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

SPONSOR: Hobbs DATE TYPED: 2/17/03 HB 14/aHBIC/aHTRC

SHORT TITLE: Technology Startup Tax Credit Act SB

ANALYST: Neel

REVENUE

Estimated Revenue		Subsequent Years Impact	Recurring or Non-Rec	Fund Affected
FY03	FY04			
		($1,000.0)	Recurring	General Fund

(Parenthesis ( ) Indicate Revenue Decreases)

Relates to:
HB 193 Technology Startup Tax Credit Act
HB 21 Amend Lab Partnership/Small Business Act
SB 12 Amend Lab Partnership/Small Business Act
SB 235 Technology Startup Tax Credit Act

SOURCES OF INFORMATION

LFC files

Responses Received From

Taxation and Revenue Department (TRD)
Department of Economic Development

SUMMARY

Synopsis of HTRC Amendment

The House Taxation and Revenue Committee Amendment defines the time where the tax credit can be taken to the preceding 12 month period prior to when the tax credit is sought. Additionally, the amendment excludes for the purposes of the credits expenditures by other entities than those claiming the credit.

The HBIC amendment eliminates the “double dip” provision whereby the credits included in HB 193a could overlap those taken pursuant to the current Technology Jobs Tax Credit Act (Section 7-9F NMSA 1978). This “double dip” provision produces claims averaging about $1.2 million per year. Last, the HTRC amendment strikes the HBIC amendment and requires that a business be established after June 30, 2002 to qualify for provisions under HB 14.

Synopsis of HBIC Amendment

The House Business and Industry Committee amendment provided for only “new businesses” to qualify for provisions of HB 14a (see discussion under fiscal impact).

Synopsis of Original Bill

House Bill 14 enacts a new section of statute titled the Technology Startup Tax Credit Act (TSTCA) to allow a business to claim tax credits equal to the gross receipts, compensating or withholding taxes due to the state for engaging in “qualified research”. Qualified research is defined as research for the (1) purpose of discovering information that is technological in nature and where (2) substantially all activities contribute to improved performance and (3) are not cosmetic in nature. In order to qualify for the tax credits the entity’s:

- Revenues cannot exceed $10.0 million;
- Qualified expenditures must equal 20 percent of its revenues for the qualifying period;
- Total employees cannot exceed 50; and
- Another company cannot have more than 50 percent interest in the entity.

Expenditures on property owned by a municipality or county in connection with an industrial revenue bond project or property for which the entity has received tax credits pursuant to the Capital Equipment Tax Credit Act, the Investment Credit Act or the Technology Jobs Tax Credit Act are expressly excluded.

The tax credit is available for 59 consecutive months and the provisions of HB 14 will be administered by TRD.

Provisions in HB 14a are effective July 1, 2003.

Significant Issues

The expressed goal for TSTCA is to provide a favorable tax climate for startup technology businesses in New Mexico thereby promoting increased employment and higher wages in New Mexico. The Legislature has consistently emphasized high technology job creation. During the 2002 session it passed HB 40 *Software Development GRT Credit* (Laws 2002, Chapter 10) to provide a gross receipts tax deduction for receipts for software design and development and web-site design and development. The 2000 Legislature passed HB 19 *Technology Jobs Tax Credits* (Laws 2000, Chapter 22, 2nd SS) that provides a basic tax credit and an additional tax credit, both in the amount of 4 percent of the qualified expenditure made by a taxpayer conducting “qualified” research at a “qualified facility”. To be eligible for the additional credit the taxpayer must increase its payroll by $75.0 over the base payroll of the taxpayer for each $1.0 million of qualified expenditures.

Attachments 1 and 2 graphically depict New Mexico's need to "promote increased employment and higher wages". Attachment 1 shows New Mexico lagging the nation in nonagricultural employment growth. This under performance is projected to continue for the next few years. Similar to employment growth, attachment 2 shows New Mexico maintaining higher personal income growth from 1991 to 1996 than the nation, however, this growth declined in 1996-1997 whereby it fell behind the rest of the nation. The next four years saw have lower personal income growth than the national average. In 2001 New Mexico's growth exceeded the national average due in part to the recession.

FISCAL IMPLICATIONS

TRD notes the following assumptions in regard to HB193, the 1997 Economic Census of Professional and Technical Services, New Mexico has over 110 research and development companies that employ fewer than 50 employees. Few of these firms have revenue in excess of $10 million. Census data also indicates that payroll expenditures for research and development firms average 36% of total receipts. This is almost twice the 20% criterion for expenditures spent "in connection with" qualified research, thus the 20% threshold does little to limit credit eligibility.

The provisions of this bill, even with amendment, are not limited to actual "start-up" companies. The amendment by inserting the word "new" in the definitions of "business" and "qualified business" provides partial clarification. If the intent is to limit the credit to bona fide new businesses in the state and not extend it to "re-formed" businesses, the credit could be restricted to businesses established after some specific date. For example, a qualified business could be defined as a "*taxpayer who is not a successor in business of another taxpayer and whose primary business in New Mexico is established after July 1, 2003*."

According to TRD, in fiscal year 2002, small research and development firms generated $161 million in total gross receipts and deducted $88 million (55%), leaving $73 million in taxable gross receipts. Payroll expenditures subject to state withholding are estimated to have been $58 million. A growth rate of 3% per year yields estimated fiscal year 2004 taxable gross receipts of $77.4 million and payroll of $61 million.

Effective Date – July 1, 2003

TECHNICAL ISSUES

It should be noted that HB 14a does not require that a qualified business be newly formed or new to New Mexico. Therefore, existing technology firms would qualify for the technology startup credit. Thus, some of the tax expenditure will benefit existing businesses that may require no additional incentive to operate and expand in New Mexico.

Additionally, this proposal appears to create a "double dip" with credits taken pursuant to the current Technology Jobs Tax Credit Act (Section 7-9F NMSA 1978), with which this proposal has many overlapping provisions, and produces credit claims averaging about $1.2 million per year. ***There is no provision contained in this proposal that would exclude a taxpayer from qualifying for credit under both programs.*** This bill does define "qualified expenditure" to exclude "*…**property** for which the taxpayer has received any credit pursuant to the Capital Equipment Tax Credit Act, the Investment Credit Act or the Technology Jobs Tax Credit Act*." But this provision simply excludes the above expenditures from being counted towards the 20%

of expenditures spent in connection with qualified research for the purposes determining credit eligibility. It does not preclude a taxpayer from qualifying for credit under both programs. Further, as stated above, payroll expenditures alone are likely to be sufficient to qualify a business for credit eligibility. Nothing in the bill states that if a taxpayer claims credit pursuant to existing credit programs, the taxpayer is no longer eligible for the "Technology Startup" credit.
Pursuant to this proposal, once a business is qualified to claim credit, there is no cap on the amount of credit a business may claim. The credit amount is limited only by the combined gross receipts, compensating, and withholding taxes due.

OTHER SUBSTANTIVE ISSUES

New Mexico compares favorably nationally regarding R&D tax incentives for industry. The following shows tax incentive provisions:

- R& D Tax Credit: 36 other states;
- Investment Credits: 50 other states;
- Specific Industry Credits: 16 state incentives;
- Sales tax exemption for R&D: 15 other states;
- Tax abatement for specific locations: 18 states; and
- Internet infrastructure tax incentives: 4 states.

SN/prr/njw