New Mexico Corporate Income Tax: Overview and Current Issues

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Presentation for

Revenue Stabilization and Tax Policy Committee

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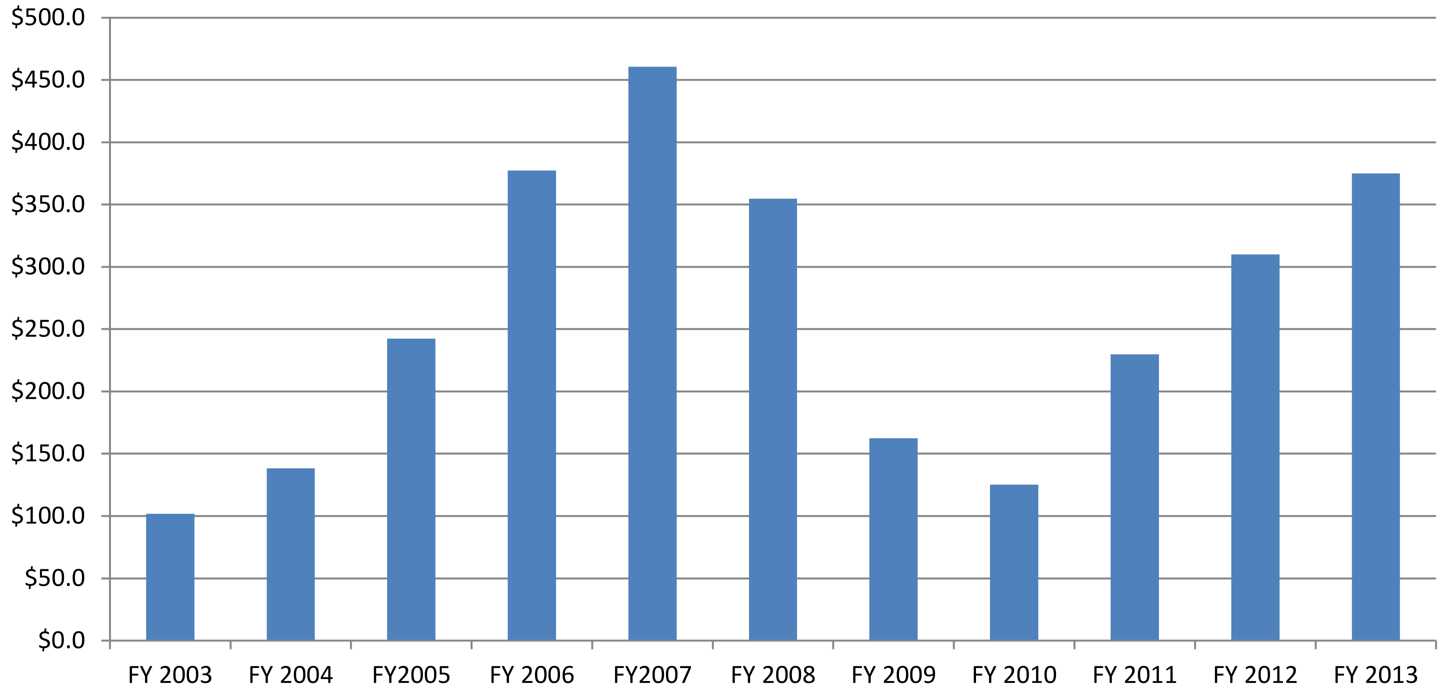
New Mexico Corporate Income Tax History, 2003-2013



