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

SPONSOR Smith **ORIGINAL DATE** 2/13/17
LAST UPDATED 2/15/17 **HB**

SHORT TITLE Delay Certain Tax Changes **SB** 199/ec

ANALYST Clark

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY17	FY18	FY19	FY20	FY21		
$0.0 - Minimal	Up to $19,000.0	Up to $19,000.0	$0.0	$0.0	Nonrecurring	General Fund

Parenthesis ( ) indicate revenue decreases

* These estimates are imprecise due to the highly volatile nature of the underlying revenue source (see Fiscal Implications)

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY17	FY18	FY19	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
Total	$18.0	$0.0	$0.0	$18.0	Nonrecurring	Taxation and Revenue Department

Parenthesis ( ) indicate expenditure decreases

SOURCES OF INFORMATION
LFC Files

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

SUMMARY

Synopsis of Bill

Senate Bill 199 delays the five-year phased reduction of corporate income tax (CIT) enacted in 2013 by two tax years at first and then speeds up to a final delay of one year. The scheduled reduction to 6.2 percent for taxable income in excess of $500 thousand, which was to have been effective for TY 2017, will be held at 6.4 percent for taxable income in excess of $500 thousand and 6.6 percent for taxable income in excess of $1 million for TY16, TY17, and TY18.

The subsequent reduction to 6.2 percent (on all taxable income over $500 thousand) is eliminated, with a final level of 4.8 percent for all taxpayers with net income under $500 thousand and 5.9 percent for all taxpayers with net income over $500 thousand effective for TY19 and subsequent years.

The phased-in sales-only provision for manufacturers (also referred to a single sales factor or single sales apportionment) would also be delayed by one to two years as follows:

Tax Year	Current Law Factors	Proposed Factors
TY 2014	(S*2+Pr+P)/4	(S*2+Pr+P)/4
TY 2015	(S*3+Pr+P)/5	(S*3+Pr+P)/5
TY 2016	(S*7+1.5*Pr+1.5*P)/10	(S*7+1.5*Pr+1.5*P)/10
TY 2017	(S*8+Pr+P)/10	(S*7+1.5*Pr+1.5*P)/10
TY 2018	(S)/1	(S*7+1.5*Pr+1.5*P)/10
TY 2019	(S)/1	(S)/1
TY 2020	(S)/1	(S)/1
TY 2021	(S)/1	(S)/1

This bill contains an emergency clause and would become effective immediately upon signature by the governor. However, because the bill alters the rates and apportionment factors for the 2017 tax year, the bill contains a penalty and interest hold harmless provision for estimated tax payments for the 2017 tax year.

FISCAL IMPLICATIONS

LFC Fiscal Impact Analysis:

LFC staff estimated the impact of this bill using data reported during the consensus revenue estimating group (CREG) process and historical estimates provided by the Taxation and Revenue Department (TRD). Due to significant volatility and uncertainty in CIT revenues, the fiscal impact is highly uncertain and could be substantially higher or lower than the estimates shown.

This bill delays the implementation of the TY 2017 top marginal rate reduction from 6.6 percent to 6.2 percent for two years. The bill provides relief from penalty and interest on estimated payments, but the taxpayers must pay the full TY17 taxes due in the final settlements. There would not be any additional revenue in penalties and interest. The estimating spreadsheet follows:

	FY14 Act	FY15 Act	FY16 Act	FY17	FY18	FY19	FY20	FY21
Gross CIT	246.8	350.0	208.3	162.1	218.8	231.3	242.6	255.5
Y/Y Growth		42%	-40%	-22%	35%	6%	5%	5%
Leg Changes		-13.0%	-19.1%	-22.6%	-22.6%	-31.5%	-38.2%	-38.2%
Subtotal		304.5	168.5	125.5	169.5	158.5	150.0	158.0
Film Credit		-50	-50	-50	-50	-50	-50	-50
Net CIT	**196.8**	**254.5**	**118.5**	**70.0***	**119.5**	**108.5**	**100.0**	**108.0**
Difference				**minimal***	**19.5**	**15.5**	**0.0**	**0.0**

* The FY17 estimate assumes the bill is signed on or after April 1, 2017. There could be a positive impact in FY17 of up to a few million dollars if the changes become effective earlier in

the fiscal year and taxpayers adjust their planned estimated payments. FY18 and FY19 see the full revenue impact, but the impact begins to wind down in FY20, and the bill's effects return to baseline for FY21 and later years.

