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FISCAL IMPACT REPORT

SPONSOR Herrell ORIGINAL DATE 2/24/15 LAST UPDATED _____ HB 583
SHORT TITLE Cultural Property Tax Credit Changes SB _____
ANALYST Graeser

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY15	FY16	FY17	FY18	FY19		
	(\$1,350.0)	(\$1,350.0)	(\$1,350.0)	(\$1,350.0)	Recurring	General Fund

(Parenthesis () indicate revenue decreases

The maximum Cultural Property Tax Credits for the combination of personal income tax and corporate income tax is proposed in the bill to be capped at \$1.5 million annually. The credits are refundable. An unknown amount of rollover has been allowed, but taxpayers have been unable to apply the credit to current-year liabilities. These rollover amounts, if they exist, would have high priority for the first few years of these capped credit amounts.

See "Fiscal Implications" below where EDD proposes judging whether the provisions of this bill constitute a revenue loss to the general fund or a revenue gain.

HB-583 is a duplicate of SB 414.

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY15	FY16	FY17	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
Total		**	**	**	Recurring	General Fund

(Parenthesis () indicate expenditure decreases

This expands the tax credits in existing programs. This may require additional administrative effort for both DCA and EDD.

SOURCES OF INFORMATION

LFC Files

Responses Received From

Department of Cultural Affairs (DCA)
Economic Development Department (EDD)
Office of the State Auditor (OSA)

SUMMARY

Synopsis of Bill

House Bill 583 significantly expands the scope and impact of the Cultural Property Income Tax

Credit Act originally enacted in 1984 and amended in 2007. The bill retains the current law provision of a PIT or CIT credit of 50 percent of expenses with a maximum of \$25 thousand. The bill, however, increases this per-project limit to as much as \$285 thousand for properties located within an arts and cultural district, a frontier community or for properties subject to the Main Street Act. The bill allows these earned credits up to a maximum annual cap of \$1.5 million (applied to the sum of credits approved for PIT and for CIT) and allows the credits to become refundable rather than the current law provision for which the credits are non-refundable and any amounts in excess of current-year liabilities allowed a four-year rollover feature.

The effective date of the act is not stated – assume 90 days after adjournment, or June 19, 2015. The new cap and enhanced amounts would be effective for projects completed on or after January 1, 2015 with credit claims based on certification by the Cultural Property Preservation Committee and limited by the annual cap on tax year claims. Apparently, the cap is administered by TRD. There is no sunset date. The LFC recommends adding a sunset date.

FISCAL IMPLICATIONS

TRD has recently released the 2014 Tax Expenditure Report. On page 141, the following data are detailed for the Cultural Property Preservation Credit. The report notes that the current version of the credit is non-refundable. Taxpayers must have sufficient state tax liability to cover the credit.

	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013
Expenditure	\$259.5	\$235.8	\$165.4	\$153.9	\$150.6
Claims	84	81	68	71	54

Thus, the recent baseline cost is assumed to be \$150. Thus, the net general fund cost is the maximum \$1.5 million minus the current cost.

EDD proposes that this credit will be, on net, a revenue gain for the general fund and local governments. Their argument follows:

“The credit is capped at \$1.5 million. Because of the refundability aspect to the credit, we expect the credit to be fully maximized annually. Assuming that about 75 percent of the credit will be claimed for commercial projects and 25 percent for residential projects; a minimum of \$3 million of the costs of the projects on commercial properties must be eligible costs (assuming a 37 percent effective tax credit rate) and a minimum of \$750 thousand of the costs of the projects for residential properties must be eligible costs. Thus, a minimum of \$3.75 million in private sector investment must occur for the credit to be fully utilized in any given year.”

“Going by the above assumptions, the following construction impacts are estimated using the multipliers from Bureau of Economic Analysis and Impact DataSource Model;

- A total of about 70 temporary construction-related jobs would be created
- About \$2.3 million in constructed-related earnings to workers
- About \$7 million in revenues to businesses
- About \$350 thousand in gross receipts tax collections to the state and about \$140 thousand in gross receipts tax collections to local governments.”

“With restoration of commercial properties, vacancies within these properties will be filled with businesses generating more economic activity with multiplier effects in our communities. The impacts of businesses that will be locating in these newly restored

commercial properties have not been calculated here. However, these businesses are expected to buy from local and state suppliers, employ New Mexicans, pay taxes, etc, hence generating more revenue for the state.”

LFC staff note, however, that the general fund cost is of different immediacy than the calculation advocated by EDD. The major difficulty in using multipliers to determine revenue impacts is that direct temporary impacts are concurrent with the construction, but that the permanent direct, indirect and induced impacts are quite uncertain as to magnitude and timing. The Consensus Revenue Estimating Group, which estimates the revenue impacts of various proposals, is adamant in its objection to dynamic scoring for assessing the budget year impacts of economic development projects.

