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

		ORIGINAL DATE	2/03/09		
SPONSOR	Arnold-Jones	**LAST UPDATED**	2/25/09	**HB**	415/aHBIC
SHORT TITLE	5-Year Old Small Business Gross Receipts			**SB**	
				ANALYST	Gutierrez

REVENUE (dollars in thousands)

Estimated Revenue			Recurring or Non-Rec	Fund Affected
FY09	**FY10**	**FY11**		
	($3,442.7)	($7,118.0)	Recurring	General Fund

(Parenthesis ( ) Indicate Revenue Decreases)

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY09	FY10	FY11	3 Year Total Cost	Recurring or Non-Rec	Fund Affected
Total	$0	$690.0	$135.0	$825.0	Recurring	Taxation & Revenue Dept.

(Parenthesis ( ) Indicate Expenditure Decreases)

SOURCES OF INFORMATION

LFC Files

Responses Received From
Taxation and Revenue Department (TRD)

SUMMARY

Synopsis of HBIC Amendment

The House Business and Industry Committee amendment to House Bill 415 adds Subsection C which states:

> "The taxation and revenue department shall deny a claim for a small business tax credit if an ownership interest equal to a controlling interest in the small business in regard to which the credit is being claimed has been purchased or acquired within the five taxable years prior to the taxable year for which the taxpayer is claiming a small business tax credit."

The original effective date made the bill more difficult for TRD to administer. This amendment relieves that particular problem by adding an effective date of January 1, 2010.

Synopsis of Original Bill

House Bill 415 creates a "Small Business Tax Credit", which may be applied for by a small business that has been in business in New Mexico for five years or more. A small business is defined as a for-profit enterprise that employs fewer than 50 employees at any time during the calendar year and that has continuously been located, operating and paying gross receipts tax in New Mexico for the number of years reported by the taxpayer. The credit allowed for a qualifying business operating for at least five years is 1/4 of one percent (.0025%) of the gross receipts taxes due to the state in the taxable period, 1/2 of one percent (.005%) for a business operating at least ten years, 3/4 of one percent (.0075%) for a business operating at least fifteen years, and 1 percent for a business operating at least twenty years. The bill also specifies what the application for the credit will include.

Because no effective date is provided in the bill, its provisions will become effective on June 19, 2009, ninety (90) days after the 2009 legislative session adjourns.

FISCAL IMPLICATIONS

According to the Bureau of Labor Statistics, roughly 8 percent of companies change ownership on an annual basis. This estimation was used in analyzing the fiscal impact of the HBIC amendment to this bill, thus reducing the original bill's revenue impact by 8 percent annually.

Because the bill now has an effective date of January 1, 2010 the general fund impact is only half of a full year cost in fiscal year 2010.

TRD:
This estimate uses taxpayer data on the amount of revenue paid apportioned by the begin date of each taxpayer's CRS account. It is assumed that the amount of "gross receipts taxes due to the state" means only the "gross receipts tax" set currently at a rate of 5% and not all gross receipts taxes paid to the State.

Based on data from fiscal year 2008 reporting 76% of revenue came from accounts older than five years, 58% from accounts older than ten years, 42% from accounts older than fifteen years, and 33% came from accounts over twenty years old. The amount of revenue from these businesses is further discounted because not all businesses meet the definition of a "small business" for example only half of the revenue coming from businesses older than twenty years is assumed to come from businesses meeting the requirements of a "small business" located in New Mexico. With the HBIC amendment the number of qualifying businesses is further reduced by 8%. The estimate assumes that the number of businesses changing ownership is evenly distributed among business sizes so the credit amounts will also be reduced by 8%. The following table breaks down the estimated credit amounts among each age group:

Business Age	FY10	FY11	FY12	FY13	FY 09-13
older than 5 years (less than 10)	409	845	881	918	3,052
older than 10 years (less than 15)	646	1,335	1,391	1,450	4,822
older than 15 years (less than 20)	451	933	972	1,013	3,369
older than 20 years	1,937	4,004	4,173	4,349	14,464
Total Credits	**3,442**	**7,117**	**7,417**	**7,731**	**25,708**

SIGNIFICANT ISSUES

This credit is available to a business that has fewer than 50 employees on any one day during the calendar year. An employer could have 95 employees for most of the year, but if it has 49 on any one day, it is eligible for the credit. Furthermore, the credit is based on the number of years it has been in business, not the number of years it has had fewer than 50 employees.

