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## FISCAL IMPACT REPORT

ORIGINAL DATE 6/03/15

SPONSOR Lewis LAST UPDATED \_\_\_\_\_ HB 2 SS

SHORT TITLE Tax Package SB \_\_\_\_\_

ANALYST van Moorsel / Graeser/Sanogo

### REVENUE (dollars in thousands)

Estimated Revenue (HWMC Amendment)						Recurring or Nonrecurr	Fund Affected
Component	FY15	FY16	FY17	FY18	FY19		
Angel Investment Tax Credit	\$0.0	(\$450.0)	(\$850.0)	(\$1,250.0)	(\$2,000.0)	Recurring	General Fund
Unreimbursed/Uncompensated Medical Expenses <sup>1</sup>	\$0.0	\$0.0*	\$0.0*	\$0.0*	\$0.0*	Recurring	General Fund
Single Sales Factor for CIT	\$0.0	(\$20.0)	(\$20.0)	(\$20.0)	(\$20.0)	Recurring	General Fund
Border Zone Trade-Support Gross Receipts	\$0.0	(\$37.0)	(\$60.0)	(\$84.0)	(\$108.0)	Recurring	General Fund
	\$0.0	(\$24.0)	(\$40.0)	(\$56.0)	(\$72.0)	Recurring	Local Gov'ts
U.S. DOD Energy Gross Receipts <sup>2</sup>	\$0.0	(\$1,700.0)*	(\$3,500.0)*	(\$5,600.0)*	(\$7,800.0)*	Recurring	General Fund
	\$0.0	(\$1,300.0)*	(\$2,800.0)*	(\$4,400.0)*	(\$6,100.0)*	Recurring	Local Gov'ts
Tech Jobs and R&D Tax Credit	\$0.0	(\$1,680.0)	(\$1,600.0)	(\$1,600.0)	(\$1,600.0)	Recurring	General Fund
<b>Total General Fund</b>	<b>\$0.0</b>	<b>(\$3,887.0)</b>	<b>(\$6,030.0)</b>	<b>(\$8,554.0)</b>	<b>(\$11,528.0)</b>	<b>Recurring</b>	<b>General Fund</b>
<b>Total Local Governments</b>	<b>\$0.0</b>	<b>(\$1,324.0)</b>	<b>(\$2,840.0)</b>	<b>(\$4,456.0)</b>	<b>(\$6,172.0)</b>	<b>Recurring</b>	<b>Local Gov'ts</b>

In addition to the impacts detailed above the following table details the revenue effects from the gasoline tax, special fuels and petroleum products loading fee dual tax remediation/refund sections of the bill (sections 19, 20 and 21)

<sup>1</sup> LFC scores this deduction with a negative impact, see "Amended Fiscal Implications."

<sup>2</sup> LFC provides this estimate in a range in "Amended Fiscal Implications"

Estimated Revenue (Original SB386)					Recurring or Nonrecurring	Fund Affected
FY15	FY16	FY17	FY18	FY19		
\$0.0	(***)	(***)	(***)	(***)	Recurring	State Road Fund
\$0.0	(***)	(***)	(***)	(***)	Recurring	Local Governments Road Fund
\$0.0	(***)	(***)	(***)	(***)	Recurring	Counties & Municipalities
\$0.0	(***)	(***)	(***)	(***)	Recurring	County Road Funds
\$0.0	(***)	(***)	(***)	(***)	Recurring	Municipal Road Funds
\$0.0	(***)	(***)	(***)	(***)	Recurring	Municipal Arterial Fund
\$0.0	(***)	(***)	(***)	(***)	Recurring	Aviation Fund
\$0.0	(***)	(***)	(***)	(***)	Recurring	Motor Boat Fuel Fund
\$0.0	(***)	(***)	(***)	(***)	Recurring	Corrective Action Fund

(Parenthesis ( ) indicate expenditure decreases.)

\*\*\* In certain limited circumstances this bill would prevent double taxation of certain special fuel or gasoline gallons. See Fiscal Implications below.

**SOURCES OF INFORMATION**

LFC Files

Responses Received From

- Department of Transportation (DOT)
- Taxation and Revenue Department (TRD)
- Department of Finance and Administration (DFA)

**SUMMARY**

Synopsis Bill

The Tax Package relates to Senate Bill 386, 2015 session, excluding provisions for estate or trust distribution tax deductions, and contingency on the approval of the tribal-state class III gaming compact. The unreimbursed medical expense deduction on personal income tax carries a sunset date of 2025, while the sunset date for the department of defense directed energy and satellite services gross receipts tax deduction has been shortened from 2025 to 2021. The effective date for the gross receipts tax deductions has been moved from July 1, 2015 to January 1, 2016 to accommodate TRD’s administrative issues.

