

Background on Corporate Income Tax

Presentation to the Legislative Finance Committee

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NM Corporate Income Tax Statutory Provisions

- Graduated rates apply to taxable income of “C-corporations” (equal to federal taxable income with modifications):
 - 4.8% on the first \$500,000,
 - 6.4% on income over \$500,000 up to \$1 million, and
 - 7.6% on income in excess of \$1 million.
- Subject to certain restrictions, corporations may elect to report their income using one of three reporting methods:
 - separate corporate entity;
 - combination of unitary corporations; or
 - federal consolidated group.
- Income is apportioned to New Mexico using an equally-weighted three-factor formula – payroll, property and sales – except that manufacturers may elect a double-weighted sales factor in apportioning their income.

NM Corporate Income Tax Statutory Provisions

Increasing Tax Base/Revenue	Decreasing Tax Base/Revenue
Relatively high tax rate	Low Franchise Tax
Prohibition of NOL carrybacks and limited carryforwards	Low entity-level taxes on non-C corporations
“Throwback” requirements	Election to file as Separate entity, combined or federal consolidated
Apportionment of tax not taxable income	No requirement to addback related party expenses
Include foreign operations on combined returns	Double-weighted sales apportionment for manufacturers

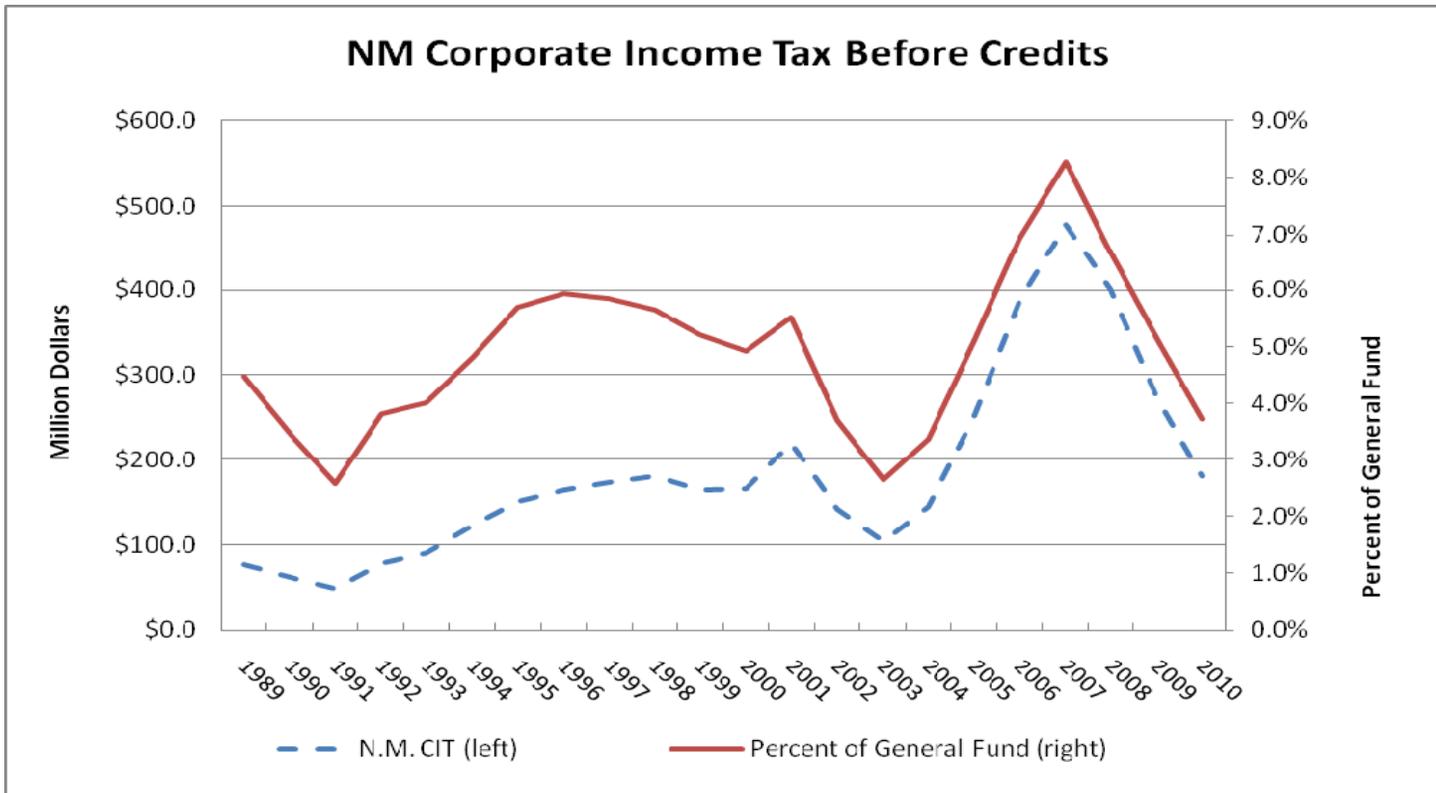
Current law contains a mix of revenue increasing and decreasing provisions

