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

SPONSOR J Campos **ORIGINAL DATE** 2/19/07 **LAST UPDATED** 3/16/07 **HB** 839/aHTRC

SHORT TITLE Military Mission Transition Gross Receipts **SB**

REVISED **ANALYST** Schardin/Francis

REVENUE (dollars in thousands)

Estimated Revenue			Recurring or Non-Rec	Fund Affected
FY07	**FY08**	**FY09**		
($200)	($2,720)	($2,120)	Recurring	General Fund
	($978)	($1,112)	Recurring	Local Governments

(Parenthesis ( ) Indicate Revenue Decreases)

Relates to SB317, HB600, HB526, HB530, HB352, HB683, HB547, HB203, HB1038, HB654, SB 495, HB838, HB757, HB236, HB434

SOURCES OF INFORMATION
LFC Files

Responses Received From: Several agencies responded to the underlying bills that are related to the provisions amended here.

SUMMARY

Synopsis of HTRC Amendment

Angel Investment Credit: This provision creates a credit against personal income tax liability for qualified investments in New Mexico companies engaged in high technology research or manufacturing. The credit is only for qualified investors and is known as the angel investment credit. The maximum amount of the credit is $25,000 per investment with a maximum of 2 investments per year per taxpayer. The credits must be certified by the economic development department which can only certify an aggregate of $750,000 per year. Any portion of the credit that exceeds tax liability can be carried forward for three consecutive years.

The credit is allowed for tax year 2007 through tax year 2012 and is only good for investments through December 31, 2011. There is a provision that allows the carry forward past 2012 but no new credits.

Permanent High Wage Jobs Credit. This provision makes permanent the high-wage jobs tax credit, which was enacted in 2004 and is currently applies only to jobs created before July 1,

2009. The bill repeals the credit's January 1, 2010, repeal date but keeps the criteria of jobs created before July 1, 2009.

Rural Jobs Tax Credit: This provision reenacts the rural job tax credit, which through a technical error was repealed as of July 1, 2006.

This credit may be claimed by employers in rural areas of New Mexico that have qualified through EDD for participation in the in-plant training program. The maximum credit for each job created will be $4 thousand for each job created in a municipality with a population of 15 thousand or less or in any unincorporated area of a county, where the credit may be claimed for up to four years. In areas with a municipality with a population under 15 thousand but less than 30 thousand the maximum credit will equal $2 thousand and may be claimed for two years.

The credit may be claimed against the personal or corporate income tax, the state portion of gross receipts tax, compensating tax or withholding tax paid by qualifying companies. The credit is equal to $1,000 per qualified job and may be claimed for four years in municipalities and areas of counties with populations of 15 thousand or less and for two years in municipalities with a population of up to 30 thousand. The credit will be nonrefundable but may be carried forward for up to three years.

The bill will require the secretary of EDD to annually evaluate the effectiveness of the credit in stimulating economic development in rural areas of New Mexico and report these findings to the legislature.

The bill will allow credits that could have been claimed in the interim period in which the credit was inadvertently repealed to be claimed. For the modified combined tax liability, the credit is available for calendar quarters beginning July 1, 2006. For the personal and corporate income tax liability the effective date is January 1, 2006.

Film Production Credit Applicability: This provision amends the film production tax credit to make the additional 5 percent credit that is scheduled to expire in 2009 permanent and delineates between direct production expenditures and postproduction expenditures. Post production expenditures for which another taxpayer has claimed the credit are ineligible for the credit. HBIC also modified the definition of "film production company" to allow producers who only work on a part of a film rather than the whole film to be eligible and the definition of "postproduction expenditures" by removing the requirement that the expenditures have to be made following principal photography.

The provision also makes three technical changes:

1. clarifies that the credit only goes to taxpayers for productions that have not already received the credit.
2. clarifies that qualified personal services corporation expenditures are those that are subject to gross receipts tax.
3. clarifies that qualified expenditures does not include chartering airplanes for out of state transportation or non-commercial airfare booked by an NM travel agent.

Space Program Gross Receipts: The provision allows receipts from the provision of research, development, testing and evaluation services for the U.S. Air Force operationally responsive space program to be deducted from gross receipts. That program is authorized pursuant to 10

U.S.C. 2273a. The effective date of these provisions will be July 1, 2007.

Border Zone Trade Support Gross Receipts: The provision extends the sunset of an existing gross receipts tax deduction for the receipts of a trade-support company that locates within twenty miles of a port of entry on New Mexico's border with Mexico. For the purposes of this deduction, a trade-support company is defined as a customs brokerage firm or a freight forwarder. To be eligible for the deduction, receipts must be received within five years of the trade-support company's establishment in New Mexico and the company must employ at least two people in New Mexico.

Currently, the deduction applies to companies locating near a port of entry between July 1, 2003 and July 1, 2008, but the bill would allow companies locating near a New Mexico port of entry before July 1, 2013 to qualify for the deduction.

This provision sunsets after FY2014.

Aircraft Manufacturer Gross Receipts: This provision expands an existing deduction for receipts of an aircraft manufacturer from selling aircraft to include receipts from an aircraft manufacturer's affiliate from selling aircraft parts, components, flight support, pilot training, or maintenance training services.