The bill makes several amendments to current statute and creates new sections of tax law. The bill’s provisions are summarized below, followed by additional detail. The bill’s provisions:

- allow the Taxation and Revenue Department to reveal tax return information to an authorized representative of a local government of another state who is charged with the responsibility for administration of that state’s tax law;
- increase the annual amount of Angel Investment Credits that can be issued to an aggregate \$2 million and eliminates some restrictions on the type and number of investments that can be made and still be eligible for the Angel Investment credits;
- create (or, perhaps, reinstate) an income tax deduction for certain unreimbursed or uncompensated medical care expenses; these deductions are allowed through December

31, 2024;

- revise the due date for corporate income tax (CIT) and franchise tax filing and payment for electronic submissions to allow extra time to file if filing electronically;
- amend the Uniform Division of Income for Tax Purposes Act (UDITPA) to allow optional single-sales income apportioning for corporate income tax (CIT) for taxpayers whose principal business activity in the state is a headquarters operation;
- restore the gross receipts tax (GRT) deduction for trade-support companies that first locate in a border zone in fiscal years 2016-2021;
- create a new section of the Gross Receipts and Compensating Tax Act to make deductible through December 31, 2020 the receipts from the sale by a qualified contractor of qualified research and development services and qualified directed energy and satellite-related inputs sold pursuant to a contract with the United States Department of Defense; and
- expand the Technology Jobs Tax Credit and to name it the Technology Jobs and Research and Development Tax Credit Act.
- provide the same treatment for petroleum products loading fee as for gasoline tax to prevent double taxation under special circumstances.

The following section provides additional information concerning each of the bill’s components. The similar legislation introduced in the 2015 regular session is identified in parentheses:

**TRD Information to Other States (HB580).** The amendment amends the Tax Administration Act to allow TRD to reveal tax return information to an authorized representative of a local government of another state who is charged with the responsibility for administration of that state’s tax laws.

**Angel Investment Tax Credit (HB261/SB413).** This amendment increases the annual amount of Angel Investment Credits that can be issued to an aggregate \$2 million and eliminates some restrictions on the type and number of investments that can be made and still be eligible for the Angel Investment credits:

- The credit percentage remains at 25 percent, but the amount of a qualified investment is no longer subject to a limit (\$100 thousand in statute). The credit for each qualified investment is limited to \$62.5 thousand.
- Rather than claiming the angel investment credit for up to two qualified investments in a tax year, the bill allows each investor only one qualified investment per investment round (federal definition) and investments in no more than 5 qualified businesses per taxable year.
- The former restriction that the total credit amount for investments made by a partnership or business association was limited to \$25 thousand is repealed.
- The limit for total allowed credits in the single business is replaced by focusing on the investor, and not the partnership or business association. However, each member of a partnership or business association may only claim a credit on the individual’s pro-rata ownership interest in the partnership.
- The amendment also extends the December 31, 2016 sunset date on the credit to December 31, 2024.
- The credit remains non-refundable, but the carry-forward period is extended to five years from the current three.
- The definition in current statute of “high technology research” is replaced by the federal

definition of “qualified research” as defined in Section 41 of the Internal Revenue Code.

- A majority of employment and a majority of the investment must be located in New Mexico.
- Claims will be paid by TRD on a first-come, first-served basis. If the total claims in a year exceed the \$2 million cap, unpaid claims will be granted priority for the following year.

**Unreimbursed or Uncompensated Medical Care Expenses (HB351).** The amendment adds a new section of the Income Tax Act to create an income tax deduction for certain unreimbursed or uncompensated medical care expenses. The deduction would sunset December 31, 2024. Depending on the taxpayer’s filing status and adjusted gross income, the deduction would be applicable if the qualifying medical expenses are not reimbursed or compensated for by insurance or otherwise and are not included with the taxpayer’s itemized deductions. Deductions would be claimed as follows for tax years beginning on or after January 1, 2015:

<b>For surviving spouses and married individuals filing joint returns:</b>	
Adjusted Gross Income:	% of medical care expenses that may be deducted
Not over \$30,000	25%
Over \$30,000, not over \$70,000	15%
Over \$70,000	10%

<b>For single individuals and married individuals filing separate returns:</b>	
Adjusted Gross Income:	% of medical care expenses that may be deducted
Not over \$15,000	25%
Over \$15,000, not over \$35,000	15%
Over \$35,000	10%

<b>For heads of household:</b>	
Adjusted Gross Income:	% of medical care expenses that may be deducted
Not over \$20,000	25%
Over \$20,000, not over \$50,000	15%
Over \$50,000	10%

These income levels and deduction percentages are the same as in the original bill (Laws 2000, 2<sup>nd</sup> SS, Chapter 7). As noted under “Significant Features,” however, the original bill was never effective because of an unfulfilled contingency.

**Corporate Income Tax Filing Dates (HB344).** For taxable years beginning on or after January 1, 2016, the amendment revises the due date for corporate income tax (CIT) and franchise tax filing and payment for electronic submissions, allowing extra time to file if filing electronically. Corporations that are approved by TRD to use electronic media for filing and paying taxes may file the return and pay tax levied on or before the 30<sup>th</sup> day of the 3<sup>rd</sup> month following the end of the taxable year for which the corporation is filing a return. Current law requires corporations to file a return on or before the 15<sup>th</sup> day of the 3<sup>rd</sup> month following the end of each taxable year.

**Oil and Gas Withholding Tax Filing Dates (HB344).** For taxable years beginning on or after January 1, 2016, a pass-through entity (PTE) may file an annual information return with TRD at the end of the month in which the entity's federal return is due if the entity's taxable year is a calendar year and if the entity uses electronic media to file the annual information return.