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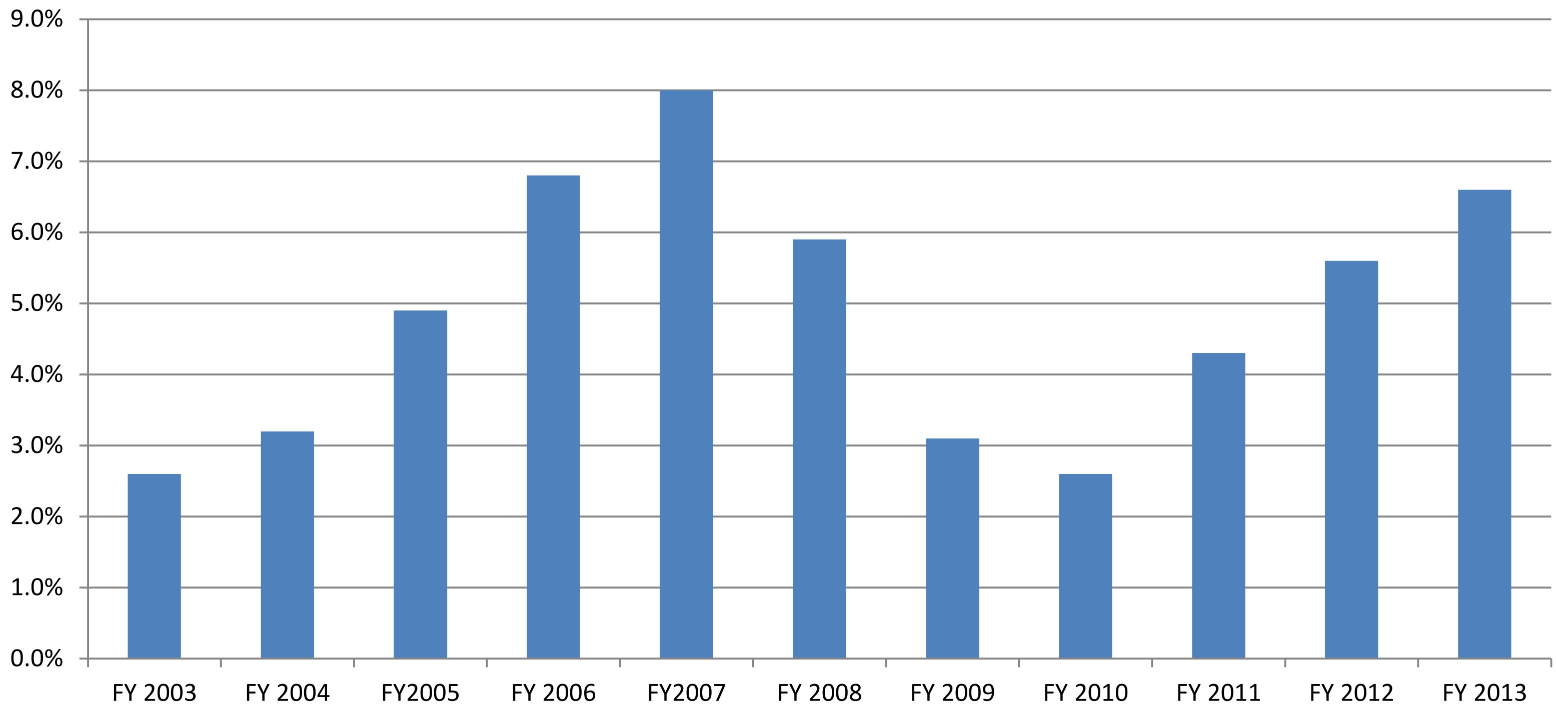