An affiliate is defined as a business entity that is directly or indirectly controlled by an aircraft manufacturer. Flight support is defined as providing navigation data, charts, weather information, online maintenance records and other aircraft or flight-related information and the software needed to access such information. An aircraft manufacturer is defined as a business entity that designs and builds FAA certified private or commercial aircraft. Control of a business is defined to mean at least 50 percent of total voting power and at least 50 percent of equity in the business. The effective date of these provisions will be July 1, 2007.

Financial Management Fee Gross Receipts: House Bill 683 creates a gross receipts tax deduction from receipts from fees received for performing management or investment advisory services for a mutual fund, hedge fund, or real estate investment trust (REIT).

The bill defines a "hedge fund" as a private investment fund or pool, the assets of which are managed by a professional management firm that trades or invests, is not an investment company, and is comprised of investments by Securities and Exchange Commission accredited investors. "Mutual fund" is defined as an entity registered pursuant to the federal Investment Company Act of 1940. "Real Estate Investment Trust" is defined as an entity described in Section 856(a) of IRS code of 1986, with investments limited to interests in mortgages on real property and shares of or transferable certificates in an entity described in Section 856(a) of the same federal code. The effective date of these provisions will be July 1, 2007.

Boxing and Other Contest Gross Receipts: This provision creates a new gross receipts tax deduction for receipts from producing or staging a professional boxing, wrestling, or martial arts contest in New Mexico, including the receipts from ticket sales and broadcasting.

This provision will become effective on July 1, 2007.

Agricultural Equipment Gross Receipts. This provision expands an existing 50 percent gross receipts tax deduction for agricultural implements to include aboveground and belowground produce irrigation systems that are used at a place where crops are grown. The effective date of the bill is July 1, 2007.

Locomotive Fuel Gross Receipts: This provision creates a new exemption from the gross receipts and compensating taxes for the sale of fuel to a common carrier for use in a locomotive engine effective July 1, 2009 if EDD certifies to TRD before July 1, 2009 that construction of a railroad locomotive refueling facility has commenced in Dona Ana County.

Leased Vehicle Surcharge Exemptions: This provision exempts cars rented as replacements from the leased vehicle surcharge. The current law does not make a distinction between short term rentals that are for pleasure/vacation/business and those rented because of an accident or malfunction. This provision would require a person renting a vehicle to sign a statement that the rental is a replacement for a vehicle that is being repaired, serviced or replaced. The exemption would apply to a dealer or repair facility that leases a car on behalf of the client. This is similar to a proposal considered by the 2003 Blue Ribbon Tax Reform Commission (BRTRC). The effective date is July 1, 2007.

Livestock Medical Treatment Gross Receipts: This provision creates a gross receipts tax deduction for receipts from the sale of veterinary medical services, medicine or medical supplies used in the medical treatment of cattle used or raised on New Mexico farms and ranches. Claiming the deduction will require the person purchasing the veterinary services to state in writing that they regularly engage in ranching or farming in New Mexico.

The effective date of this provision is July 1, 2006.

National Lab Small Business Partnership Credits: The provision expands the existing laboratory partnership with small business tax credit. It increases the credit that a national laboratory can claim against its gross receipts tax liability for assistance to each small business in Bernalillo County from $5 to $10 thousand per year, and increases the credit that a national laboratory can claim for assistance to each small business outside of Bernalillo County from $10 to $20 thousand per year. The total amount of credits that can be claimed by a national laboratory is increased from $1.8 to $2.4 million per year.

National laboratories claiming this credit will be required to submit a joint annual report to the Taxation and Revenue Department (TRD), the Economic Development Department (EDD), and the appropriate legislative interim committee by October 15 of each year. The report will summarize program results, describe projects funded, provide results of surveys of small businesses that received assistance, quantify the total amount of credits claimed, and include an economic impact study of jobs created and retained.

If more than one national lab claims the credit, those labs will be required to coordinate their efforts.

The provision also expands eligibility requirements for claiming the laboratory partnership with small business tax credit. To be eligible for the credit, the national laboratory providing small business assistance will be required to 1) offer each small business receiving assistance the option of obtaining ownership of license to property developed through the assistance; 2) acknowledge that the small business assistance is rendered once it is completed; and 3) provide forms for small business assistance requests and for completion of small business assistance that are in accordance with state and federal laws. The effective date of these provisions is July 1, 2007.

ADDITIONAL PROVISIONS

Additionally, the amendment changes the original provisions by requiring the military installation to be in a class-B county with a population greater than 42,000 and a net taxable value of less than $1 billion. The deduction sunsets December 31, 2010.

Synopsis of Original Bill

House Bill 839 creates a new gross receipts tax deduction for receipts from military construction services provided at New Mexico military installations to implement special operations mission transition projects pursuant to contracts with the U.S. Department of Defense. The deduction will only apply to contracts in effect anytime between October 1, 2007 and September 30, 2010.

