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

ORIGINAL DATE 2/04/07
SPONSOR Salazar **LAST UPDATED** 3/07/07 **HB** 430/aHBIC/aHTRC

SHORT TITLE Advanced Energy Product Tax Credit **SB**

ANALYST Francis

REVENUE (dollars in thousands)

Estimated Revenue			Recurring or Non-Rec	Fund Affected
FY07	**FY08**	**FY09**		
	(750.0)	(900.0)	Recurring	General Fund
	(112.5)	(135.0)	Recurring	Local Government

(Parenthesis ( ) Indicate Revenue Decreases)

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

Responses Received From
Taxation and Revenue Department (TRD)
Energy Minerals and Natural Resources Department (EMNRD)

SUMMARY

Synopsis of HTRC Amendment

The House Taxation and Revenue Committee amended House Bill 430 to clarify the definition of eligible equipment. The value is defined as the adjusted basis used for federal income tax purposes as of the time of acquisition or introduction into the state or the time of conversion to use.

Synopsis of HBIC Amendment

The House Business and Industry Committee amended House Bill 430 to change the date for qualified to expenditures to July 1, 2007. The original eligibility date was July 1, 2006.

Synopsis of Original Bill

House Bill 430 provides a credit against combined reporting taxes (gross receipts, compensating and withholding) for manufacturing advanced energy products. Advanced energy products are defined:

- Advanced energy vehicle
- Fuel cell system
- Renewable energy system or component of an advanced energy vehicle
- Fuel cell system or renewable energy system or components for integrated gasification combined cycle coal facilities
- Equipment related to sequestration of carbon from integrated gasification combined cycle plants

The credit is for qualified expenditures after July 1, 2006, and cannot exceed five percent of the taxpayer's qualified expenditures. To be eligible, the taxpayer must show that they have hired an additional full time employee from the previous year for each $500 thousand of qualified expenditures up to $30 million and an additional full time job for each $1 million of qualified expenditures above $30 million. The jobs are net new jobs not just new jobs. For a taxpayer that has $10 million in qualified expenditures, it would need to show that they have hired 20 full-time employees over last year ($10,000,000 ÷ $500,000 = 20) to qualify for the $500 thousand credit; if the taxpayer has $40 million in qualified expenditures, it would need to show at least 70 full-time employees (60 for the first $30 million and 10 for the balance) to receive a $2 million credit.

Table 1: Examples of Required Jobs

Qualified Expenditures	Number of Jobs Required	Calculation
$1,000,000	2	$1,000,000 / 500,000
$10,000,000	20	10,000,000 / 500,000
$40,000,000	70	(40,000,000 – 30,000,000) / 1,000,000 + 30,000,000 / 500,000

FISCAL IMPLICATIONS

Revisions shown here reflect most current TRD analysis.

TRD:

> Based on information provided by industry representatives, eligible investment is expected to be about $70 million in FY 2008 and about $190 million in FY 2009 with the annual amount falling thereafter. Thus, potential credit claims under the proposal would be $3.5 million in FY 2008 and $9.5 million in FY 2009. Because these credits are non-refundable, actual credit claims will be limited to the amount of tax liability less the amount of other tax credits. Amounts in excess of tax liability may be carried forward for up to five years. If the affected taxpayers qualify for industrial revenue bond financing, they will not owe GRT or compensating tax on the equipment they install. Thus, their liability will consist mainly of any GRT on their product sales and withholding tax on their payroll. If their products are exported, their GRT liability will be further limited. Thus, the main base for the tax credit claims will be withholding tax.

If the investments are $100 million, the impact is $5 million. This could be the case if a company as large as Advent Solar or the proposed concentrating solar power plant applied for the credit.

The credit will primarily impact the general fund, but the local government will experience a small impact. Claims against the gross receipts and compensating taxes will impact the general fund and local governments. Overall, general fund revenue will be reduced by about $750 thousand and local government revenue will be reduced by about $112.5 thousand based on the share of combined taxes (CRS taxes) that are gross receipts.

