FISCAL IMPACT REPORT

SPONSOR SCORC **ORIGINAL DATE** 01/28/14 **LAST UPDATED** 02/10/14 **HB**

SHORT TITLE Exclude NOL Carryover For Up To 20 Years **SB** 106 & 156/SCORCS

ANALYST Graeser

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY14	**FY15**	**FY16**	**FY17**	**FY18**		
	$0.0	$0.0	$0.0	~($6,000.0)	Nonrecurring	General Fund

(Parenthesis ( ) Indicate Revenue Decreases)

HB 234 is apparently a duplicate of this SCORC substitute for Senate Bills 106 and 156.

SOURCES OF INFORMATION
LFC Files

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

SUMMARY

Synopsis of Bill

The Senate Corporations and Transportation Committee substitute for Senate Bills 106 & 156 would extend net operating loss carryovers (NOLs) incurred from net income reported for ***corporate income tax (CIT)*** purposes from the current five-year period following the year of loss to 20-years following the year of loss for taxable years (TYs) beginning after January 1, 2013. The bill would also extend net operating loss carryovers (NOLs) incurred from net income reported for ***personal income tax (PIT)*** purposes from the current five-year period following the year of loss to 20-years for taxable years (TYs) beginning after January 1, 2013. For both CIT and PIT TYs beginning before January 1, 2013, NOLs not recovered after five years would be extinguished.

FISCAL IMPLICATIONS

This bill would have very little fiscal impact until at least FY 2018, but would serve to make New Mexico's personal and corporate income tax NOL rules conform to federal policy and the policies of our neighboring states of Arizona, Colorado and Utah. Neither this bill, nor HB 234 would benefit corporations that survived the 2008 "Great Recession," but incurred extensive losses in that year and in the few years following the recession. Either of these bills extinguish the unrecovered losses from these tax years. 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. So, there might be some losses that would not have been recovered that would be extinguished pursuant to the provisions of this bill. Losses incurred in TYs 2009, 2010, 2011, 2012 and 2013 would be allowed to be carried forward for five years and any losses remaining after the five years would be extinguished. For TYs beginning after January 1, 2014, NOLs could be carried forward for 20 years. Thus, the fiscal effects of this bill will be minimal.

Individuals, partnerships, limited liability partnerships, limited liability corporations, Sub-Chapter S corporations and other pass-through entities are accorded the extended carryover period in Section 1 of the bill.

If the State were ever to experience another recession of the duration and severity of the 2008-2009 "Great Recession," this provision could potentially cost the State General Fund some money. However, any substantial revenue impact would occur at least five years after the losses occurred, so at the earliest 2020 if the State were to have a recession or major corporate NOLs in 2014 or 2015.

While acknowledging that this type of bill is very difficult to estimate, TRD provided the following:

> Current tax law allows an 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% 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% and personal income tax rate of 4% was applied to estimate the tax impact due to the NOLs attributed by both corporate and personal income tax.
>
> While Taxation and Revenue Department (TRD) does not normally make projections more than 5 years out, because of the unique circumstances of this bill, TRD has attempted to project this out one extra year. It should be noted that projections this far out come with a high degree of uncertainty.
>
> Since not all firms with available NOL carryovers will be able to use this amount each year, it was assumed that only 15% would be applied against tax liability per tax year after 2018. A 10% growth rate in the amount applied against tax liability was assumed to estimate the fiscal impact for the years after 2018. TRD estimates the impact to be at least of $6 million General Fund loss in these future years.

EFFECTIVE DATE

Not stated – assume May 21, 2014; applicable for taxable years beginning on or after January 1, 2013. This does not constitute an illegal ex post imposition of tax, since only tax reductions are created by this bill. The bill does not cancel tax reductions that had been accorded to taxpayers prior to the bill's passage.

SIGNIFICANT ISSUES

Net operating loss carrybacks and carryovers are difficult even for an experienced practitioner. Some explanation of the effect of current statute and the changes proposed in the bill are warranted. Assume for the purpose of argument that a calendar year taxpayer (Sub-C corporation, pass-through entity or individual) incurred a substantial loss for the 2009 tax year because of the effect the recession. Further assume this taxpayer had not recovered the total loss from taxable earnings in TYs 2010, 2011, or 2012. Pursuant to the terms of this bill, the corporation could apply the 2009 losses to TY 2013 or TY 2014, but any NOLs remaining after 2014 could not be recovered. This bill would not alter that policy. However, if the taxpayer incurred a new loss in TY 2013, then that year would be closed to the TY 2009 carried-over loss. For the 2014 TY, the taxpayer could first apply the remaining 2009 losses that had not been recovered in TYs 2010, 2011 or 2012. If any net income were left after applying the last of the 2009, the NOL from 2010 loss could be applied. These 2010 losses would also be extinguished if they could not be applied by the 2015 TY. It would only be losses incurred in 2013, 2014 or subsequent years that could be applied for up to 20 years.

It should not be assumed that no taxpayer can incur substantial losses for more than five years without going into bankruptcy. In the new technological economy, it may easily take five years to get an idea from drawing board to market. Self-financed research firms, research firms funded by Angels, and research and development firms funded by venture capitalists are all possible.

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.

Because this bill does not create any significant fiscal impacts, it should not be considered a tax expenditure, but a measure to conform the State's corporate and personal income taxes to national and regional norms.

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 and other information from taxpayers taking advantage of the increased time to apply previous losses to determine whether the deduction is meeting its purpose. However, accountability can be met with routine reports available from TRD detailing the amounts and types of specific state adjustments to income, such as this.

ADMINISTRATIVE IMPLICATIONS

Administrative impacts of this bill will be moderate and affect forms, instructions and training of audit staff.

WHAT WILL BE THE CONSEQUENCES OF NOT ENACTING THIS BILL

The state will lose the opportunity this year to adjust New Mexico's personal and corporate income taxes to be more congruent with the national and regional norms.

LG/svb