FISCAL IMPACT REPORT

SPONSOR HTRC ORIGINAL DATE 1/28/09 LAST UPDATED HB 8/HTRCS/aHTRC

SHORT TITLE Estimated Tax Payments and Withholding SB

ANALYST Francis

REVENUE (dollars in thousands)

Estimated Revenue			Recurring or Non-Rec	Fund Affected
FY09	FY10	FY11		
$65,000.0	$6,900.0	$21,800.0	Recurring	General fund

(Parenthesis ( ) Indicate Revenue Decreases)

Duplicates SB80 in part

SOURCES OF INFORMATION
LFC Files
Taxation and Revenue Department (TRD)

Responses Received From
Taxation and Revenue Department (TRD)

SUMMARY

Synopsis of HTRC Substitute as Amended

The House Taxation and Revenue Committee substituted House Bill 8 and amended the substitute. The substitute restores a quarterly payment date to require four quarterly payments of estimated corporate income tax (CIT) as is the case for the personal income tax (PIT) and makes certain changes to tax withholding statutes. Changes to the withholding statutes include allowing withholding pursuant to the Oil and Gas Proceeds Withholding Act count toward estimated payments for taxpayers and requires withholding reporting of certain companies.

The amendment allows taxpayers to make a one-eighth payment for the first payment in lieu of a one-fourth payment and the other one eighth in the second payment for tax year 2009. Taxpayers required to file estimated CIT payments will make the first payment equivalent to one-eighth of the estimated tax on the 15th of the fourth month—April 15th for most taxpayers—a three-eighths payment (one quarter plus the one-eighth) on the 15th of the six month, and then the normal quarterly payments after that. For payments in tax year 2010 and beyond, there are four quarterly payments equal to 1/4th of the estimated tax liability.

There is an emergency clause so the law will become effective upon passage. Provisions that affect income taxes are applicable to tax year 2010, except for the CIT quarterly payment change which is effective for tax year 2009. Provisions that affect the gross receipts tax code are effective July 1, 2009.

Synopsis of Original Bill

House Bill 8 restores a quarterly payment date to require four quarterly payments of estimated corporate income tax (CIT) as is the case for the personal income tax (PIT) and makes certain changes to tax withholding statutes. Changes include allowing withholding pursuant to the Oil and Gas Proceeds Withholding Act count toward estimated payments for taxpayers, defining "film performing artist entity" and requiring these entities that contract performing artists to withhold personal income tax in order to qualify as an expenditure for the film production tax credit, exempts film performing artist entities gross receipts, and requires withholding reporting of certain companies.

There is an emergency clause so the law will become effective upon passage. Provisions that affect income taxes are applicable to tax year 2010, except for the CIT quarterly payment change which is effective for tax year 2009. Provisions that affect the gross receipts tax code are effective July 1, 2009.

FISCAL IMPLICATIONS

The fiscal impact of restoring the quarterly payment is estimated to be 25 percent of 80 percent of the 2009 CIT liabilities (before credits). Under current law, a quarterly payment will not be due from calendar year corporations until June 15, 2009, and this bill would make the half of the first payment due April 15, 2009 and the other half due on the normal second quarterly payment (making that payment equal to three-eighths of the estimated quarterly tax liability). There are some companies that start their tax year in February or March which is why the statute refers to the "fourth month" rather than April. Based on December 2008 revenue estimates for FY09 CIT, the restoration of the quarterly payment will generate $65 million.

Some taxpayers may already be making the first payment in April pursuant to the pre-2003 law, representing a risk to the fiscal impact projection. TRD reports that current first quarter estimated payments are quite small.

TRD reports that the fiscal impact for the withholding provisions will be a positive $20 million annually due to the increased compliance.

TRD:

> The latest available in-depth study of income tax noncompliance from the National Research Program at IRS found that the net misreporting percentage[1] for most forms of PTE income (partnership, subchapter S corporation, estates and trusts) was 17.8% and for royalties (and rents) was 51.3%, whereas for wages and salaries subject to withholding the net misreporting percentages is only 1.2%. The estimated revenue impact for extending the Withholding Tax Act to the PTE income of residents assumes that that the net misreporting percentage would be reduced from 17.8% to 1.2% by withholding. This reduction in misreporting was applied to the amount of PTE income reported by residents on their federal income tax returns in 2006 (the latest year available). That amount was

[1] The net misreporting percentage is the net amount of income or offset misreported divided by the amount that should have been reported.

multiplied by the weighted average marginal tax rate on this income of 4.8%. This result was reduced by an estimate of the fraction of this underreported tax that is currently being collected through enforcement activities.[2] This final 2006 amount was then extrapolated to 2010 and later years using the growth rate in personal income (actual rate for 2007 and 2008; December forecast rate for 2009 and later years), and converted to a fiscal year collections basis.

Currently, Oil and Gas Proceeds Withholding does not apply to any recipient ("remittee") of such income with a New Mexico mailing address. Nonresidents can therefore easily avoid withholding (and evade New Mexico income tax) by using a mailing address in the State for receipt of oil and gas proceeds. This form of noncompliance by nonresidents is eliminated in the bill by the extension of withholding to all recipients of oil and gas proceeds. The estimated revenue impact of this effect is based on an assumption that 85% of all oil and gas proceeds paid to nonresidents is subject to withholding, with a reduction in the misreporting percentage to 1.2%, and the remaining 15% is escaping withholding and not subject to either withholding or income tax reporting. Overall, under these assumptions the misreporting percentage for oil and gas proceeds paid to nonresidents is therefore 16.0% (compared to the IRS finding of a 51.3% misreporting percentage for royalties (and rents), but with no federal withholding). This misreporting percentage was assumed to be reduced to 1.2% by extension of Oil and Gas Proceeds Withholding to all recipients. This change in misreporting was applied to the estimated amount of current withholding applied to nonresidents ($30.1 million, or about 75% of the total, in FY07). The result was then extrapolated to 2010 and later years using the growth rate in oil and gas revenues (actual for FY2007 and FY2008; December forecast for 2009 and later years), and converted to a fiscal year collections basis.