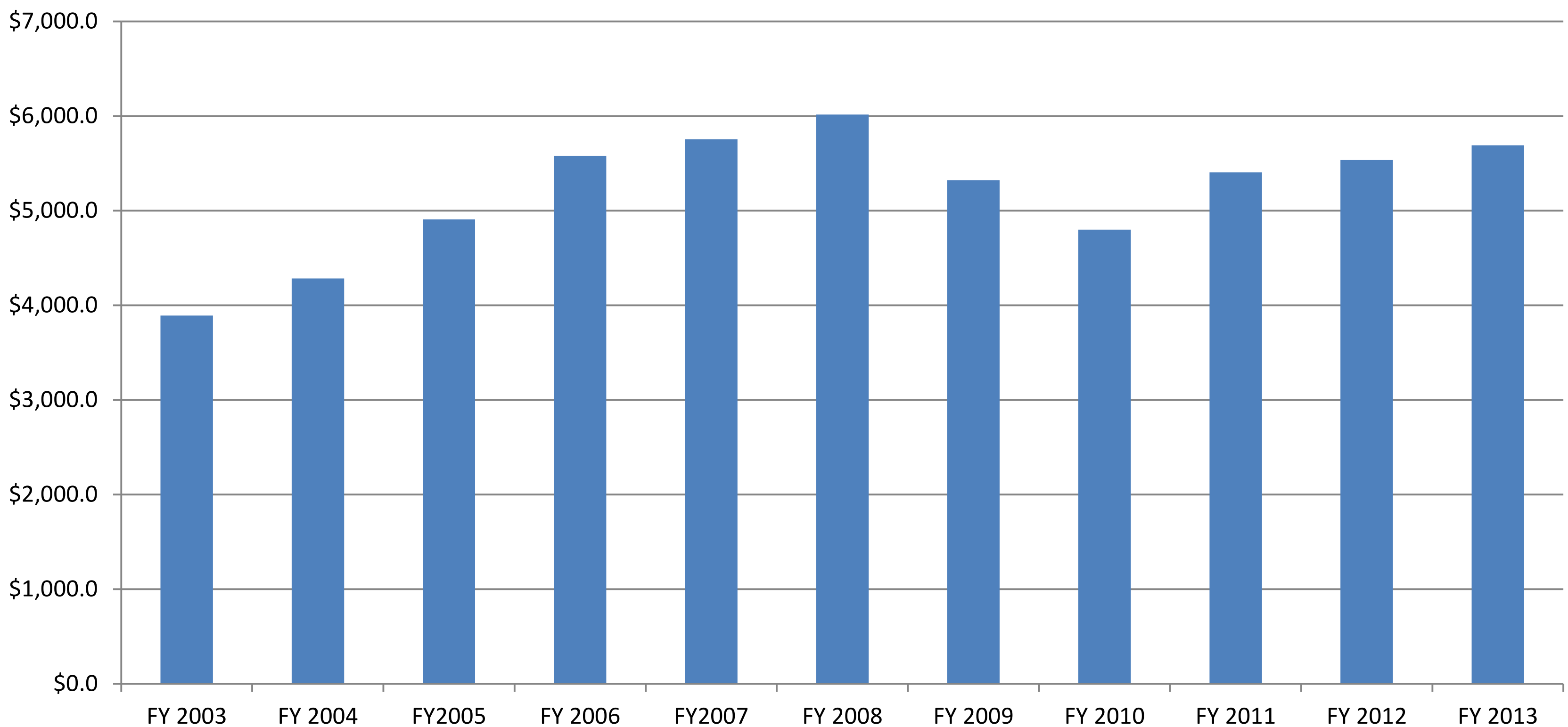
Corporate Income Tax as Percent of Total General Fund Revenues



