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

SPONSOR Dodge
ORIGINAL DATE 02/07/14
LAST UPDATED
HB 234

SHORT TITLE Exclude NOL Carryover For Up To 20 Years
SB

ANALYST Graeser

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY14	FY15	FY16	FY17	FY18		
				***	Nonrecurring	General Fund

(Parenthesis ( ) Indicate Revenue Decreases)

See "FISCAL ISSUES" below for a discussion of impacts in FY18 and beyond.

Duplicates SB 156 and conflicts with SB 106. See discussion below in "FISCAL ISSUES."

SOURCES OF INFORMATION
LFC Files

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

SUMMARY

Synopsis of Bill

House Bill 234 would extend net operating loss carryovers (NOLs) incurred from net income reported for corporate income tax purposes and personal income tax purposes from the current five-year period to 20-years for taxable years (TYs) beginning after January 1, 2013. For TYs beginning before January 1, 2013, NOLs not recovered after five years would be extinguished. Losses incurred in taxable years beginning after January 1, 2013 would be allowed to be excluded from net income until recovered or twenty years from the taxable year of loss, whichever is earlier.

FISCAL IMPLICATIONS

TRD notes further analysis of the fiscal impacts of this proposal:

> Current law allows a net operating loss (NOL) to be carried over up to four years; therefore the negative fiscal impact will not begin until after FY2018. New Mexico

corporate income tax data for tax years 2007 through 2011 was used in this analysis. Total apportioned NOL for each year that was going to be carried over was estimated. Average apportioned NOL carried over was found to be approximately $3 billion. A 15 percent increase per year in NOL carry over was assumed due to the carry over period being extended from 4 to 20 years. An average corporate income tax rate of 5 percent was applied to estimate the tax impact due to the NOLs.

The TRD cannot establish the exact impact after 2018 since our forecast does not go beyond 2018. However, since not all firms with available NOL carry-overs will be able to use this amount each year, it was assumed that only 15 percent would be applied against tax liability per tax year after 2018. A 10 percent growth rate in the amount applied against tax liability was assumed to estimate the fiscal impact for the years after 2018. TRD estimated the impact to be about a $6 million General Fund loss in these future years.

Note: since HB 234 applies the 20-year NOL carry forward to individuals and pass-through entities including Subchapter S corporations, Limited Liability Companies (LLCs), partnerships, limited liability partnerships (LLPs) and other similar organizational structures, the future General Fund revenue impact post FY2018 may be greater than indicated.

On the other hand, the "Great Recession" of Dec 2007 – June 2009 was the deepest and longest recession since the "Sui Generis – end of War" recession of 1945. Thus sampling tax filings from this period that includes the "Great Recession" may overestimate the delayed impact of this bill.

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. On the other hand, as pointed out below, the provisions of this bill do not create a tax expenditure. Although there may well be a revenue decrease attributable to this bill, the provisions of the bill serve to make New Mexico's policies in this regard more closely conform to national and regional norms.

EFFECTIVE DATE

Not stated – assume May 21, 2014; applicable for taxable years beginning on or after January 1, 2014.

SIGNIFICANT ISSUES

This bill would have no fiscal impact until FY2018 and very little General Fund fiscal impact after FY2018. The major purpose of the provisions of this bill would be to make New Mexico's corporate and personal income tax NOL rules conform to federal policy and the policies of our neighboring states of Arizona, Colorado and Utah. This would be very important policy for very few corporations.