FISCAL IMPLICATIONS

Revenue Impacts of House Bill 839/aHTRC

Title	FY07	FY08	FY09	FY10		
Agricultural Equipment Gross Receipts		(340)	(340)	(340)	Recurring	General Fund
		(227)	(227)	(227)	Recurring	Local Governments
Aircraft Manufacturer Gross Receipts	-	(160)	(240)	(250)	Recurring	General Fund
		(107)	(160)	(167)	Recurring	Local Governments
Border Zone Trade Support Gross Receipts	*	*	*	*	Recurring	General Fund
					Recurring	Local Governments
Boxing and Other Contest Gross Receipts	-	(77)	(81)	(85)	Recurring	General Fund
		(51)	(54)	(57)	Recurring	Local Governments
Financial Management Fee Gross Receipts		(125)	(125)	(125)	Recurring	General Fund
		(83)	(83)	(83)	Recurring	Local Governments
Locomotive Fuel Gross Receipts		-	-	(3,300)	Recurring	General Fund
		-	-	(2,200)	Recurring	Local Governments
Leased Vehicle Surcharge Exemptions		(1,500)	(1,500)	(1,500)	Recurring	General Fund
Livestock Medical Treatment Gross Receipts	-	(475)	(500)	(525)	Recurring	General Fund
		(317)	(333)	(350)	Recurring	Local Governments
Angel Investment Credit		(750)	(750)	(750)	Recurring	General Fund
Rural Jobs Tax Credit	(200)	(200)	(200)	(200)	Recurring	General Fund
Space Program Gross Receipts	-	(20)	(20)	(100)	Recurring	General Fund
		(13)	(13)	(67)	Recurring	Local Governments
Film Production Tax Credit Applicability		2,400	3,200	(2,900)	Recurring	General Fund
National Lab Small Business Tax Credits	-	(1,200)	(1,200)	(1,200)	Recurring	General Fund
Sub Total - Amendments	(200)	(2,447)	(1,756)	(11,275)	Recurring	General Fund
	-	(798)	(870)	(3,150)	Recurring	Local Governments
Military Mission Transition Gross Receipts	-	(273)	(364)	(455)	Recurring	General Fund
		(182)	(243)	(303)	Recurring	Local Governments
Grand Total	**(200)**	**(2,720)**	**(2,120)**	**(11,730)**	**Recurring**	**General Fund**
	-	**(980)**	**(1,113)**	**(3,453)**	**Recurring**	**Local Government**

*** Insignificant Impact**

Agricultural Equipment Gross Receipts: According to TRD, the USDA Census of Agriculture's publication "2003 Farm and Ranch Irrigation Survey" indicates that New Mexico farms spent nearly $17 million on irrigation equipment and machinery in 2003. Making 50 percent of these receipts ($8.5 million) deductible would reduce gross receipts tax revenues by $561 thousand, assuming a statewide average tax rate of 6.6 percent. About 60 percent of that revenue decrease will accrue to the general fund and about 40 percent will accrue to local governments.

Permanent High Wage Jobs Credit. The bill will only have a fiscal impact in the last half of FY10 and beyond, when it will prevent the high-wage jobs tax credit from being repealed. Without a response from TRD, it is difficult to estimate the fiscal impact in FY10 and beyond. However, LFC analysis of data provided by TRD indicates high wage jobs tax credits claimed from September 2005 to December 2006 totaled $249.3 thousand. This indicates that credits of about $187.0 thousand are being claimed each year.

Aircraft Manufacturer Gross Receipts: Based on industry information and the Report 80, "Analysis of Gross Receipts by Standard Industrial Classification," TRD estimates taxable gross receipts for this new deduction will total about $4 million in FY08 and about $6 million thereafter. With a statewide average gross receipts tax of 6.6 percent, the provision will reduce gross receipts tax revenue by about $264 thousand in FY08. About 60 percent of this revenue loss will accrue to the general fund and the remaining 40 percent will accrue to local governments.

Border Zone Trade Support Gross Receipts: TRD expects the fiscal impacts of this provision, beginning in FY09, to be minimal. However, LFC notes that construction of a large Union Pacific facility near Santa Teresa may lead more companies to claim this deduction in future years.

Boxing and Other Contest Gross Receipts: TRD's fiscal impact estimate is based on information provided by the New Mexico Athletic Commission (NMAC) on the amount promoters receive from selling the rights to broadcast professional contests staged in New Mexico.

Financial Management Fee Gross Receipts: TRD's fiscal impact estimate of the amended bill is based on the Report 80, Analysis of Gross Receipts Tax by Industrial Classification. The state collects about $4.2 million in gross receipts tax from investment advisory service providers. Only about 5 percent of this amount is expected to be eligible for the new deduction because the other 95 percent is believed to be attributable to "retail" level services, not services provided to fund managers. About 60 percent of this revenue decrease will accrue to the general fund, while about 40 percent will accrue to local governments.

Locomotive Fuel Gross Receipts: Based on information from the U.S. Department of Transportation, TRD estimates that approximately 59 billion ton-miles of freight are carried on New Mexico's railroad lines each year. Based on an estimate of 710 ton-miles traveled per gallon of fuel, TRD estimates that about 82.6 million gallons of railroad fuel are consumed in New Mexico each year.

