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FISCAL IMPACT REPORT

ORIGINAL DATE 03/03/11
LAST UPDATED 03/03/11 **HB** _____

SPONSOR Morales

SHORT TITLE Chile Industry Modernization Tax Credit **SB** 575

ANALYST Burrows

REVENUE (dollars in thousands)

Estimated Revenue			Recurring or Non-Rec	Fund Affected
FY11	FY12	FY13		
	(\$600.0 - \$2,000.0)	(\$600.0 - \$2,000.0)	Recurring	General Fund

(Parenthesis () Indicate Revenue Decreases)

SOURCES OF INFORMATION

LFC Files

Responses Received From

The New Mexico Dept of Agriculture (NMDA)
 The Economic Development Department (EDD)
 Taxation and Revenue Department (TRD)

Other Responses

Other responses received (see page 3)

SUMMARY

Synopsis of Bill

Senate Bill 575 proposes to offer a credit against the modified combined tax liability of up to \$100 thousand per year of the gross receipts or compensating tax paid on equipment purchased by a chile producer or processor. The credit would be referred to as the “chile investment credit.”

The bill defines “chile processor” as a person who processes chile in a processing facility in which either 33 percent of total hours, 33 percent of gross receipts, or 33 percent of square feet was devoted to chile processing, and who derived at least 33 percent of gross receipts from products derived from producing or processing chile in the previous 12-month period prior to the month in which the credit was claimed.

The bill defines “chile producer” as a person who derived at least 33 percent of the gross receipts from chile production in the previous 12-month period prior to the month in which the credit was claimed, and who produces chile on at least 15 percent of agricultural land controlled or owned by the person.

The bill defines “modified combined tax liability” as the total liability of withholding, gross receipts and compensating taxes, excluding any local option gross receipts tax liability.

The proposal limits the amount of credit per tax year to 85 percent of the taxpayer’s modified combined tax liability per reporting period. The balance of the credit remaining that exceeds the 85 percent of tax liability can be claimed in subsequent reporting periods.

The bill also requires the Department of Taxation and Revenue to provide a report to the revenue stabilization and tax policy committee (RSTP) prior to October 30 each year. RSTP would review the effectiveness of the tax credit every four years beginning in 2014.

The effective date of the provisions of this bill is July 1, 2011.

FISCAL IMPLICATIONS

Annual revenue of the chile producing and processing industry in New Mexico is expected to be approximately \$300 million in FY12 according to data from the New Mexico State University (NMSU) and the U.S. Department of Agriculture. The revenue impact assumes processors and producers spend approximately \$10 million to \$30 million per year on qualifying equipment purchases, or approximately 4-10 percent of annual revenue. All chile producers and processors are expected to have withholding tax liability against which the credit can be applied. To the extent that producers or processors also apply credits against their gross receipts tax or compensating tax liabilities, counties and municipalities would experience a decrease in revenues.

Attachment 1 lists New Mexico production as of 2009, and Attachment 2 lists the average costs and returns for producing chile in New Mexico per county per acre.

SIGNIFICANT ISSUES

NMSU reports that New Mexico is the leading state in chile acreage. Red chile and paprika represent over 40 percent of the state’s total production. Approximately 12,800 acres of chile were planted in 2009.

The New Mexico Department of Agriculture notes in their New Mexico Chile Task Force report that the following New Mexico counties produce significant quantities of chile peppers: Chaves, Doña Ana, Eddy, Hidalgo, Lea, Luna, Sierra and Socorro. Doña Ana, Hidalgo and Luna counties accounted for approximately 86 percent of the state’s chile pepper production in 2000.

The NMDA report also states the chile pepper processing industry in New Mexico imports large quantities of chile peppers from Mexico. Imports of chile peppers from Mexico have grown since 1994 with passage of the North American Free Trade Agreement (NAFTA). As of 2003, fresh or chilled Mexican chile pepper imports have been completely free of import tariffs or quotas. Many chile pepper industry observers and participants believe that the recent increases in chile pepper imports from Mexico threaten market shares held by New Mexico farmers.

According to the New Mexico Chile Association (NMCA), New Mexico competes with China for the oleoresin (paprika) market, which accounts for 30 percent of New Mexico acreage. NMCA states that automation is the only solution for New Mexico to compete in the market.

Senate Bill 575 would provide additional incentive to mechanize production and processing, and lessen the risk of market share loss to other states. This proposal could encourage the expansion

of the New Mexico chile industry, which could lead to additional revenue in the form of income and property taxes.

