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## FISCAL IMPACT REPORT

**SPONSOR** Keller **ORIGINAL DATE** 02/06/14 **HB**  
**LAST UPDATED** \_\_\_\_\_  
**SHORT TITLE** Business Facility Reinvestment Tax Rebate **SB** 47  
**ANALYST** Graeser

### REVENUE (dollars in thousands)

Estimated Revenue Impact*					Recurring or Nonrecurring	Fund(s) Affected
FY2014	FY2015	FY2016	FY2017	FY2018		
		(\$31,850.0)	(\$75,960.0)	(\$66,030.0)	Recurring	General Fund

(Parenthesis ( ) Indicate Revenue Decreases)

### ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY14	FY15	FY16	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
<b>Total</b>		\$0.0	\$50.0	\$50.0	Recurring	General Fund

(Parenthesis ( ) Indicate Expenditure Decreases)

Note: EDD expects it will need 1 FTE to receive and process the post-performance tax rebate.

Conflicts with SB-10

### SOURCES OF INFORMATION

LFC Files

#### Responses Received From

Economic Development Department (EDD)

Taxation and Revenue Department (TRD)

#### Synopsis of Bill

### SUMMARY

#### Synopsis of Bill

Senate Bill 47 proposes a "Business Post-Performance Tax Rebate." This would be a Corporate Income Tax provision, but not a Personal Income Tax provision. The credit amount is 25 percent of the actual (pre-rebate) Corporate Income Tax liability for the taxable year of the investment in a new business or in upgrading equipment or buildings of an existing New Mexico business. The economic development department is charged with certifying eligibility. Once the business is certified, the 25 percent of pre-rebate CIT liability rebate would continue for seven years following initial qualification and certification. The rebate is not transferable. Eligibility is based on the following:

- Investment of \$1 million or more in a new business; or
- Investment of \$250 thousand in new equipment for an existing New Mexico business; and
- One full-year of operations in New Mexico; and
- Payment of all New Mexico tax liabilities of the business; and
- Signed consent by the taxpayer to allow TRD and EDD to reveal to the legislature information needed to evaluate the effectiveness of the business post-performance tax rebate.

The rebate will be paid within 60 days of application. This rebate will not be administered as a credit applied against pre-rebate liability, but as a refund of taxes actually paid.

The purposes of the new business post-performance tax rebate are to: (1) encourage corporations to begin a new business or relocate to New Mexico and invest significant amounts of capital in the state; (2) encourage corporations to invest in upgrading equipment of an existing business in New Mexico; and (3) generate new state revenue from construction, employment, improved production capacity and business activity in New Mexico.

TRD is required to promulgate rules to implement the provisions of the corporate income tax rebate. The EDD will be required to promulgate rules establishing procedures to provide a certificate of eligibility for purposes of obtaining the new business post-performance tax rebate. TRD is required to compile annual reports on the rebate to evaluate the effectiveness of the rebate beginning in 2019 and every five years thereafter for the applicable legislative committees.

## **FISCAL IMPLICATIONS**

TRD reports the following:

Tax Year 2011 New Mexico corporate income tax data was used in this analysis. Existing corporations with a tax liability of \$1 million or more that invest \$250,000 in renovating equipment or facilities qualify for a rebate of up to 25%. Assuming they qualify for the rebate at the 25% level, since most of these corporations typically continually keep investing at least \$250,000 in their facilities and/or equipment, they can get at least \$250,000 back as a business facility reinvestment tax rebate (assuming a New Mexico income tax of \$1 million). According to the data, there were less than 10 corporations with a total rebate capacity of approximately \$50 million in this category.

Also, it was assumed that among the corporations with New Mexico income tax between \$50,000 and \$1 million, 70% of the corporations would take advantage of this credit since they would normally invest \$250,000 in facilities and/or equipment or would choose to invest this amount due to the availability of this tax credit. According to TRD data, there were less than 10 corporations with a total rebate capacity of approximately \$19 million in this category.

Both of these were summed up and calendar year growth rates were used from the December 2013 consensus revenue estimates to calculate calendar year impacts which were then converted to fiscal years. The first fiscal year impact was estimated to be partial due to both lower estimated payments and not all corporations having a December year-end. The impacts are expected to continue through 2023.

