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## FISCAL IMPACT REPORT

	<b>ORIGINAL DATE</b>	03/20/13	
	<b>FIRST REVISION</b>	03/25/13	
<b>SPONSOR</b> <u>HBIC</u>	<b>LAST UPDATED</b>	<u>04/15/13<sup>1</sup></u>	<b>HB</b> <u>CS/641/aSfI#1</u>
	Film Production Tax Credit Increase		
<b>SHORT TITLE</b> <u>( &amp; Decrease Certain Corporate Income Tax Rates )</u>	<b>SB</b>	<u>Walker-Moran &amp; van Moorsel</u>	
	<b>ANALYST</b>	<u>Walker-Moran &amp; van Moorsel</u>	

### REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY13	FY14	FY15	FY16	FY17		
\$0.0	\$9,656.0	\$5,469.0	(\$47,321.7)	(\$70,786.4)	Recurring	General Fund
\$0.0	\$8,469.0	\$17,334.0	\$5,457.7	\$2,633.4	Recurring	Local Governments
\$0.0	\$11.0	\$23.0	\$31.0	\$42.0	Recurring	Small County Assistance Fund
\$0.0	\$17.0	\$34.0	\$46.0	\$63.0	Recurring	Small City Assistance Fund
\$0.0	\$6.0	\$11.0	\$15.0	\$21.0	Recurring	Municipal Equivalent Distribution
\$0.0	\$18,159.0	\$22,871.0	(\$41,772.0)	(\$68,027.0)	<b>Recurring</b>	<b>Total</b>

(Parenthesis ( ) Indicate Revenue Decreases)

Estimated General Fund Revenue Impacts					Bill Component
FY13	FY14	FY15	FY16	FY17	
\$0.0	(\$8,368.0)	(\$28,833.0)	(\$48,832.0)	(\$70,496.0)	CIT Rate Reduction
\$0.0	(\$80.0)	(\$10,949.0)	(\$28,761.0)	(\$45,313.0)	Optional SSF Apportioning
\$0.0	\$1,200.0	\$7,500.0	\$5,800.0	\$4,200.0	Combined Reporting for Certain Retailers
\$0.0	\$6,447.0	\$19,572.0	(\$9,520.0)	(\$9,711.0)	HWJTC Changes
\$0.0	\$10,457.0	\$18,179.0	\$26,265.0	\$34,796.0	GRT Manufacturing Changes
\$0.0	\$0.0	\$0.0	\$7,726.3	\$15,737.6	Repeal Local Hold Harmless
<b>\$0.0</b>	<b>\$9,656.0</b>	<b>\$5,469.0</b>	<b>(\$47,321.7)</b>	<b>(\$70,786.4)</b>	<b>Total General Fund</b>

<sup>1</sup> The first revision corrected references in the bill summary that erroneously referred to a previous version of the tax bill. The final revision updated fiscal impacts pursuant to TRD's April 10 release of its analysis of HB641.

**SOURCES OF INFORMATION**

LFC Files

Responses Received From

Taxation and Revenue Department (TRD)

Economic Development Department (EDD) to HB379

**SUMMARY**

Synopsis of Senate Floor Amendment

The Senate Floor amendment to HBIC substitute for HB 641 makes several changes to the tax code. The bill phases out the hold-harmless distribution to municipalities and counties that offset the food and health care practitioner (medical) deductions over 15 years, lowers the corporate income tax (CIT) rate over five years and allows municipalities and counties to impose a local option gross receipts tax. This bill also requires combined reporting for certain corporations, permits single sales factor apportioning for certain manufacturing corporations phased in over five years, amends the gross receipts tax (GRT) deduction for tangible property consumed in the manufacturing process to narrow the qualifications for the deduction, and amends the high-wage jobs tax credit (HWJTC) to extend the credit and add criteria for the qualifications for the credit.

**Sections 1 and 2** amend current law to phase out the hold-harmless distribution to municipalities and counties that offset the food and health care practitioner (medical) deductions. A community that *does not* adopt the Hold Harmless Gross Receipts Tax with a population less than 10,000, or a county of less than 48,000 population will receive its Hold Harmless Distribution from the General Fund (pursuant to existing provisions of Sections 7-1-6.46 and 7-1-6.47 NMSA 1978).

All other communities will continue to receive “hold harmless” payments from the general fund for food and medical deductions, but the hold harmless distributions are *reduced* by six percent per year through FY20, and by seven percent per year thereafter until fully phased out in FY30.