TRD Fiscal Impact Analysis:

Estimated Revenue (in thousands)					Recurring or Nonrecurring	Fund Affected
FY17	FY18	FY19	FY20	FY21		
$0.0	$0.0 - $19,000.0	$0.0 - $19,000.0	$0.0	$0.0	Nonrecurring	General Fund

TRD reviewed CIT taxpayer data in GenTax for the tax years 2012 – 2015. Tax year 2014 is the most current data set; tax year 2015 is not complete as taxpayers have not all reported. The prescribed tax rates were applied to tax year 2014 returns, and then the differences were calculated. CREG growth estimates were applied, as appropriate, to estimate current and future year impacts. While the legislation should return revenue to the general fund, the reduced estimate is attributed to historical consistent overpayments that exist in the CIT regime.

There are two sets of calculations necessary to estimate the fiscal impact: 1) changes/delays to tax rates and 2) impact of changes/delays to apportionment formulae.

TRD estimated the savings from delaying the rate change by first calculating the estimated tax using both rate structures and taking the difference. The delay increases revenue to the general fund for the two fiscal years noted.

TRD estimated the savings from delaying a change in the apportionment factor by calculating the estimated tax using both formulae and taking the difference. Tax year 2014 data and tax rates were used; therefore, TRD adjusted the tax estimate for the current tax rates. The delay increases the revenue to the general fund for the two fiscal years noted.

Current CREG forecasts account for the full implementation of the 2013 tax package (HB641). Therefore, there are neither savings nor losses attributed to fiscal years 2020 and beyond.

TRD analysis during the 2016 special session included a downward adjustment attributed to the difference between the CREG gross CIT forecast and the CREG net CIT forecast. This adjustment was not included in this analysis. There is a mechanic occurring in the CIT regime attributed to overpayment of tax liability by taxpayers. It is not clear what the full impact of overpayment is. To the extent that overpayment represents pre-paid tax liability, the delay in rate changes and apportionment will increase taxpayer liability. The result will be a decrease in the amount of overpayment. However, all overpayments affect CIT collections in two ways: 1) carry-forward amounts reduce the liabilities to be collected, and 2) overpayment refunds reduce the general fund by the amount refunded. Overpayments are taxes paid during previous tax years that negatively impact current fiscal year budget estimates. TRD continues to investigate the reasons and impacts of the overpayment of corporate income taxes.

In consideration of this, TRD assumes that the state will not realize the full contribution of revenue as cash to the general fund the delay is intended to produce. The delay is estimated to produce approximately $39 million in tax revenue ($34 million from the rate change delay and

$5 million from the apportionment delay). However, at the end of tax year 2015, TRD estimated that CIT taxpayers have approximately $87 million in tax overpayments that will be applied as a carry forward. Consequently, the range for savings is estimated as zero to 50 percent of what might otherwise be realized.

SIGNIFICANT ISSUES

Testimony in 2013 indicated that new companies, particularly manufacturing companies, were not expanding in New Mexico because the top marginal income tax rate was an outlier among competitive states. It is likely too early to arrive at a definitive conclusion about the effectives of the CIT rate reductions and single sales factor phase-in. However, since the 2013 tax package, the state's economy continues to struggle at growth rates well below national and regional averages, and New Mexico has shed manufacturing jobs in nearly every month over the last few years.

EDD notes, "Businesses and business development are negatively affected by 'inconsistent and uncertain' business climates. A change to the corporate tax policy at this time does not signal 'consistency and certainty' to the business community – both in-state and out-of-state…. On January 25, 2017, at the House Appropriations and Finance Committee hearing, the president and CEO of New Mexico Partnership stated that New Mexico had been eliminated for a project that would have brought 700 jobs due to the uncertainty associated with the future of the EDD programs and tax incentives."

Along the same lines, TRD notes, "It is permissible to delay or retroactively impose a tax. Under the applicable standard, a tax statute's retroactive application must be supported by a legitimate legislative purpose furthered by rational means. The rational basis in this instance is to increase revenue to the general fund. However, there is a risk that such action will create uncertainty in the business community, and uncertainty may negatively impact economic conditions."

ADMINISTRATIVE IMPLICATIONS

There would be a minimal administrative impact to TRD. Forms and systems will need to be updated in conjunction with annual tax year updates.

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

JC/jle