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

SPONSOR Munoz **ORIGINAL DATE** 02/18/13 **LAST UPDATED** **HB**

SHORT TITLE Foreign Source Dividends as Corporate Income **SB** 568

ANALYST van Moorsel

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY13	FY14	FY15	FY16	FY17		
	($5,760.0)	($14,690.0)	($15,430.0)	($16,200.0)	Recurring	General Fund

(Parenthesis ( ) Indicate Revenue Decreases)

Relates to SB 59, SB 277, SB 293, SB 319, SB 373, SB 508, SB 538, SB 545, HB 182, HB 596, and HB 616.

SOURCES OF INFORMATION
LFC Files

Responses Received From
Taxation and Revenue Department (TRD)

SUMMARY

Synopsis of Bill

Senate Bill 568 creates a new section of the Corporate Income and Franchise Tax Act to wholly or partially exempt foreign source dividends received by a taxpayer from net income when determining corporate income tax (CIT) liability as follows:

- 70 percent of the dividends included on lines 13 and 14, Schedule C, federal form 1120 received from corporations owned less than 20 percent by the taxpayer but only if those dividends would have been subject to the 70 percent deduction under 26 U.S.C. 243(a)(1) had the payor of the dividends been a domestic corporation;
- 80 percent of the dividends included on lines 13 and 14, Schedule C, federal form 1120 received from corporations owned 20 percent to 80 percent by the taxpayer but only if those dividends would have been subject to the 80 percent deduction under 26 U.S.C. 243(c) had the payor of the dividends been a domestic corporation; or
- 100 percent of the dividends included on lines 13 and 14, Schedule C, federal form 1120 received from corporations owned more than 80 percent by the taxpayer but only if those

dividends would have been subject to the 100 percent deduction under 26 U.S.C. 243(a)(3) had the payor of the dividends been a domestic corporation.

The provisions of SB 568 apply to taxable years beginning on or after January 1, 2014. There is no effective date of this bill. It is assumed that the new effective date is 90 days after this session ends (June 14, 2013).

FISCAL IMPLICATIONS

The TRD used tax year 2010 New Mexico CIT data in its analysis of SB 568. According to this data, TRD reports corporations using the "separate corporate entity (SCE)" reporting method deduct approximately $30 million from their tax liability at a 7.2 percent average tax rate. This amount is approximately 18.5 percent of total receipts from corporations using "SCE" reporting method. A similar percentage was applied to the receipts from corporations using "combined" and "consolidated" reporting methods to estimate the fiscal impact. The foreign dividends were assumed to grow 5 percent per year.

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

This bill would exempt certain income for purposes of determining CIT liability, and would have the effect of making the tax base narrower. An alternative would be broad-based tax rate reduction proposed in several related bills introduced during the 2013 legislative session.

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."

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

PvM/blm