**Section 3** amends the Corporate Income and Franchise Tax Act to phase in a corporate income tax (CIT) rate reduction between tax years 2014 and 2018 as follows:

Net Income	Tax Year 2013	Tax Year 2014	Tax Year 2015	Tax Year 2016	Tax Year 2017	Tax Year 2018
<b>Less Than \$500 thousand</b>	4.8%	4.8%	4.8%	4.8%	4.8%	4.8%
<b>Between \$500 thousand and \$1 million</b>	\$24,000 plus 6.4% of excess over \$500k	\$24,000 plus 6.2% of excess over \$500k	\$24,000 plus 5.9% of excess over \$500k			
<b>Greater than \$1 million</b>	\$56,000 plus 7.6% of excess over \$1m	\$56,000 plus 7.3% of excess over \$1m	\$56,000 plus 6.9% of excess over \$1m	\$56,000 plus 6.6% of excess over \$1m		

**Section 4** of the substitute requires that a unitary corporation that provides retail sales of goods in a facility of more than 30 thousand square feet file a combined return, provided that such a corporation need not file a combined return if it has operations in New Mexico that do not provide retail sales of goods that employ at least 750 employees.

**Section 5, 6, and 13** relate to the film credit (as described in the substitute bill synopsis).

**Section 7** of the bill amends the Uniform Division of Income for Tax Purposes Act (UDITPA) to phase in over five years an optional single sales apportionment factor for businesses engaged in manufacturing. To elect the apportionment formula, the taxpayer must notify the Taxation and Revenue Department (TRD) in writing before first filing a return using the new apportionment formula. Once opting into this apportionment formula, the taxpayer must use the formula for three years before being able to opt back out. The single sales factor would be phased in over five years as follows:

Tax Year	Apportionment Formula
2013 (current law)	$\frac{(\text{sales factor})+(\text{property factor})+(\text{payroll factor})}{3}$
2014	$\frac{(2X\text{sales factor})+(\text{property factor})+(\text{payroll factor})}{4}$
2015	$\frac{(3X\text{sales factor})+(\text{property factor})+(\text{payroll factor})}{5}$
2016	$\frac{(7X\text{sales factor})+(1.5X\text{property factor})+(1.5X\text{payroll factor})}{10}$
2017	$\frac{(8X\text{sales factor})+(\text{property factor})+(\text{payroll factor})}{10}$
2018	$\frac{(\text{total sales in New Mexico})}{(\text{total corporate sales})}$

**Section 8** amends the UDITPA to exclude certain sales from being apportioned as sales in New Mexico.

**Section 9** amends the Gross Receipts and Compensating Tax Act to amend the provisions governing the deduction of receipts from selling tangible personal property that is consumed in the manufacturing process. The amendments specify that the tangible personal property must be a consumable. The bill defines "consumable" as tangible personal property that is incorporated into, destroyed, depleted or transformed in the process of manufacturing a product, including electricity, fuels, water, manufacturing aids and supplies, chemicals, gases, repair parts, spares and other tangibles used to manufacture a product. The definition excludes tangible personal property used in power generation, the processing of natural resources, including hydrocarbons, and the preparation of meals for immediate consumption on- or off-premises.

The effective date of section 7 is July 1, 2013, and the provisions of the section apply to gross receipts received on or after July 1, 2013.

**Section 10** amends the provisions governing the high-wage jobs tax credit to tighten a host of high wage tax credit definitions and to extend the sunset to the end of FY20. The most important changes to the law are:

- Requiring taxpayers to apply for the credit within one year of the end of the calendar year in which the taxpayer’s final qualifying period closes. Currently there is no time limitation;
- Providing that eligible jobs cannot be recycled through mergers or acquisitions;
- Limiting eligible employers to those certified by the Economic Development Department to be eligible for job training program assistance, commonly known as “JTIP”. Eligible employers must also have made more than 50 percent of its sales of goods and services produced in New Mexico to persons outside New Mexico during the applicable qualifying period.
- Clarifying that wages are calculated exclusive of benefits or the employer’s share of payroll taxes.
- Increasing wage requirements for jobs created after July 1, 2015 to qualify for the HWJTC. These jobs must pay wages of \$60 thousand (if in an urban area) and \$40 thousand (if in a rural area). Currently, the requirements are that the jobs pay \$40 thousand and \$28 thousand, respectively; and
- Providing specific definitions of “wages” and “benefits.”

The provisions of section 8 of the bill apply to credit claims received on or after the effective date of the bill. Because the bill contains an emergency clause, it would become effective immediately upon signature by the governor.

**Section 11** adds a new section allowing a municipal hold harmless gross receipts tax to be imposed by ordinance but not to exceed an aggregate rate of 3/8 percent of the gross receipts of any person engaging in business in the municipality.

**Section 12** adds a new section allowing a county hold harmless gross receipts tax to be imposed by ordinance but not to exceed an aggregate rate of 3/8 percent of the gross receipts of any person engaging in business in the county.

**Section 14** provides for the applicability of the bill’s sections as follows:

- Sections 3, 4, 7 and 8 of the bill apply to taxable years beginning on or after January 1, 2014;
- Section 5; subsections A, B and D – N of Section 6 apply to production and postproduction expenditures made on or after April 15, 2013;
- Section 9 applies to gross receipts received on or after July 1, 2013; and
- Section 10 applies to credit claims received on or after the effective date.