LFC Staff analysis:

- (1) This rebate will only apply for new investments, but could be widely used. For a few firms, the amount of the rebate could exceed the amount of the investment by an order of magnitude. For example, a firm with a corporate income tax liability of \$2 million annually could invest \$250 thousand initially and receive rebates of \$500 thousand each year for seven years, for a total of 14 times the qualifying investments;
- (2) in 2010 TY, 102 oil and gas firms with taxable income in excess of \$1 million paid corporate income tax of \$53 million. Most, if not all of the firms with taxable income in excess of \$1 million would have invested in at least \$250 thousand of new equipment in the ordinary course of business. Thus, the cost to the General Fund for the oil and gas and mining categories would have been approximately \$11 million (assuming 80 percent of the firms paying tax that year would have invested at least \$250 thousand in new equipment) with virtually no stimulated new investment above what would have occurred in the absence of the rebate. Similarly, in tax year 2010, the total corporate income tax paid by firms with over \$1 million in taxable income was \$215 million. Even assuming that only 50 percent of the non-oil and gas mining firms invested over \$250 thousand in new equipment, the fiscal impact on the General Fund would have been a total of \$30 million. This General Fund impact would continue for 7 years. Because of the phased decrease in the top marginal corporate income tax rates enacted in 2013's HBIC/HB-641 from 7.6 percent currently to 5.9 percent for tax years on or after January 1, 2018, the fiscal impact will decline each year because total corporate income taxes will decline because of the rate change.

This bill may be counter to the LFC tax policy principle of adequacy, efficiency and equity. Due to the increasing cost of tax expenditures revenues may be insufficient to cover growing recurring appropriations. This bill does not require a determination that an investment be made because of the rebate. Thus, these investments might have made in the normal course of business and the rebate may not lead to any expanded business activity that would not otherwise have occurred.

Estimating the cost of tax expenditures is difficult. Confidentiality requirements surrounding certain taxpayer information create uncertainty, and analysts must frequently interpret third-party data sources. The statutory criteria for a tax expenditure may be ambiguous, further complicating the initial cost estimate of the expenditure's fiscal impact. Once a tax expenditure has been approved, information constraints continue to create challenges in tracking the real costs (and benefits) of tax expenditures. This bill provides explicitly for modification of the confidentiality provisions. Taxpayers must allow TRD and EDD to release confidential information on the investments to the legislature to allow relevant committees to evaluate the effectiveness of the rebate in generating new business activity in the state and whether the cost in revenue foregone is offset by new economic activity.

## EFFECTIVE DATE

January 1, 2015 and applicable for tax years beginning January 1, 2015 and sunseting for tax years ending December 31, 2022. The bill is also applicable for businesses relocating to New Mexico or existing businesses that begin to re-equip or renovate facilities on or after January 1, 2015.

## SIGNIFICANT ISSUES

TRD notes:

New Mexico currently provides exceptions to the tax structure through exemptions, deductions, or credits. This bill would create the first rebate which requires the taxpayer to pay the taxes only to have TRD turn around and pay the taxpayer back the amount to which they are entitled. While there is no difference to the state between crediting the amount against a taxpayer's liability and collecting the tax before returning the amount to the taxpayer, it could potentially make a great difference to the taxpayer. After all, a rebate requires the taxpayer to pay the money to TRD meaning that those funds will not be available for the taxpayer to use for other purposes until TRD returns the funds to them.

A program such as this arguably (1) encourages new businesses to move to New Mexico; (2) encourages existing businesses to upgrade their equipment and facilities; and (3) provides for a significant reduction in total New Mexico corporate income tax which may improve the overall business climate in New Mexico.

Releasing information from taxpayer returns to parties not specifically authorized in Section 7-1-8 NMSA 1978 may be considered to be a violation of the Taxpayer's Bill of Rights. Per Section 7-1-4.2 NMSA 1978 the New Mexico Taxpayer Bill of Rights includes: "the right to have the taxpayer's tax information kept confidential unless otherwise specified by law, in accordance with Section 7-1-8 NMSA 1978.

(LFC Staff Analysis) This proposal is a classic example of "buying the base" where a relatively large fiscal impact is experienced for a relatively low amount of net new businesses locating in the state or expanding or renovating above the level that would be generated in the absence of the rebate. This is known as a "but-for" test. Laws 2013 Chapter 160 (HBIC/HB 641) also "bought the base" and did not require a "but-for" certification.