CIT Western State Comparison

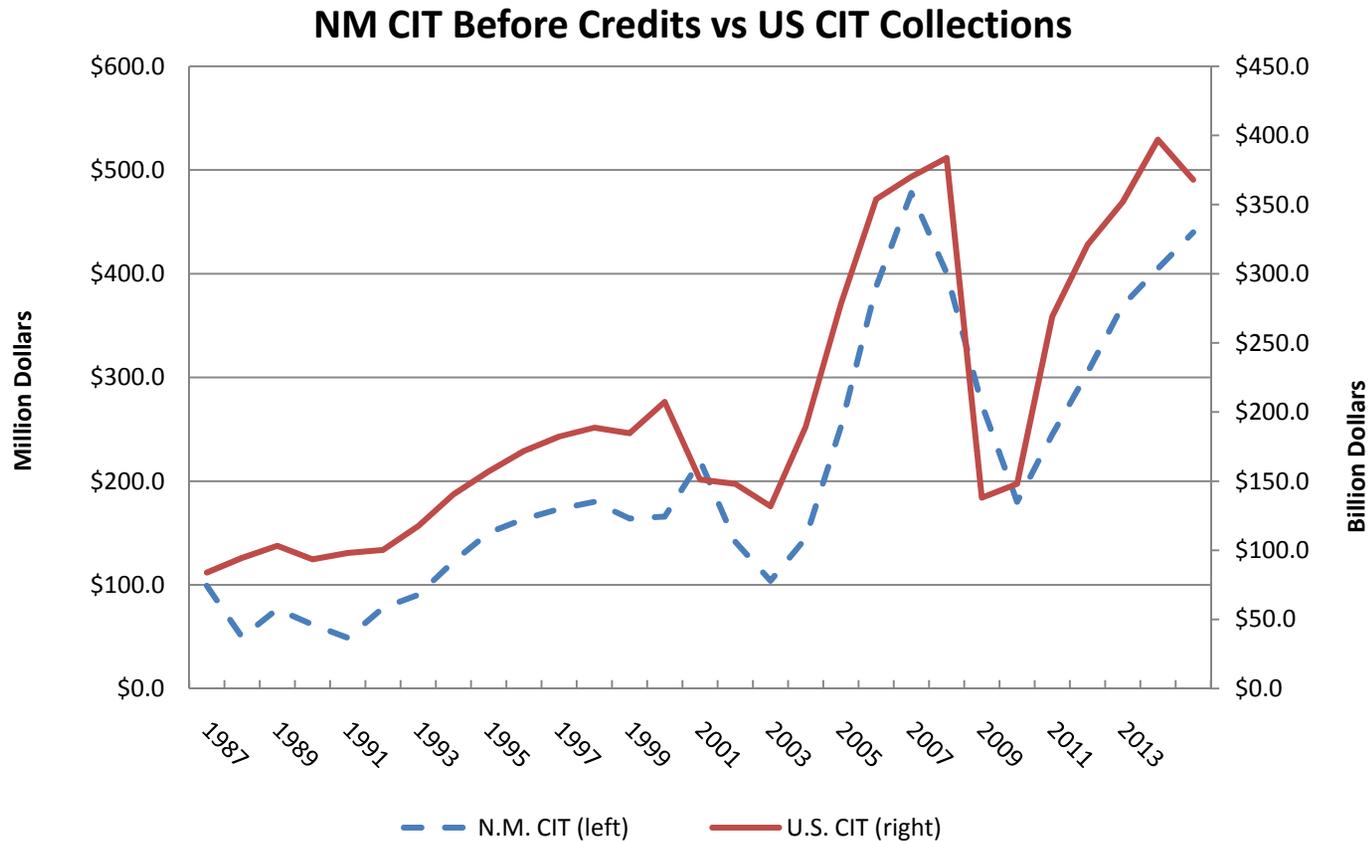
State	Tax Rates	Combined Reporting Required?	Federal Consolidated Allowed?	Apportionment Rules
Arizona	6.968%	Yes	Yes	3 Factor with DWS*
California	8.84%	Yes	No	3 Factor with DWS
Colorado	4.63%	Yes	Yes	3- or 2-Factor (no payroll)
Idaho	7.6%	Yes	No	3 Factor with DWS
Montana	6.75%	Yes	Yes	3 Factor
New Mexico	4.8%/6.4%/7.6%	No	Yes	3 Factor; DWS (Manufact.)
Oklahoma	6%	No	Yes	3 Factor with DWS
Oregon	6.6%	No	Yes	100% Sales
Texas	1%**	Yes	No	100% Sales
Utah	5%	Yes	No	3 Factor