TRD notes that the credit proposed by this bill creates the possibility of “double dipping” with other tax incentives, such as the investment tax credit. The bill does not exclude the taxpayer from taking the investment tax credit at the same time as the proposed credit for expenditures on the same equipment.

ADMINISTRATIVE IMPLICATIONS

TRD would need to develop forms and instructions for taxpayers, and apply changes to the current tax system. The Revenue Processing Division would be required to manually process, track and apply the credit. Additional funding would not be needed.

TECHNICAL ISSUES

TRD notes that the taxpayer claiming the credit is not the same taxpayer that is liable for the gross receipts tax. Gross receipts taxes are paid to the department by the seller of the equipment, not the purchaser.

A possible amendment would require the equipment purchaser to submit receipts to TRD including the price of equipment and gross receipts tax paid. TRD could then verify this information against returns submitted by the equipment seller.

According to TRD, the credit created by this bill meets the criteria of an “economic development tax incentive” as defined in Section 9-15-56 NMSA 1978. However, this bill excludes several items required in that section, including:

- 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;
- the requirement that the EDD track job creation; and
- a description of the financial obligation of the taxpayer if specific qualifying standards are not met.

OTHER SUBSTANTIVE ISSUES

Industry representatives report that a test model for a green chile de-stemmer will be released later this year at a price of \$200 thousand to \$500 thousand. A mechanized harvester for green chile will likely be released within the next few years at a similar price. Other equipment purchases could include tractors, tillers, irrigation systems, de-seeders, dryers or dehydrators, mills, and packaging equipment.

The figure below lists sales and use tax exemptions for other chile producing states:

	Processing	Production
Arizona	Full sales/use tax exemption	Full sales/use exemption on new equipment
Texas	Sales/use tax exemption for specific equipment uses	Full sales/use exemption on agricultural equipment
California	Sales/use tax exemption for specific equipment uses	Full sales/use exemption on agricultural equipment

AMENDMENT

A possible amendment would limit the aggregate amount of credits available per tax year to minimize the impact to the general fund.

WHAT WILL BE THE CONSEQUENCES OF NOT ENACTING THIS BILL

New Mexico chile producers and processors will not receive a tax credit against their modified combined tax liability.

LB/svb:bym

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



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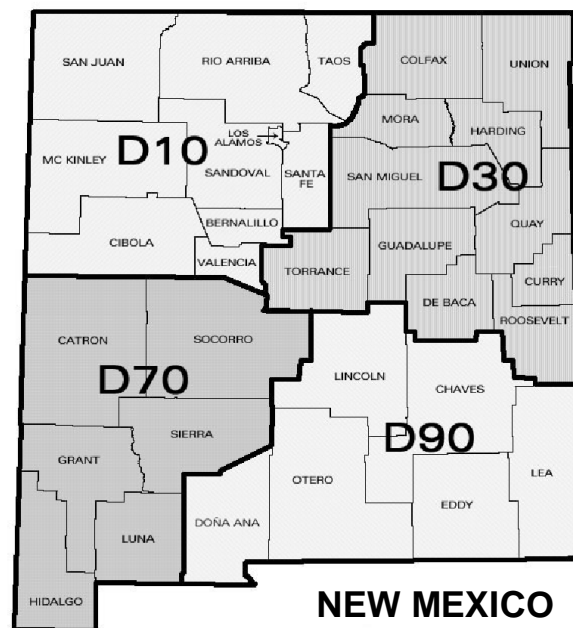
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2009 NEW MEXICO CHILE PRODUCTION

Planted chile acreage in 2009 increased by 4 percent to 12,800 acres from 2008, with 96 percent of the crop harvested at 12,300 acres. These increases helped boost production by 21 percent from 60,140 tons in 2008 to 72,700 tons in 2009. All varieties had a larger overall percentage of harvested acreage from the 2008 crop year.

At the state level, yields were up for most varieties with Long Mild Green having the largest increase from 11 tons per acre in 2008 to 13.3 tons per acre in 2009. Paprika yields remained steady at 1.6 tons per acre, while Red Long Mild yields increased from 1.3 tons per acre to 2.1 tons per acre. Long Hot Red yields rose from 1.1 to 1.7 tons per acre.

The value of New Mexico chile was estimated at \$57.4 million, rising 21 percent above the previous year.



