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

SPONSOR SCTC **DATE TYPED** 2/4/05 **HB**

SHORT TITLE Technology Investment Income Tax Credits **SB** CS/150/SCTC

ANALYST Taylor

REVENUE

Estimated Revenue		Subsequent Years Impact	Recurring or Non-Rec	Fund Affected
FY05	FY06			
(94.0)	(375.0)*		Recurring	General Fund

(Parenthesis ( ) Indicate Revenue Decreases)

See text

SOURCES OF INFORMATION
LFC Files
Taxation and Revenue Department (TRD)
Economic Development Department (EDD)

SUMMARY

The Senate Corporations and Transportation Committee substitute for Senate Bill 150 provides an income tax credit for qualified investment in certain qualified businesses. The credit is called the "angel investment credit", and its stated purpose is to encourage investment in qualified businesses. A qualified investment is defined as a cash investment in a qualified business for equity.

A qualified business is defined as: a business whose principal place of business is New Mexico; that engages in high technology research or manufacturing in New Mexico; whose gross revenues during the prior fiscal year were $5 million or less; a business entity that is independent of another business entity; and is not primarily engaged in certain businesses (these are specified).

The income tax credit is limited to 25 percent of the investment, but may not exceed $25 thousand. A taxpayer may claim up to 3 three qualified investments per tax year, but each investment must be in a different company. A taxpayer may claim the credit for investment in the same business for a maximum of three years. The credit may only be deducted from the taxpayer's income tax liability, but any unused portion of the credit may be carried forward for three consecutive years.

The provisions of the bill would be applicable beginning January 1, 2005. The bill carries a delayed repeal (sunset) of January 1, 2011. Temporary provisions allow credits approved for investments made in 2007, 2008 and 2009 to be carried forward to tax years 2010 through 2012.

FISCAL IMPLICATIONS

TRD estimates the FY06 impact of this legislation to be a $375 thousand dollar reduction in general fund revenues. Their analysis notes that they have no information on the number of angel investments in New Mexico, and thus caution that estimated impacts should be regarded as a rough approximation.

Although TRD does not provide the methodology employed to determine the estimate, they report that only about 2,300 New Mexico taxpayers report tax obligations in excess of $25 thousand, and fewer than 10 report tax obligations greater than $75 thousand. The estimated impact implies that both current and prospective (stimulated by this incentive) angel-like investments are likely to be quite limited. A $375 thousand fiscal impact only implies $1.5 million in qualified investments and only about 15 investors (full value equivalent) taking full advantage of the credit. This is less than 1 percent of the 2,300 taxpayers with income tax obligation in excess of $25 thousand. Note also that TRD reports that nationwide Angel investors reported roughly $18 billion of investment in 2003 and approximately 20 thousand or so angel investments. Assuming that New Mexico's share of such investments is only 0.1 percent would imply potential qualified investments could exceed 200 implying a much larger fiscal impact. Although this assumption may be high in the near term (it will take time for people to learn about and use the credit), it does imply that the long-term fiscal impacts could be significantly higher.

Finally, it also should be recognized that if the credit is successful in encouraging investment in qualified firms, the fiscal impact could be significantly higher.

ADMINISTRATIVE IMPLICATIONS

TRD reports modest administrative impacts that could be absorbed with existing resources.

TECHNICAL ISSUES

TRD submitted the following technical issues:

1) It would be difficult for the Department to know if the qualified business has gross revenue of less than $5,000,000.
2) The measure does not identify procedures by which a taxpayer can claim the credit. The proposal does not make clear, for example, whether the taxpayer must apply for the credit and whether the Department, prior to a taxpayer taking the credit on their personal income tax return, must approve the claim for credit. For comparison, see 7-9A-8 and 7-9A-9, setting forth procedures for claiming a tax credit. If, on the other hand, the taxpayer may simply claim the credit without advance approval from the Department, then the Bill should specify in which tax years the credit may be claimed.
3) The proposal contains a typographical error in subsection F(4)(e) excluding ".preparing meals for immediate consumption".

OTHER SUBSTANTIVE ISSUES

TRD submitted the following issues:

- The proposal appears to be motivated by the view that angel investment activity benefits the state by providing capital to relatively risky business ventures – that would not otherwise be provided by market forces. And resulting economic development would benefit taxpayers in excess of the "tax cost" of the proposal.
- An angel investor is generally defined as an individual who provides capital to one or more startup companies. Angel investors are affluent and have a personal interest in the success of businesses in which they invest. Unlike partners, angel investors rarely manage firms they invest in. Angel investments are characterized by high levels of risk and potentially high returns on investment. Venture capitalists are also investors that provide capital for start-up or expansion and seek higher rates of return than would be given by more traditional investments. The primary difference between venture capitalists and an angel investors is that venture capitalists are professional investors. Venture capitalists often have no business experience in the industries they invest in. Angel investors, on the other hand, often have business experience relevant to the companies they invest in and want to add value to the firms in addition to making a return on the investment.
- According to the Angel Capital Association, angel investors provided approximately $12.4 billion in financing to almost 28,000 entrepreneurial businesses in the first half of 2004, a substantial increase over the $18.1 billion in all of 2003. A typical investor prefers to invest locally and enjoys a net worth in excess of $1 million and an annual income of $250,000.

BT/yr