FISCAL IMPACT REPORT

		ORIGINAL DATE	02/13/14		
SPONSOR	SCORC	**LAST UPDATED**	02/17/14	**HB**	
SHORT TITLE	New Revenue Income Tax Credit			**SB**	CS/10/aSFC
				ANALYST	Graeser/van Moorsel

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY14	**FY15**	**FY16**	**FY17**	**FY18**		
		**	**	**	Recurring	General Fund (CIT)
		**	**	**	Recurring	General Fund (PIT)
Negative in Out Years - See "Fiscal Implications," below.						

(Parenthesis ( ) Indicate Revenue Decreases)

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY14	FY15	FY16	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
Total	$0.0	$0.0	$50.0	$50.0	Recurring	General

(Parenthesis ( ) Indicate Expenditure Decreases)

SOURCES OF INFORMATION
LFC Files

Responses Received From
Attorney General's Office (AGO)
Economic Development Department (EDD)
Taxation and Revenue Department (TRD)
Department of Finance and Administration (DFA)

SUMMARY:

Synopsis of SFC Amendment

The Senate Finance Committee amendment provides taxpayers subject to a tax pursuant to the Resources Excise Tax Act or the Oil and Gas Emergency School Tax Act is not eligible for the new revenue income tax credit.

The bill also clarifies that "new revenue" is defined as the combined tax liability in the taxable year in which the qualifying period closes minus the combined revenue in the taxable year immediately prior. This clarified a technical issue in the calculation of "new revenue."

A technical issue remains with the amendment, as the amended definition of “new revenue” refers to “the taxpayer’s taxable year in which the qualifying period closes.” However, “qualifying period” is itself defined as a taxable year in which the qualifying investment or job creation occurs. Thus, it is unclear what is meant by a “taxable year in which a taxable year closes,” and this ambiguity could have a bearing on the first year in which the tax credits could be claimed. The sponsor may wish to clarify one or both definitions.

See “**Amended Fiscal Implications**,” below

Synopsis of Original Bill

Senate Corporations and Transportation Committee Substitute for Senate Bill 10 proposes “new revenue” personal and corporate income tax credits. Specifically, the bill:

- Creates a new refundable personal income tax credit, entitled the “new revenue income tax credit.”
- The amount of the credit is 30 percent of the qualifying year’s increase in modified combined tax (the sum of income tax and gross receipts tax liability minus any tax credits allowed for the tax year) over the base year’s tax.
- In order to qualify for this credit, the taxpayer must create five or ten new jobs or invest $2.5 million or $5.0 million in the qualifying year, the lower number of jobs or investment applicable to small cities and rural areas and the larger applicable for cities over 60,000 and county areas within 10 miles of a larger city.
- The tax credit must be approved by the Economic Development Department. Provisions are added to prevent abuse and provide a clawback if the company folds or a qualifying employee is discharged.
- For ten years after the initial qualifying period (five or ten new jobs or specified investment), a taxpayer could claim a credit for a new qualifying period based on an increase in jobs, but not investment. The subsequent credit would also be 30 percent of the new revenue (increase in modified combined tax) for the subsequent tax period that includes the increase in jobs.
- Two interacting factors would determine subsequent post-performance benefits: an increase in number of jobs and an increase in modified combined tax. This personal income tax credit would apply to sole proprietors and all pass-through entities, including sub-chapter S corporations, partnerships, master limited partnerships, limited liability companies, etc.

The bill also creates a companion new refundable corporate income tax credit, entitled the “new revenue corporate income tax credit.”

- The amount of the credit is 30 percent of the qualifying year’s increase in modified combined tax (the sum of income tax and gross receipts tax liability) over the base year’s tax.
- In order to qualify for this credit, the taxpayer must create five or ten new jobs or invest $2.5 million or $5.0 million in the qualifying year, the lower number of jobs or investment applicable to small cities and rural areas and the larger applicable for cities over 60,000 and county areas within 10 miles of a larger city.