2009 Chile: Acreage and Production by District & County

District/ County	Planted Acreage			Harvested Acreage			Production (Tons)		
	2007	2008	2009	2007	2008	2009	2007	2008	2009
District 70	5,600	5,200	5,100	5,200	4,700	4,900	31,700	32,640	33,400
Hidalgo	700	700	900	600	700	800	2,850	4,500	5,300
Luna	4,000	3,700	3,200	3,700	3,300	3,200	25,150	23,220	22,900
Other Counties ^{1/}	1,200	800	1,000	1,200	700	900	4,100	4,920	5,200
District 90	6,100	7,100	7,700	5,500	6,400	7,400	16,900	27,500	39,300
Doña Ana	3,400	3,800	3,900	3,200	3,200	3,700	12,800	20,600	32,000
Other Counties	2,700	3,300	3,800	2,300	3,200	3,700	4,100	6,900	7,300
STATE	12,000	12,300	12,800	11,000	11,100	12,300	49,000	60,140	72,700

^{1/} District 10 & District 30 were included in District 70 Other Counties.

Chile Acreage, Yield, Production & Value by Variety

Variety	Acreage Harvested ^{1/}		Yield Per Acre ^{2/}		Production		Average Price Per Ton		Value of Production	
	2008	2009	2008	2009	2008	2009	2008	2009	2008	2009
Green			-----Tons-----				-----Dollars-----		-----\$1,000-----	
Long Mild	3,600	3,300	11.0	13.3	39,700	44,000	395	455	15,700	20,000
Long Hot ^{3/}	1,000	1,300	9.0	10.3	9,000	13,400	462	538	4,160	7,210
Red										
Paprika	5,000	5,800	1.6	1.6	7,800	9,000	1,910	1,971	14,900	17,740
Long Mild	2,300	2,500	1.3	2.1	3,100	5,300	2,032	2,000	6,300	10,600
Long Hot	500	600	1.1	1.7	540	1,000	2,315	1,820	1,250	1,820
Total	11,100	12,300	5.4	5.9	60,140	72,700	704	789	42,310	57,370

^{1/} 1,200 acres were harvested for both green and red, but only counted once in the total.

^{2/} Yields influenced by lower yielding acreage harvested for both green and red.

^{3/} Beginning in 2008 Jalapeño and Cayenne were combined with Green Long Hot to avoid disclosing individual information.

Chile Yields by District, County & Variety

District/County	----Green----				----Red----					
	Long Mild		Long Hot		Paprika		Long Mild		Long Hot	
	2008	2009	2008	2009	2008	2009	2008	2009	2008	2009
	----- Tons -----				----- Tons -----					
District 70	11.5	12.9	9.2	1/	1.8	1.6	1.3	2.5	1/	1/
Luna	10.9	16.7	1/	1/	1.8	1.6	1.6	2.0	1/	1/
Other Counties	1/	1/	1/	1/	1/	1/	1.0	3.2	1/	1/
District 90	10.2	13.8	8.7	10.4	1.5	1.5	1.4	1.8	1.0	1.5
Doña Ana	10.2	13.8	9.3	10.5	1.4	1.6	1.4	1.8	1.0	1.5
Other Counties	1/	1/	1/	1/	1.5	1.5	---	1/	---	1/
State	11.0	13.3	9.0	10.3	1.6	1.6	1.3	2.1	1.1	1.7

^{1/} Not published to avoid disclosing individual information.