Total General Fund Revenues, 2003-2013 (in millions)



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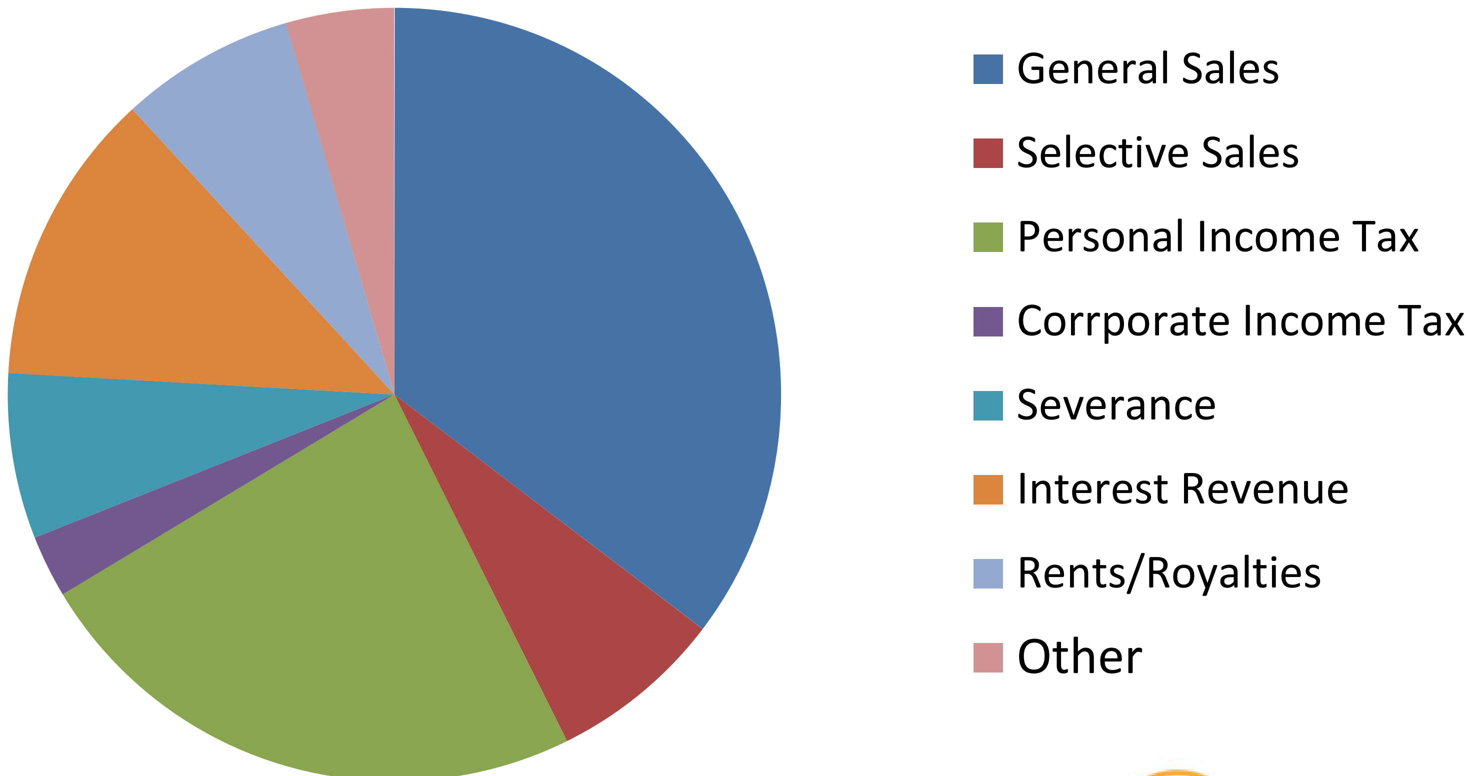