Of the 82.6 million gallons of railroad fuel consumed in New Mexico each year, it is estimated that about 40.6 million are purchased in California, where sales tax is paid, making those 40.6 million gallons eligible for an existing compensating tax credit. The remaining 42 million gallons will qualify for the exemptions created in the amended bill.

Assuming an average fuel price of $2 per gallon, the tax base eligible for the new exemptions will be $84 million (42 million gallons X $2). Since the compensating tax rate is 5 percent, tax collections will be reduced by $4.2 million. Eighty percent of this revenue reduction will accrue to the general fund ($3,360 thousand) and 20 percent will accrue to the small cities and small counties assistance funds ($840 thousand).

Summary of FY10 Impacts (dollars in thousands)

General Fund:	(3,360.0)
Small Cities Assistance Fund:	(420.0)
Small Counties Assistance Fund:	(420.0)

If construction of a railroad locomotive refueling facility commences before July 1, 2009, the exemptions created in this bill will apply to fuel sold on or after July 1, 2009, so the fiscal impacts calculated above will apply only to FY10 and beyond.

Leased Vehicle Surcharge Exemptions: The Blue Ribbon Tax Reform Commission report estimated that the exempting replacement rentals paid for by insurance companies would cost the general fund $900 thousand. The more expansive definition here increases the impact on the general fund to $1.5 million.

Livestock Medical Treatment Gross Receipts: Based on LFC analysis of TRD's "Report 80: Analysis of Gross Receipts by Industry," veterinary services receipts are expected to be about $29.4 million per year. Since that total includes veterinary services for livestock as well as domestic pets, it is assumed that only half of these receipts ($14.7 million) are provided for livestock. The 2002 Census of Agriculture indicates that there were 1.6 million head of cattle in New Mexico in 2002 and less than 300 thousand head of other livestock. Assuming that treatment of cattle represents 80 percent of all livestock veterinary services, the deduction's tax base will be about $11,760. Taxed at the statewide average tax rate of 6.6 percent, the new deduction will decrease revenue collections by about $776.2 thousand. About 60 percent of this reduction will impact the general fund, and the remaining 40 percent will impact local governments.

Angel Investment Credit: The provision only allows the angel investment credit to accredited investors as defined by the Securities and Exchange Commission (SEC). 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)

According to 2005 tax return data, there are approximately 22,000 taxpayers in NM with adjusted gross income greater than $200,000 but according to the US Census, there are only 18 individuals in NM with a net worth greater than $1 million in 2001. With the strong growth in the last five years, that number is estimated to be 25 individuals in 2007. Given this number of eligible investors, the $750 thousand cap on the credit is highly likely to be reached each year. The fiscal impact recurs until FY2014 due to the delayed repeal provision and the three year carry forward.

Table 1: Delayed repeal of angel investor credit

Timeline	2007	2008	2009	2010	2011	2012	2013	2014	2015
Investments									
Credit									
Carry forward									

Rural Jobs Tax Credit: According to TRD, averages of $200 thousand worth of credits were being claimed per year. The bill will therefore reduce revenues by about $200 thousand per year. While a small amount may be claimed against the compensating tax, to date TRD has applied all credits against the state's general fund distributions. Because the bill reinstates credits that could have been claimed while the credit was repealed, it will also affect FY07 revenue.

Space Program Gross Receipts: According to EDD the operationally responsive space program currently consists of three part-time contractors who earn about $500 thousand per year in salaries and benefits. Assuming the program does not expand, taxed at the statewide rate of 6.6 percent, the bill would reduce gross receipts tax collections by about $33 thousand. About 60 percent of this revenue loss will accrue to the general fund and the other 40 percent will accrue to the local government in which the operationally responsive space program is located.

The amount and timing of this fiscal impact depends on if and when the operationally responsive space program locates in New Mexico. EDD believes that FY09 is the earliest time operations could begin. EDD reports that the fiscal impacts of this deduction will grow larger over time but cannot predict how much.

Film Production Credit Applicability:

Film Production Tax Credit: Senate Bill 839 as Amended Impacts

(thousands of dollars)

	2007	**2008**	**2009**	**2010**	**2011**	**2012**
Assumptions:						
Total Qualified expenditures by tax year	133,000	146,300	160,900	177,000	195,000	215,000
Share due to performing artists > $20 million	12,000	13,200	14,500	16,000	17,600	19,400
Present law:						
Credit rate	25.0%	25.0%	20.0%	20.0%	20.0%	20.0%
Film Production credit approved by tax year	**(33,250)**	**(36,575)**	**(32,180)**	**(35,400)**	**(39,000)**	**(43,000)**
Credit s claimed by year from approval	**0%**	**80%**	**20%**			
Film Production credit claimed by fiscal year	**(15,000)**	**(26,600)**	**(35,910)**	**(33,059)**	**(34,756)**	**(38,280)**
HB 757:						
Credit Base	121,000	133,100	146,400	161,000	177,400	195,600
Credit rate	25.0%	25.0%	25.0%	25.0%	25.0%	25.0%
Credit	(30,300)	(33,300)	(36,600)	(40,300)	(44,400)	(48,900)
Film Production credit approved by tax year	**(30,300)**	**(33,300)**	**(36,600)**	**(40,300)**	**(44,400)**	**(48,900)**
Credit s claimed by year from approval	**0%**	**80%**	**20%**			
Film Production credit claimed by fiscal year	**(15,000)**	**(24,240)**	**(32,700)**	**(35,940)**	**(39,560)**	**(43,580)**
Impacts of HB839a (Rounded)	**-**	**2,400**	**3,200**	**(2,900)**	**(4,800)**	**(5,300)**