**Single Sales Apportionment for Headquartered Corporations (HB286).** The amendment to UDITPA allows optional single-sales income apportioning for corporate income tax (CIT) for taxpayers whose principal business activity in the state is a headquarters operation as follows:

“Headquarters operation” is defined as:

- the center of operations of a business:
  - where corporate staff employees are physically employed;
  - where centralized functions are performed, including administrative, planning, managerial, human resources, purchasing, information technology and accounting, but not including operating a call center;
  - the function and purpose of which is to manage and direct most aspects and functions of the business operations within a subdivided area of the United States;
  - from which final authority over regional or sub regional offices, operating facilities and any other offices of the business are issued; and
  - including national and regional headquarters if the national headquarters is subordinate only to the ownership of the business or its representatives and the regional headquarters is subordinate to the national headquarters; or
  
- the center of operations of a business:
  - the function and purpose of which is to manage and direct most aspects of one or more centralized functions; and
  - from which final authority over one or more centralized functions is issued.

All elections to apportion income using a single-sales apportioning formula apply to the separately filed return of the taxpayer or the combined or consolidated return the taxpayer has elected to be included pursuant to provisions of law requiring combined returns for some corporations and permitting consolidated returns.

The amendment also amends the provision governing the “throwback” rule to exclude those headquartered corporations electing for single sales apportionment from having sales out of state that are not taxable in that state being taxable in New Mexico. This is consistent with the treatment of manufacturing corporations that have elected single sales apportionment pursuant to the 2013 amendment that authorized such apportionment.

**Trade Support Company GRT Deduction (SB332).** The amendment restores the GRT deduction for trade-support companies that first locate in a border zone between January 1, 2016 and December 31, 2020. Currently, the deduction is available only to trade-support companies that first located in New Mexico within 20 miles of a port of entry on New Mexico’s border with Mexico during fiscal years 2004-2013.

Taxpayers allowed a deduction must report the amount of the deduction separately, and TRD must compile an annual report on the deduction that includes the number of taxpayers approved by the TRD to receive the deduction, the aggregate amount of deductions approved and any other

information necessary to evaluate the effectiveness of the deduction. Beginning in 2016 and every four years thereafter that the deduction is in effect, TRD must compile and present the annual reports to the Revenue Stabilization and Tax Policy committee and the LFC with an analysis of the effectiveness and cost of the deduction.

**U.S. Department of Defense Energy Gross Receipts (HB94/SB502).** The amendment creates a new deduction for gross receipts from the sale by a qualified contractor of qualified research and development services and qualified directed energy and satellite-related inputs sold pursuant to a contract with the to the United States Department of Defense. Receipts are deductible until December 31, 2020, and the deduction would be limited to new contracts entered into on or after January 1, 2016.

The purposes of the deduction are to promote new and sophisticated technology, enhance the viability of directed energy and satellite projects, attract new projects and employers to New Mexico and increase high-technology employment opportunities in New Mexico.

The following terms are defined:

- "directed energy" means a system, including related services, that enables the use of the frequency spectrum, including radio waves, light and x-rays;
- "inputs" means systems, subsystems, components, prototypes and demonstrators or products and services involving optics, photonics, electronics, advanced materials, nanoelectromechanical and microelectromechanical systems, fabrication materials, test evaluation and computer control systems related to directed energy or satellites;
- "qualified contractor" means a person other than an organization designated as a national laboratory by act of congress or any operator of national laboratory facilities in New Mexico; provided that the operator may be a qualified contractor with respect to the operator's receipts not connected with operating the national laboratory;
- "qualified directed energy and satellite-related inputs" means inputs supplied to the department of defense pursuant to a contract with that department entered into on or after January 1, 2016;
- "qualified research and development services" means research and development services related to directed energy or satellites provided to the department of defense pursuant to a contract with that department entered into on or after January 1, 2016; and
- "satellite" means composite systems assembled and packaged for use in space, including launch vehicles and related products and services."

Taxpayers allowed the deduction must separately report the amount of the deduction, and TRD must compile an annual report on the deduction that includes the number of taxpayers that claimed the deduction, the aggregate amount of deductions claimed and other information necessary to evaluate the deduction. Beginning in 2017 TRD and EDD must present the report to the Revenue Stabilization and Tax Policy committee and the LFC with an analysis of the effectiveness and cost of the deduction and whether the deduction is performing the purpose for which it was created.

**Technology Jobs and Research and Development Tax Credit (HB230).** The amendments to the Technology Jobs Tax Credit Act combine two existing tax credits, the Technology Jobs Tax Credit and the Small Business Research and Development Tax Credit, and amends current qualifying criteria to provide additional benefit and allow for greater participation.

The amendment increases the amount of the basic and the additional credit available in the existing Technology Jobs Tax Credit from 4% to 5% of qualified expenditures and increases the employment maximum definition of small business from the existing Small Business R&D Tax Credit from 25 employees to 50 employees. The definition of "rural areas" in the existing Technology Jobs Tax Credit is expanded to allow more businesses to claim the higher 10% credit in rural areas and allows a portion of the additional credit to small businesses to be refunded, based on the size of the business.

The new refundability provision is based on total qualified expenditures of small businesses:

- less than \$3 million, 100% of the excess additional credit is refundable;
- \$3 million to less than \$4 million, 2/3 of the excess will be refunded;
- \$4 million to less than \$5 million, 1/3 of the excess will be refunded.