- The tax credit must be approved by the Economic Development Department. Provisions are added to prevent abuse and provide a clawback if the company folds or a qualifying employee is discharged.
- For ten years after the initial qualifying period (five or ten new jobs or specified investment), a taxpayer could claim a credit for a new qualifying period based on an increase in jobs, but not investment. The subsequent credit would also be 30 percent of the new revenue (increase in modified combined tax) for the subsequent tax period that may or may not include the qualifying period.
- Two interacting factors would determine subsequent post-performance benefits: an increase in number of jobs and an increase in modified combined tax.

The provisions of the act are applicable to taxable years beginning on or after January 1, 2015.

AMENDED FISCAL IMPLICATIONS

The Senate Finance Committee amendment should reduce the potential negative fiscal impact of the bill, as it excludes oil and gas producers (and other industries subject to the Resources Excise Tax Act or the Oil and Gas Emergency School Tax Act from qualifying for the new revenue income tax credit. Businesses in this industry are expected to make the sufficient investments to qualify for the credit, and in an environment of growing revenues could have contributed to a significant negative fiscal impact. According to TRD, the oil and gas industry contributes about 40 percent of the revenues for taxpayers who have at least $1 million dollar CIT liability. Their exclusion from this tax credit is expected to reduce its cost by about 40 percent.

However, even after this exclusion, it is likely that a base of businesses in New Mexico would make either qualifying investments or increases in employment, and would thus qualify for the new revenue income tax credit. As such, there remains a potential negative impact after the oil and gas industries are excluded from qualifying for the credit.

ORIGINAL FISCAL IMPLICATIONS

The bill's applicability to tax years beginning on or after January 1, 2015, means the first qualifying period would not end until January 1, 2016, and the first credits could thus be claimed in FY15, but more likely in FY16.

The initial impacts of the bill would be suppressed due to the continuing implementation of Laws 2013, Chapter 160, which phases in a CIT rate reduction and a move toward single-sales factor income apportioning for some corporations. This phase-in has the effect of reducing the consensus revenue estimate for CIT revenue, and would likely have the effect of reducing CIT liability, placing downward pressure on tax liability and minimizing the credit's impact.

*** However, upon stabilization of the CIT rate and apportioning rules, this credit would likely reduce revenue to the general fund due to the likelihood that existing taxpayers would qualify. Some firms, particularly oil and gas producing firms that routinely make annual investments, would qualify annually for this credit and claim it for ten years.

*** As such, significant losses in excess of $10 million could result from the provisions of this bill in the out years, perhaps as soon as FY17.

DFA notes "[t]he New Revenue Income Tax Credit may have a large, but unknown impact, as the New Mexico economy, lagging the nation, starts to recover and many new jobs are added and substantial investments are made in the state. For illustration, the 30 percent credit, if taken on all additional personal income tax and CRS tax revenue as projected by the Consensus Revenue Estimating Group, would be $22.9 million for FY15, $47.1 million for FY16, $54.3 million for FY17, and $39.3 million for FY18. CIT revenue is smaller, volatile and projected to have negative year over year revenue changes due to the phased-in reduction of corporate income tax rates. It should be noted that the figures above are based on an aggregate of net new growth, representing an average of openings, expansions, contractions and closings. Measuring openings and expansions alone could increase the estimate. However, the employment and investment requirements in the bill could limit the full impact on general fund revenues."

DFA notes that "new jobs" and related revenue are broadly defined in the bill, so some jobs or revenue that may have occurred anyway in the absence of the legislation may qualify for this large credit. During a recovery, this effect may add up quickly. Further, despite complex eligibility and restrictions on the new revenue income tax credit, multiple or expansive claims may still arise for this relatively large and refundable income tax credit.

Unlike the original bill, companies would not have to certify to EDD that the company would not have made the investment or created the jobs "but for" the credit.

SIGNIFICANT ISSUES

DFA adds that complexity and job creation requirements may discourage small businesses with high rates of job creation that would benefit greatly from such a credit from claiming the credit

Firms with a stable or declining work force, but continuing investment and increasing profit would benefit. Firms with both an increase in employment and an increase in modified combined income would be the primary beneficiaries.