Source: TRD

In 2006, there were 21 films with $96.8 million in qualified expenditures or $4.6 million per project. The cap on the services of performing artists (e.g. actors) will reduce the amount of the credit for large productions. The Taxation and Revenue Department (TRD) estimates this impact is a reduction in the credit amount of $3.3 million in FY08 and $3.6 million in FY09. This is based on information provided by the NM Film Office. They report that this is the reduction of credit for a major film, similar to one last year, and they expect at least one of these films per year. In FY10 and beyond, the fiscal impact will include the 5 percent credit that had been scheduled to expire on January 1, 2009. That impact is estimated to be a reduction in revenues of $8 million in FY09 and growing roughly $1 million per year if current trends continue.

It is important to note that the amount of film expenditures has grown dramatically. Last year, House Bill 358 was passed adding an additional 10 percent credit for film expenditures. That bill was scored as having a $1.5 million impact, based on information provided by NM Film Office. It is now estimated that the impact was closer to $10 million for that bill. The film credit under current law will reduce general fund revenues $23 million in FY08 growing to $34 million by FY10.

National Lab Small Business Partnership Credits: Under current law, Sandia National Laboratories (SNL) and Los Alamos National Laboratory (LANL) are each eligible to claim $1.8 million per calendar year in credits (LANL became eligible for the credit in 2006 when its new contract made it liable for the gross receipts tax). By increasing the total amount of credits that each national laboratory can claim to $2.4 million per calendar year, the bill will reduce state gross receipts tax collections from each lab by $600 thousand per year, for a total of $1.2 million per year. The fiscal impact assumes that SNL will be able to reach the higher cap of $2.4 million in calendar year 2007, while LANL will not reach the cap until calendar year 2008.

Since this gross receipts tax credit can only be claimed against the state portion of gross receipts tax liability it has no impact on local governments.

Military Mission Transition Gross Receipts: EDD estimates that construction projects at Cannon AFB eligible for the proposed deduction will cost $9.2 million in FFY08, $9.2 million in FFY09, and $15 million in FFY10. Taxed at a statewide rate of 6.6 percent, the deduction would reduce gross receipts tax revenue by $607.2 thousand in FFY08, $607.2 thousand in FFY09, and $990.0 thousand in FFY10. Translating those impacts into state fiscal years yields a revenue reduction of $455.4 thousand in FY08, $607.2 thousand in FY09, $758.1 thousand in FY10, and $247.5 thousand in FY11. About 60 percent of the revenue reduction will accrue to the general fund and the remaining 40 percent will accrue to local governments.

This fiscal impact only incorporates deductions that may be claimed for receipts of activities occurring between October 1, 2007 and September 30, 2010. However, the bill is unclear whether the receipts must be attributable to activities in that period, or only to contracts that are effective at some point in that period. The latter interpretation would increase the fiscal impact of the bill (see Technical Issues).

This estimate is uncertain because funding for these projects depends on the federal budget process; delay of these projects would lessen the bill's fiscal impact or shift the impact into the farther future.

SIGNIFICANT ISSUES

Agricultural Equipment Gross Receipts: According to NMDA, the provisions of this bill may provide an incentive for New Mexico farmers to utilize irrigation systems. These irrigation systems will save water and increase crop yields.

Aircraft Manufacturer Gross Receipts: According to EDD and Eclipse Aviation, this provision will help aviation manufacturing companies located in New Mexico competitively provide manufacturing services. New Mexico aircraft service providers compete with providers in other states that may not be subject to gross receipts or sales tax and that may have more convenient locations.

The language contained in this provision will benefit Eclipse Aviation's JetComplete program, which provides pilot and maintenance training, data services, flight support services, and aircraft repair and maintenance services on a fixed payment basis. Eclipse asserts that the deduction creates a favorable business climate for aircraft owners to have services performed in New Mexico instead of other out-of-state locations.

Eclipse currently plans to develop a national customer and product support headquarters in Albuquerque. This facility is expected to employ 77 workers at an average annual salary of $42.8 thousand and a median annual salary of $32 thousand.

Permanent High Wage Jobs Credit. The high-wage jobs tax credit may currently be claimed by an eligible employer who creates a new economic-based job that is filled for at least 48 weeks of the prior year. The credit may be claimed against the state gross receipts tax, the compensating tax, withholding taxes, and several smaller surcharges. To be eligible for the credit, more than half of an employer's sales in the previous year must have been made to persons outside of New Mexico.

The amount of the credit is equal to 10 percent of wages, not to exceed $12 thousand per year, for each job that pays over $40 thousand per year in a municipality with population over 40 thousand or for each job that pays over $28 thousand per year in a smaller municipality or in an unincorporated area of a county. The credit is refundable and may be claimed for up to four years for each job created.