An investment of $10 million means 20 full time jobs.

SIGNIFICANT ISSUES

Manufacturing jobs typically pay more than average wages. According to the NM Department of Labor, two occupations likely to be employed by companies receiving the credit have starting wages well above minimum. Manufacturing wages were $14.24 per hour or almost $30 thousand in December 2006. Specialized or highly skilled manufacturing boasts even higher wages.

One beneficiary of the credit is likely to be Advent Solar, a photovoltaic solar cell manufacturer located within the Mesa del Sol tax increment for development district. The credit will take away from the development's projected gross receipts tax revenues.

ADMINISTRATIVE IMPLICATIONS

TRD:

The new Credit will impose a set of record-keeping requirements on the Department. These functions have to be performed manually because at the present time the Department does not have an automated system for processing tax credits. With the proliferation of new tax credits in recent years, each of which has different eligibility criteria and record-keeping requirements, the Department has had to allocate more staff time to manually processing credits. A more efficient method, that would yield more accurate financial results, would be for the Legislature to streamline the credit provisions in tax law – i.e. impose the same criteria for eligibility and applicability of the credits -- and appropriate funds to the Department to develop an automated system for processing credits.

TECHNICAL ISSUES

The definition of "advanced energy product" is confusing regarding renewable energy system. The definition seems to suggest that the renewable energy system is for an advanced energy vehicle or for integrated gasification combined cycle coal facilities and not a stand alone renewable energy system. The definition of renewable energy system suggests a stand alone power generator.

TRD:

The bill does not define the value of the qualified equipment. That can be a problem because you can have delivery costs, installation costs, and construction costs associated with self-constructed equipment, and value of used equipment brought into the state or used equipment that was previously granted the credit. An existing definition that could be adopted for this purpose is the definition of value in the Compensating Tax: "the adjusted basis of the property for federal income tax purposes determined as of the time of acquisition or introduction into this state or of conversion to use, whichever is later."

TRD also reports problems with the methodology in determining increased employment. HB430 establishes a fixed point in time as the baseline to determine new jobs. An employer could time its purchase based on a day when employment was lower than usual, due to any number of reasons, the year before on that day.

OTHER SUBSTANTIVE ISSUES

TRD:

Investment credits and the Gross Receipts Tax on Manufacturing Equipment:
Unlike most states, New Mexico does not provide an exemption from its broad-based sales and use tax – the Gross Receipts and Compensating Tax ("GRT and Comp. Tax") – for sales of equipment to manufacturers. Since these equipment costs can be a very large expense in the early period of operations, a number of manufacturers have argued that this policy makes New Mexico a less desirable location in which to invest. The proposal is an attempt to reduce this taxation by the mechanism of a tax credit for a particular industry. Although this approach is generally consistent with making New Mexico's tax treatment more consistent with that of other states, it does not provide the same treatment to all industries. In addition, since manufacturing operations are often able to secure Industrial Revenue Bond ("IRB") financing from local governments, their equipment purchases will already be exempted from the GRT or Comp. Tax through the IRB mechanism. In this case, the proposed credit becomes a way for the manufacturer to reduce the GRT, Comp. Tax or Withholding they owe on other transactions, not a credit against the GRT or Comp. Tax on their equipment purchases.

The proposal includes in the definition of "advanced energy products" components related to integrated gasification combined cycle coal facilities. The proposed credit is not available to a power plant that uses such equipment, however, because the credit is available only for equipment used to manufacture advanced energy products. If the credit were modified to include purchases of combined cycle equipment for producing electricity, the fiscal impacts would be much larger.

ALTERNATIVES

To address TRD concerns, the calculation of the value of qualifying expenditures could match the calculation in the gross receipts and compensating tax.

The method of calculating net new employment could be changed to use an average of the year or quarter prior to the eligible expenditure and the average employment of the year or quarter in which the expenditure happened.

To address possible financing problems within tax increment development districts, eligible expenditures within these districts could be excluded.

QUESTIONS

How will this incentive and any GRT-based incentive affect tax increment for development districts?

NF/csd