Table 1. Costs and Returns for Producing Chile in New Mexico for 2008

Country	Doña Ana/		Hidalgo		Eddy		Hidalgo		Eddy		
Area	Luna	Sierra	Cotton City	Socorro	Valencia	Doña Ana	Luna	Artesia	Cotton City	Carlsbad	Valencia
Color	Green	Green	Green	Green	Green/Red	Red	Red	Red	Red	Red	Red
Marketing System	Wholesale	Wholesale	Wholesale	Local	Local	Wholesale	Wholesale	Wholesale	Wholesale	Wholesale	Wholesale
Yield	11 tons	11 tons	12 tons	12,000 lbs	275 bushels	3,500 lbs	4,000 lbs	3,200 lbs	3,500 lbs	3,200 lbs	11 tons
Green	\$380.00	\$380.00	\$380.00	\$0.15	\$7.50						
Units											
Red						\$0.79	\$0.79	\$0.79	\$0.68	\$0.72	\$300.00
Other Income				\$500.00	\$600.00						
Gross Returns	\$3,685.00	\$3,685.00	\$3,420.00	\$2,300.00	\$2,662.50	\$2,765.00	\$3,160.00	\$2,525.00	\$2,380.00	\$2,304.00	\$3,300.00
Cash Operating Expenses											
Seed	\$68.00	\$85.00	\$84.00	\$147.00	\$112.00	\$136.00	\$68.00	\$136.00	\$72.00	\$128.00	\$114.00
Fertilizer	\$169.95	\$184.00	\$114.90	\$61.55	\$52.00	\$154.00	\$151.58	\$90.40	\$122.85	\$98.60	\$83.25
Chemicals	\$31.08	\$165.80	\$25.13	\$19.05	\$54.71	\$165.80	\$31.08	\$75.47	\$28.32	\$75.56	\$54.71
Crop Insurance	\$72.58	\$40.00		\$40.00	\$76.22	\$20.00		\$40.00			
Other Purchased Inputs		\$106.33		\$115.50	\$67.50						\$10.00
Canal Water	\$52.36	\$56.93	\$75.23	\$25.00	\$28.00	\$113.00	\$56.34	\$49.43	\$51.28	\$43.00	\$28.00
Fuel & Lubricants—Equipment	\$149.93		\$116.68	\$149.92	\$291.77	\$56.93	\$130.89	\$30.16	\$105.79	\$45.43	\$97.02
Fuel—Irrigation											
Repairs	\$28.65	\$2.66	\$40.96	\$38.61	\$18.91	\$0.89	\$14.33	\$3.60	\$33.51	\$15.92	\$11.44
Custom Charges	\$1,089.00	\$1,137.50	\$1,243.33	\$720.00	\$70.71	\$815.00	\$880.00	\$736.00	\$790.00	\$816.00	\$70.71
Land Taxes	\$1.76	\$9.65	\$2.96	\$1.62	\$5.33	\$9.65	\$1.76	\$1.98	\$2.96	\$1.46	\$5.33
Other Expenses	\$65.75	\$71.58	\$51.71	\$91.19	\$165.27	\$71.58	\$65.75	\$53.43	\$51.52	\$150.48	\$179.64
Total Cash Expenses (B)	\$1,729.06	\$1,859.45	\$1,754.90	\$1,369.43	\$866.20	\$1,562.85	\$1,475.95	\$1,196.47	\$1,258.23	\$1,414.45	\$654.10
Return Over Cash Expenses (C = A - B)	\$1,955.94	\$1,825.55	\$1,665.10	\$930.57	\$1,796.30	\$1,237.15	\$1,724.05	\$1,331.53	\$1,121.77	\$889.55	(\$2,645.90)
Fixed Expenses (D)	\$110.39	\$59.53	\$87.06	\$130.83	\$191.99	\$50.09	\$89.72	\$52.81	\$77.40	\$99.96	\$171.54
Total Expenses (E = B + D)	\$1,839.45	\$1,918.98	\$1,841.95	\$1,500.26	\$1,058.19	\$1,612.94	\$1,565.67	\$1,249.28	\$1,335.63	\$1,514.41	\$825.64
Net Farm Income	\$1,845.55	\$1,766.02	\$1,578.05	\$799.74	\$1,604.31	\$1,187.06	\$1,634.33	\$1,278.72	\$1,044.37	\$789.59	\$2,474.36
Labor and Management Costs (G)	\$263.74	\$250.07	\$239.40	\$324.49	\$1,393.87	\$229.97	\$218.85	\$248.81	\$200.12	\$155.87	\$2,889.67
Net Operating Profit (H = F - G)	\$1,581.81	\$1,515.95	\$1,338.65	\$475.26	\$210.44	\$957.09	\$1,415.48	\$1,029.91	\$844.25	\$633.72	(\$415.30)
Capital Costs											
Interest on Operating Capital (I)	\$26.16	\$37.06	\$22.32	\$16.27	\$13.35	\$35.91	\$23.48	\$14.14	\$19.01	\$18.81	\$11.58
Interest on Equipment Investment (J)	\$49.78	\$31.30	\$68.51	\$65.70	\$996.68	\$26.78	\$35.28	\$27.15	\$55.63	\$240.20	\$231.09
Total Capital Costs (K = I + J)	\$75.94	\$68.36	\$90.83	\$81.97	\$1,010.03	\$62.69	\$58.76	\$41.29	\$74.63	\$259.01	\$242.67
Return to Land and Risk (L = H - K)	\$1,505.87	\$1,447.59	\$1,247.80	\$393.28	(\$799.59)	\$894.40	\$1,356.72	\$988.62	\$769.62	\$374.71	(\$657.98)

Letters in parentheses refer to definitions in the Glossary