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

SPONSOR Wirth **ORIGINAL DATE** 2/16/15 **LAST UPDATED** **HB**

SHORT TITLE Income for Tax Purposes Act Changes **SB** 281

ANALYST van Moorsel

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY15	**FY16**	**FY17**	**FY18**	**FY19**		
Indeterminate – potentially positive					Recurring	General Fund

(Parenthesis ( ) indicate revenue decreases

Relates to HB286 – Single Sales Factor for Corporate Income

SOURCES OF INFORMATION
LFC Files

Responses Received From
Taxation and Revenue Department (TRD)

SUMMARY

Synopsis of Bill

Senate Bill 281 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 bill authorizes TRD to promulgate rules to carry out the purposes of the bill's provisions. The provisions of the bill apply to taxable years beginning on or after January 1, 2016.

FISCAL IMPLICATIONS

TRD notes it does not have the data needed to estimate the fiscal impact of the bill. 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 multistate 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.

ADMINISTRATIVE IMPLICATIONS

TRD states 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

TRD identifies two technical issues within the bill. The first is that TRD will have to adopt regulations to delineate when a service is “delivered” into this state. As an MTC compact member, New Mexico generally adopts the proposed regulations developed by the MTC. The MTC has begun a working group to develop model regulations. At this juncture, the regulations have not yet been developed, and it is uncertain whether they will be completed before the January 1, 2016 effective date of the bill.

Second, while the bill generally follows the MTC amendment, it does not adopt it verbatim. TRD points out the MTC amendment was the result of a studied approach and much of the language that was stricken or changed serves specific purposes. For example, in the MTC amendment several items are sourced “if and to the extent” that the item is sold, used, or delivered in the State. The proposed bill simply uses the term “if.” MTC’s amendment, by using “to the extent” allows for proportional apportionment when items are used, sold, or licensed in more than one state. TRD therefore notes that the proposed bill, to some degree forces New Mexico to rely on the “reasonable approximation” provision rather than the language of the sourcing rules, which can lead to uncertainty and litigation.

TRD states a tangential issue is that MTC proposed regulations, when developed, may not adequately address the differences between the proposed bill and the MTC amendment, which would require the development of New Mexico-specific regulations. As a compact member, the Legislature may want to consider better conformity to the MTC amendment.

TRD adds 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 make this clearer.

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/je/aml