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

ORIGINAL DATE 3/13/19
SPONSOR SFC **LAST UPDATED** ______ **HB** ______

SHORT TITLE Industrial Revenue Bond Changes **SB** 511/SFCS

ANALYST Clark/Graeser

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY19	**FY20**	**FY21**	**FY22**	**FY23**		
	Indeterminate and Highly Variable, Possibly ($1,000.0) to ($10,000.0) in a Given Year				Recurring	General Fund
	Indeterminate				Recurring	Local Governments
	Indeterminate but Negative				Recurring	GOB Bonding Capacity

Parenthesis ( ) indicate revenue decreases

SOURCES OF INFORMATION
LFC Files

Responses Received From (for a similar bill)
New Mexico Attorney General's office (NMAG)
New Mexico Finance Authority (NMFA)
Economic Development Department (EDD)

SUMMARY

Synopsis of Bill

The Senate Finance Committee Substitute for Senate Bill 511 repeals the municipal Industrial Revenue Bond Act and the County Industrial Revenue Bond Act and enacts a new, consolidated local government Industrial Revenue Bond Act. Industrial revenue bonds (IRBs) are discussed in more detail in *Significant Issues*, but the primary intent typically is not for use as a financing instrument but to remove taxability from property taxes, gross receipts taxes (GRT), and compensating taxes.

The bill significantly expands IRB applicability to the extractives industry, water utilities, and electricity transmission in the following ways:

- It allows for the operation of a mine "not otherwise in operation"

  - Current statute for municipalities does not allow this at all
  - Current statute for counties has more restrictive language stating for a mine "that has not been in operation prior to the issuance of bonds for the project"
- It allows for the operation of an energy product refinery, treatment plant, or processing plant "not otherwise in operation"
  - Current statute for municipalities does not allow this at all
  - Current statute for counties has more restrictive language stating for a facility "that was not in operation prior to the issuance of bonds for the project"
- It allows for the operation of a water service utility enterprise
  - Current statute for municipalities does not allow this, although the statute for counties does allow this
- It allows for the operation of an electricity generation or transmission facility
  - Current statute allows electric generation facilities but not transmission facilities

It narrows IRB applicability for counties to exclude the sale of goods at retail; currently this is allowed under county IRBs but not municipality IRBs. It also potentially narrows IRB applicability by specifying that a telecommunications sales enterprise only qualifies if it makes the majority of its sales to persons outside the state.

Under current statute, when a county or municipality offers an IRB, it can choose to exempt the relevant taxes and receive no direct financial benefit in return, or more commonly it can choose to require a payment in lieu of taxes (PILOT) from the company to make up for some portion of the lost tax revenue. Almost without exception, it is at the discretion of the county or municipality issuing the IRB whether to forgo all or a portion of the taxes. The bill continues this practice and keeps the exception but makes the following changes:

- It requires that for projects to be situated in more than one county, each county assessor, local government, and taxing entity be notified
  - It provides these entities the opportunity to negotiate PILOTs or other consideration from the person proposing the project to the entities. If any local taxing entity fails to reach an agreement with the person proposing the project, that taxing entity forfeits its right to any remuneration.
- It requires the state to receive a PILOT of 5 percent of the total value of PILOTs to the other entities and 5 percent of any other consideration given

It removes a non-compete clause in current statute for counties but not municipalities – currently, if a county plans to issue an IRB, an existing business that alleges the proposed project would directly and substantially compete with it may file a complaint with the Board of Finance, and the bonds shall not be issued unless the Board of Finance determines otherwise. This bill follows the statute for municipalities in this regard and provides no protection to existing businesses. See *Other Substantive Issues* for more information on this issue.

It updates the "contribution by a local government" section to specify that contributions allowed under the Local Economic Development Act are permissible.

It uses different language regarding the construction of the act. Existing statutes say nothing in the acts shall be construed as any additional restriction or limitation of powers the county or municipality would otherwise have, but the powers in the statutes shall be construed as cumulative. This bill instead states, "The Industrial Revenue Bond Act shall be construed liberally to promote its purpose."

It repeals an existing provision that requires an employer benefitting from an IRB project funding in a class B county if the IRB exceeds $8 million to provide health insurance for employees and pay 50 percent of the premiums.

It adds authorization to use IRBs for the provision of entertainment to the general public, although it is unclear why this is needed given the retained language allowing for the supplying of services to the general public. This may or may not be broadening the applicability of the statute.

It makes various other changes from the existing statutes, although the remainder appear to be of relatively minor significance.

