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

ORIGINAL DATE 02/18/13
SPONSOR Campos **LAST UPDATED** 02/19/13 **HB**

SHORT TITLE Manufacturing Single Sales Tax Factor **SB** 508

ANALYST van Moorsel

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY13	**FY14**	**FY15**	**FY16**	**FY17**		
	($100.0)	($11,725.0)	($32,375.0)	($53,525.0)	Recurring	General Fund

(Parenthesis ( ) Indicate Revenue Decreases)

Duplicate to HB 507

Conflicts with SB 59, SB 277, SB 293, SB 319, SB 373, SB 538, SB 545, SB 568, HB 182, HB 596, HB 616.

SOURCES OF INFORMATION
LFC Files

Responses Received From
Taxation and Revenue Department (TRD)
Department of Finance and Administration (DFA)

SUMMARY

Synopsis of Bill

Senate Bill 508 (SB 508) amends the Corporate Income and Franchise Tax Act to phase in over five years a single sales apportionment factor for businesses engaged in manufacturing. To elect the apportionment formula created in SB 508, the taxpayer must notify the Taxation and Revenue Department (TRD) in writing before first filing a return using the new apportionment formula. Once opting into this apportionment formula, the taxpayer must use the formula for three years before being able to opt back out. The single sales factor provided for in SB 508 would be phased in over five years as follows:

Tax Year	Apportionment Formula
2013 (current law)	$\frac{\text{(sales factor)+(property factor)+(payroll factor)}}{3}$
2014	$\frac{\text{(2Xsales factor)+(property factor)+(payroll factor)}}{4}$
2015	$\frac{\text{(3Xsales factor)+(property factor)+(payroll factor)}}{5}$
2016	$\frac{\text{(7Xsales factor)+(1.5Xproperty factor)+(1.5Xpayroll factor)}}{10}$
2017	$\frac{\text{(8Xsales factor)+(property factor)+(payroll factor)}}{10}$
2018	$\frac{\text{(total sales in New Mexico)}}{\text{(total corporate sales)}}$

The bill also amends the act to and to exclude certain sales from being apportioned as sales in New Mexico.

The effective date of this bill is January 1, 2014, and the provisions are applicable to taxable years beginning on or after January 1, 2014.

FISCAL IMPLICATIONS

The TRD used 2010 New Mexico CIT data for manufacturing corporations (NAICS code 31 through 33) to analyze the impact of SB 508. The TRD notes there are approximately 1,750 corporations which file under the manufacturing NAICS codes with a total gross NM CIT of $75 million. The impact was estimated assuming that all manufacturing corporations whose sales factor is less than an average factor would make the election. Since not all eligible corporations will make this election due to the 36 consecutive month election requirement, the impact was reduced by 10 percent. February consensus forecast estimates were used to estimate the fiscal impacts from FY14 through FY17.

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.

SIGNIFICANT ISSUES

New Mexico's top corporate income tax rate of 7.6 percent is high, compared with the national average of 6.4 percent. New Mexico's CIT rate is especially high when considering a corporation can be taxed at the 4.9 percent personal income tax rate simply by organizing under another section of the IRS code. This violates the principle of tax equity. In 2011, the Council on State Taxation (COST) commissioned Ernst & Young to perform a 50-state study of effective tax rate/after-tax return on investment over a 30-year investment, New Mexico ranked last. The study found that tax rates and a complex tax credit incentive system are a burden on firms considering investments in New Mexico and are "almost certainly impeding economic growth." Among other options, the New Mexico Tax Research Institute (NMTRI) noted a reduction in the top corporate rate would make New Mexico more appealing to business investment.

The NMTRI also addressed the option of allowing corporations to apportion income with a single- or double-weighted sales factor. All states parse a multistate corporation's income into a state taxable base. New Mexico uses an "apportionment formula" that averages the percentage of a corporation's sales occurring in New Mexico, the percentage of payroll in New Mexico, and the percentage of property (or assets or investment) domiciled in New Mexico. The equally weighted corporate income apportionment formula creates a disincentive to expansion in New Mexico; if a company increases its operations in New Mexico, its taxes in New Mexico would increase, even without the benefit of additional sales, creating a disincentive to growth. Firms can lower exposure to New Mexico tax by firing workers and closing plants.

The "single sales" factor, by which income is apportioned only on the percentage of sales made in the state, is the alternative in favor nationally. This formula does not punish firms for investing or employing workers within a state. In New Mexico, a single sales formula would likely benefit extractive and manufacturing industries while penalizing direct sellers of goods and services and multistate banks. Mining and manufacturing pay well over half of New Mexico CIT, however, and this formula could result in lower revenues.

A corporate subsidiary doing business in New Mexico can pay taxes on a "separate corporate entity" basis or the entire corporation can pay on a "combined reporting" basis. Separate reporting brings up concerns about charges between related companies. For example, a company domiciled outside of New Mexico might provide management services or legal services to one domiciled in New Mexico and receive a payment for those services. The company making the payment would incur an expense. If the paying company is reporting on the separate entity basis, this expense will reduce its taxable income. The company not domiciled in New Mexico receiving the payment increases its income, and if it is located in a state with no income tax it might avoid the tax. Although it is hard to estimate the impact of this activity, combined reporting eliminates any chance of "gaming the system" because the income of all members of the corporate group is included. Because of the sales factor, combined reporting could have unintended consequences because a corporation could pay more tax based on the profits of its affiliates nationwide, regardless of whether the in-state subsidiary is profitable.

The Department of Finance and Administration (DFA) adds that most Western states with a corporate income tax currently allow "single-weighted sales factor" apportionment of income for all industries. For companies with a large portion of sales outside the state, such as big box retailers, this method has the effect of reducing their corporate income tax liability.

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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