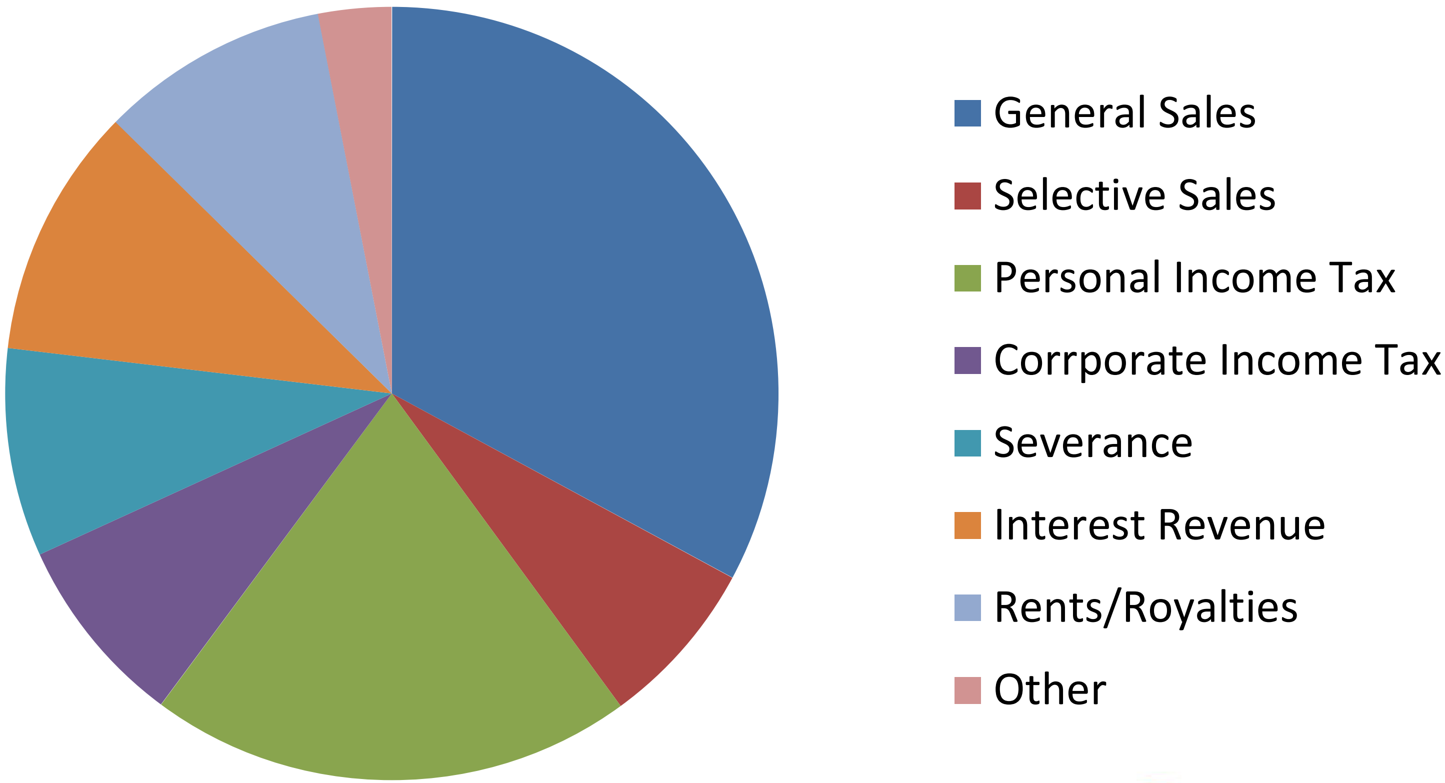
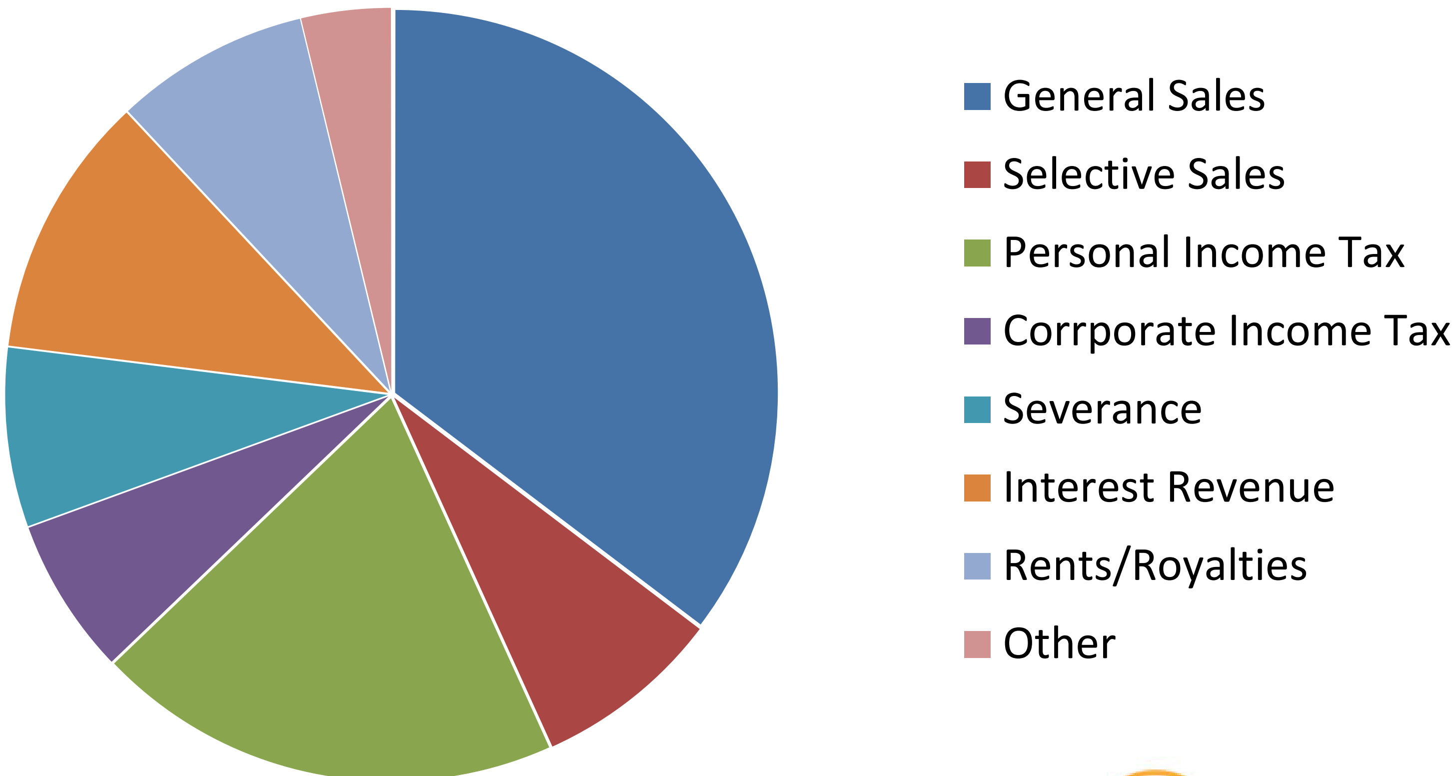
General Fund Revenues by Tax, FY03