This credit is not intended to reward individuals, partnerships or corporations in the startup year, whether that startup year is the result of a New Mexico firm expanding or starting or an out-of-state firm expanding into New Mexico. The employees that qualify the firm for a new revenue credit must work for the firm for 48 weeks in the qualifying period. However, there is no similar duration requirement for investment. Since the credit is determined by both the qualification factors and the new revenue, it is not at all clear that expanding firms will always qualify for this credit because of technical factors. The substitute anticipates that even if a firm loses its credit for the start-up year, it can still qualify in subsequent years

Advocates for economic development tax incentives state the tax incentive will spur economic growth, and taxes on that economic growth will make up for the cost of the tax incentive. Three points must be made in rebuttal to that argument:

- Economic development tax incentives present a problem called "Buying the Base." A proposal that rewards behavior that would occur anyway erodes the possibility that any marginal stimulus will cover the static loss.
- When trying to determine an investment location, tax incentives may not be as important as an overall fair tax system. Early in plant relocation or expansion, site location consultants put together a large amount of information about the suitability

of a particular site for a particular purpose. Factors such as a job-ready workforce, water, land, construction costs, utility costs, transportation costs and political climate go into the worksheet before tax considerations.

The bases for the new revenue income tax credit and/or the new revenue corporate income credit are narrow, but most of the 100 largest private corporations would qualify for the reduced CIT rate based on either an increase in employment or an increase in investment in the state.

The top 10 private firms in New Mexico by level of employment are listed in the table below (see attachment for complete list):

Rank	Organization	City	FTE
13	Intel Corporation	Rio Rancho	3,300
14	PNM Resources Inc	Albuquerque	3,000
21	Wells Fargo Bank of New Mexico	Albuquerque	1,900
26	T-Mobile	Albuquerque	1,750
30	Eclipse Aviation	Albuquerque	1,500
36	Citicards	Albuquerque	1,274
41	Honeywell Defense Avionics System	Albuquerque	1,100
43	American Property Management Corp	Albuquerque	1,050
44	MJG Corporation	Roswell	905
46	First State Bancorporation Inc	Albuquerque	900

(http://nmnetlinks.com/cms/kunde/rts/nmnetlinkscom/docs/1044065435-01-19-2011-18-16-39/xls_upload.htm)

Most, if not all of these corporations will be eligible for the new revenue corporate income tax credit based on an increase in investment, if not an increase in employment. Note that although oil and gas and other mining corporations paid an average 29.8 percent of the total gross CIT for the period TY06 through TY2010, these corporations are not included in the list of major employers. However, the oil and gas industry ties investment to technology and anticipated prices, both of which are favorable factors for New Mexico for the next three or four years. Particularly for oil and gas firms, the investment that qualifies the firm for the 30 percent reduction in CIT for any increase in modified combined tax is expected to be made even in the absence of this proposed credit.

Unlike the original bill, the substitute does not disqualify a firm from the credit if it also accepts JTIP or LEDA support, or has qualified for high-wage jobs tax credit or rural job tax credit or has claimed an investment credit or technology jobs tax credit. The measure of “new revenue,” however, is decreased by any high-wage, rural jobs, investment or technology jobs tax credits.

PERFORMANCE IMPLICATIONS:

The LFC tax policy of accountability is met with the bill’s requirement to report annually to an interim legislative committee regarding the data compiled from the reports from taxpayers taking the deduction and other information to determine whether the deduction is meeting its purpose. This is specifically required in Section 1, Subsection S and Section 2, Subsection Q of the bill, which requires annual reports and an analysis of effectiveness beginning in 2020 and every five years thereafter.

OTHER SUBSTANTIVE ISSUES

The AGO comments that, "… generally, the state's authority to create tax credits and other types of tax expenditures to incentivize favorable economic outcomes or achieve favored policies is broad; provided the provisions are drafted and applied in ways that are not illegally discriminatory. Similarly, the state's authority to limit use of state funds for certain purposes or to exempt certain activities, entities or property from taxation is largely discretionary. As such, the measures proposed in SB 10 do not appear to implicate significant legal issues or barriers."

ADMINISTRATIVE IMPLICATIONS

TRD reports little additional impact; EDD notes it would need an additional FTE to process applications from, potentially, hundreds of firms.