"Qualified research and development small business" is defined as a taxpayer employing 50 or fewer employees, had total qualified expenditures of no more than \$5 million and did not have more than 50 percent of its controlling interest owned by another business. The amendment removes the restrictions under the existing Small Business R&D Credit that require business to have qualified research expenditures of at least 20 percent of total expenditures.

The amendment excludes mergers as a source of eligible payroll growth, limits the carry forward provision to 3 years, and adds reporting requirements to better allow the TRD to enforce the recapture provision.

The amendment excludes local option GRT from taxes against which the credit can be applied, repeals the Small Business R&D Tax Credit, and provides a transition procedure for current claims outstanding as of January 1, 2016. Taxpayers that claim the credit after January 1, 2016 may claim the credit in accordance with the new statute.

**Gasoline and Special Fuels Taxation (SB386).** The bill amends the fuel tax refund provisions of Sections 7-13-11 and 7-16A-13 NMSA 1978 to prevent instances of double taxation in which a claim for refund of taxes paid on gasoline or special fuels (diesel) is denied in certain limited circumstances. Those circumstances involve tax paid on gasoline or diesel previously received from a source different than a refiner or pipeline terminal. The bill provides a mechanism to refund the gasoline or diesel excise tax paid on the fuel by someone other than the claimant.

The bill also provides a method to refund the petroleum products loading fee on the same fuel at the same time and in the same manner as the original bill's gasoline excise tax credit or the special fuel excise tax credit.

**Applicability.** The amendment provides for various dates of applicability:

- The provisions of the technology jobs credit apply to taxable years beginning on or after January 1, 2016.
- Qualified investments made on or after January 1, 2015 will qualify for the new Technology Jobs credit;
- The provisions of the GRT-related amendments are effective January 1, 2016.

**FISCAL IMPLICATIONS**

**Angel Investment Tax Credit.** Utilization of the Angel Investment Credit has increased significantly. The history, as reported by DFA is as follows:

Calendar Year	No. of Investments	Amount of CY Investment	Amt. of Credit	Avg. Investment	Avg. Per Investment
2005	2	\$130	\$33	\$65	\$17
2006	2	\$330	\$83	\$165	\$42
2007	6	\$785	\$196	\$131	\$33
2008	7	\$1,310	\$328	\$187	\$47
2009	6	\$750	\$188	\$125	\$31
2010	5	\$562	\$141	\$112	\$28
2011	2	\$1,300	\$325	\$650	\$163
2012	7	\$1,600	\$400	\$229	\$57
2013	6	\$1,500	\$375	\$250	\$63
<b>Total</b>	43	\$8,267	\$2,067	\$192	\$48

(In thousands of dollars)

The amount for CY2013 has been approximated and the amount for CY2014 not reported. Average investment from the inauguration of the credit in 2007 through FY13 averaged \$192 thousand per investment and \$48 thousand in credits per investment. Note: data for CY 2013 and 2014 have not been provided at the time of this review. TRD has just published the 2014 Update of the Tax Expenditure report. In that document, TRD reports claims paid as follows:

	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013
<b>Fiscal Impact</b>	\$152.80	\$261.6	\$250.0	\$325.2	\$310.7
<b>Number of Claims Paid</b>	27	37	44	60	45

Although these tables do not seem consistent they report different things. The DFA table is based on information from the Angel Investors and the TRD data is based on claims actually paid.

In last year’s HB-94 and SB-114, TRD reported:

“...currently, the angel investment tax credit amounts to an average of about \$350 thousand per year. This bill expands the opportunity for investors to make more investments per year and also raises the credit to twenty-five percent of \$250 thousand per investment. Using confidential taxpayer data from previous years of the angel investment tax credit and making estimates of the level of new investment attracted by the increased maximums, the Taxation and Revenue Department (TRD) estimates that the credit will increase gradually until reaching the new yearly maximum of \$2 million in fiscal year 2019. Due to the amount of time needed for planning large investments, a portion of the initial increase is projected to come from existing investors. TRD data shows that in a given year there are a few investors that are already making qualified investments greater than \$100 thousand, even though they will only receive a credit on the first \$100 thousand under the current statute. Those investors would receive a larger credit on the same size investment under this bill, and would have the opportunity to make more eligible investments in a year. Over time, it is



expected that the increased credit amounts available will attract new investors which should push the credit to reach the new cap.”

The estimated impact of these provisions is shown below:

Angel Investment Tax Credit	FY15	FY16	FY17	FY18	FY19	Fund
	\$0.0	(\$450.0)	(\$850.0)	(\$1,250.0)	(\$2,000.0)	General Fund

**Unreimbursed or Uncompensated Medical Care Expenses.** TRD and DFA score the general fund revenue impact as zero; however, this provision’s fiscal impact can be interpreted in two ways:

- TRD reports it has allowed this separately-stated deduction and included it on its PIT return forms for the past 14 years despite the deduction not being in law (see “Significant Issues”). The department’s analysis notes this bill would allow the deduction to be continued to be taken for tax years 2015 and onward<sup>3</sup>. TRD considers the changes in the bill to be a technical amendment and reports the bill has no fiscal impact.

Because the deduction has been taken in previous years and is considered in the February 2015 consensus revenue estimate, enactment of the bill would not reduce general fund revenue compared with the February estimate.