General Fund Revenues by Tax, FY07



General Fund Revenues by Tax, FY13



Unitary Combined Reporting for Corporate Income Tax

- Two or more integrated corporations (other than any foreign corporation incorporated in a foreign country and not engaged in trade or business in the United States during the taxable year)
- Owned in the amount or more than 50 percent
- Controlled by the same person
- For which at least one of the following conditions exists:

Unitary Combined Reporting for Corporate Income Tax

Conditions:

1) There is a unity of operations evidenced by central purchasing, advertising, accounting or other centralized services;
2) There is a centralized management or executive force and centralized system of operation; or
3) The operations of the corporations are dependent upon or contribute property or services to one another individually or as a group.

(Laws 1999 Chapter 47, Section 6)

Unitary Combined Reporting for Corporate Income Tax

Goals of Requiring Combined Reporting:

- Stop corporate income tax avoidance based on artificially shifting income to commonly owned corporations in **low tax** or **no tax** states that are beyond the reach of New Mexico taxing authorities.

Unitary Combined Reporting for Corporate Income Tax

Goals of Requiring Combined Reporting:

- Ensure that a corporation's income tax liability to New Mexico is the same regardless of the corporation's legal structure.

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States' Combined Reporting Status

States Requiring Unitary Combined Reporting:

Alaska
Arizona
California
Colorado
Hawaii
Idaho
Illinois
Kansas
Maine
Massachusetts
Michigan
Minnesota
Montana
Nebraska
New Hampshire
New York
North Dakota
Oregon
Texas
Utah
Vermont
West Virginia
Wisconsin

States' Combined Reporting Status

States *Not* Requiring Unitary Combined Reporting:

Alabama	Kentucky	North Carolina
Arkansas	Louisiana	Oklahoma
Connecticut	Maryland	Pennsylvania
Delaware	Mississippi	Rhode Island
Florida	Missouri	South Carolina
Georgia	New Jersey	Tennessee
Indiana	New Mexico	Virginia
Iowa	North Carolina	

