BILL ANALYSIS AND FISCAL IMPACT REPORT
Taxation and Revenue Department

February 1, 2024

Bill: SB-181 **Sponsor:** Senator Peter Wirth and Representative Micaela Lara Cadena

Short Title: Corporate Income Tax Liability

Description: This bill amends the corporate income tax act to remove the subtraction of subpart F income under Section 952 of the Internal Revenue Code (IRC) from base income. The bill also changes the definition of "water's-edge group" to include all corporations that are part of a unitary group and that are organized or incorporated in the United States, no matter the proportion of property, payroll, and sales of such corporation that are sourced to the United States.

Effective Date: Not specified; 90 days following adjournment (May 15, 2024). Applicable to tax years beginning on or after January 1, 2025.

Taxation and Revenue Department Analyst: Asif Rasool and Lucinda Sydow

Estimated Revenue Impact*					R or NR**	Fund(s) Affected
FY2024	FY2025	FY2026	FY2027	FY2028		
--	--	$1,000 - $1,700	$1,100 - $1,700	$1,100 - $1,800	R	General Fund

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

Methodology for Estimated Revenue Impact: The fiscal impact is based on reviewing Corporate Income Tax (CIT) tax return data from fiscal years 2021 through 2023. The revenue increase was modeled bringing in subpart F income back into base income under Section 7-2A-2(C) NMSA 1978. CIT is an extremely challenging revenue to forecast 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.

Policy Issues: Subpart F of the IRC was enacted in the 1960s to prevent the deferral of taxation of certain types of income of "controlled foreign corporations" (CFCs). A foreign corporation is a CFC if more than 50% of either: (1) the total combined voting power of all classes of stock entitled to vote, or (2) the total value of the stock of such corporation, is owned by United States shareholders on any day during the foreign corporation's taxable year. IRC Section 957(a). Prior to the enactment of Subpart F, a CFC's income was not taxable income of its U.S. shareholders until it was distributed to them, usually in the form of a dividend. Corporations were incentivized to earn and hold income in low- or no-tax foreign jurisdictions to defer taxation of their income as long as possible. Shareholders used various methods, most often loans from the CFC, to access the income without paying tax. The U.S. Congress responded by enacting Subpart F, which requires U.S. shareholders to include some CFC income in their taxable income, whether or not it was actually distributed. The rules regarding calculation of Subpart F income are very complicated, and subject to extensive regulation by the U.S. Department of the Treasury. Subpart F income forms approximately 2.3% of federally taxable corporate income.

Until 2019, New Mexico included such income in "base income" under the Corporate Income and Franchise Tax Act. The federal Tax Cuts and Jobs Act of 2017 (TCJA) made further adjustments to the

calculation of corporate taxable income by addressing the off-shoring of a different type of income, primarily derived from the sale of intangible property. This income is called "global intangible low taxed income", or "GILTI". The rules regarding GILTI are set out in IRC Section 951A.

As part of the legislative changes enacting "water's edge" reporting that were made in the 2019 Session, the requirement to include Subpart F income in taxable income was removed from statute. Such change was also in response to a "transition tax" included in the TCJA, which temporarily expanded the amount of Subpart F income that would be included in shareholder income. However, this removal was not legally required. As New Mexico generally conforms to federal tax law, it is therefore consistent with that conformity, and with sound tax policy generally, to put Subpart F income back into the corporate income tax base.

The second change made by the bill is to the definition of "water's edge group". Current law excludes from the water's edge group all corporations, no matter where organized or incorporated, that have less than 20 percent of their property, payroll, and sales sourced to the United States under the sourcing rules of the Uniform Division of Income for Tax Purposes Act, Section 7-4-1 *et seq.*, NMSA 1978. The bill eliminates this exclusion for corporations organized or incorporated in the United States; all such corporations will be included in the water's edge group, no matter how much of their property, payroll, and sales are sourced to the United States. This change conforms to federal law and relevant case law describing the boundaries of states' power to tax income not sourced to the United States, and furthers federal policy of preventing corporate tax deferral by shifting income to foreign sourcing.

Technical Issues: None.

Other Issues: Many taxpayers and tax practitioners have inquired with Tax & Rev about Section 250 in the current language in the definition of base income. Changing the language to "less the amount deducted pursuant to Section 250" makes clear that Section 951A income *less* the Global Intangible Low Tax Income (GILTI) deduction provided for in Section 250, is excluded from taxable income.

Administrative & Compliance Impact: Tax & Rev will make information system changes and update forms, instructions, and publications. This implementation will be included in the annual tax year changes.