This bill apparently extinguishes pre-TY13 losses after the fifth year following the loss year. For corporations, individuals and pass-through entities such as Subchapter S corporation, partnerships and LLCs that survived the 2008 "Great Recession," but incurred extensive losses in that year and in the few years following the recession, this bill extinguishes the unrecovered losses from these tax years after the fifth year following the loss year and will not create either a negative fiscal impact on the General Fund or a tax benefit for these corporations with unrecovered Pre TY 2013 losses. Those corporations might include those that received support from the Federal Treasury known as "the bailout." Corporations that received this support included some major banks and financial institutions and several members of the automotive industry. For New Mexico purposes, however, these corporations were not allowed to carry these losses back for two years, as would have been allowed for federal corporate income tax purposes. These corporations carrying NOLs on their books would be allowed to carry forward these losses for the year following the loss and four more years. Assuming the losses were incurred in TY 2008, the losses could be carried forward to TY 2009, 2010, 2011, 2012 and 2013. For most corporations, this would be adequate to recover all of the losses incurred in TY 2008. However, there might be others that would lose the privilege of recovering those losses. This does not create a revenue loss or gain for the State. If these pre-2013 losses were allowed to be carried forward to 2013 et. seq. for a total of 20-years, there would be a revenue loss for the General Fund. If one believes that there will never be another "Great Recession," then this bill will have virtually no impact. Unlike NOL carry-backs which can generate refunds from taxes paid in years prior to the loss year, NOL carry-forwards do not generate refunds. In terms of peak to trough declines in GDP for 20th and 21st century recessions and depressions, the "Great Recession" is in 11th place of 23. If a recession that was relatively mild in long-term historical perspective has created a situation where some corporations could lose the ability to recover their losses, the State should give consideration to changing its policies to be more fair to our business community.

Arizona extended the carry-forward period from five years to 20 years in 2012. Colorado has allowed 20-year forward carryovers since 1987. Utah has allowed limited carry-backs for three years and forward 15 years. However, allowed losses are limited in any carry-back or carry-forward year to $1,000,000 in taxable income (1994 legislation). For Federal purposes, there is a two-year carry-back period and twenty-year forward period.

PERFORMANCE IMPLICATIONS

The LFC tax policy of accountability is <u>not</u> met since TRD is <u>not</u> required in the bill to report annually to an interim legislative committee regarding the data compiled from the reports from taxpayers taking the deduction and other information to determine whether the deduction is meeting its purpose. However, the provisions of this bill could be considered moving the states income tax closer to a mainstream tax system. Under this interpretation, this would not be considered a tax expenditure and LFC's accountability policy may not be applicable.

ADMINISTRATIVE IMPLICATIONS

TRD reports that administrative impacts of this bill will be moderate and affect forms, instructions and training of audit staff.

CONFLICT

HB 234 duplicates SB 156, and conflicts with SB-106.

HB 234 and SB 156 provide the extended NOL carry-forward for losses reported for personal income tax and corporate income tax purposes. These duplicate bills set the new 20-year carry-forward period for losses incurred in TYs beginning January 1, 2013. This, however, will not extend the loss carry-forward period for losses incurred in FYs 2008 through 2012.

SB 106 provides a 20 year NOL carryover period for corporations, but not for individuals or pass-through entities. However, pre-2014 losses are extinguished in SB 106.

OTHER SUBSTANTIVE ISSUES

Putting the "Great Recession" into perspective, it was the 11th most severe recession or depression of the 23 that have occurred since 1900

Name	GDP decline (peak to trough) or Trade & industrial activity
Early 2000s recession	−0.3%
Recession of 1969–70	−0.6%
Early 1990s recession	−1.4%
Recession of 1960–61	−1.6%
Recession of 1949	−1.7%
1980 recession	−2.2%
Recession of 1953	−2.6%
Early 1980s recession	−2.7%
1973–75 recession	−3.2%
Recession of 1958	−3.7%
Great Recession	−4.3%
1899–1900 recession	−8.8%
1926–27 recession	−10.0%
Panic of 1910–1911	−10.6%
Recession of 1945	−12.7%
Post-World War I recession	−14.1%
1902–04 recession	−17.1%
Recession of 1937–1938	−18.2%
Recession of 1913–1914	−19.8%
1923–24 recession	−22.7%
Great Depression	−26.7%
Panic of 1907	−31.0%
Depression of 1920–21	−32.7%

WHAT WILL BE THE CONSEQUENCES OF NOT ENACTING THIS BILL

Per EDD, the state will lose the opportunity this year to adjust New Mexico's personal and corporate income taxes to national and regional norms.

LG/svb