Border Zone Trade Support Gross Receipts: New Mexico's ports of entry that may benefit from this bill are located in Santa Teresa and Columbus.

EDD reports that as trade between Mexico and New Mexico grows so will the demand for trade support services. Customs brokers assist firms that trade internationally with necessary documentation. Currently, custom broker services are usually performed in El Paso instead of Santa Teresa. The additional time of stopping in El Paso before Santa Teresa may be a deterrent to trade in New Mexico.

EDD also reports that the deduction extended in this bill is currently being requested for the first time since it was enacted by a company moving to Santa Teresa. Another company, Juarez Customs Brokers' Association, is reportedly considering constructing a facility in Santa Teresa.

Boxing and Other Contest Gross Receipts: This bill aims to bring additional boxing, wrestling and martial arts events to New Mexico. Currently, NMAC competes with neighboring states and tribal entities to host such sporting events in New Mexico. The receipts of tribal entities are not subject to taxation, so NMAC feels this bill will level the playing field.

Currently, about half of these professional sporting events that occur in New Mexico are regulated by the NMAC and about half occur at tribal facilities. NMAC reports that the share of these events occurring at tribal facilities has grown in recent years.

Financial Management Fee Gross Receipts: According to SIC, EDD, and RLD, the bill may help attract hedge and mutual fund managers to New Mexico because most other states do not tax this type of activity. These types of investment firms provide high-wage jobs and improve the investment and financial planning sector environment.

However, any hedge and mutual fund management firms currently located in New Mexico will also receive the tax deduction. LFC is aware of one company already located in New Mexico, Thornburg Investment Management, which will benefit from the proposed deduction.

According to EDD, because most shares in New Mexico-based funds are owned by non-New Mexicans, the types of management services addressed in this bill have generally been regarded as provided outside of New Mexico, and therefore are not subject to gross receipts tax. EDD states that this bill is largely a symbolic act that signals New Mexico's desire to attract financial services companies. The LFC cautions against altering the tax code for symbolic reasons because doing so unnecessarily complicates tax statutes and makes tax administration more difficult.

Locomotive Fuel Gross Receipts: In October 2006, Union Pacific railroad announced plans to build a new terminal facility four miles west of Santa Teresa, New Mexico, which is near El Paso, Texas. However, Union Pacific's agreement to build the facility in New Mexico is contingent on removal of New Mexico's gross receipts and compensating tax liabilities for locomotive fuel by 2009.

The Santa Teresa facility will employ 260 Union Pacific employees who currently work in El Paso as well as 285 new employees. The 285 new jobs will be mainly engineers and mechanical workers. The Santa Teresa facility will be constructed on about 1 thousand acres of Bureau of Land Management (BLM) and State of New Mexico land. Union Pacific is said to be waiting to purchase that land until the tax deductions contained in this bill are enacted.

By 2015, Union Pacific plans to construct an intermodal ramp at the Santa Teresa facility that is expected to process about 100 thousand container units each year. This type of facility is used to transfer shipping containers from one train to another or from train to truck.

In 2005, federal Safe, Accountable, Flexible, and Efficient Transportation Equity Act provided $14 million to relocate Union Pacific's facility from El Paso to Santa Teresa. About $5 million of that federal funding will be used to construct a road connecting Pete Domenici Highway in Santa Teresa to the new Union Pacific facility.

Currently, Union Pacific is also negotiating with the Arizona Land Department for a parcel of land halfway between Tucson and Phoenix. The company plans to build a new switching station there. According to the Arizona Joint Legislative Budget Committee, Union Pacific has not sought any tax relief from the State of Arizona as a precursor to doing business in that state.

Leased Vehicle Surcharge Exemptions: The administration of collecting and validating statements from individuals may be onerous if the burden lies with the rental agency. The Department of Transportation describes the pitfalls of this type of program:

Experience with other similar provisions of law relating to a purchasers' statement regarding the intended tax-exempt use of a product has proven to be subject to substantial abuse. There would be little or no possibility of compliance or audit review, and leasing companies might well suggest to the customer how they might save a few dollars by signing a statement.

DOT provided this summary of BRTRC:

- *Summary of Blue Ribbon Commission Testimony (2003):*

The industry suggested that the Leased Vehicle Surcharge may impose an undue burden on state residents. The Leased Vehicle Surcharge was initially imposed with the thought of exporting the tax burden to tourists, who were assumed to be the predominate users of rental cars. In the case of "replacement car rentals" (rentals to replace a vehicle while it is being repaired), state residents are generally the users of those rental cars**. Insurance companies cover the cost of replacement rentals at an agreed upon daily price, but the renter of the vehicle is generally required to pay the Leased Vehicle Surcharge.** Since replacement rentals may often be required for an extended period of time, the surcharge may impose an annoying tax burden on residents who expected their insurance would cover the costs. Industry representatives report that 7 states currently exempt "replacement car rentals" from similar taxes or surcharges – Maryland, Oklahoma, Indiana, Louisiana, Rhode Island, Utah, and Wisconsin

Angel Investment Credit: The definition of a qualified business is one that has fewer than 100 employees, has not issued stocks publicly, and has less than $5 million in gross revenues. The company must also be engaged in high technology research or manufacturing other than construction, farming, natural resource processing or meal preparation. The investor also cannot be affiliated with the company either through immediate family connection or business transactions within one year of the investment.

