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

ORIGINAL DATE 2/16/15
SPONSOR Strickler **LAST UPDATED** **HB** 337

SHORT TITLE Rural Infrastructure Tax Credit **SB**

ANALYST Graeser

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY15	FY16	FY17	FY18	FY19		
	($5,000.0)	($10,000.0)	($10,000.0)	($10,000.0)	Recurring	General Fund (PIT, CIT, GRT, Comp, Withholding)

(Parenthesis ( ) indicate revenue decreases)

See Fiscal Implications below. The $10 million is the statutory annual cap. However, this is a very flexible instrument and will be fully subscribed below.

The bill may duplicate provisions of the Angel Investment Credit Act reinstatement (HB 261 and SB 413). It may also duplicate some of the provisions of SB 319 which expands the County Industrial Revenue Bond Act to allow investments in housing or extractive industries.

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY15	FY16	FY17	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
Total		$86.0	$80.0	$166.0	Recurring	TRD Operating

(Parenthesis ( ) indicate expenditure decreases)

TRD notes that transferability between tax programs and taxpayers may cause some administrative difficulties.

SOURCES OF INFORMATION
LFC Files

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

SUMMARY

Synopsis of Bill

TRD describes the bill as follows:

> "House Bill 337 creates the Rural Infrastructure Tax Credit. A taxpayer may claim a tax credit in an amount not to exceed thirty percent of the cost of the qualified investment against the taxpayer's modified combined tax liability or the taxpayer's liability pursuant to the provisions of the Income Tax Act and the Corporate Income and Franchise Tax Act. The purpose of the Rural Infrastructure Tax Credit is to stimulate economic development by providing gap funding for manufacturers, processors and natural resource extractors to build infrastructure; encourage private investment in manufacturing facilities; give rural communities an advantage in attracting investment by private industry and promote job creation. The New Mexico Finance Authority and the Department will be required to compile an annual report before December 1 of each year that includes the number of certificates of eligibility issued in the previous year, the number of taxpayers approved by the Department to receive the tax credit, the aggregate amount of tax credits and any other information necessary to evaluate the cost and effectiveness of the tax credit and whether the tax credit is performing the purpose for which it was created."

The total credits granted are limited to $10 million per calendar year. If total claims in a fiscal year exceed the cap, the credits, once approved, may be claimed with priority against the subsequent year's cap. The sunset, however, may extinguish any rollover credits after December 31, 2020. This credit is non-refundable, and amounts that exceed a taxpayer's liability for any particular tax year may be rolled forward for ten years from the year of approval. However, once granted, the tax credits may be sold or otherwise transferred to another taxpayer.

If a regular corporation makes the investment, that corporation may apply for and be granted a tax credit. The corporation may apply the tax credit against its Corporate Income Tax liability or against it gross receipts, compensating tax or withholding tax liabilities. Similarly, an individual or pass-through entity (Subchapter S corporation, partnership, or LLC, among others) may apply for and be granted a tax credit and apply that granted credit against personal income tax liability or gross receipts, compensating tax or withholding tax liabilities.

Although the title of the bill is "Rural Infrastructure Tax Credit," the only restriction is that the investment is not creditable under this act if made in a Class A County: Bernalillo County, Dona Ana County, Sandoval County, San Juan County and Santa Fe County are currently Class A counties. The remaining 28 counties, including Los Alamos County, Torrance County and Valencia County would be considered rural pursuant to the provisions of this bill.

The provisions of the bill include the requirement that the New Mexico Finance Authority do an analysis prior to granting a credit that the project is likely to produce "quantifiable benefits."

The effective date of the act is not stated – assume 90-days after adjournment. The provisions of the act are applicable to taxable years beginning on or after January 1, 2015 and ending prior to January 1, 2021.

FISCAL IMPLICATIONS

TRD notes that the demand for this credit cannot be established currently:

> "The benefits can be extended to multiple programs and there is a lack of data to confidently substantiate the impact. Additionally, a taxpayer having the ability to claim a rural infrastructure tax credit in an amount not to exceed one million dollars ($1 million) per qualified investment for not more than three qualified investments in a taxable year creates a lot of un-

predictability as to how the taxpayers will take advantage of the credit. The Taxation and Revenue Department (TRD) is assuming that this credit, like the angel investment tax credit, has a great potential to be utilized to stimulate development in rural areas that would otherwise be marginalized by limited resources. TRD therefore is assuming that the impact will be in the range of $0-$10 million. Transferability of this credit between taxpayers and tax programs in addition to the carry forwards provision will create tracking complexities."