This bill may be counter to the LFC tax policy principles of adequacy, efficiency, accountability and equity. Due to the increasing cost of tax expenditures revenues may be insufficient to cover growing recurring appropriations.

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.

SIGNIFICANT ISSUES

The bill amends the current cultural properties income tax credit statute administered by the Historic Preservation Division of the Department of Cultural Affairs by raising the cap on certain state historic tax credits and allowing a refund of an eligible portion of the credits awarded for a completed rehabilitation, restoration, or preservation of an eligible property listed in the New Mexico Register of Cultural Properties.

Currently, the cap is \$25 thousand per approved project outside Arts and Cultural Districts and \$50 thousand for projects in Arts & Cultural Districts. The only increase to the cap in the last 30 years was an increase from \$25 thousand to \$50 thousand in 2007 for projects in Arts and Cultural Districts.

EDD notes the following:

For many of the commercial property owners with older, under-utilized buildings the costs to bring their properties up to current building and fire code is currently prohibitive. Property owners often do not qualify for traditional commercial property loans which would support building renovations such as electric, plumbing roof repairs, HVAC and fire suppression systems. A refundable state historic tax credit is a critical component for the restoration of the commercial property and to package financing for rehabilitation of those renovation costs that are not eligible for the tax credit.

EDD also points out that this program is intended to leverage financing for preservation and renovation projects:

New Mexico MainStreet in the Economic Development Department has been looking for financial tools to utilize for property owners, especially owners of small commercial

properties in rural and underserved urban neighborhoods to utilize to support commercial property owners in the restoration and rehabilitation of vacant and/or under-utilized commercial property. In particular, small property owners throughout New Mexico are often cash poor but property rich. The property often does not qualify as security for a loan to address the full rehabilitation of the building.

A refundable state historic tax credit potentially provides private commercial property owners the security lenders require for building rehabilitation work which could provide eligible property owners a way to package a rehabilitation project that otherwise was financially untenable.

DCA and EDD have filed similar agency bill reviews. The following is excerpted from the DCA review:

The proposed bill retains:

- Eligibility of both individual and corporate tax payers
- Eligibility of both residential and commercial properties
- The maximum amount of credit at 50 percent for certain projects, based on eligible project costs

The proposed bill amends the statute in the following ways:

- Establishes the ability of taxpayers to receive a refund in the amount that their credits exceed their liability tax liability that may be refundable upon approval of completed projects
- Limits the cumulative total annual credits available for all projects to \$1.5 million
- Establishes the maximum credit based on eligible project work and the budget of each project
- Expands the eligibility for the higher--fifty percent--credit on residential and commercial credits for properties to include those within designated MainStreet Districts and Main Street Frontier Initiative project areas.
- Provides for accountability and performance based on an annual report from TRD.

The intent of the bill is to stimulate greater private investment in existing historic properties and communities, return under-used historic buildings to productive use, create more commercial spaces for new business enterprises, and generate employment opportunities in communities both large and small throughout the state.

The Historic Preservation Division in the Department of Cultural Affairs has been looking for ways to increase the amount of rehabilitation of listed cultural resources and to provide financial incentives for greater participation in rural and underserved communities throughout the state. In many of those areas property owners lack sufficient state income tax liability to benefit from the existing program, but own many run-down historic properties.

As other states report, having a robust state tax credit program has positive economic effects. In addition to stimulating the local construction industry and local business areas, refundable and transferable state tax credit programs increase the use of the federal historic preservation tax credit that is known to attract investment capital to states and return federal tax dollars to taxpayers in those states.

Known as rural and impoverished, Kentucky has a \$5 million annual program cap on refundable/transferable tax credits. The Kentucky Heritage Council/State Historic Preservation Office reported in 2011: “In just six years, Kentucky’s program leveraged \$197.1 million in

private investment to preserve historic structures and created 4,534 jobs since its enactment in 2005.” Kentucky also reported that \$13.6 million in tax credits were awarded in that period and each \$1 of credit issued averaged \$14.54 in direct economic impact, and “In FY 2010 alone, Kentucky had 27 projects successfully completed that earned a 20 percent federal tax credit with investments totaling \$18,223,755.” They pointed out their state credit can be the tipping point that makes projects feasible when federal credits are not enough and it puts under-utilized real estate back on local and state tax rolls.

Minnesota’s program began in 2010, has no annual or per-project caps and is refundable (called a “grant”) and transferable. Their annual report for 2013 states “In the three years of the Minnesota Historic Rehabilitation Tax Credit, the tax credit has generated an estimated \$1.1 billion in output in the state’s economy, 7,582 jobs, and \$370 million in labor income.” It stated that projects approved for federal tax credits completed in that period also applied for state credits totaling \$134.5 million. Using those amounts, the report concluded that, for every state dollar of tax credit or grant (refund) allowed in the past three years, \$8.38 in economic activity was generated in Minnesota.