- DFA’s analysis notes the February general fund revenue estimate did not make an adjustment for the fact that this deduction would not be allowed for taxable year 2015, so PIT revenue would not deviate from the consensus revenue estimate by this bill becoming law. DFA contends the 2014 tax return forms have not been edited to remove this deduction, so it is still available under current law. As a result, DFA scores this bill as having zero fiscal impact. In a memo dated April 29, 2015, DFA points out that deletion of this deduction was not included in the General Fund forecast, and that relative to the forecast – which is the standard baseline from which to measure the fiscal impact of proposed legislation – SB 386, as amended, will have no fiscal impact. Because the consensus revenue group did not increase personal income tax revenues in the February 2015 forecast to reflect the elimination of this deduction, the deduction is already accounted for in the forecast and therefore the provision in SB 386 as amended has no fiscal impact.

In addition, it is not clear at this time that the deduction should be removed when the forecast is updated. Further legal analysis is warranted given that the deduction has been in place for 15 years.

- However, current law does not provide for this deduction. If the bill is not enacted, the deduction could *not* be taken in tax years 2015 onward, the department would not include this deduction on PIT forms, and general fund revenue would increase. As such, the status quo would be an increase in general fund revenue and fiscal impact of the bill could be considered negative. This increase is not included in the consensus general fund revenue estimate, as the consensus group was not aware that the deduction was not permitted under current law until after the introduction of this bill. However, future consensus estimates should consider the presence or absence of this deduction.

<sup>3</sup> Tax year 2015 returns are due by April 15, 2016 in the 2016 state fiscal year. A small percentage of the revenue effect would be realized in the 2017 state fiscal year from taxpayers filing for a two-month or six-month extension.

This is a significant deduction, and it is important the Legislature is informed of its size. TRD reports the deduction is claimed on approximately one third of PIT returns, and LFC staff has requested that TRD provide data on the amount of the deduction, as this information is not included in the agency’s analysis of the bill. As of the writing of this FIR, LFC staff has not received this information. LFC staff approximated the general fund cost of the deduction at approximately \$8-10 million, based on the TRD estimate of the initial deduction in 2000, using the growth rates of actual net personal income tax receipts to estimate the impact in the current forecast period of FY15-FY19. Of final note, DFA reports TRD staff have begun analysis on the fiscal impact to General Fund of the deduction. Preliminary results suggest that the deduction is much less than the LFC figure, perhaps as low as \$2-3 million.

Unreimbursed Or Uncompensated Medical Expenses	FY15	FY16	FY17	FY18	FY19	Fund
	\$0.0	\$0.0- (\$8,000.0)	\$0.0 - (\$8,300.0)	\$0.0 - (\$8,600.0)	\$0.0 - (\$8,900.0)	General Fund

It is important to note that these estimates do not include adjustments for the implementation of the Affordable Care Act or the expansion of Medicaid. Further, the assumptions on which the estimate was made in 2000 may no longer hold, for example, the percentage of filers taking advantage of the deduction may be higher in the present day after 14 years of the deduction being available.

**Corporate Income Tax Filing Dates.** TRD anticipates this provision will have no fiscal impact.

**Single Sales Apportionment for Headquartered Corporations.** TRD indicates the sample of companies that would be eligible to take this income apportioning option and that would benefit from the election is very small, comprising only \$8.7 million in gross income, based on tax year 2012 data. TRD states here are as few as 200 current New Mexico corporations which file under the non-manufacturing NAICS codes and have headquarters in New Mexico. The impact was estimated by apportioning these firms’ income under the current and proposed formulae and assuming corporations elect to choose the apportioning formula that minimizes their tax liability.

**The fiscal impact presented in the revenue table reflects a phase-in of the apportionment formula pending an updated estimate from TRD. It is important to note that the top tier corporate income tax rate has been reduced over a five-year period from FY 2015 through FY 2019. This reduction is reflected in the following table.<sup>4</sup>**

DFA also states the fiscal impact is expected to be small as there are few existing businesses that qualify for this election. However, DFA adds that to the extent that the provisions allowed through this legislation attract headquarters to the state, the economic impact to the New Mexico economy through the creation of relatively high-salaried jobs would be positive.

Single Sales Factor for Corporate Income	FY15	FY16	FY17	FY18	FY19	Fund
	\$0.0	(\$9.6)	(\$12.7)	(\$17.7)	(\$25.7)	General Fund

**Trade Support Company GRT Deduction.** The bill extends the credit for new companies that first locate in the border zone between FY16-FY21. TRD reports taxpayers that became eligible

<sup>4</sup> Laws 2013, ch. 160, § 3: top corporate income tax rate is 7.6% for tax periods prior to January 1,2014. The top rate will be reduced in five steps to 5.9% for tax years beginning after January 1, 2018.

for the deduction by first locating in New Mexico between July 1, 2003 and July 1, 2013, remain eligible to deduct receipts for five years after locating in the border zone. The gross receipts of currently eligible companies are not included in the estimated impact of this bill.

TRD adds that the geographic areas covered are also limited and largely very rural, further limiting the revenue impact. TRD considered all of Columbus, Sunland Park, Anthony and unincorporated Luna, Dona Ana and Hidalgo Counties in its estimate. Combining the narrow industry definition, the small geographical area, and the eligibility of only taxpayers that are new to the border zone, TRD reports the impact is relatively small. In FY14, taxpayers registered in the applicable NAICS industry codes and locations accounted for about \$10.5 million in total gross receipts, \$4.2 million in taxable gross receipts, and \$275 thousand in gross receipts tax paid.

