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

ORIGINAL DATE 1/23/19
SPONSOR Wirth/Rep Harper **LAST UPDATED** **HB**

SHORT TITLE Tax Determination of In-State Sales **SB** 6

ANALYST Clark

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY19	FY20	FY21	FY22	FY23		
Indeterminate but potentially positive					Recurring	General Fund

Parenthesis ( ) indicate revenue decreases

SOURCES OF INFORMATION
LFC Files

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

SUMMARY

Synopsis of Bill

Senate Bill 6 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, either with inclusion in the numerator or the denominator.

The provisions of the bill apply to taxable years beginning on or after January 1, 2019.

FISCAL IMPLICATIONS

The Taxation and Revenue Department (TRD) was unable to estimate the fiscal impact of this legislation. TRD anticipates that there will be some revenue loss from firms currently taxed under cost of performance and some revenue gain from firms that would be subject to taxation under market-sourcing. Revenue loss is attributed to New Mexico firms subject to taxation in market-sourcing states as well as New Mexico. Revenue gain is attributed to economic value received from New Mexico market participation but not taxed under the cost of performance standard.

LFC staff note, 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).

SIGNIFICANT ISSUES

TRD provided the following analysis.

> States that tax corporate and business income determine the portion of the income of multistate enterprises that is taxable in the state using an apportionment formula. Part of that formula is the percentage of sales in the state to the total nationwide sales of the enterprise—called the sales or receipts factor. (The formula also includes property and payroll percentages.)
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> Sales of tangible property are generally considered New Mexico sales if the customer is in the state and the property is delivered in the state. But sales of services and intangibles will be considered sales in New Mexico only if the business incurs more costs of performance of the activities giving rise to those sales in New Mexico than any other state. This is called the predominant cost of performance method.
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> As a result of this method, business selling substantial services or intangibles in the state may nevertheless report no New Mexico sales as part of their apportionment formula and will, as a result, apportion less income to the state. It is generally agreed that, as part of the apportionment formula, sales represents the value that the market states contributes to the taxpayer's income, while property and payroll represent the value that the production

states contribute. But under predominant cost of performance, the sales factor may not fairly represent the market contribution. For this reason, states are moving to market-sourcing of sales of services and intangibles. Of the states that impose a form of corporate income tax, 28 now use market-sourcing.

The bill follows the uniform model adopted by the Multistate Tax Commission. The commission has also adopted uniform regulations to implement this approach. Colorado is the most recent state to adopt this method. Other states, including California and Oregon, have adopted a slightly different form of market sourcing.

It is important to note that market-based sourcing does not affect taxpayers selling tangible personal property, as well as taxpayers already subject to special apportionment methods (many of which incorporate market-based concepts). Sales of tangible personal property are sourced on a destination basis (i.e. where the consumer is located). In many respects, market-based sourcing achieves a similar result and adds some parity between how tangible goods and how services and intangibles are sourced.

OTHER SUBSTANTIVE ISSUES

Some research materials on market-based sourcing are available at:

- http://taxexecutive.org/states-fine-tune-market-based-sourcing-rules-through-regulation/
- https://www.tei.org/chapters/carolinas/Public%20Documents/Carolinas%20Chapter%20September%2025,%202015%20Meeting/TEI_Presentation%20State%20Apportionment%20(FINAL%209-21-2015).pdf
- http://www.tax.virginia.gov/sites/tax.virginia.gov/files/6.4.15FortheWG.pdf

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

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