TECHNICAL ISSUES

DFA identifies several technical issues with the bill:

- The bill contains several technical issues with regards to the definition and application of the terms "new jobs" and "eligible employee." Page 7, lines 20-25 provide procedure for recapture of the credit if an "eligible employee" is terminated and the position is not filled. As written, a business could replace all employees other than the 5 or 10 needed to qualify for the credit and would not be subject to the recapture provision. Recommend amending language to reference "new jobs" or "total jobs" if the intent is employment growth and subsequent retention.

- On page 8, line 5, the procedure "calculated as a percentage that the total terminated employee's job bears to the total number of new jobs created" is not clear. Is the percentage based on the number of jobs, the employees' wages, the employees' hours worked, or some other factor?

- On page 12 and 13, it might make sense to reference the annual average wage in the previous calendar year as wage data is often not available contemporaneously.

- On page 8, subsection O outlines the recapture procedure for businesses that cease operations for a period of 180 consecutive days within a 2-year period. It is not clear how this provision interacts with the ability of taxpayers to claim the credit for up to 10 years. For instance, if a business claimed the credit each year for 8 years and then ceased operation for 180 days, would the business be required to repay all 8 years' worth of credits? DFA recommends some type of statute of limitations on the claw-back provision.

- On page 11, line 1, DFA recommends adding "in New Mexico" after services to avoid ambiguity.

LG/PvM/ds:jl:ds

Attachment

Rank	Organization	City	FTE
13	Intel Corporation	Rio Rancho	3,300
14	PNM Resources Inc	Albuquerque	3,000
21	Wells Fargo Bank of New Mexico	Albuquerque	1,900
26	T-Mobile	Albuquerque	1,750
30	Eclipse Aviation	Albuquerque	1,500
36	Citicards	Albuquerque	1,274
41	Honeywell Defense Avionics System	Albuquerque	1,100
43	American Property Management Corp	Albuquerque	1,050
44	MJG Corporation	Roswell	905
46	First State Bancorporation Inc	Albuquerque	900
49	Albuquerque Publishing Company	Albuquerque	870
50	Coldwell Banker Legacy	Albuquerque	864
53	Bank of America	Albuquerque	825
57	Sprint PCS	Rio Rancho	800
58	Tricore Reference Laboratories	Albuquerque	800
62	Ambercare Home Health	Belen	691
64	Heritage Home Health Care	Albuquerque	670
66	Comcast	Albuquerque	647
67	EMCORE Corp	Albuquerque	632
68	Ktech Corporation	Albuquerque	619
69	eTelecard Global Solutions	Rio Rancho	616
71	Ethicon Endo-Surgery	Albuquerque	560
73	Border Foods Inc	Deming	550
74	Tresco Inc	Las Cruces	530
75	GE Aircraft Engines	Albuquerque	525
76	Sunland Park Racetrack & Casino	Las Cruces	520
77	Akal Security Inc	Espanola	500
78	Basin Coordinated Healthcare Inc	Farmington	500
79	Brycon Corporation	Rio Rancho	500
80	GE Aviation	Albuquerque	500
81	JB Henderson Construction Company	Albuquerque	500
83	Victoria's Secret Direct	Rio Rancho	500
84	The Peters Corporation (Gerald Peters Gallery)	Santa Fe	490
85	IMC Kallum	Carlsbad	454
91	Boeing-SVS, Inc.	Albuquerque	425
93	Bell Group	Albuquerque	400
94	Eye Associates of New Mexico Ltd	Albuquerque	400
95	JCPenney Catalog Customer Service Ctr	Rio Rancho	400
96	Thomas & Betts Elastimold Division	Albuquerque	400
97	Tyson Prepared Foods Inc	Santa Teresa	400
98	Oso Biopharmaceuticals Manufacturing LLC	Albuquerque	392
99	Hilltop Landscape Architects & Contractors	Albuquerque	380

http://nmnetlinks.com/cms/kunde/rts/nmnetlinkscom/docs/1044065435-01-19-2011-18-16-39/xls_upload.htm