This credit will place new businesses at a disadvantage to existing businesses. It provides a small disincentive to businesses starting in, moving to, or expanding into New Mexico.

For some small taxpayers the compliance costs of filing for this credit may outweigh the monetary benefit it affords them. For example a small taxpayer that had annual taxable gross receipts of $100,000 would have a gross receipts tax liability of $5,000 at the State 5% rate, assuming they had been in business for eight years with no change in ownership they would be eligible for a $12.50 credit. The costs to pay an accountant or the opportunity cost of the taxpayers own labor to file for the credit might not be worth the credit amount in some cases.

ADMINISTRATIVE IMPLICATIONS

The bill does not contain a sunset date and there is no provision for reporting on this credit. It is important for policy makers to have regular information and an opportunity to review the effectiveness of the credit.

TRD:
This proposal has a high revenue and credit processing impact to the Department. Unlike other business credits for which only a limited number of taxpayers are eligible, this proposal would affect a high percentage of all gross receipts taxpayers. Without additional resources, this tax credit will jeopardize the Revenue Processing Division's ability to meet the deposit requirement and subsequently the distribution of receipts to the local options. The Department must process all payments within 24 hours. The use of a credit claim form to be filed with the CRS-1 Form increases the cost of processing CRS-1 Forms and decreases the speed with which the forms are processed. Additionally, each of the CRS-1 Forms claiming the credit will require manual review. We recommend an additional equipment purchase as well, at a cost of $550,000 per machine, and 3 FTE at a cost of $45,000 per FTE to implement. As businesses can often change ownership or reorganize for one reason or another, the small business will need clarification and manual review to determine qualification.

The Legislative Finance Committee has adopted the following principles to guide responsible and effective tax policy decisions:

1. ***Adequacy:*** *revenue should be adequate to fund government services.*
2. ***Efficiency:*** *tax base should be as broad as possible to minimize rates and the structure should minimize economic distortion and avoid excessive reliance on any single tax.*
3. ***Equity****: taxes should be fairly applied across similarly situated taxpayers and across taxpayers with different income levels.*
4. ***Simplicity****: taxes should be as simple as possible to encourage compliance and minimize administrative and audit costs.*
5. ***Accountability/Transparency:*** *Deductions, credits and exemptions should be easy to monitor and evaluate and be subject to periodic review.*

More information about the LFC tax policy principles will soon be available on the LFC website at www.nmlegis.gov/lcs/lfc

It will be very difficult to set up administration capabilities and educate taxpayers in this short period of time. The Department can expect costs related to a special mail-out, press releases and other advertising activities. We can also expect that we will have more amended returns to process for the first year than normal. By changing the effective date, some of these additional costs can be alleviated. Changes to Gentax and CRS-Net would be needed. CRS-Net would need to be modified to accommodate the business tax credit. Additional costs could be reduced by purchasing and implementing the requested business tax credit module.

The IT Division impact will be low totaling 120 hours and include the setup of a CRS business credit with revenue accounting changes and testing.

TECHNICAL ISSUES

The bill states that small business means an enterprise employing fewer than 50 employees "at any time during the calendar year." It is unclear whether that means the calendar year prior to the application for the credit or the calendar year in which the credit is claimed.

The language used to calculate the amount of the credit, varying percentages of the "gross receipts taxes due to the state," is unclear. It is unclear if the credit is calculated against all gross receipts taxes due (including local option gross receipts taxes) or just the "gross receipts tax" at its current rate of 5%. All gross receipts taxes levied in New Mexico are paid to the State; however, not all gross receipts taxes are levied by the State and not all of the revenues from gross receipts taxes go to the State.

Under Subsection A, the bill states "the owner of a small business that has been in business in New Mexico" is not clear as to whether the business should be a New Mexico business or if it can also be an out-of-state business with a New Mexico location.

Under Subsection C, the bill states that a new owner must wait five years before claiming the credit even though the actual business may be older than 5 years and thus eligible for the credit. This Subsection does not state that this new owner would then have to start at the lowest increment of the tax credit. For example, if the business is 15 years old and is then purchased by a new owner, the new owner must wait five years but could then apply for the credit of a business that has been in business in NM for 20 years (1% credit) not 5 years (.0025% credit).

BLG/mc:svb