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FISCAL IMPACT REPORT

ORIGINAL DATE 02/12/14

SPONSOR Wirth LAST UPDATED _____ HB _____

SHORT TITLE Determine Sourcing of Certain Sales & Svcs. SB 118

ANALYST van Moorsel

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY14	FY15	FY16	FY17	FY18		
Indeterminate – potentially positive.					Recurring	General Fund

(Parenthesis () Indicate Revenue Decreases)

SOURCES OF INFORMATION

LFC Files

Responses Received From

Taxation and Revenue Department (TRD)

SUMMARY

Synopsis of Bill

Senate Bill 118 amends the Uniform Division of Income for Tax Purposes Act (UDITPA) to determine the sourcing of certain sales and services. Sourcing is a means of identifying which state's taxes should be applied to a transaction. This bill amends sourcing rules for sales as they are included in the sales factor for the division of income for tax purposes.

Under the provisions of the bill, sales would be sourced to New Mexico if:

- sale, rental, lease or license of real property and the real property is located in New Mexico;
- rental, lease or license of tangible personal property and the tangible personal property is located in New Mexico;
- sale of a service and the service is delivered to a location in New Mexico; and
- sale, rental, lease or license of intangible property and the intangible property is used in New Mexico.

If the source state cannot be determined, sourcing must be reasonably approximated. If the taxpayer is not taxable in a state to which a sale is assigned or the state of assignment cannot be determined or approximated, that sale shall not contribute to the calculation of the sales factor.

The Taxation and Revenue Department may promulgate rules to carry out the purposes of this section.

The provisions of this bill apply to taxable years beginning on or after January 1, 2015.

FISCAL IMPLICATIONS

The Taxation and Revenue Department (TRD) notes it does not have the data needed to estimate the fiscal impact of SB 118. However, New Mexico's status as a net market state – that is, a state that tends to be a buyer of services from without rather than a seller of services from within – indicates that the change from cost-of-performance sourcing rules to market-based sourcing could have a positive impact on revenues.

Currently, sales, other than sales of tangible personal property, are considered to be in New Mexico if:

- the income-producing activity is performed in this State; or
- the income-producing activity is performed both in and outside this state and a greater proportion of the income-producing activity is performed in this state than in any other state, based on costs of performance (COP).

TRD notes an issue with this treatment, namely:

- The cost of performance is difficult to determine, and
- “All or nothing” assignment of sales based on the state with greatest cost of performance is not a reasonable treatment.
- The COP rule somewhat duplicates the function of property and payroll.

SIGNIFICANT ISSUES

This bill would change the way the state measures intangibles from a cost of performance basis to a market sourcing basis. Cost of performance is the current method used. However, the difficulty in reasonably measuring cost of performance in multiple states – especially for multi-state corporations, has resulted in several states either modifying the calculation of cost of performance or moving towards (a variant of) market sourcing. TRD notes that, based on past experience of the states, it does not appear that market sourcing has proved to be a better method, as there are issues within market sourcing that still need to be sorted out.

The New Mexico Tax Research Institute remarks the market based sourcing proposal is consistent with a national trend in apportionment, along with greater reliance on the sales factor. Such a rule needs lots of regulations, makes sense on some levels, but also has the potential to whip-saw taxpayers in states with cost of performance rules- and certainly a few winners and losers would result. Apportionment rules affect “business income”, so their implications are not limited to corporate income tax.

TRD notes the bill is similar to the proposed Multistate Tax Commission (MTC) compact amendments. This bill changes the sourcing from cost of performance to market based sourcing which is a new trend.

ADMINISTRATIVE IMPACT

The terms “reasonable approximation” and “delivered” would need to be defined by regulation. TRD would promulgate the needed rules to provide the detail necessary to the taxpayer while providing a breakdown on the taxes paid to help identify the impact of the proposed rule.

TECHNICAL ISSUES

A definition of “market sourcing” and “cost performance” should be included in the bill to enhance the understanding of the bill.

TRD reports in its analysis of the bill that the phrase “delivered to a location” in Section 1(A)(3) may not be very clear in its application. For instance, it may be difficult to determine the location that an accounting service, a tax service, a research service, or a legal service is delivered. If knowing who is the ultimate consumer is an important factor, perhaps the phrase “delivery to a consumer in this state” or “the service is delivered to a person, or entity, that is the ultimate consumer and whose business or residence is in this state” would clarify this issue.

TRD also adds that the Hearing Office Report on Proposed Recommended Amendments to Model Multistate Tax Compact Article IV [UDITPA] at the Multistate Tax Commission treats specific sale, lease, rental, and license case as eligible to be adopted or excluded from the numerator and the denominator of the sales factor based on certain criteria. As such, TRD suggests the following language:

- “(4) In the case of intangible property,
- (i) that is rented, leased, or licensed, if and to the extent the property is used in this state, provided that intangible property utilized in marketing a good or service to a consumer is “used in this state” if that good or service is purchased by a consumer who is in this state; and
 - (ii) that is sold, if and to the extent the property is used in this state, provided that:
 - (a) a contract right, government license, or similar intangible property that authorizes the holder to conduct a business activity in a specific geographic area is “used in this state” if the geographic area includes all or part of this state;
 - (b) Receipts from intangible property sales that are contingent on the productivity, use, or disposition of the intangible property shall be treated as receipts from the rental, lease or licensing of such intangible property under subsection (4)(i); and
 - (c) All other receipts from a sale of intangible property shall be excluded from the numerator and denominator of the sales factor.”

OTHER SUBSTANTIVE ISSUES

In September 2013, the National Conference of State Legislatures Executive Committee Task Force on State and Local Taxation sent a memorandum discussing legal questions regarding the impact of New Mexico’s membership in the Multistate Tax Compact. Litigation is pending in

four states seeking to determine whether membership in the compact removes the state legislature's control over corporate income tax apportionment and certain tax base definitions. The challenges are based on whether states have modified the traditional three-factor apportionment formula for determining corporate income subject to tax and whether out-of-state taxpayers are able to override state law by electing to use apportioning rules provided by the compact. It is unclear whether similar challenges can be expected in New Mexico, as the single-sales income apportioning is optional.

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/ds