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 that 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 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.

It should be noted that the personal income tax rate cuts since 2003 have benefited these high income investors more than other New Mexicans. If you had $200,000 in adjusted gross income, your New Mexico taxes decreased $4,000 from 2003 to 2007. This is in addition to cuts at the federal level. This credit would allow high net worth taxpayers even more tax relief for investments they may already be inclined to make without additional incentive. Investments are also tax preferred income over other types of income. The federal government taxes capital gains, for example, at 15 percent rather than the top rate of 35 percent.

Investment in start-up or struggling companies is a risky investment which is why the tax credit is only meant to encourage those who have a higher risk tolerance than smaller investors. The returns, if there are any, are usually much greater than lower risk investments. Investors with high net worth tend to look for these investments without any tax incentives and it is unclear if a tax incentive even of this size will induce investments that would not otherwise be made. In other words, if it is a good investment, the investors will come but if it is a bad investment, no tax incentive will help.

TRD:

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.[1]

State Investment Council:

While the bill offers obvious tax benefits to New Mexico angel investors, the legislation primarily benefits the state's early and seed stage high tech companies. This sizeable and growing entrepreneurial community currently has somewhat limited funding options when developing new ideas or technology into a marketable product or company. Start-up companies, which by definition lack a track record for their technology or service, rarely have the ability to attract private equity funds or similar investors like the State Investment Council. On the other end of the spectrum, start ups also often have difficulty securing significant lines of credit or funding from standard banking entities, as their product/technology/company is still in development or prototype stage, where profit does not yet exist.

The SIC believes this legislation would help fill an existing lending/funding "gap" in New Mexico by giving investors additional incentive to invest in young companies and early stage technology. While these types of investments are high risk, they are also high reward, and can have lasting and significant impact in creating jobs and growing NM's economy.

Rural Jobs Tax Credit: In 2005, the legislature passed and the Governor signed a bill that intended to remove the sunset of the rural job tax credit (House Bill 410). However, a technical error in that bill allowed the credit to sunset anyway.

According to EDD, 84 thousand jobs have been created in New Mexico since January 2003. EDD has assisted in creation of over 7 thousand of these jobs in rural areas. EDD reports that the rural job tax credit has been a successful tool in helping attract companies to rural New Mexico.

This bill will cause medical service providers claiming the deduction created in Section 7-9-93 to be subject only to the regular gross receipts tax reporting penalty that applies to all taxpayers.

Space Program Gross Receipts: The operationally responsive space program, which is part of the U.S. Department of Defense, will provide space launch and space reconnaissance capability within days to meet national security requirements. The program will consist of on-call space launch capability and satellites that can be configured quickly.

According to EDD, Kirtland Air Force Base is currently being considered as a location for the operationally responsive space program. EDD contends that if Kirtland AFB is chosen as the location of this program, state gross receipts tax revenues could rise by several million dollars.

Film Production Credit Applicability: The clarification regarding air charters and commercial air travel closes a loophole in the credit that currently allows an in-state travel agent to arrange

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[1] http://www.gmtoday.com/news/local_stories/2004/December_04/12152004_06.asp

travel for film productions using charter planes. This was the subject of some controversy in the fall of 2006 when a film production claimed $25,000 for the charter of a plane for one of the lead actors.

NM Film Office:

> With significant infrastructure investments being made by private companies, and more investments being contemplated in the next several years, removing the end date of December 31, 2007 for the additional five percent (enacted last session, bringing the tax credit to 25%) will encourage these investments to come to fruition. Other states have lost film infrastructure opportunities due to sunset clauses, and a general lack of confidence in the longevity of a state's incentive program.

National Lab Small Business Partnership Credits: EDD reports that this credit has enabled SNL to help New Mexico businesses create 449 jobs with an average salary of $37 thousand per year over the last five years. According to TRD, this credit benefited 278 small businesses in 2004.

By doubling the cap on assistance a national laboratory may provide to each small business from $5 to $10 thousand in Bernalillo County and from $10 to $20 thousand in the rest of the state, the provision is likely to result in a smaller number of businesses receiving assistance, but those that do receive assistance will receive a larger amount.

Military Mission Transition Gross Receipts: According to EDD, the gross receipts tax deduction created in the bill is targeted for construction projects at Cannon Air Force, which is located near Clovis, New Mexico. As a result of the Base Realignment and Closure (BRAC) recommendations, Cannon and the U.S. Department of Defense were directed to find a new mission for Cannon to prevent its closure. On June 20, 2006, it was announced that the base would transition to a special operations mission effective October 1, 2007. Cannon AFB's new special operations mission will require construction projects in FFY08 to FFY10, the dates between which a contract must be in place to be eligible for the deduction proposed in this bill.

LFC notes that while individual deductions from the gross receipts tax may have small fiscal impacts, their cumulative effect significantly narrows the gross receipts tax base. Narrowing the gross receipts tax base increases revenue volatility and requires a higher tax rate to generate the same amount of revenue.

