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

		ORIGINAL DATE	02/17/21
SPONSOR	Wirth	**LAST UPDATED**	02/21/21	**HB**	
SHORT TITLE	Corporate Income Tax Rates			**SB**	211
				ANALYST	Graeser

REVENUE (dollars in thousands)

Estimated Revenue					Recurring	Fund
FY21	**FY22**	**FY23**	**FY24**	**FY25**	**or Nonrecurring**	**Affected**
	0.0	$9,000.0	$20,471.0	$28,700.0	Recurring	General Fund (CIT)
	($62,700.0)	($66,350.0)	($69,000.0)	($72,400.0)	Recurring	General Fund (GRT)
	($2,100.0)	($2,210.0)	($2,280.0)	($2,380.0)	Recurring	General Fund (Comp)
	($820.0)	($860.0)	($890.0)	($930.0)	Recurring	Local Government (Comp)
	$500.0	$520.0	$540.0	$560.0	Recurring	Small Cities Assistance Fund
	$320.0	$340.0	$350.0	$370.0	Recurring	Small Counties Assistance Fund

Parenthesis ( ) indicate revenue decreases

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY21	FY22	FY23	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
Total	$38.2			$38.2	Nonrecurring	TRD Operating***

Parenthesis ( ) indicate expenditure decreases

*** TRD indicates that major redesign efforts to the combined reporting system attributed to the change to destination sourcing for gross receipts tax is scheduled for delivery effective July 1, 2021..

SOURCES OF INFORMATION
LFC Files

Responses Received From
Taxation and Revenue Department (TRD)
Economic Development Department (EDD)

SUMMARY

Synopsis of Bill

Senate Bill 211 (SB211) increases the corporate income tax (CIT) rate for tax years beginning January 1, 2022, rising incrementally for four succeeding tax years. The bill also creates a new tax bracket for corporate taxpayers with taxable income over $1 million starting in the 2023 tax year. For taxable years beginning on or after January 1, 2026, the top marginal rate is 6.4 percent for taxable incomes over $1 million. The bill also decreases the state gross receipts tax rate and compensating tax rate from 5.125 percent to 5 percent. The bill adjusts the distribution amount to the small cities assistance fund and small counties assistance fund from compensating tax to keep the amount of distribution constant.

The effective date of this bill is July 1, 2021.

FISCAL IMPLICATIONS

TRD describes the methodology for the estimated revenue impact as follows:

> The December 2020 Consensus Revenue Estimating Group (CREG) forecast and growth estimates are used in the calculation for Sections 1-5 in the bill. Tax year 2018 CIT filings data were used to model the impact of the CIT increases in Section 3.
>
> The impact of new local compensating tax rates effective July 1, 2021 is incorporated into the small municipalities' and counties' distributions, and local government compensating tax revenue effects from the legislation.

SIGNIFICANT ISSUES

EDD is concerned with the effect the provisions of this bill might have regarding corporate income tax and business recruitment and retention.

> Stability in the tax code is valued heavily by businesses as they want as much certainty as possible when making long-term business decisions such as where to locate an operation. Raising CIT rates relatively soon after the previous rate reduction was fully phased in can create some unpredictability and uncertainty for corporations, making it difficult for economic developers to retain existing companies and convince businesses here and outside the state that New Mexico is the best location for them to expand or relocate.
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> Additionally, CIT rates in surrounding states are generally low compared to the upper brackets of the proposed CIT rate increase and can make New Mexico an outlier that could be a disincentive for businesses looking at multiple states when deciding where to locate operations. The CIT rates for Arizona and Colorado are a flat 4.9 percent and 4.63 percent, respectively, while Texas does not have a CIT.
>
> While decreasing GRT and compensating tax rates may be designed to offset the increase in CIT, these taxes are often passed onto the consumer, and New Mexico businesses may see limited benefits from these reductions. Because of this, a higher CIT rate may discourage new corporations from starting in the state or impede growth from existing and new companies. High GRT rates are certainly an ongoing issue for the state, but this minor reduction would not likely

sway any consumer or business decisions. The higher CIT rates are far more likely to negatively impact business decisions.

TRD has the following comments:

The increased CIT rates may negatively impact business decisions to locate or expand in New Mexico due to profitability decisions, however decreased gross receipts tax (GRT) and compensating tax rates may offset this impact. Additionally, all else being equal, businesses prefer a stable tax environment so that they can make future business plans and investments with some certainty. The CIT rates from 2013 legislation were fully phased in for tax year 2018. If this proposed legislation is implemented, there will have been 10 years that the CIT rate table changed from one year to the next over a 13-year period, ending in tax year 2026.

