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

SPONSOR Sanchez, C. **ORIGINAL DATE** 02/05/14 **LAST UPDATED** **HB**

SHORT TITLE Exclude NOL Carryover For Up To 20 Years **SB** 156

ANALYST Graeser

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY14	FY15	FY16	FY17	FY18		
	$0.0	$0.0	$0.0	$0.0	Nonrecurring	General Fund

(Parenthesis ( ) Indicate Revenue Decreases)

Note: SB 156 conflicts with SB 106 to the extent that SB 106 extinguishes corporate income tax net operating loss carryovers (NOLs) for losses incurred in taxable years beginning prior to January 1, 2014 and sets up the new 20-year carryover rules for taxable years beginning on or after January 1, 2014, while this bill extinguishes NOL carryovers for losses incurred in taxable years beginning prior to January 1, 2013 and sets up the new 20-year carryover rules for taxable years beginning on or after January 1, 2013. 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

Senate Bill 156 would extend net operating loss carryovers (NOLs) incurred from net income reported for corporate 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. The bill would also extend net operating loss carryovers (NOLs) incurred from net income reported for 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.

FISCAL IMPLICATIONS

This bill would have very little fiscal impact, 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 SB 106, 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.

The major differences between SB 106 and SB 156 is that SB 106 extends the 20-year NOL carryover period to the personal income tax. Individuals, partnerships, limited liability partnerships, limited liability corporations, Sub-Chapter S corporations and other pass-through entities are also accorded the extended carryover period.

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.

EFFECTIVE DATE

Not stated – 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.

CONFLICT

SB 156 extends the NOL carry-forward for losses reported for personal income tax purposes. It sets 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.

TECHNICAL ISSUES

Although not a serious problem, the shortened title of this bill in the locator reverses the impact of this bill. The proper title of the bill is "… ALLOWING THE EXCLUSION OF NET OPERATING LOSS CARRYOVER FROM NET INCOME.. FOR TWENTY YEARS" is proper and accurate. The locator title, “EXCLUDE NOL CARRYOVER FOR UP TO 20 YEARS” implies that NOL carryovers would not be allowed.”

OTHER SUBSTANTIVE ISSUES

It has been the usual practice with regard to structural changes in corporate income tax to be mirrored with equivalent changes for personal income tax. This is particularly true for provisions particularly applicable to the pass-through entities, including Subchapter S corporations, Limited Liability Companies (LLCs), partnerships, limited liability partnerships (LLPs) and other similar organizational structures. This bill provides such a mirror, while SB 106 extends the 20-year NOL carryover only to Subchapter C corporations.

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