In the National Trust for Historic Preservation’s 2010 report on State Tax Credits for Historic Preservation, 31 state programs were included (there are currently 34 states with tax credit programs) and 48 percent (15 states) had no annual caps. The average cap for the other 16 states was \$27.4 million. The caps ranged from \$0.7 million to \$140 million with only three state caps less than \$3 million. The annual cap proposed for NM of \$1.5 million is therefore well below average.

The Office of State Auditor notes that this repeal and recompile does not conform to the mandate of Section 9-15-56 NMSA 1978 which requires a number of features be included whenever an economic development tax incentive is enacted. These requirements include reporting (accomplished with this credit) and accountability which is not. The OSA suggests adding the following general statement to all economic development tax incentive bills - -- and in particular, to this bill – to satisfy the requirements of 9-15-56 NMSA 1978.

“The taxation and revenue department shall compile an annual report on the _____ (name of tax credit or deduction) created pursuant to Section _____ (Section/Subsection) that shall include the number of taxpayers approved by the department to receive the tax credit/deduction, the aggregate amount of credits/deductions approved and any other information necessary to evaluate the effectiveness of the tax credit/deduction. Beginning in _____ (year) and every _____ (number of years) thereafter that the tax credit/deduction is in effect, the department shall compile and present the annual reports to the revenue stabilization and tax policy committee and the legislative finance committee with an analysis of the effectiveness and cost of the tax credit/deduction and whether the tax credit/deduction is performing the purpose/purposes for which it was created.”

PERFORMANCE IMPLICATIONS

Performance objectives for both DCA and EDD might benefit from this proposal.

EDD notes the following performance objectives are implicated:

There are a number of qualifying areas that must be satisfied for a property to be eligible for state historic tax credits and for the award thereof.

- The property has to be on the state registry of historic places
- The property owner must be interested in restoring the property

- The property owner will need to file paperwork and project budget and plan with the Cultural Property Review Committee of the Historic Preservation Division
- The application will need to be reviewed and approved by the Cultural Property Review Committee of the Historic Preservation Division
- A letter of approval will set the conditions of the state historic tax credit including which elements of the project and their costs are eligible for the credit
- The Historic Preservation Division will review the project for compliance with award stipulations
- The property owner will need to complete the work which the Historic Preservation Division will do a final review and approval to ensure compliance
- Upon that certification the refundable amount that the project qualifies for will be reimbursed to the property owner.
- Property owners with limited liability may apply for the portion of the tax credit in proportion to their liability.
- Actual performance impacts may take up to two years from enactment of the bill.

Projects requiring larger financing that are eligible for state historic tax credits often partner the tax credit with national historic tax credits and other federal sources of revenue to package a full restoration and rehabilitation project. The Clovis Hotel in Clovis New Mexico is a good example that engaged a variety of tax credits loans and financial, which attracted a private developer who renovated and re-opened the once vacant historic hotel for housing, retail and services.

The LFC tax policy of accountability is met since TRD is required in the bill 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. While neither the historic preservation division nor the Main Street program at EDD are required to assist in the preparation of this report by TRD, it will be in the interest of both agencies to cooperate fully.

ADMINISTRATIVE IMPLICATIONS

None on the state. These are not new programs. It is unlikely that the uptake on the credits will be sufficiently robust to require a significant increase in administrative effort.

TECHNICAL ISSUES

This bill does not contain a sunset date. The LFC recommends adding a sunset date.

OTHER SUBSTANTIVE ISSUES

34 states have state historic tax credit programs, 6 have refundable tax credit programs with transferability as an option, 23 have transferability where the awardee of a tax credit who does not have a tax burden may sell the tax credit to another entity with a tax burden. The awardee in the transaction of transferability applies the cash directly to the building restoration.

In neighboring states the following have historic tax credit programs to compare with this bill:

Arizona - working on their program for 2015.

Colorado - created in 2014, \$10 million cap, fully transferable.

Nebraska - created in 2014, \$15 million cap, transferable.

Oklahoma - created in 2005, no cap, transferable.

Texas – created in 2013, no cap, fully transferable.

The following states have refundable state historic tax credits with the potential pf transferability;

Iowa – 25 percent tax credit for commercial property, 30 percent for projects in the arts and cultural districts, no project cap, fully transferable

Kentucky – 20 percent credit for all non-residential properties, cap \$400 thousand per project, \$5 million annual program cap fully refundable or transferable.

Maine – 25 percent tax credit, project cap \$5 million no annual cap on program

Minnesota – Created in 2010, 100 percent equal to federal tax credit for commercial property fully refundable or transferable

Ohio – 25 percent tax credit, project cap \$5 million, \$3 million maximum refundable. \$60 million cap annually. Fully transferable or refundable.

States using state historic tax credits usually identify negative economic conditions that need to be mitigated by attracting private sector reinvestment including: census areas of low to moderate income levels, metropolitan redevelopment areas, federal or state designated economic redevelopment and revitalization areas (MainStreet, Frontier, and Arts & Cultural Districts), or scenes of national catastrophe (hurricanes, tornadoes, earthquakes, forest fires).

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