TRD reports that between FY09 and FY14, GRT for “trade support” companies within a 20 mile radius of a point of entry on the New Mexico-Mexico border has increased by an average of 10.5 percent a year. Assuming similar growth continues the FY16 revenue impact would be about \$61 thousand, assuming all of the growth is from newly located companies.

Border Zone Trade-Support Gross Receipts	FY15	FY16	FY17	FY18	FY19	Fund
	\$0.0	(\$37.0)	(\$60.0)	(\$84.0)	(\$108.0)	General Fund
	\$0.0	(\$24.0)	(\$40.0)	(\$56.0)	(\$72.0)	Local Governments

**U.S. Department of Defense Energy Gross Receipts.** The Economic Development Department reports in its analysis of the bill that the Air Force Research Laboratory at Kirtland Air Force Base is the primary purchaser of directed energy and satellite research and development services with a procurement budget of approximately \$700 million, approximately 65 percent of which is currently spent out of state. EDD notes that of the \$245 million spent in New Mexico, approximately 70 percent (\$171.5 million) would qualify for the deduction. Applying Albuquerque’s 7.0 percent tax rate, the estimated fiscal impact on GRT collections totals approximately \$12 million, resulting in an average annual loss of \$6.7 million to the general fund. Out-year revenue impacts depend on the size of AFRL’s New Mexico budget, but for the purposes of this FIR, are assumed to grow at the rate of GRT growth in December consensus revenue estimate.

The bill makes the deduction available to contracts entered into on or after January 1, 2016; however, nothing in the bill would preclude contractors from renegotiating contracts after the bill’s effective date, thus achieving the savings equal to foregone GRT. It is unclear at what rate contractors would renegotiate contracts, and for this reason the FIR presents a range of revenue impacts. The low end of the range assumes 25 percent of contractors renegotiate contracts each year, whether at the expiration of existing contracts or earlier, meaning the full impact of the bill would be seen after four years. The high end assumes all contractors renegotiate immediately, meaning the full impact of the bill is realized in the first year the deduction is in law.

U.S. DOD Energy Gross Receipts	FY15	FY16	FY17	FY18	FY19	Fund
	\$0.0	(\$850.0- \$3,350.0)	(\$3,500.0 - \$7,000.0)	(\$5,600.0- \$7,400.0)	(\$7,800.0)	General Fund
	\$0.0	(\$650.0- \$2,650.0)	(\$2,800.0- \$5,600.0)	(\$4,400.0- \$5,800.0)	(\$6,100.0)	Local Governments

DFA notes there are several other types of deductions that apply to this spending under present law as described further below. To derive its estimate that 42 percent of gross receipts in this industry are taxable, DFA used TRD's RP-80 report, which shows total and taxable gross receipts by business type. In the R&D services industry, an average of 42% of total gross receipts are taxable according to the RP-80 data. DFA reports sales of tangible property to the federal government are deductible. Thus, any tangible property purchased by the AFRL as part of their R&D spending is currently deductible. In addition, sales of subcontractors to contractors are deductible if the final sale by the contractor to the AFRL is taxable. In addition to these, there is also a deduction for sales of R&D services to a 501(c)3 organization for resale to the U.S. Air Force (section 7-9-54.1). For all of these reasons, it is reasonable to assume that less than 100 percent of receipts from sales of R&D services to the DOD are taxable under current law.

However, information regarding new contracts for services that would be made deductible under this provision further complicate the estimate, and further research is warranted. For instance, Boeing Co.'s Directed Energy Systems division won a \$30 million contract to build a precision beam control system for ship-mounted solid-state lasers. The company's directed energy operations are centered in Albuquerque, and further analysis is required to determine whether this contract increases the taxable base that would be made deductible.

An analysis of the Air Force Research Laboratory's economic impact on the state was conducted by UNM's Bureau of Business and Economic Research (BBER) and published in February 2015. This analysis indicated the direct and indirect economic impact of the AFRL in New Mexico was \$536 million (an excerpt of this study is appended to this FIR), with an estimated indirect gross receipts tax impact of \$6.0 million, of which approximately \$3.6 would be recorded by the general fund and \$2.4 million to local governments.<sup>5</sup> The deduction proposed in this bill, however, is broader than the AFRL analysis. Any directed energy or satellite services receipts from contracts with the Department of Defense would be eligible for the deduction.

LFC staff, however, while accepting DFA's premise that less than 100 percent of receipts from sales of directed energy and satellite services R&D contracts to the DOD would be taxable, note that the bulk of the deductions reported in the RP-80 may represent receipts from services delivered out-of-state. These receipts have been deducted in the EDD/LFC analysis. The BBER report referred to above assumed that all of the receipts from the AFRL contracts would be GRT taxable and that a relatively small proportion of the contracts would themselves generate newly taxable receipts from subcontracts negotiated by the prime contractors.

**Technology Jobs and Research and Development Tax Credit.** Using FY14 gross receipts tax, compensating tax, and withholding, TRD estimated the fiscal impact of the bill by updating the fiscal impact provided for HB 16 introduced during the 2014 session. TRD then determined results of the updated estimate are marginal when compared to the original and would fall well within the margin of error. TRD notes the difference between the two estimates is largely due to updated forecasts for manufacturing employment provided by UNM's Bureau of Business and Economic Research which are essentially flat over the next several fiscal years.