**Section 15** provides contingent effective dates for the bill’s sections as follows:

- Sections 1, 2, 4, 9, 11 and 12 are effective July 1, 2013.
- The effective date of provisions 3, 7, and 8 are January 1, 2014, provided that the provisions of sections 1, 2, 4, 9, 11 and 12 are in effect on July 1, 2013.

Synopsis of Original Bill

**Sections 1 and 2** (*section 5 and 6 in Senate floor amendment*) of HBIC substitute for HB 641 amends Section 7-2F-1 NMSA 1978, to allow for an additional five percent film credit for direct production expenditures:

1. On series television productions intended for commercial distribution with a budget per episode of \$50,000;
2. That are attributable to wages and fringe benefits paid to a NM resident directly employed in an industry crew position, excluding a performing artist;
  - a. with a total budget of at least \$30 million that shoots at least 10 principal photography days at a qualified production facility in NM or
  - b. \$30 million or more that shoots at least 15 principal photography days at a qualified production facility in NM.

Additionally, language is added to allow for the carry-over of any amounts under the fifty million dollar annual limit not expended in a fiscal year but not to exceed \$10 million, and these amounts will not count toward a subsequent years' annual limitation. Section 7-2F-2 NMSA 1978, is amended to alter the definitions of "direct production expenditure" and "physical presence." It also tightens the income tax provisions on performing artists by requiring withholding when the artist has an equity interest in the production. The bill also excludes expenditures from qualifying for the credit that are supplied by nonresidents whether hired or subcontracted by an in-state vendor.

The bill also adds language to:

- allow the film production tax credit to be claimed on an information return filed by a pass-through entity;
- adds a definition of a "qualified production facility"; and
- amends the definition of "vendor" to exclude director, writer, producer, an associate producer, a co-producer, an executive producer, a production supervisor, a director of photography, a motion picture driver, a production or personal assistant, a designer, a still photographer, and a carpenter and utility technician.

This bill is applicable to direct production expenditures and postproduction expenditures made on or after April 15, 2013 and to principal photography on or after January 1, 2014.

This bill contains an emergency clause.

**FISCAL IMPLICATIONS**

**Film Credit:** The bill mandates that the film credit be constrained by the \$50 million annual cap. However, the richer credits for television and the \$10 million carry-over indicate that the credit will likely be greater over a multiyear period. For example, there is some indication that the credit will not be fully expended in FY13 which will result in increased General Fund revenue of \$12 million. Given the provisions in this substitute, the FY 14 cap will be increased from \$50 million to \$60 million and General Fund revenue will decrease by \$10 million.

The Taxation and Revenue Department (TRD) researched the share of total New Mexico film credits approved and pending approval since FY11 that can be identified as relating to eligible television series. On that basis, it is estimated that approximately 20 percent of the film credits

approved or pending approval since FY11 are related to television series that could qualify for the enhanced credit. The New Mexico Film Office and the Consensus Revenue Estimating Group are forecasting that the \$50 million cap will be reached in each of the forecast period fiscal years. This would imply that approximately \$10 million of the total credits earned (determined based on 25 percent of production expense), or an addition \$2 million in film credits would be added to these television productions as a result of the enhanced credit opportunity. However, the \$50 million cap would still constrain the film credits offered, so no additional fiscal impact is forecast.

**Table 1: SUMMARY OF FILM CREDITS — MATRIX OF YEAR AWARDED VERSUS YEAR CREDIT DISTRIBUTED**

FY FILM CREDIT DISTRIBUTED												
(in thousands of dollars)												
FY FILM CREDIT AWARD APPROVED	FY03	FY04	FY05	FY06	FY07	FY08	FY09	FY10	FY11	FY12	Grand Total	
	FY03	\$1,116.2	\$103.3									\$1,219.5
	FY04		\$1,633.3	\$1,771.6								\$3,405.0
	FY05			\$333.0	\$1,446.9	\$285.5						\$2,065.3
	FY06				\$4,274.2	\$4,320.4	\$6.3					\$8,600.8
	FY07					\$13,917.8	\$2,250.5	\$477.2				\$16,645.6
	FY08						\$40,312.5	\$5,248.1	\$6.4			\$45,567.1
	FY09							\$76,336.8	\$86.6		\$1.1	\$76,424.4
	FY10								\$45,274.5	\$20,632.6	\$0.2	\$65,907.3
	FY11									\$75,559.6	\$1,411.5	\$76,971.2
	FY12										\$8,081.6	\$8,081.6
	Grand Total	\$1,116.2	\$1,736.7	\$2,104.6	\$5,721.1	\$18,523.7	\$42,569.3	\$82,062.1	\$45,367.4	\$96,192.3	\$9,494.5	\$304,887.8

**Hold Harmless Distribution Changes:** Under the current law, the hold harmless distributions are forecasted using Global Insight economic indicators: for the food distribution the indicator used is the CPI for food, and consumer spending on health care services is used for the medical distribution. The table below lists the forecast amounts of both deductions under current law. Negative numbers indicate the impact to the general fund, which is a positive impact to local governments. The FY12 food and medical hold harmless distribution by county and municipality is listed at the end of this FIR. The table also shows the six percent per year distribution reduction if distributions hold at the FY12 levels.