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY15	**FY16**	**FY17**	**FY18**	**FY19**		
	(0 to $10,000.0)	(0 to $10,000.0)	(0 to $10,000.0)	(0 to $10,000.0)	Recurring	General Fund

However, LFC staff note that this is a very flexible instrument. It allows NMFA to approve investments in oil and gas extraction, other resource extraction and processing, as well as manufacturing. The credits, once approved, may be used by the investor or may be sold or otherwise transferred. The credits may be applied against virtually any tax liability of the taxpayers. Corporations, pass-through entities or individuals may apply for credits. The investment may be for buildings or infrastructure or land (if the value of the land does not exceed 50% of the investment in the project). The project must be granted a loan from a commercial bank, but the value of the loan is not specified. The project must show "quantifiable benefits," but the magnitude of those benefits is not specified. The bill does not require NMFA to pick the best projects, only the projects that are applied for first. Projects that are approved but are in excess of the cap may be rolled over to the next year's cap. All in all, this is one of the most attractive tax credits that the state has ever offered. There is little likelihood that the credit will not be fully subscribed with minimum delay. LFC believes that a more reasonable fiscal impact is that shown in the table on page 1 of this review.

This bill may be counter to the LFC tax policy principles of adequacy, efficiency, accountability and equity. Due to the increasing cost of tax expenditures revenues may be insufficient to cover growing recurring appropriations. Although the provisions of the bill require NMFA to calculate "quantifiable benefits," there is no requirement that these "quantifiable benefits" are commensurate with the amount of approved tax credits.

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

The bill does not prohibit a taxpayer from claiming this tax credit in addition to other tax credits, such as the angel investment credit, that may be available for the same investment.

This credit seems to be an extension of the venerable investment credit that provides a 5.125% tax credit against modified tax liability of manufacturers and certain other businesses for the purpose of stimulating economic development. However, in addition to manufacturers, this bill allows NMFA to approve investments in the extractive industries. To that extent, this bill, similar to others of this session (see SB 319 that extends IRB provisions to housing and extractive industries). The amount of this credit potentially far exceeds the levels of credit granted by the investment credit act.

TRD notes that the New Mexico Finance Authority issues the certificates and regulates the credit. “However, it seems that this is done before the construction is completed. TRD then comes in later and validates the true credit amount. The cap may not be truly manageable in this scenario.”

PERFORMANCE IMPLICATIONS

EDD indicates that this bill would assist that agency in accomplishing its stated mission: “Passage of this bill will increase job creation and business relocation/expansion opportunities in New Mexico. Therefore, creation of this tax credit will assist the New Mexico Economic Development Department in its efforts toward job creation, business attraction and expansion.”

The LFC tax policy of accountability is met since TRD and NMFA are required in the bill to report annually to an interim legislative committee regarding the data compiled from the reports from taxpayers taking this credit and other information to determine whether the credit is meeting its purpose.

ADMINISTRATIVE IMPLICATIONS

TRD reports that the provisions of the bill will create a moderate impact (400 hours and estimated cost $28,000) – Requires changes to the personal income tax, corporate income tax, combined reporting system (CRS) GenTax and Taxpayer Access Point documents, and configuration changes to the Business Credit Module. Additional reports need to be developed to summarize the annual credit details.

> “The agency must create forms instructions, publications and processes to record the credit and track the credit and manage and monitor the applications. Creating the credit forms would cost $6,000. One FTE would be needed to administer the credit at a cost of $80,000 to manage this program. The FTE would need to be trained in monitoring the construction, ensuring the project meets the qualifications set by the authority.”

> “The credit can be applied against personal income tax, corporate income tax and (CRS) liabilities. The CRS credit will require administrative changes to return processing and will require procedural changes for audit. Definitions could be placed closer to the top of the document to add clarity.”

RELATIONSHIP

The provisions of this bill may duplicate similar features of HB 161 and SB 413 which provide tax credits to angel investors. It may also duplicate some of the financing provisions of the SB 319 which expands the County Industrial Revenue Bond Act to allow investments in housing or extractive industries.

TECHNICAL ISSUES

TRD notes a problem, "Subsection G requires that TRD issue a document granting the tax credit even after receiving a certification from the Finance Authority. This seems redundant to Section F and how the credit is claimed. TRD suggests striking the first two sentences in Section G and changing "this section" to "Section F" in the following sentence."

> "Subsection K is requiring TRD to monitor the projects to determine if the projects are "substantially complete" within 12 months of the date of issuance of the certificate of eligibility. Recommend adding definitions for "substantially complete" and "meaningful and measurable progress," in order that Section K on page 5 can be properly administered."

LFC staff note that the sunset date of December 31, 2020 as applied to tax year investments may or may not extinguish any credits that would have been granted except for the cap. This provision should be clarified.

LG/bb