ADMINISTRATIVE IMPLICATIONS

Locomotive Fuel Gross Receipts: By converting the proposed tax provisions from deductions to exemptions, the House Taxation and Revenue Committee amendment will no longer require taxpayers claiming those tax incentives to report the gross receipts and then show the amount deducted. This reduces the amount of information available to TRD, auditors, and policymakers. It is more difficult for auditors to determine whether exemptions are being claimed correctly.

Leased Vehicle Surcharge Exemptions: Taxation and Revenue Department would be required to verify and validate the returns but there is no provision in the bill for the rental car company to retain and share the statements with TRD. It may also prove to be to cumbersome to audit as well as costly compared to the amount of the credit.

Angel Investment Credit: Provisions of the proposal would probably require a new claim form to be developed and a new line on the PIT-ADJ form. The proposal would also require changes to other forms, instructions and publications. Manual review would be necessary to track credit applications and carry forwards. Moreover, it would be difficult for the Department to determine whether claims for the credits are consistent with the various conditions pertaining to the types of businesses which would qualify for the investments and that the investors qualify within the meaning of Rule 501 of the Federal Securities Act.

Military Mission Transition Gross Receipts: TRD will be able to administer this proposal with existing resources, although the deduction would be easier to administer if it became effective on July 1, 2007, since that is when revisions to taxpayer instructions are normally sent.

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

Agricultural Equipment Gross Receipts: House Bill 256 conflicts with House Bill 530, Senate Bill 477, and Senate Bill 317 (the Senate's omnibus tax bill). Those bills amend the same section to expand the existing deduction for receipts of aircraft manufacturers to include from an aircraft manufacturer's affiliate from selling aircraft parts, components, flight support, pilot training, or maintenance training services.

Aircraft Manufacturer Gross Receipts: This provision relates to Senate Bill 477 and House Bill 530. It conflicts with House Bill 256, which amends the same section to create a gross receipts tax deduction for belowground irrigation systems.

Border Zone Trade Support Gross Receipts: provision relates to Senate Bill 701 and House Bill 785.

Angel Investment Credit: Senate Bill 864 is a duplicate bill.

Rural Jobs Tax Credit: House Bill 654 duplicates Senate Bill 495.

Space Program Gross Receipts: This provision relates to Senate Bill 809 and House Bill 838.

Film Production Credit Applicability: SB 802 as amended is identical to HB 757 as amended.

National Lab Small Business Partnership Credits: This provision relates to Senate Bill 1 and House Bill 236.

Military Mission Transition Gross Receipts: House Bill 839 duplicates Senate Bill 785.

House Bill 839 relates to House Bill 838 and Senate Bill 809. To provide an incentive for the U.S. Air Force's operationally responsive space program to locate a Kirtland Air Force Base, bills create a gross receipts tax deduction for the provision of research, development, testing and evaluation services for the U.S. Air Force operationally responsive space program.

TECHNICAL ISSUES

Agricultural Equipment Gross Receipts: TRD notes that the definition of agricultural implement is vague and could mean almost any tool, utensil or irrigation instrument. The definition could also be interpreted to include construction materials.

Boxing and Other Contest Gross Receipts: House Bill 352 duplicates Senate Bill 330.

Financial Management Fee Gross Receipts: House Bill 683 duplicates Senate Bill 801.

Livestock Medical Treatment Gross Receipts: TRD suggests amending the bill to become effective on July 1, 2007 to make administration easier.

TRD suggests adding language similar to that found in Section 7-9-43 NMSA 1978 to indicate a time limit on providing a written statement that a person is engaged in ranching or farming.

Rural Jobs Tax Credit: TRD notes that the bill contains language to prevent "double dipping" with regard to the gross receipts tax and other sales taxes (Section 1(J)(4)), but does not contain similar language for individual or corporate income taxes. To prevent taxpayers from claiming more than one credit for the same job created, add a new subsection that prohibits claiming an income tax credit under these provisions for a job that is also claimed for other credits.

TRD also notes that Section 1(F) states that a taxpayer may apply tax credits against personal income tax liability. The term "personal" in this context is not a legally accurate way to refer to a liability under the Income Tax Act. The reference should be changed to "individual" income tax.

Film Production Credit Applicability:
TRD:

> **Allowing credit only once for each activity:**
> As amended, the bill clarifies that the credit can be claimed only once for a given amount of direct production expenditures or postproduction expenditures. This is helpful because present law is not clear on this issue. The remaining problem is how should credits be allocated between two otherwise eligible taxpayers for expenditures related to the same services? For example, one film production company could provide services to another film production company in such a way that both companies would otherwise be eligible for the credit for their expenditures. As amended, the statute does not specify which company has the priority in claiming the credits. This could lead to disputes and litigation. One possible solution would be to stipulate that the company selling the services is the one entitled to the credit. The Department may be able to address this issue through regulations.

National Lab Small Business Partnership Credits: TRD notes that to qualify for the program, small businesses must certify that assistance is not available at a reasonable cost through private sources. There is currently no mechanism in place to verify these assertions.

SS/NF/nt:csd