Current Law Distributions (\$ thousands)	FY13	FY14	FY15	FY16	FY17
Food Hold Harmless (GF)	(\$105,450.0)	(\$105,554.0)	(\$107,066.0)	(\$108,589.0)	(\$110,009.0)
Medical Hold Harmless (GF)	(\$35,111.0)	(\$36,734.0)	(\$38,068.0)	(\$39,735.0)	(\$40,995.0)
<b>Total-General Fund</b>	<b>(\$140,561.0)</b>	<b>(\$142,287.0)</b>	<b>(\$145,134.0)</b>	<b>(\$148,324.0)</b>	<b>(\$151,004.0)</b>
<b>Municipalities – Revenue</b>	<b>\$111,912.0</b>	<b>\$113,289.0</b>	<b>\$115,557.0</b>	<b>\$118,099.0</b>	<b>\$120,233.0</b>
<b>Counties – Revenue</b>	<b>\$28,648.0</b>	<b>\$28,998.0</b>	<b>\$29,577.0</b>	<b>\$30,226.0</b>	<b>\$30,770.0</b>

Under the proposed legislation, the distributions would be phased out over fifteen years in six or seven percent increments, beginning in FY16. The following table lists the forecast impacts to the distributions. Positive numbers reflect a positive impact to the general fund, which is a negative impact to local governments.

GF Fiscal Impacts (in thousands of dollars)	FY13	FY14	FY15	FY16	FY17
Food Hold Harmless (GF)	0	0	0	\$6,151.0	\$12,525.0
Medical Hold Harmless (GF)	0	0	0	\$1,538.0	\$3,131.0
<b>Total</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>\$7,689.0</b>	<b>\$15,656.0</b>

**Small Municipality and County Hold Harmless GRT Changes:** This part of the impact is extremely difficult to estimate with any degree of certainty. Therefore no assumptions have been made as to when the counties and municipalities will enact new tax rates. It cannot be predicted how counties and municipalities will react to the change in law without making some fairly broad assumptions. The different tax rates currently enacted by localities illustrate that each county or municipality faces unique circumstances and makes choices about tax increments based on those circumstances. They will necessarily make decisions based on the particular set of circumstances faced, and so the response cannot be predicted as a group.

Some counties and municipalities already choose to have tax rates lower than the potential maximum rate. The issue of selecting tax increments is more complex than simply maximizing revenues: it is an optimization problem constrained on several fronts, not the least of which is political will. The actual outcome, therefore, could range anywhere from a large negative to a large positive impact on local governments.

**Corporate Income Tax Rate Reduction:** The first step in this analysis is to estimate the change in revenue from lowering the top CIT rate from 7.6 percent to 5.9 percent over five years, as illustrated in the table below. The fiscal impact of the rate changes is in the table below. The January 1, 2014, effective date for this portion creates a 60 percent impact in FY14.

	FY13	FY14	FY15	FY16	FY17
Forecast Gross CIT	\$330,000	\$377,000	\$433,000	\$450,000	\$460,000
Impact, Rate Changes	0	(\$8,368)	(\$28,833)	(\$48,832)	(\$70,496)

**Manufacturing Single Sales Factor:** The TRD used 2010 New Mexico CIT data for manufacturing corporations (NAICS code 31 through 33) to analyze the impact of the phase in of the single sales apportionment formula. Recognizing that the definition provided in the bill has a broader scope than the NAICS code definition, the TRD notes approximately 1,750 corporations file under the manufacturing NAICS codes with a total gross NM CIT of \$75 million. The impact was estimated assuming that all manufacturing corporations whose sales factor is less than an average factor would make the election. The estimate recognizes that several of the eligible manufacturers are taking advantage of the existing double-weighted sales factor apportionment method. Since not all eligible corporations will make this election due to the 36 consecutive month election requirement, the impact was reduced by 10 percent. February consensus forecast estimates were used to estimate the fiscal impacts from FY14 through FY17. These estimated effects assume the modified tax rates in the bill are in effect.

	FY13	FY14	FY15	FY16	FY17
Impact, Manufacturing SSF	0	(\$80.0)	(\$10,949.0)	(\$28,761.0)	(\$45,313.0)

**Combined Reporting:** Analysts are widely in agreement that corporations will reorganize transactions and trade relationships to avoid the revenue effects of mandatory filing if it makes economic sense. Reorganization incurs transaction costs and must be less than the tax advantage gained for a corporation to act. For example, Wal-Mart’s earnings before interest, taxes, depreciation and amortization (EBITDA) is estimated at \$36.5 billion for 2013. Since New Mexico is such a small part of their market (and tax bill), reorganization might not be worth the transaction costs.

