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

ORIGINAL DATE 1/21/06
SPONSOR Heaton **LAST UPDATED** 1/25/06 **HB** 36/aHBIC

SHORT TITLE Tax Credit For Certain Business Investments **SB**

ANALYST Francis

REVENUE (dollars in thousands)

Estimated Revenue			Recurring or Non-Rec	Fund Affected
FY06	**FY07**	**FY08**		
(7,500.0)	(15,000.0)	(15,000.0)	Recurring	General Fund

(Parenthesis ( ) Indicate Expenditure Decreases)

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

Responses Received From
Taxation and Revenue Department (TRD)

SUMMARY

Synopsis of HBIC Amendment

The House Business and Industry amendment clarifies the dates of when the carry forward is allowed. A carry forward is allowed in 2012 and 2013 for investments made in 2009. This means that credits for investments made in 2009 can be carried forward through 2013. The fiscal impacts reported in the original are unchanged.

Synopsis of Original Bill

House Bill 36 amends the Income Tax Act to provide a credit for investment in high technology research or manufacturing companies. The credit is for 25 percent of up to $100 thousand in investment and is a credit against income tax liability. Taxpayers may receive the credit on up to three distinct investments and a maximum of three years for any individual investment.

Qualified investments beginning January 1, 2006, are eligible for the credit. The credit would be against the 2006 tax liability, filed in 2007. There is a provision for a carry-forward of unused tax liability for qualified investments made in calendar years 2009, 2010 and 2011. The credit expires January 1, 2012.

FISCAL IMPLICATIONS

TRD:

The "2006 Book of Business Lists" published by the New Mexico Business Weekly identifies 25 technology companies that could be identified as having their "principal place of business" in New Mexico. These companies have combined revenue of several hundred million dollars per year. Other companies engaged in manufacturing of technology products would also be eligible for the proposed credit. The total investment in these companies is probably well in excess of $1 billion. If even 5 percent of the ownership of these investments changes hands each year, credits of nearly $20 million per year would be generated. Actual utilization of the credits will depend on the amount of liability of the investors, with unused credits being carried forward for use in future years.

Since the proposal takes effect for tax years beginning on January 1, 2006, 50% of the full tax year impact would accrue in FY 2006. The measure contains a delayed repeal, which would eliminate impacts on the General Fund after the year 2011.

SIGNIFICANT ISSUES

Generally, the term "angel investor" refers to a high net-worth individual who is able to invest in a company that is just starting up operations or is still in the research phase and needs capital to begin operations. HB 36 uses the term "angel investor" and refers to high technology but there is no language regarding start-up companies. HB 36 defines high-technology research as "research that is undertaken for the purpose of discovering information that is technological in nature and the application of which is intended to be useful in the development of a new or improved business component of the taxpayer and substantially all of the activities of which constitute elements of a process or experimentation related to a new or improved function, performance, reliability or quality…." This definition is sufficiently broad that it could apply to many more companies and types of investment than intended.

Anyone who invests in any local manufacturing or high tech research company qualifies for this credit. This is because HB 36 does not define who a qualified investor is and is vague as to what a qualified business is. Similar legislation introduced in the 2005 regular session defined qualified business as one with less than $5 million in revenues for the previous year.

TRD:

The proposed measure would provide credits for essentially any investment in a business that maintains its principal place of business in New Mexico and engages in high technology research or manufacturing activities. The sponsor's intent may be to further limit the types of activities that would allow the proposed credits. If so, the bill should be amended accordingly

SEC definition of "accredited investor" (for individuals):

- a natural person who has individual net worth, or joint net worth with the person's spouse, that exceeds $1 million at the time of the purchase;
- a natural person with income exceeding $200,000 in each of the two most recent years or joint income with a spouse exceeding $300,000 for those years and a reasonable expectation of the same income level in the current year; (Rule 501-D Securities Act of 1933)

Wisconsin has an angel investment credit and requires certification of a qualified "angel" investor as well as specifies that a qualified business must answer yes to the following questions:

1. Are you seeking private equity funding for pre-commercialization activities related to the development of a proprietary new product or process?
2. Have you been in business for no more than seven consecutive years?
3. Are your principal administrative offices located in Wisconsin or does at least 80 percent of your payroll go to people employed in Wisconsin?
4. Do you have less than 100 full-time equivalent (FTE) employees?
5. Do at least 50 percent of your employees work in Wisconsin?
6. Since its inception, has your business received, in aggregate, no more than $5 million of private equity investment in cash?

(Wisconsin Department of Commerce - www.commerce.state.wi.us)

Kansas defines "angel investors" as:

> INVESTOR OR ANGEL INVESTOR
> An accredited individual investor of high net worth, as defined in 17 C.F.R. 230.501(a) as in effect on the effective date of this act, who seeks high returns through private investments in start-up companies and may seek active involvement in business, such as consulting and mentoring the entrepreneur. For the purposes of this act, a person who serves as an executive, officer, employee, vendor or independent contractor of the business in which an otherwise qualified cash investment is made is not an angel investor and such person shall not qualify for the issuance of tax credits for such investment. (Kansas Department of Revenue www.ksrevenue.org)

Representatives from the venture capital industry have indicated that anything to encourage investment in small areas is beneficial to New Mexico. In fact, angel investors are much more likely to invest in rural areas than are venture capitalists who have much stricter criteria for investments. Many venture capitalists will not consider an investment unless there is some level of investment locally, primarily an angel investor. Angel investors tend to know the business that they are investing in in much more detail than venture capitalists. Also, angel investors have historically invested similar amounts as venture capitalists but in ten times the number of businesses, making this mode of investment much broader than what is typically the domain of venture capitalists.

ADMINISTRATIVE IMPLICATIONS

Provisions of the proposal would probably require a new claim form to be developed and a new line on the PIT-ADJ form. The measure would also require changes to forms instructions and publications. Manual review would be necessary to track credit applications and carry forwards. The measure would also impose moderate costs for form design and form and publication changes, as well ass systems changes.

TECHNICAL ISSUES

It does not appear that the credit can be used to lower corporate income tax liability.

Section 1-F-3a indicates that the research should be intended to be useful in the development of a new or improved business component of the **taxpayer**. The taxpayer here is the investor receiving the credit; this definition should refer to the **qualified business**.

ALTERNATIVES

To address the issue noted above, there should be language indicating that the credit is only for investment in start-up companies or that the investment has to be a certain minimum size (such as $10,000).

Another alternative is to include a definition of qualified investor to conform with the Securities and Exchange Commission's definition of "accredited investor."

There could also be a cap on the total amount of the credit for all taxpayers to limit the liability of the state. In this case the credit would be available to the first to apply. Arizona has a cap of $20 million over five years on their credit. Wisconsin caps theirs at $3 million per year.

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