SIGNIFICANT ISSUES

The HTRC substitute for HB 8 as amended, which is similar to the original HB8 sponsored by the Revenue Stabilization and Tax Policy interim committee, has several provisions mostly aimed at clarifying the Withholding Tax Act and the Oil and Gas Proceeds Withholding Tax Act. Many of the changes are technical such as referring to the Oil and Gas Proceeds Withholding Tax Act in sections that refer to the Withholding Tax Act only. The only provision with a fiscal impact amends the quarterly estimated CIT payments to include a date for the first payment CIT estimated payment. In 2003, the manner in which estimated payments for corporate income tax was amended and, according to the fiscal impact report (FIR) from HB762, there was no fiscal impact reported because it was assumed that the bill would be fixed with a technical amendment. TRD's FIR also brought this up at the time but the final version did not include the amendment and so one due date for quarterly payments was omitted. The enacted legislation only provided for three due dates for the quarterly payments rather than four. This bill adds back in a payment date of the 15th day of a corporation's fourth month (April 15 for calendar year corporations) to accommodate all four quarterly estimated payments referred to in the law. The amendment allows companies in the first tax year to split the first quarterly payment into two payments.

Most affected parties have likely been informed that this bill is being considered and LFC staff has discussed the matter with members of the business community. Richard Anklam, executive director of the New Mexico Tax Research Institute, reported to LFC staff (on this provision of

[2] The fraction used was 16%, which is the fraction of the tax gap that IRS currently collects.

the bill only) that the subject came up during a board meeting and there was general agreement that the proposal is correcting a technical error and will not place a burden on corporate taxpayers. There may, however, be some taxpayers that planned on deferring the quarterly payment and so would have to adjust their cash-flow planning to accommodate the April payment. If an accommodation requires access to short-term capital markets, this may pose problems for some taxpayers. The amendment greatly reduces the possible impact.

Reporting requirement. Section 7 requires employers with fifty employees or more that is not required to file an unemployment insurance tax form with Workforce Solutions or a payor, defined as an entity making payment of a pension or annuity to an NM resident, to file a quarterly withholding information return with TRD.

Clarifying withholding rate. The withholding rate for the Oil and Gas Proceeds Withholding Act was set by department regulation not to exceed the maximum corporate or personal income tax rate. This is amended to match the withholding rate with the type of filer (corporate or individual). This should clarify the withholding rate and make it more convenient for the entity withholding taxes.

TRD:

> Extending PTE and oil and gas proceeds withholding to residents should reduce the burden of making quarterly estimated payments and remove the need for withholding agents to distinguish between residents and non-residents.
>
> Bringing estates and trusts which in practice are pass-through entities under the PTE withholding rules will simplify compliance and administration of these rules.

PERFORMANCE IMPLICATIONS

TRD believes that many of the changes here clarify statutes and make technical updates. Particularly, the inclusion of the Oil and Gas Proceeds Withholding Act into those parts of statute that refer to the Withholding Tax Act makes it clear that the two types of withholding should be treated equally as they relate to estimated payments in particular.

ADMINISTRATIVE IMPLICATIONS

The Legislative Finance Committee has adopted the following principles to guide responsible and effective tax policy decisions:

1. ***Adequacy**: revenue should be adequate to fund government services.*
2. ***Efficiency**: tax base should be as broad as possible to minimize rates and the structure should minimize economic distortion and avoid excessive reliance on any single tax.*
3. ***Equity: taxes should be fairly applied across similarly situated taxpayers and across taxpayers with different income levels.***
4. ***Simplicity**: taxes should be as simple as possible to encourage compliance and minimize administrative and audit costs.*
5. ***Accountability/Transparency**: Deductions, credits and exemptions should be easy to monitor and evaluate and be subject to periodic review.*

More information about the LFC tax policy principles will soon be available on the LFC website at www.nmlegis.gov/lcs/lfc

CIT estimated payment. If the bill does not pass early in the session, it may be difficult to inform all of the taxpayers of the change in time for the first payment in April. TRD reported to the Revenue Stabilization and Tax Policy interim committee in December when the committee agreed to support a similar bill that corporate taxpayers would be notified that the new payment date was being considered. TRD made the same commitment to the LFC during its consideration of the proposal on January 14.

TRD has already issued a notice that this change has been proposed and that corporate income taxpayers should monitor the legislative session for updates and enactments.

TECHNICAL ISSUES

The HTRC substitute for HB8 as amended still has some references to the "film performing artist entity" that was included in the original HB8. This has been left in this bill because another bill, HB404, uses the definitions in this bill and duplicates that section. This is duplicated for technical reasons. If two bills that amend the same section of statute are passed by the legislature and signed by the governor, they are both NM laws but only the last one signed is compiled into the public law books.

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

Senate Bill 80 as amended contains similar language restoring the first quarterly estimated CIT payment but requires only half of the first quarterly payment in tax year 2009 in lieu of the full quarter. This shifts half of the fiscal impact into FY10.

NF/mt/mc