The credit is assumed to grow at the rate of growth of manufacturing employment, since manufacturers constitute most of the credit taken.

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<sup>5</sup> <http://afrlnewmexico.com/economic-impact-report/>

Tech Jobs & Research Development Tax Credit	FY15	FY16	FY17	FY18	FY19	Fund
	\$0.0	(\$1,680.0)	(\$1,600.0)	(\$1,600.0)	(\$1,600.0)	General Fund

**Fuel Tax.** The fiscal impact of the fuel tax provisions of the bill is undefined but likely to be minimal to the State General Fund or the State Road Fund and other beneficiary funds. The scenarios where tax is currently applied twice on the same gallons of fuel are not common or represent preferred practices for rack operators. Because the double taxation events have occurred in the past in very small numbers and during exceptional situations, the fiscal impact considers double taxation may occur in the future for short periods of time until normal pipeline or refinery functions can be improved. The volume of these events may be meaningful for a single taxpayer’s profitability during their duration, but is not a significant portion of total annual gasoline or special fuel revenue.

**AMENDED SIGNIFICANT ISSUES**

**TRD Information to Other States.** TRD reports that several large states, including New York, have shifted some of the administration of its state’s tax laws to large municipalities within the state. To be fully compliant with our compact with the Multistate Tax Commission (MTC), the department needs to be able to share return information with these large local governments in other states. This bill will bring us into compliance with the MTC, and TRD reports it will enter into Memorandums of Understandings with the local governments that administer state tax laws.

DFA, however, is concerned about misuse of data:

“There is no requirement that the receiving local government of another state use the return information for tax purposes only, or that confidentiality requirements as provided in Sections 7-1-8 and 7-1-76 NMSA 1978 are applicable. Accordingly, there would be no limits on how the receiving local government of another state could use the return information, nor would the receiving local government be prohibited from further disclosure of the return information.”

“Moreover, the penalty in current law for misuse of taxpayer information is too low (misdemeanor charge with a \$1,000 fine) to serve as a deterrent to the potential theft or misuse of taxpayer information.”

**Angel Investment Tax Credit.** In order for an activity to qualify for an Angel Investment Credit, the research must meet all the requirements as described in section 41(d) of the Internal Revenue Code. Under section 41(d), the term "qualified research" means research:

1. With respect to which expenditures may be treated as expenses under section 174, (also known as the section 174 test);
2. Which is undertaken for the purpose of discovering information which is technological in nature, (also known as the discovering technological information test);
3. The application of which is intended to be useful in the development of a new or improved business component of the taxpayer (also known as the business component test); and

4. Substantially all of the activities of which constitutes elements of a process of experimentation for a qualified purpose (also known as the process of experimentation test).

To be considered “qualified research”, the taxpayer must be able to establish that the research activity being performed meets ALL four of the above tests. These tests must be applied separately to each business component of the taxpayer.

**Unreimbursed or Uncompensated Medical Care Expenses.** TRD indicates it has been allowing the deduction since taxable year 2000. Section 3 of Chapter 7 of Laws 2000 (2nd S.S.) initially enacted this deduction with a contingent effective date. The contingency language read as follows:

“The provisions of this act shall not become effective unless Senate Bill 33 or similar bill of the second special session of the forty-fourth legislature is enacted into law and the General Appropriation Act of 2000 passed by the second special session of the forty-fourth legislature and enacted into law includes an appropriation of four million nine hundred seventy-five thousand dollars (\$4,975,000) for the sole purpose of implementing an amendment to the state Medicaid plan making eligible an individual who is the parent of a child under nineteen years of age who resides with that parent and whose family income does not exceed sixty percent of the federal poverty guidelines.”

Senate Bill 33 was vetoed by the governor and the appropriation of \$4,975,000 was in Laws 2000 (2nd S.S.), ch. 5, but was line item vetoed. As such, the contingency was not met, the deduction did not take effect, and TRD should not have been allowing the deduction.

**Corporate Income Tax Filing Dates.** TRD reports that currently, New Mexico CIT returns are due on the same day as the company’s federal income tax return. The additional time to file allows corporate taxpayers time to assure compliance with New Mexico laws and some reprieve during the busy tax season. TRD encourages taxpayers to file electronically. TRD adds the bill likewise brings CIT extension for electronic filers into line with the extension granted on the personal income tax side for electronic filers.

EDD adds electronic filings will increase both tax payer and agency efficiency and reduce complications and potential late delivery of paper filings. According to EDD, the Internal Revenue Service estimates that more than 20 percent of paper filings contain errors, compared with just 1 percent of electronic filings.

**Single Sales Apportionment for Headquartered Corporations.** 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) discussed 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

created 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, does not punish firms for investing or employing workers within a state. The same legislation that reduced the CIT rate phased in an optional single-sales factor income apportionment formula for manufacturing corporations.

DFA reports many states currently offer headquarters incentives, including Alabama, Florida, Georgia, Indiana, South Carolina, and Tennessee, among others.