According to TRD, businesses with at least 750 non-retail employees would be exempted from this requirement. Utilizing confidential taxpayer information, the department estimates this could significantly reduce the positive impact of this portion of the bill, but currently it has no effect.

	FY13	FY14	FY15	FY16	FY17
<b>Combined Reporting for Certain Retailers</b>	<b>0</b>	<b>\$1,200.0</b>	<b>\$7,500.0</b>	<b>\$5,800.0</b>	<b>\$4,200.0</b>

The Taxation and Revenue Department’s (TRD) estimate assumes that mandatory combined reporting would increase corporate income tax revenues before credits between 5 percent and 10 percent for the unitary corporations that have a retail facility of over thirty thousand square feet. The estimate reflects a range derived from a review of several studies of combined reporting, but the range of estimates in general is very wide, from -5 percent (no increase in revenue) to 20 percent. Revenues are expected to increase by 10 percent initially and the rate of increase is expected to slow to 5 during the later years as these taxpayers adjust their corporate structures and transactions to avoid taxation. Part of the initial gain is due to one-time factors like the disallowance of losses earned by separate entities. Once taxpayers realize they are subject to combined reporting, they are more likely to restructure their business operations to reduce their liability.

Different states have taken the mandatory combined route and have had widely different experiences with respect to revenues. The range of estimates has varied from a 5 percent decline in revenues to a 20 percent increase in revenues depending on the corporate landscape in that state. However, in most states the increase in the growth rate of revenue was not permanent and the growth rate decreased over time due to the corporations restructuring their operations to minimize their tax liability.

**Manufacturer Consumables Changes:** The TRD notes its estimates for this portion of the analysis include a high degree of uncertainty for several reasons which make it difficult to estimate the baseline level of the deduction, as well as the impacts from the proposed changes:

- The deduction is not separately stated, and the historical size of the deduction is not known.
- 2012 amendments to the law governing the deduction are expected to greatly increase the size of the deduction; the changes have not been in effect long enough to assess their impact.
- Given the current and proposed definitions of manufacturing, it is difficult to identify with certainty the pool of firms that will be eligible for the credit.

To establish a baseline level of the manufacturers’ consumables deduction, the TRD relied on the Department of Finance and Administration’s revised analysis of a REMI Input-Output model of manufacturer consumption. This model estimates the size of the deduction under current law as described in the table below.

<b>Current Law</b>	<b>FY13</b>	<b>FY14</b>	<b>FY15</b>	<b>FY16</b>	<b>FY17</b>
<b>Deduction</b>	(\$16,545.0)	(\$30,748.0)	(\$53,304.0)	(\$77,846.0)	(\$104,324.0)

With the baseline established, the TRD identified the proposed changes that are expected to have a significant revenue impact. The effect of each of these changes is to tighten the qualifying standards for businesses receiving this deduction.

<b>GRT Manufacturing Changes</b>	<b>FY13</b>	<b>FY14</b>	<b>FY15</b>	<b>FY16</b>	<b>FY17</b>
General Fund (GRT)	0	\$10,378.0	\$18,020.0	\$26,050.0	\$34,501.0
Local Governments	0	\$6,444.0	\$11,187.0	\$16,174.0	\$21,419.0
<b>Net GRT Impact</b>	<b>0</b>	<b>\$16,822.0</b>	<b>\$29,207.0</b>	<b>\$42,224.0</b>	<b>\$55,920.0</b>
General Fund (Comp)	0	\$79.0	\$159.0	\$215.0	\$295.0
Small County Assistance Fund	0	\$11.0	\$23.0	\$31.0	\$42.0
Small City Assistance Fund	0	\$17.0	\$34.0	\$46.0	\$63.0
Municipal Equivalent Distrib.	0	\$6.0	\$11.0	\$15.0	\$21.0
<b>Net Comp Tax Impact</b>	<b>0</b>	<b>\$113.0</b>	<b>\$227.0</b>	<b>\$307.0</b>	<b>\$421.0</b>
<b>Total Impact</b>	<b>0</b>	<b>\$16,935.0</b>	<b>\$29,434.0</b>	<b>\$42,531.0</b>	<b>\$56,341.0</b>

**High Wage Jobs Tax Credit:** The changes to the HWJTC have the effect of tightening the eligibility requirements for both employers and employees. Much of this analysis reflects the TRD analyses of similar legislation that makes other HWJTC changes.

The 17 companies filing the greatest number of the HWJTC applications had those claims approved in recent years (FY11 and part of FY12). These companies account for about 75 percent of all credits by dollar amount during the period analyzed. Growth in new qualified jobs was estimated using BBER FOR-UNM forecast employment growth for the applicable sectors (-0.3 percent for FY13, 1.2 percent for FY14, 1.6 percent for FY15, and 2.0 percent for FY16).