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States' Combined Reporting Status

States without a Corporate Income Tax:

Nevada
Ohio
South Dakota
Washington
Wyoming

(Note: Texas requires combined reporting with its franchise tax)

New Combined Reporting States
(in the last six years)

- Massachusetts
- Michigan
- Texas
- New York
- Vermont
- West Virginia
- Wisconsin

New Mexico Tax Research Institute Business Tax Competitiveness Study: An Update

Study conducted by Ernst & Young to expand on a study commissioned by the Council on State Taxation:

Showed New Mexico with the highest Effective Tax Rate (ETR) among the 50 states.

New Mexico Tax Research Institute Business Tax Competitiveness Study: An Update

Second Ernst & Young study compared New Mexico to the eight other states:

- before and after subsidies
- for a broad set of industry sectors

Original COST study ranked estimated tax burden **before** credits and subsidies.

The new study looked at New Mexico CIT **before** and **after** credits and subsidies.

New Mexico Tax Research Institute Business Tax Competitiveness Study: An Update

The expanded study still ranked the New Mexico ETR before credits and subsidies as highest among the nine states.

However, when subsidies (incentives and credits) were taken into account, New Mexico ranked 6^{th} out of the 9 states by ETR.

The Ernst and Young study looked at New Mexico ETR after subsidies (incentives and credits) for services and for manufacturing

New Mexico ranked 8^{th} highest in services and 3^{rd} highest for manufacturing.

Quite a different picture emerged from the second study!

New Mexico Tax Research Institute Business Tax Competitiveness Study: An Update

The new and improved Ernst and Young study took the following subsidies into account:

1.) Industrial Revenue Bonds

a.) exemption from gross receipts and compensating taxes on initial purchases of equipment with bond proceeds

b.) exemption from 95% of property taxes for 20 years

2.) Investment Tax Credit

3.) Technology Jobs Tax Credit

4.) High Wage Jobs Tax Credit

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Corporate Income Tax Apportionment

Like most states, for most multi-state corporations, New Mexico uses a **Three-Factor Formula** to apportion net income from all states:

- Three-Factor Formula equally weights payroll, property, and sales.
- Utilizes total percentage of each factor attributable to New Mexico and then divides by three.

Corporate Income Tax Apportionment
Three-Factor Formula

For example, **if** a multi-state corporation had:

1.) 20% of its total (all state) payroll;

2.) 30% of its total (all state) property; and

3.) 10% of its total (all state) sales;

the Three-Factor Formula would work like this:

Corporate Income Tax Apportionment
Three-Factor Formula

20% of total payroll

30% of total payroll

+10% of total sales

= 60% of total factors

Then divide by 3:

60% /3 = 20% of total net income from all states will be apportioned to New Mexico

Corporate Income Tax Apportionment
Double-Weighted Sales Factor Formula

Double-Weighted Sales can be used by manufacturing corporations.

The sales factor is doubled and then the total of the three factors is divided by four instead of three:

Corporate Income Tax Apportionment
Double-Weighted Sales Factor Example

(with numbers from previous example):

20% of payroll

30% of property

+ (10% of sales times 2) = 20%

= 70% of total factors

Then divide by 4 (instead of 3)

= 70% /4 = 17.5%

Corporate Income Tax Apportionment
Double-Weighted Sales Factor Example

Under the Double-Weighted Sales Factor, New Mexico's apportionment share (with numbers from previous example) drops from 20% to 17.5%.

Corporate Income Tax Apportionment
Single-Sales Factor Formula

Single-Sales Factor Formula eliminates the payroll and property shares and uses *only* the sales factor.

Corporate Income Tax Apportionment
Single-Sales Factor Formula

Under the Single-Sales Factor Formula, New Mexico's apportionment share (with numbers from previous example) drops from 20% or 17.5% to 10% of net income.

Since 10% of total sales are made in New Mexico, only 10% of net income is apportioned to New Mexico.