**Trade Support Company GRT Deduction.** The Economic Development Department (EDD) states the deduction is critical in recruiting trade support companies to the Borderplex and creating jobs in the transportation, warehousing, and logistics industries. Together with the 2011 legislation allowing overweight vehicles to operate within a limited radius of the international border crossing at Santa Teresa, the GRT deduction for locomotive fuel enacted last year, and the state’s capital investment in the water and wastewater systems in Santa Teresa, companies such as Union Pacific, TE Connectivity, and Alaska Structures have moved to southern New Mexico or expanded their operations there. In the last three years and due to these concerted efforts, the Borderplex has become an international business hub.

EDD reports on some economic development successes in the border zone, stating W. Silver Recycling, a metal recycling company, and Twin Cities, a warehousing, distribution and logistics company, expanded to Santa Teresa in July 2014, creating 20 and 50 jobs respectively. EDD reported a record number of commercial crossings at the Santa Teresa port of entry in 2012 totaling 81,339 vehicles, 13 percent higher than the previous record.

**U.S. Department of Defense Energy Gross Receipts.** DFA points out in its analysis of HB94 that the use of a GRT in place of a sales tax allows New Mexico to capture some of the transactions that occur as a result of the strong federal presence in the state. However, this tax system may result in higher costs to contractors than in other states, which are often passed along to the federal agencies. This may put contractors that operate in New Mexico at a competitive disadvantage as those out of state may be able to offer lower bids due to their state’s tax structure. A deduction against some of these gross receipts as provided for in this bill may reduce overall costs for contractors in the state and make New Mexico a more attractive location for increased DoD activity.

**Technology Jobs and Research and Development Tax Credit.** The purpose of the amended credit is to provide a favorable tax climate for technology-based businesses engaging in research, development, and experimentation and to promote increased employment and higher wages in those fields in New Mexico.

**Gasoline and Special Fuels Taxation.** NMDOT provides the following analysis:

New Mexico (like all other states) does not apply motor fuels excise taxes at the point of final retail sale to the end consumer. This allows better compliance, lower costs for business, easier administration, and thousands of fewer taxpayers; however, it

necessitates more complex definition of a taxable event where and when the gasoline or special fuel tax is due. In New Mexico's statutory terms, the tax is applied when fuel is "received." Different events are defined as "receiving" fuel and triggering the taxable event such as:

- 1) When fuel is loaded for transport (such as into a tank truck) from a refinery or pipeline terminal it is "received" by the rack operator (the fuel's owner) at that time.
- 2) When fuel is first imported into the state other than by pipeline (such as when a tank truck drives into New Mexico) the person who owns the fuel being imported has "received" the fuel.
- 3) When fuel from a refinery or terminal is transferred into a container from which sales will be made not involving further transport it is "received."
- 4) In order to reapply tax after a deductible receipt to a tribe, fuel is also "received" after it has been initially received by an Indian tribe within that tribe's territory and subsequently is moved from that tribe's territory to another part of New Mexico (excluding in a vehicle's gas tank or via pipeline).

This system allows a taxable event to be triggered once (and generally only once) for every gallon of fuel that is ultimately sold in New Mexico. However, in certain uncommon circumstances a taxable event can be triggered twice on the same gallons of fuel. Fuel terminal tanks usually receive all of their fuel via inter-state pipeline or nearby refinery, but sometimes that supply is interrupted (such as due to refinery fire or pipeline maintenance) and terminal tanks must still be supplied to meet obligations to wholesale distributors. If a terminal tank is supplied by fuel imported by truck from out-of-state, the fuel was "received" when it crossed into New Mexico by truck and it will be "received" again when it is transferred back out of the terminal thus being taxed twice. There is no method in current statute to remedy double taxation in this scenario.

The intent of the bill is to create a new credit or refund to remedy the above double taxation scenario. If a rack operator (the holder of fuel at a terminal) proves to the Taxation and Revenue Department's satisfaction that 1) tax was paid on fuel "received" into a terminal from a source other than a refiner or pipeline (such as by tanker truck), and 2) it will subsequently be loaded for transport from the terminal, then the rack operator may claim a refund on that first tax paid.

## **TECHNICAL ISSUES**

The bill may not allow TRD to rectify double taxation in all scenarios. The new proposed provisions would not permit TRD to approve a claim for refund on any fuel when the issue was whether the documentation was defective. If the rack operator could not prove the fuel received by alternative means was tax-paid, a TRD auditor could not approve the refund claim.

PvM/bb/je/aml



From 2014 BBER Study:

AFRL New Mexico contracted The University of New Mexico's Bureau of Business and Economic Research to compile the economic impact study based on its spending in New Mexico. Using fiscal year 2013 figures, the study found AFRL directly spent \$315 million in New Mexico on employee salaries and benefits, purchases of goods and services, construction and contracts with New Mexico businesses. More than half of that—\$167 million—was spent on outside contractors.

In addition, the study found AFRL's investment in New Mexico had an indirect impact to the state of an additional \$221 million. ...

The study found AFRL has a tremendous employment impact in New Mexico, creating 861 direct jobs plus 1,033 contractor jobs and 1,820 indirect jobs in the private sector.

It is estimated that the total tax revenues to the State in FY13 as a result of the spending by AFRL amounted to \$30.6 million consisting of \$19.7 million in GRT (\$13.7 million direct and \$6.0 million indirect and induced), \$7.8 million in personal income tax, and \$3.2 million in property tax.