Applications for the HWJTC surged in FY12 and in FY13 (to-date), apparently due to a “mining” of potential claims by several consulting accounting firms, and due to an increasing awareness of the potential claims under the existing HWJTC statutes. At present, approximately \$110 million in pending HWJTC claims are under evaluation by the TRD. In other FIRs, the TRD has estimated the “normal” applications per year under the current law to be approximately \$65 million. Assuming one third of claims are not approved, the total amount approved would be \$43.3 million per year.

The bill also extends the sunset of the HWJTC from July 1, 2015, to July 1, 2020, reflected as a reduction in revenues in FY16 and FY17. The \$120 million in the HWJTC applications that are pending would be processed under the current provisions of law. The proposed legislation would only be applicable to applications received after April 1, 2013.

The extension of the definition of urban jobs to within ten miles of a municipality with a population of 60,000, or in Los Alamos County would have a minimum impact because the wage limit of a qualified job in Los Alamos County and ten miles of its external boundaries would be \$40,000 under the proposed law, which would potentially reduce the number of qualified jobs. However, the wage limit of a qualified job in other municipalities, for example Roswell (population: 48,366) and Farmington (population: 45,877) would be reduced from \$40,000 to \$28,000, causing a potential increase in the number of qualified jobs.

Beginning in FY16, the proposal raises the threshold wages to \$40,000 in rural jobs and \$60,000 for urban jobs, from \$28,000 and \$40,000 respectively. This would cause a 20 percent reduction in the amount of the credit (5 percent of credits issued are tied to jobs below \$40,000 that would be eliminated, and 15 percent of credits issued are estimated to arise from urban jobs between \$40,000 and \$60,000 that would be eliminated.). The total estimated revenue impact of the HWJTC portion of this bill is in the table below.

<b>HWJTC Changes</b>	<b>FY13</b>	<b>FY14</b>	<b>FY15</b>	<b>FY16</b>	<b>FY17</b>
<b>General Fund</b>	\$0.0	\$6,447.0	\$19,572.0	(\$9,520.0)	(\$9,711.0)
<b>Local Government</b>	\$0.0	\$2,025.0	\$6,147.0	(\$2,990.0)	(\$3,048.0)
<b>Total Impact, HWJTC Changes</b>	\$0.0	\$8,472.0	\$25,719.0	(\$12,510.0)	(\$12,759.0)

This bill may be counter to the LFC tax policy principle of adequacy, efficiency and equity. Due to the increasing cost of tax expenditures revenues may be insufficient to cover growing recurring appropriations.

Estimating the cost of tax expenditures is difficult. Confidentiality requirements surrounding certain taxpayer information create uncertainty, and analysts must frequently interpret third-party data sources. The statutory criteria for a tax expenditure may be ambiguous, further complicating the initial cost estimate of the expenditure’s fiscal impact. Once a tax expenditure has been approved, information constraints continue to create challenges in tracking the real costs (and benefits) of tax expenditures.

**SIGNIFICANT ISSUES**

New Mexico’s top corporate income tax rate of 7.6 percent is high, compared with the national average of 6.4 percent. New Mexico’s CIT rate is especially high when considering a corporation can be taxed at the 4.9 percent personal income tax rate simply by organizing under another section of the IRS code. This violates the principle of tax equity. In 2011, the Council on State Taxation (COST) commissioned Ernst & Young to perform a 50-state study of effective tax rate/after-tax return on investment over a 30-year investment, New Mexico ranked last. The study found that tax rates and a complex tax credit incentive system are a burden on firms considering investments in New Mexico and are “almost certainly impeding economic growth.” Among other options, the New Mexico Tax Research Institute (NMTRI) noted a reduction in the top corporate rate would make New Mexico more appealing to business investment.

The NMTRI also addressed the option of allowing corporations to apportion income with a single- or double-weighted sales factor. All states parse a multistate corporation’s income into a state taxable base. New Mexico uses an “apportionment formula” that averages the percentage of a corporation’s sales occurring in New Mexico, the percentage of payroll in New Mexico, and the percentage of property (or assets or investment) domiciled in New Mexico. The equally weighted corporate income apportionment formula creates a disincentive to expansion in New Mexico; if a company increases its operations in New Mexico, its taxes in New Mexico would increase, even without the benefit of additional sales, creating a disincentive to growth. Firms can lower exposure to New Mexico tax by firing workers and closing plants.

The “single sales” factor, by which income is apportioned only on the percentage of sales made in the state, is the alternative in favor nationally. This formula does not punish firms for investing or employing workers within a state. In New Mexico, a mandatory single sales formula would likely benefit extractive and manufacturing industries while penalizing direct sellers of goods and services and multistate banks. Mining and manufacturing pay well over half of New Mexico CIT, however, and this formula could result in lower revenues.