Source: CCH Group, *State Tax Handbook, 2009*. ***Double-weighted sales*". ***Texas' franchise tax is imposed on a much larger base than most states' taxable income for corporate tax purposes.*

- *NM's top rate is second highest in the region*
- *Most western states require combined reporting, allow federal consolidated*
- *Most states increase sales factor weight*



- *Collections have grown over time, but fluctuate widely with the economy*
- *FY10 collections were lowest since 2004, equal to level of 1998*
- *General Fund share averages 5%, similar to other states*



- *NM's tax base tracks U.S. base closely; NM has chosen not to "de-couple"*
- *U.S. drop was faster in 2009, but cumulative NM decline is now similar to U.S.*
- *CBO expects federal collections to rise sharply in next few years*

N.M. Corporate Income Taxpayers by Industry

- The Mining industry is usually the largest single contributor to the tax base, contributing one-third to one-half of total payments.
- Manufacturing companies are the second largest contributor at 20% to 30% of total payments.
- A variety of other industries also contribute including Information, Retail, Finance and Utilities.
- Approximately 20,000 companies pay some corporate income tax, compared with approximately 100,000 taxpayers in the gross receipts tax program.
- Most of the liability is owed by a few hundred firms.

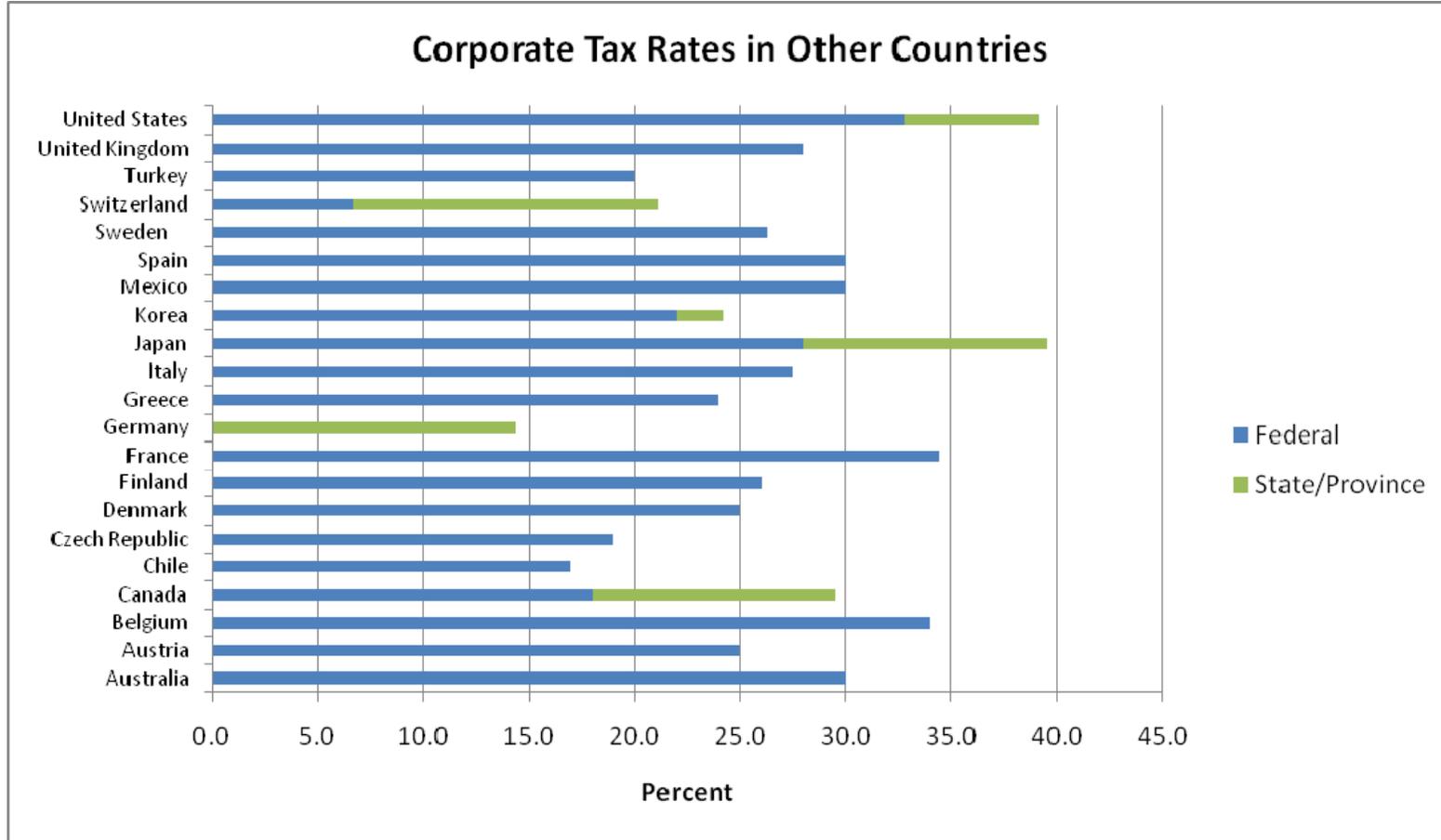
Western States Business Tax Comparison

<u>State</u>	<u>Property Tax</u>	<u>Sales Tax</u>	<u>Excise & GRI</u>	<u>CIT</u>	<u>WJ</u>	<u>PIT</u>	<u>Other</u>	<u>Total</u>	<u>Total Excl. Other</u>
Arizona	1.8%	1.6%	0.5%	0.4%	0.1%	0.1%	0.3%	4.7%	4.4%
California	1.1%	1.2%	0.5%	0.6%	0.3%	0.4%	0.5%	4.6%	4.1%
Colorado	1.6%	1.3%	0.3%	0.2%	0.2%	0.3%	0.2%	4.2%	4.0%
Idaho	1.8%	0.9%	0.4%	0.4%	0.2%	0.4%	0.4%	4.7%	4.3%
Montana	2.7%	0.0%	0.7%	0.7%	0.3%	0.3%	1.7%	6.4%	4.7%
New Mexico	0.8%	1.9%	0.5%	0.5%	0.2%	0.2%	2.1%	6.0%	3.9%
