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

SPONSOR Trujillo | **ORIGINAL DATE** 02/11/11 | **LAST UPDATED** 02/23/11 | **HB** 273/aHTRC

SHORT TITLE Small Business Tax Credit Eligibility Period | **SB**

ANALYST Golebiewski

REVENUE (dollars in thousands)

Estimated Revenue			Recurring or Non-Rec	Fund Affected
FY11	FY12	FY13		
$0.0	($44.0)	($50.0)	Recurring	Local Governments
$0.0	($106.0)	($120.0)	Recurring	General Fund
$0.0	($150.0)	($170.0)	Recurring	Total

(Parenthesis ( ) Indicate Revenue Decreases)

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY11	FY12	FY13	3 Year Total Cost	Recurring or Non-Rec	Fund Affected
Total	$1.0	$25.0	$25.0	$51.0	Recurring	Taxation and Revenue Department

(Parenthesis ( ) Indicate Expenditure Decreases)

SOURCES OF INFORMATION
LFC Files

Responses Received From
Taxation and Revenue Department (TRD)
Economic Development Department (EDD)

SUMMARY

Synopsis of HTRC Amendment

The HTRC Amendment to HB 273 limits the research and development small business tax credit "to the sum of all gross receipts taxes or 50 percent of withholding taxes paid on behalf of employees and owners with no more than 5 percent ownership that are due to the state or payable by the taxpayer with respect to that business for the reporting period." This amendment addresses the concern that including 100 percent of the withholding tax liability creates incentives for business owners to over-withhold on their employees' salaries and to take their own income in the form of salary. With the 50 percent limit and the requirement that they have no more than 5 percent ownership, this incentive is expected to be much weaker.

Synopsis of Original Bill

House Bill 273 would extend the eligibility period for the research and development small business tax credit which expired June 30, 2009 under current statute. The credit would not be available for the period between July 1, 2009 and June 30, 2011, but would be offered beginning FY12 and extending through FY15. The credit proposed in House Bill 273 would be applicable to gross receipts tax (GRT) and withholding tax liability, but not to compensating tax liability.

TRD:

> The research and development small business tax credit was allowed for small businesses that make at least 20 percent of their expenditures on research and development. In calculating qualified expenditures to meet the 20 percent threshold, businesses are not to count research funded by outside grants, or industrial revenue bond-financed property, or property for which the taxpayer has received a capital equipment tax credit, an investment credit or a technology jobs tax credit.
>
> The amount of the credit is equal to the taxpayer's total gross receipt and withholding tax liability. The credit can be claimed for up to 3 years. If a taxpayer claims the credit in any period, they are ineligible to claim credits in that same period under the capital equipment tax credit, the investment credit or the technology jobs tax credit acts. Eligible businesses are those with 25 or fewer employees and with no more than $5 million of total revenues.

FISCAL IMPLICATIONS

TRD:

> This revenue estimate assumes that half of the credit is taken against withholding liabilities and half against gross receipts tax liabilities. It is based on experience with this credit before it expired.

The imposition of limits by the HTRC amendment is expected to reduce the fiscal impact estimates by 1/3 of what is estimated using the state's previous experience. This is reflected in the estimates above.

SIGNIFICANT ISSUES

TRD:

> The proposal creates a tradeoff between the goal of targeted economic development incentives and preserving the simplicity and fairness of the tax system. Although it appears that not a large number of taxpayers are eligible for the credit, the targeting of relief to special classes of taxpayers adds complexity and reduces equality in New Mexico's tax system.

ADMINISTRATIVE IMPLICATIONS

TRD:

It has proven difficult for the Department to audit and ensure compliance with this credit. The credit is reviewed at the time the CRS return and application is filed so that there is little time to review whether the taxpayer qualifies, and process the return and payment for distribution.

Administrative costs would include the following. Reinstate the old form, revising instructions and publications at a cost of $800. Revise the CRS tax program instructions and documentation as a part of the cyclical revision process at no additional cost. There will be a low IT impact of 40 hours at a cost of around $3,600 to remove compensating tax from calculation. The largest administrative cost comes from the additional quarter of an FTE required to approve, monitor and track the credit at a cost of $25,000.

TECHNICAL ISSUES

TRD:

- The change deleting the compensating tax on credits claimed or eligible for the period up to June 30, 2009, should be clarified to avoid any implication of retroactive removal.
- This proposal meets some but not all guidelines required by the economic development tax incentive guidelines in Section 9-15-56. It does have a statement of purpose, a requirement for the economic development

This proposal follows some of the guidelines for economic development tax incentives in Section 9-15-56 1978 NMSA. However, the research and development small business tax credit reinstated by this bill does not contain the following:

- a statement of purpose;
- the designation of a responsible agency to establish measurable policy goals, track state expenditures, quantify the state's return on investment and report regularly to the interim revenue stabilization and tax policy committee and the legislative finance committee;
- a requirement that the economic development department track job creation;
- reporting requirements for the taxpayer;
- a description of the financial obligation of the taxpayer if the specific standards are not met; and
- a mandatory review of the incentive no more than every seven years.

OTHER SUBSTANTIVE ISSUES

TRD:

If a taxpayer claims this credit they may not claim the capital equipment tax credit, the investment credit, or the technology jobs tax credit; however, they are still eligible to claim all other credits.

JAG/mew

The Legislative Finance Committee has adopted the following principles to guide responsible and effective tax policy decisions:

1. ***Adequacy:*** *revenue should be adequate to fund government services.*
2. ***Efficiency:*** *tax base should be as broad as possible to minimize rates and the structure should minimize economic distortion and avoid excessive reliance on any single tax.*
3. ***Equity****: taxes should be fairly applied across similarly situated taxpayers and across taxpayers with different income levels.*
4. ***Simplicity***: *taxes should be as simple as possible to encourage compliance and minimize administrative and audit costs.*
5. ***Accountability/Transparency:*** *Deductions, credits and exemptions should be easy to monitor and evaluate and be subject to periodic review.*

More information about the LFC tax policy principles will soon be available on the LFC website at www.nmlegis.gov/lcs/lfc