The CIT increase will increase revenue to the general fund. This may allow for an increase in governmental services, a reduction in taxes in other areas, or both. However, CIT tends to be a fairly volatile revenue source, with oil and gas corporations contributing heavily to the CIT base.

The Taxation and Revenue Department (TRD) estimates the revenue received from the increase in the rate increase for those with corporate income liability of $500 thousand to $1 million is small in comparison to the increase in revenue from new tax rate bracket increases for corporations with liability in excess of $1 million. As an example, in FY25 the revenue received from the proposed increase in tax rates for liability between $500 thousand and $1 million is less than 5 percent of the CIT revenue increase in that year. It may be reasonable to take into consideration whether the added complexity of a middle tax bracket for taxpayers and the optics of an increased tax rate are worth the moderate increase in revenue.

The reduction in the state GRT and compensating tax rates will lessen the tax burden on consumers and businesses. Lower taxes on consumption increase the purchasing power of consumers, lower costs on services, and reduce the costs for many businesses. To the extent there remains some pyramiding in the GRT, especially on professional services, reducing the tax rate reduces pyramiding.

The reduction in gross receipts and compensating tax revenues will reduce overall general fund revenue, which may result in a decrease in governmental services, an increase in taxes in other areas, or both.

ADMINISTRATIVE IMPLICATIONS

TRD expects moderate administrative impacts to implement these changes. Both Corporate Income Tax and the Gross Receipts Tax rates would change. Distributions to the Small Cities and Small Counties Assistance Funds will also change.

Administrative Services Division (ASD) estimates that implementation will cost $12.7 thousand in staff workload. The Information and Technology Division (ITD) of TRD estimates implementation will cost $15.5 thousand in staff workload.

TRD expects to be able to absorb the impact of these changes as outlined in this standalone bill within the annual tax year implementation. This July 1, 2021, TRD implements the conversion for the combined reporting system (CRS) redesign project, which received a nonrecurring appropriation. On July 1, 2021, TRD also implements the local option compensating tax, local option GRT on Internet sales, a new version 12 of Gentax, and moves to destination-based sourcing of the GRT. Due to the effective date of July 1, 2021 for this bill and other proposed bills, any changes to rates, deductions and distributions add to the complexity and risk TRD faces on July 1 to ensure complete readiness and testing of all processes. If several bills with similar effective dates become law there will be a greater impact to TRD, and additional staff workload costs or contract resources may be needed to complete the changes specified by the effective date(s) of each bill. TRD recommends an effective date of date of January 1, 2022 or July 1, 2022 to ensure proper implementation of the legislation in TRD administration and system processes.

Estimated Additional Operating Budget Impact*				**Recurring or Nonrecurring****	**Fund(s) or Agency Affected**
FY2021	**FY2022**	**FY2023**	**3 Year Total Cost**		
$12.7	--	--	$12.7	Nonrecurring	TRD – ASD Staff Workload
$15.5	--	--	$15.5	Nonrecurring	TRD – ITD Staff Workload

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

OTHER SUBSTANTIVE ISSUES

EDD has prepared the following table of phased changes in CIT rates and brackets:

Corporate income tax (CIT) rates and brackets are revised over 5 years with a new top bracket and rate of 7.6 percent instead of the current highest 5.9 percent. CIT rate increases are phased in as follows:

- **Prior to 2022**- Current corporate income tax rates:
  - Taxable income not over $500 thousand is taxed at 4.8 percent and remains at this rate in subsequent years;
  - Taxable income over $500 thousand is taxed $24 thousand plus 5.9 percent of excess over $500 thousand.
- **2022** –
  - Taxable income over $500 thousand is taxed $24 thousand plus 6.2 percent of excess over $500 thousand.
- **2023** –
  - Taxable income over $500 thousand and up to $1 million is taxed $24 thousand plus 6.4 percent of excess over $500 thousand and remains at this rate in subsequent years;
  - Taxable income over $1 million is taxed $56 thousand plus 6.6 percent of excess over $1 million.
- **2024** –
  - Taxable income over $1 million is taxed $56 thousand plus 6.9 percent of excess over $1 million.
- **2025** –
  - Taxable income over $1 million is taxed $56 thousand plus 7.3 percent of excess over $1 million.
- **2026 and after** –
  - Taxable income over $1 million is taxed $56 thousand plus 7.6 percent of excess over $1 million

TRD notes, "Traditionally, small cities and small counties have received a portion of the state compensating tax revenue. As of July 1, 2021, New Mexico will for the first time be imposing a local option compensating tax. Given this new local revenue stream, policymakers may wish to consider reducing or eliminating the amount of state compensating tax that is currently shared with small cities and small counties.

LG/sb