Corporate Income Tax Apportionment (continued)

The example shows net income apportioned to New Mexico is:

20% under the Three-Factor Formula

17.5% under the Double-Weighted Sales Formula

10% under the Single-Sales Factor Formula

Winners and Losers from SSFF

Single-Sales Factor Formula (SSFF) would benefit those corporations with large shares of their total payroll and/or property in New Mexico:

- manufacturing corporations
- mining corporations

SSFF would result in less net income apportioned to New Mexico for these corporations.

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Winners and Losers from SSFF

SSFF would disadvantage corporations with large shares of their total sales in New Mexico:

- retail sales corporations

SSFF could increase net income apportioned to New Mexico for retail corporations that have a substantial share of their sales in New Mexico.

January 2008 Revenue Estimates testimony

The January 2008 Revenue Estimates testimony furnished information on the industry shares of large corporations under the CIT:

- The 100 top CIT taxpayers accounted for two-thirds of total CIT payments in 2006

January 2008 Revenue Estimates testimony

Of the total $303 million paid by the 100 largest CIT taxpayers in 2006-07:

- $25.6 million was paid by manufacturers
- $197.6 million was paid by the mineral extraction industry
- Only $19.5 million was paid by retailers

January 2008 Revenue Estimates testimony

Of the total $309.5 million paid by the 100 largest CIT taxpayers in 2005-06:

- $89.1 million was paid by manufacturers
- $157.3 million was paid by the mineral extraction industry
- Only $9.4 million was paid by retailers

Scenario for SSFF

Since roughly two-thirds of CIT revenues come from the 100 largest corporations and:

- 65% of that total was paid by mining corporations in 2006-07
- 51% of that total was paid by mining corporations in 2005-06

Scenario for SSFF

Since roughly two-thirds of CIT revenues come from the 100 largest corporations and:

- 44% of *total CIT revenues* were paid by mining corporations in 2006-07
- 34% of *total CIT revenues* were paid by mining corporations in 2005-06

(reducing by the proportion paid by the 100 largest firms)

Scenario for SSFF

Since roughly two-thirds of CIT revenues come from the 100 largest corporations and:

- 8.6% of that total was paid by manufacturing corporations in 2006-07
- 29% of that total was paid by manufacturing corporations in 2005-06

Scenario for SSFF

Since roughly two-thirds of CIT revenues come from the 100 largest corporations and:

- 6% of *total CIT revenues* were paid by manufacturing corporations in 2006-07
- 19% of *total CIT revenues* were paid by manufacturing corporations in 2005-06

Scenario for SSFF

Since roughly two-thirds of CIT revenues come from the 100 largest corporations and:

- 50% of *total CIT revenues* were paid by mining and manufacturing corporations in 2006-07
- 54% of *total CIT revenues* were paid by mining and manufacturing corporations in 2005-06

(this is a very conservative estimate that assumes that all mining and manufacturing revenues come from corporations from the top 100 taxpayers)

Scenario for SSFF

The mining and manufacturing sectors could be expected to have little or no net income apportioned to New Mexico under the SSFF because these sectors have very little in sales to New Mexico, but a lot of property and payroll.

So the base for the CIT would be reduced by at least half under these assumptions.

(Again - this is a very conservative estimate that assumes that all mining and manufacturing revenues come from corporations from the top 100 taxpayers. Those 100 taxpayers account for about two-thirds of CIT revenue)

CIT 'Throwback Rule'

Sales of tangible personal property are New Mexico sales if:

- The property is delivered or shipped to a purchaser other than the US government within New Mexico regardless of the FOB point or other conditions of the sale or
- The property is shipped from an office store factory or other place of storage in this state and: 1.) the purchaser is the United States government, or
- The taxpayer is not taxable in the state of the purchaser.

(New Mexico Instructions for Corporate Income and Franchise Tax Return, New Mexico Taxation and Revenue Department, p. 14)

CIT ‘Throwback Rule’

The ‘throwback rule’ is designed to prevent the emergence of ‘nowhere profits’ – profits that are not taxed by any state under a corporate income tax.

Elimination of the throwback rule would lead to this outcome.