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

ORIGINAL DATE 02/19/13
SPONSOR Sanchez, C. **LAST UPDATED** **HB**

SHORT TITLE Tax Expanded Net Operating Loss Carryover **SB** 560

ANALYST Smith

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY13	FY14	FY15	FY16	FY17		
$0.0	$0.0	($2,100.0)	($5,500.0)	($6,000.0)	Recurring	General Fund

(Parenthesis ( ) Indicate Revenue Decreases)

SOURCES OF INFORMATION
LFC Files

Responses Received From
Taxation and Revenue Department (TRD)

SUMMARY

Senate Bill 527 provides that for taxable years beginning on or after January 1, 2010, a net operating loss carryover from a taxable year beginning on or after January 1, 2010 may be excluded from net income as follows:

(1) in the case of a timely filed return, in the taxable year immediately following the taxable year for which the return is filed; or
(2) in the case of amended returns or original returns not timely filed, in the first taxable year beginning after the date on which the return or amended return establishing the net operating loss is filed; and
(3) in either case, if the net operating loss carryover exceeds the amount of net income exclusive of the net operating loss carryover for the taxable year to which the exclusion first applies, in the next fourteen succeeding taxable years in turn until the net operating loss carryover is exhausted; in no event shall a net operating loss carryover be excluded in any taxable year after the fourteenth taxable year beginning after the taxable year to which the exclusion first applies.

The bill also adds a new section to the Corporate Income and Franchise Tax Act regarding reporting that must be done by the department to the interim legislative revenue stabilization and tax policy committee on fourteen-year net operating loss carryover.

Effective Date: January 1, 2014

FISCAL IMPLICATIONS

TRD used New Mexico corporate income tax data for tax years 2007 through 2010 to construct an estimate. Total apportioned net operating loss (NOL) for each year that was going to be carried over was estimated. Average apportioned NOL carried over was found to be approximately $4 billion. A 10 percent increase per year in NOL carried over was assumed due to the carry over period being extended to 14 years for taxable years beginning on or after January 1, 2010.

A 6 percent average corporate income tax rate was applied to estimate the tax impact. However, since not all firms with available NOL carryovers will be able to use this amount each year, it was assumed that only 15 percent would be applied against tax liability per tax year. A 10 percent growth rate in the amount applied against tax liability was assumed to estimate the fiscal impact for the subsequent years. These amounts were "fiscalized" according to the recent New Mexico corporate income tax revenue patterns while assuming that estimated payments will be impacted.

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 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 recognizes a net operating loss (NOL) for New Mexico corporate income tax only when the federal corporate tax return shows the NOL or when federal taxable income minus interest on U.S. obligations yields a negative number. A net operating loss deduction (NOLD) is the amount of excess loss from the NOL year that is deductible from a corporation's federal taxable income in a carry-over year.

For NOLs generated in tax years prior to January 1, 1991, the carry-back and carry-over periods was the same for New Mexico as for federal purposes: usually three years back and 15 years forward. For NOLs generated in tax years beginning on or after January 1, 1991, the loss is eligible for carry forward only up to five years.

PERFORMANCE IMPLICATIONS

The LFC tax policy of accountability is met with the bill's requirement to report annually to an interim legislative committee regarding the data compiled from the reports from taxpayers taking the deduction and other information to determine whether the deduction is meeting its purpose.

TECHNICAL ISSUES

This bill does not contain a sunset date. The LFC recommends adding a sunset date.

POSSIBLE QUESTIONS

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

SS/blm