction to the three-factor formula currently in law, using “three factor” apportionment based on sales, property, and payroll. Section 7-4-19 NMSA 1978 is amended to remove references to additional apportionment factors. The bill also repeals Section 7-4-11 through 7-4-15 NMSA 1978, which provide for the use of the property factor and payroll factor for apportionment of income.

Effective Date: January 1, 2025. Sections 1 through 3 are applicable to taxable years beginning on or after January 1, 2025.

Taxation and Revenue Department Analyst: Lucinda Sydow

Estimated Revenue Impact*					R or NR**	Fund(s) Affected
FY2024	FY2025	FY2026	FY2027	FY2028		
--	--	$11,710 - $18,100	$11,900 - $18,400	$12,300 - $19,100	R	Section 1: General Fund–Single CIT Tax Bracket
--	--	Likely Positive, indeterminate			R	Section 2: General Fund–CIT Single Sales Factor

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

Methodology for Estimated Revenue Impact: [Section 1]: The fiscal impact is based on reviewing Corporate Income Tax (CIT) tax return data from fiscal years 2021 through 2023 and is done in isolation from Section 2. The revenue increase was modeled applying the single tax rate of 5.9% to the portion of taxable income less than $500 thousand. CIT is an extremely challenging revenue to forecast even in times of relative stability. Given the variable economic conditions that may impact CIT taxpayers, the estimate has been presented as a positive range to emphasize the uncertainty of the magnitude of the impact. Using the December 2023 Consensus Revenue Estimating Group (CREG) forecast, the average range impact is grown by the current growth rate for gross CIT.

[Section 2]: The directional positive impact is based on reviewing CIT tax return data from tax years 2019 through 2023. The taxpayer liability was modeled applying the single-sales factor. On an individual basis, the impact is diverse among taxpayers, but in aggregate the impact is a revenue increase to the state. The increase is due to the fact that New Mexico imports and consumes more than it produces and exports; New Mexico is a “market” state. Therefore, eliminating the two other factors of property and payroll increases the amount of income apportioned to New Mexico overall.

[Sections 1 & 2]: The fiscal impacts are done in isolation between the two sections, but these changes do interact and will alter the final positive impact in the bill.

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 3 – 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 reduces the complexity of the CIT code. 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%, incurred that liability with taxable income less than $500,000 placing them at the 4.8% 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] An argument 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 CIT, and the District of Columbia, in enacting a single-rate corporate income tax.

A single-sales factor and one tax rate reduces the complexity of the CIT code even further. 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, Tax & Rev incurs administrative costs to collect taxes, review the accuracy of tax returns and tax payments, and bring taxpayers into compliance. The reduction of apportionment from three factors to one simplifies the tax code for both taxpayers and Tax & Rev.

Some policymakers have argued that using a single sales factor method of apportionment incentivizes corporations to increase payroll in a state. However, the data regarding increase in local employment from adopting the single sales factor are inconclusive. Furthermore, the large majority of states have now adopted the method, diluting any potential positive impact on employment substantially.

Changing to a single sales factor will place New Mexico as a more competitive environment compared to other states with a similar application of a single sales factor or no corporate income tax at all. Most states have moved to a single sales factor for purposes of income apportionment. As of January 2022, of states with CIT, only four states including New Mexico used the three-factor formula, while 30 states and the District of Columbia used only sales in their apportionment formula[2]. The remaining states with a corporate income tax used a formula that gave greater weight to sales. "By using the portion of a corporation's sales rather than employment or property to determine tax liability, states hope to encourage companies to relocate or to expand their production operations within the states they operate in."[3] By shifting the burden of taxation to out-of-state companies, the single sale factor apportionment method encourages companies to set up their physical plant and locate employees in states that do not apportion based on these two factors. In an environment where most other states have adopted single-sales factor, New Mexico's continuing use of the three-factor apportionment test places it at a disadvantage for companies to form or relocate here. However, it is also true that corporations look to more than just the

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

[2] Federation of Tax Administrators, January 2022

[3] https://www.urban.org/policy-centers/cross-center-initiatives/state-and-local-finance-initiative/projects/state-and-local-backgrounders/corporate-income-taxes

tax code when considering operations. These include among other things, the work force skill-level and education, infrastructure, and education systems.

The change from a property-payroll-sales formula to a sales-only formula substantially reduces the corporate tax burden of businesses that arguably are benefiting the most from public services in a state and unfairly shifts the tax burden to out-of-state businesses that benefit from state services to a lesser extent.[4] The shifting of the tax burden to out-of-state companies counters a fundamental principal of tax equity and to an extent adequacy of tax revenues, as in-state corporations benefit from the expenditures of state government revenue: roads, health care, K-12 education and higher education State revenues also help support local government expenditures for public safety.

The three factors were meant to represent the profits attributable to labor (employment), capital (physical plant), and market (sales). In an economy increasingly service-oriented and based on the internet, investment in physical plant no longer has the importance in generating profit for companies that it once did. Profits are less attributable to the location of physical plant in one state, and therefore assume less importance in deciding how to apportion income to each state. Increases in productivity also mean that businesses can do more with a smaller payroll, decreasing the importance of the payroll factor. Remote work also may have some impact on the payroll factor.

But, overall, to the extent that New Mexico remains more weighted to consumption than the presence of corporate operations, then the single-sale factors will remain revenue positive to the state.

Technical Issues: [Section 2]: The provisions that are repealed from the Uniform Division for Income Tax Purposes Act (UDIPTA) are used in Corporate Income Tax as well as Personal Income Tax (PIT) calculations, including fiduciary filers, S-CORP filers and non-income pass-through entity. While CIT will move to a single sales factor in this bill, the apportionment rules will still be needed for PIT calculations and should not be repealed.

Other Issues: [Section 3]: New Mexico is a member state of the Multistate Tax Commission (MTC). MTC is an intergovernmental state tax agency whose mission is to promote uniform and consistent tax policy and administration among the states, assist taxpayers in achieving compliance with existing tax laws, and advocate for state and local sovereignty in the development of tax policy.

New Mexico is a member of the “Multistate Tax Compact" as enacted into law and entered into with all jurisdictions legally joining therein, in the form substantially as follows: Ch. 7, art. 5 NMSA 1978. This compact requires the adoption of uniform language. It is not clear if this proposed changes to UDIPTA conflict with agreements for uniformity.

Administrative & Compliance Impact: Tax & Rev will need to update forms, instructions, and publications. Implementing this bill will have a moderate impact on the Information Technology Division (ITD), approximately 900 hours or about 5 months and an estimated staff workload cost of $49,950. These updates will be incorporated into annual tax year revisions.

Estimated Additional Operating Budget Impact*				**R or NR****	**Fund(s) or Agency Affected**
FY2024	**FY2025**	**FY2026**	**3 Year Total Cost**		
--	$49.9	--	$49.9	NR	Tax & Rev – ITD staff workload

* In thousands of dollars. Parentheses ( ) indicate a cost saving. ** Recurring (R) or Non-Recurring (NR).

[4] Mazerov, Michael (2005), ‘The “Single Sales Factor” Formula for State Corporate Taxes: A Boon to Economic Development or a Costly Giveaway?’ Center on Budget and Policy Priorities, Washington, D.C.

Related Bills: Similar to SB-119 (2024 Session); HB-322 (2023 Session)