The high-wage jobs tax credit provides qualifying employers with a 10 percent tax credit, up to \$12 thousand, for each employee with annual wages and benefits totaling more than \$28 thousand if in a rural area and more than \$40 thousand if in an urban area. Eligible employers

include those eligible for the Job Training Incentive Program (JTIP) or that earned more than 50 percent of their sales from out-of-state entities in the prior year. The cost of the credit is higher than initially estimated, with FY12 claims exceeding \$48 million, and FY13 projected at \$50 million. The credit is intended to create new jobs, but data suggests most of the claims are for jobs created from previous business activity. The TRD estimates as little as 19 percent of all FY12 credit applications were for jobs created during the current qualifying period. In the last two fiscal years, employers claimed credit for creating roughly 3,000 jobs. However, it should be noted that the UNM's Bureau of Business and Economic Research estimates employment actually declined by 258 jobs during that time.

Legislation enacted in 2012 expanded the GRT deduction for tangible personal property to include property consumed in the manufacturing process. The deduction was intended to exempt the cost of electricity used in the manufacturing process, but it can be construed to cover refining, processing, restaurants, and even art. Further, the electric utilities report it will be difficult to identify electricity "consumed" during manufacturing. These issues doubled the original estimate of the deduction's general fund impact to \$4.7 million in FY13, rising to \$80 million when fully phased in by FY17.

### **ADMINISTRATIVE IMPLICATIONS**

TRD reports the phase out of hold harmless distributions will reduce other state fund revenue to TRD. Laws 2011, Chapter 179, Section 4 (HB2) supplanted \$4.4 million in General Fund revenue with other state funds for the personal services and employee benefits category of the Tax Administration Act (TAA) Program pursuant to the expansion of TRD administrative fees charged to local governments. The language applies to the food and medical hold harmless distribution to municipalities and counties. The General Appropriation Acts of 2012 and 2013 appropriate to TRD twenty-five hundredths percent of an administrative fee in the amount of three and twenty-five hundredths percent of the distributions in Subsection E of Section 7-1-6.41 NMSA 1978, to fund the fair share initiative. The language was intended to be a permanent increase to fund staff and operations to generate revenue for local governments, as well as the general fund and other state funds through increased compliance.

TRD notes it would lose funding by the 6 percent annual increments proposed from FY16 through FY20, and then at 7 percent annual increments through FY30. Ultimately, TRD would lose \$4.4 million dollars by the final phase out in 2030, which it reports is used to fund critical operations, including collection and audit activities of the TAA.

According to TRD, the phase out for the payroll and property factors could be burdensome for the taxpayer because they would need to calculate their CIT returns for the next 3 years using a different method of apportionment. TRD suggests it would be taxpayer friendly to allow the taxpayer to elect the single sales factor effective tax year January 1, 2014.

Also, TRD would have some difficulty in administering this phase out. The department would need to reprogram their systems to accept these returns for the 3-year phase out of the payroll and property factors. The forms and instructions would need to be revised every year and the audit staff and the Multistate Tax Commission that audits CIT on the state's behalf would need to adjust procedures for the years in question.

Does the bill meet the Legislative Finance Committee tax policy principles?

1. **Adequacy:** Revenue should be adequate to fund needed government services.
2. **Efficiency:** Tax base should be as broad as possible and avoid excess reliance on one tax.
3. **Equity:** Different taxpayers should be treated fairly.
4. **Simplicity:** Collection should be simple and easily understood.
5. **Accountability:** Preferences should be easy to monitor and evaluate