Oklahoma	1.0%	1.7%	0.4%	0.3%	0.2%	0.4%	1.3%	5.3%	4.0%
Texas	2.2%	1.3%	0.7%	0.0%	0.1%	0.0%	1.0%	5.3%	4.3%
Utah	1.2%	0.9%	0.5%	0.4%	0.2%	0.2%	0.3%	3.9%	3.6%
Average	1.6%	1.2%	0.5%	0.4%	0.2%	0.3%	0.9%	5.0%	4.1%

Tax collections as a percent of Gross State Product in FY 2008.

Source: Ernst & Young, Council on State Taxation, "Total State and Local Business Taxes," January 2009.

- *Excluding severance taxes (in "Other"), NM burden from all taxes is about average*
- *High sales tax (on purchases not sales) offsets low property tax*
- *NM CIT slightly above average, PIT slightly below average*



Source: Organization for Economic Cooperation and Development (OECD).

- *U.S. combined state/federal rate is one of the highest in the world*
- *Most countries do not impose state-level tax*

Economic Policy Analysis

- Why impose tax only on C-corporations?
 - Privilege tax on limited liability/access to capital markets?
 - No longer limited to C-corporations
- Who bears the burden of the tax?
 - Federal: Unknown
 - State: Shifted to Payroll, Property & Sales
 - Sales factor includes pyramiding; Property factor = original cost; Payroll factor adds burden on businesses with larger NM payrolls
- What are the impacts on economic development?
 - Imposition on origin-based factors (payroll & property) may discourage investment
 - Some large, multi-state companies may be likely to move to other states in response to higher business taxes

Corporate Income Tax and Tax Principles

- Revenue adequacy is highly variable, declines sharply during recessions
- Efficiency – i.e. economic growth – may be reduced by higher taxes on investment by large multi-state companies
- Horizontal equity – fairness to similar companies – may be reduced because CIT applies only to certain types of businesses
- Contribution to vertical equity is unknown
- Substantial complexity imposes high compliance costs on taxpayers and administrative costs on the state