It decreased top marginal tax rates from 7.6 percent currently to 5.9 percent for tax years on or after January 1, 2018. Because CIT is overwhelmingly paid by the top rate bracket taxpayers, this phased decrease creates a 22 percent reduction in the corporate income tax rate. Analysts expected that 2013's rate and apportionment change would have some "feedback" effect, but were unable to estimate how much additional business activity could be attributed to the CIT rate reduction. This inability is also true of this proposal. Comparing the two proposals is not particularly appropriate, since the CIT rate reduction was, again, "buying the base," with revenue loss and little, if any, corresponding increase in business activity. Prudence indicates that we should wait until the full rate reduction has been phased in and measure the feedback from the rate reduction on business activity prior to implementing this additional rate reduction contained in this bill. This bill has delayed effective and applicability dates; however, the delay is only one year.

## 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. In fact, the bill explicitly provides for a limited waiver of confidentiality to allow appropriate legislative committees an expanded range of information upon which the committees can make a judgment whether the provisions of the bill are effective in accomplishing the stated purposes of the bill.

## ADMINISTRATIVE IMPLICATIONS

TRD reports that the provisions of this bill impose a minimal impact. TRD will need to develop a rebate form that is needed to be attached to the corporate income tax form.

Note: EDD expects it will need 1 FTE to receive and process the post-performance tax rebate.

## CONFLICT

SB-10 proposes a "new revenue income tax credit" and a "new revenue corporate income tax credit." These are 30 percent credits against "modified combined taxes," which is the sum of income tax and any gross receipts taxes paid in the qualifying period. SB-10 requires a company to certify that it would not have made the investment or created the jobs "but for" the rebate of taxes paid.

## TECHNICAL ISSUES

TRD notes a number of technical issues:

- (1) Releasing information from taxpayer returns to parties not specifically authorized in Section 7-1-8 NMSA 1978 may be considered to be a violation of the Taxpayer's Bill of Rights. Per Section 7-1-4.2 NMSA 1978 the New Mexico Taxpayer Bill of Rights includes: "the right to have the taxpayer's tax information kept confidential unless otherwise specified by law, in accordance with Section 7-1-8 NMSA 1978.
- (2) Page 5, lines 19-21 requires the department to give the taxpayer the rebate within 60 days whereas 120 days are allowed under Section 7-1-26 (B)(2).
- (3) Page 3, Subsection H(1) requires that the taxpayer invests at least \$1 million to establish a new business located in New Mexico or no less than \$250,000 invested in new equipment. Page 2, lines 1-3 allow the rebate for a new business that constructs and equips a new business or upgrades equipment or facilities for an existing business in New Mexico, which implies that if the business does one or the other i.e., they can get the rebate if they invest only \$250,000.
- (4) Page 5, lines 1-5, asks for employment information to be submitted on the application for a certificate of eligibility, yet employment is not one of the requirements that the taxpayer has to meet in order to qualify for the rebate (Page 2, lines 1-3).

The sentence on page 7, lines 4-6 may need to be adjusted. “B. businesses relocating to or beginning operation in New Mexico, or existing businesses beginning to upgrade or [~~existing businesses~~] that begin to re-equip or renovate facilities on or after January 1, 2015.” This is not important but the suggested changes will be easier for readers to understand.

## **OTHER SUBSTANTIVE ISSUES**

### **Description - Detailed Discussion:**

This bill defines the following terms: (1) "business" means a for-profit corporation that is required to pay corporate income and franchise taxes pursuant to the Corporate Income and Franchise Tax Act; (2) "new business" means a corporation that: (a) operates a business in New Mexico that owns or leases real property as a physical address for the business in New Mexico and employs personnel at that physical address; (b) is required to pay tax pursuant to the Corporate Income and Franchise Tax Act; and (c) began business operations on or after July 1, 2014; and (3) "wages" means all remuneration in cash and the cash value of remuneration paid in any other form for services performed by an employee for an employer; "wages" includes the value of benefits.

TRD notes the following:

The rebate is not tied to the value invested but tax liability which does not reflect the purpose (2) which is to encourage corporations to invest in upgrading equipment of an existing business in New Mexico. TRD recommends that companies should be rewarded on what they invest and therefore the rebate should be a proportion of what was invested not a proportion of the entire tax liability.

Qualifying once and continuing to receive the rebate for seven consecutive years fails to encourage corporations to invest in upgrading equipment of an existing business in New Mexico annually. In order to encourage companies and businesses to be proactive, the qualification should be connected to every time they make the investment rather than a one-time investment.

The rebate has a potential to reduce corporate income tax significantly in addition to the impact of HB- 641 of New Mexico Legislative Session 2013 which has not taken full effect.

## **POSSIBLE QUESTIONS**

Would it be prudent to wait on implementation of this proposal until HB-641's corporate income tax rate reduction is fully phased in and the effect on business activity measured?

LG/jl