PvM:EWM/blm

**Estimated Effect of Phase-Out in HB641 on the Food and Medical Hold  
Harmless Distribution**  
(thousands of dollars)

	FY16			FY17		
	HH Reduction		-6%	HH Reduction		-12%
	Food	Medical	Total	Food	Medical	Total
Albuquerque	(\$1,590.4)	(\$916.3)	<b>(\$2,506.7)</b>	(\$3,222.4)	(\$1,890.8)	<b>(\$5,113.2)</b>
Santa Fe	(\$469.5)	(\$215.1)	<b>(\$684.6)</b>	(\$951.2)	(\$443.9)	<b>(\$1,395.1)</b>
Bernalillo County	(\$426.6)	(\$239.9)	<b>(\$666.6)</b>	(\$864.4)	(\$495.1)	<b>(\$1,359.5)</b>
Las Cruces	(\$392.9)	(\$171.2)	<b>(\$564.0)</b>	(\$796.0)	(\$353.2)	<b>(\$1,149.2)</b>
Farmington	(\$253.5)	(\$112.9)	<b>(\$366.4)</b>	(\$513.6)	(\$232.9)	<b>(\$746.5)</b>
Roswell	(\$186.4)	(\$51.0)	<b>(\$237.4)</b>	(\$377.7)	(\$105.2)	<b>(\$483.0)</b>
Rio Rancho	(\$168.9)	(\$61.7)	<b>(\$230.6)</b>	(\$342.1)	(\$127.4)	<b>(\$469.5)</b>
Santa Fe County	(\$152.3)	(\$62.0)	<b>(\$214.3)</b>	(\$308.5)	(\$127.9)	<b>(\$436.4)</b>
Gallup	(\$191.4)	(\$14.6)	<b>(\$206.1)</b>	(\$387.9)	(\$30.2)	<b>(\$418.1)</b>
Clovis	(\$151.8)	(\$51.8)	<b>(\$203.6)</b>	(\$307.6)	(\$107.0)	<b>(\$414.5)</b>
Alamogordo	(\$144.0)	(\$36.5)	<b>(\$180.4)</b>	(\$291.7)	(\$75.2)	<b>(\$367.0)</b>
Hobbs	(\$153.0)	(\$8.3)	<b>(\$161.3)</b>	(\$310.0)	(\$17.2)	<b>(\$327.2)</b>
San Juan County	(\$119.4)	(\$40.2)	<b>(\$159.7)</b>	(\$242.0)	(\$83.0)	<b>(\$325.1)</b>
Carlsbad	(\$119.6)	(\$29.8)	<b>(\$149.4)</b>	(\$242.4)	(\$61.5)	<b>(\$303.9)</b>
Los Alamos	(\$72.1)	(\$49.4)	<b>(\$121.5)</b>	(\$146.2)	(\$101.9)	<b>(\$248.1)</b>
Dona Ana County	(\$83.9)	(\$32.6)	<b>(\$116.6)</b>	(\$170.0)	(\$67.4)	<b>(\$237.4)</b>
Los Lunas	(\$97.0)	(\$9.9)	<b>(\$106.9)</b>	(\$196.6)	(\$20.4)	<b>(\$217.1)</b>
Silver City	(\$81.5)	(\$24.4)	<b>(\$105.9)</b>	(\$165.0)	(\$50.4)	<b>(\$215.5)</b>
Mckinley County	(\$92.4)	(\$5.6)	<b>(\$98.0)</b>	(\$187.3)	(\$11.5)	<b>(\$198.8)</b>
Espanola	(\$85.9)	(\$11.5)	<b>(\$97.4)</b>	(\$174.0)	(\$23.7)	<b>(\$197.7)</b>
Artesia	(\$74.8)	(\$5.7)	<b>(\$80.6)</b>	(\$151.6)	(\$11.9)	<b>(\$163.5)</b>
Las Vegas	(\$60.2)	(\$16.9)	<b>(\$77.1)</b>	(\$122.1)	(\$34.8)	<b>(\$156.8)</b>
Deming	(\$63.3)	(\$10.5)	<b>(\$73.8)</b>	(\$128.2)	(\$21.8)	<b>(\$150.0)</b>
Chaves County	(\$44.0)	(\$9.7)	<b>(\$53.7)</b>	(\$89.2)	(\$20.0)	<b>(\$109.2)</b>
Portales	(\$47.5)	(\$2.6)	<b>(\$50.1)</b>	(\$96.2)	(\$5.4)	<b>(\$101.6)</b>
Curry County	(\$28.9)	(\$9.6)	<b>(\$38.5)</b>	(\$58.5)	(\$19.8)	<b>(\$78.3)</b>
Valencia County	(\$31.6)	(\$5.8)	<b>(\$37.3)</b>	(\$64.0)	(\$11.9)	<b>(\$75.9)</b>
Lovington	(\$32.8)	(\$1.4)	<b>(\$34.2)</b>	(\$66.4)	(\$2.9)	<b>(\$69.3)</b>
Sandoval County	(\$25.2)	(\$5.9)	<b>(\$31.1)</b>	(\$51.1)	(\$12.2)	<b>(\$63.3)</b>
Otero County	(\$20.2)	(\$4.7)	<b>(\$24.9)</b>	(\$40.9)	(\$9.7)	<b>(\$50.6)</b>
Eddy County	(\$18.1)	(\$3.2)	<b>(\$21.3)</b>	(\$36.6)	(\$6.6)	<b>(\$43.2)</b>
Lea County	(\$18.9)	(\$1.0)	<b>(\$19.9)</b>	(\$38.3)	(\$2.0)	<b>(\$40.3)</b>
Sunland Park	(\$5.4)	(\$0.9)	<b>(\$6.3)</b>	(\$10.9)	(\$1.9)	<b>(\$12.8)</b>
<b>Total</b>	<b>(\$5,503.5)</b>	<b>(\$2,222.8)</b>	<b>(\$7,726.3)</b>	<b>(\$11,151.0)</b>	<b>(\$4,586.6)</b>	<b>(\$15,737.6)</b>

Notes: Counties with over 48K people and cities with over 10K people based on the most recent 2010 census. County and city share of the total is based on FY12 distribution and is subject to change.

Food and Medical Hold Harmless growth is based on average food and medical inflation rates.