The bill repeals the existing two acts related to IRBs but notes the repeal and any changes in this bill shall not impair or otherwise apply to outstanding bonds.

The effective date of this bill is July 1, 2019.

FISCAL IMPLICATIONS

This bill likely narrows the GRT base. See *Significant Issues* for more information. This bill expands a special tax feature that functions like tax expenditure with a cost that is difficult to determine but likely significant. LFC has serious concerns about the significant risk to state revenues from tax expenditures and the increase in revenue volatility from erosion of the revenue base.

The committee recommends the bill adhere to the LFC tax expenditure policy principles for vetting, targeting, and reporting or be held for future consideration. Because this bill was not vetted and could have significant negative revenue impacts for decades, it should be held for future consideration and vetted during the 2019 interim.

The *Significant Issues* section discusses taxability issues in more detail, but the table below shows what is taxable, deductible, or exempt under an IRB. The general fund revenue impact cannot be estimated with any accuracy, but it could be significant. For a very large project or multiple projects, the cost could be as much as $10 million or more.

	IRB Project
Construction GRT	Taxable
Equipment GRT	Deductible
Equipment Comp	Deductible
Property Tax	Exempt for period of bonds

IRBs may be issued for up to 30 years under existing statute and the provisions of this bill. Expanding the allowable uses for IRBs creates an indeterminate but potentially significant revenue loss for the general fund, and unlike other tax expenditures that may be repealed in any given year, once issued, these bonds can remain in existence for up to three decades. Therefore, any changes require more careful scrutiny and vetting than changes to traditional tax expenditures.

This bill may be counter to the LFC tax policy principles 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

This bill likely narrows the GRT base. Many of the efforts over the last few years to reform New Mexico's taxes focused on broadening the GRT base and lowering the rates. Narrowing the base leads to continually rising GRT rates, increasing volatility in the state's largest general fund revenue source. Higher rates compound tax pyramiding issues and force consumers and businesses to pay higher taxes on all other purchases without an exemption, deduction, or credit.

History and Purpose

IRBs function as tax expenditures, and despite the name, are not typically used as the mechanism for financing a project but instead are used as a method to reduce taxation for a business, primarily long-term property tax, gross receipts tax, and compensating tax relief.

The intent for IRBs is to authorize local governments to acquire the assets of a private business and then lease them back for tax relief purposes to spur economic development. It is not intended to authorize any local government itself to operate such an enterprise. On paper, the sponsoring government "owns" the project's assets, including buildings, land, and infrastructure, and leases these assets to the operating company. The lease payments are calculated to service the IRB debt from the bonds sold at the inauguration of the project (and usually bought by the operating company or its holding company).

Since the project's assets are "owned" by a government entity, the property is exempt from property taxes for the period the IRB is valid – up to 30 years, although some counties and municipalities choose to restrict the bonds to a shorter timeframe. In addition to the property tax exemption, operating equipment purchased by the sponsoring government using the proceeds of the IRB is leased to the operating company. This is effectively tangible personal property owned by a government and is therefore deductible from gross receipts and compensating tax.

Although IRBs can be used for small to very large projects, most companies choose not to pursue them for projects smaller than about $2 million to $3 million due to legal fees and possible timing and other issues.

PERFORMANCE IMPLICATIONS

Under existing statute, there is no required state approval for IRBs, nor is there any required reporting of IRBs or any benefits accruing from their issuance to the state. This makes it difficult to track the impact this tax incentive has on state revenues. The bill adds reporting to the Department of Finance and Administration of any PILOT agreement but requires no other reporting to the state and none to the Legislature.

TECHNICAL ISSUES

A possible technical issue is the bill allows the local government to issue refunding bonds, even if the original bonds have matured. It seems this was carried over from Section 3-32-10 NMSA 1978, and it may or may not be an issue.

Another possible technical issue is the bill retains restrictions on the use of IRBs for an electricity generation or transmission facility that requires location approval and a certificate of convenience and necessity issued by PRC under the Public Utility Act. This seemingly would allow a small, private dedicated power plant, but not a utility scale power plant. However, the language in the Public Utility Act does not reference certificates of convenience and necessity. If this is an error, it is likewise carried over from existing statute.

OTHER SUBSTANTIVE ISSUES

Below is some additional history and information on IRBs.

Payments in Lieu of Taxes

It is relatively common for local governments issuing IRBs to exempt the city and county property tax portions but keep the school district whole through a PILOT. The drawback to the system in current statute is the issuing government entity makes this choice for all entities that would otherwise receive tax revenues. The state has no input in the decision of whether or not to forgo GRT and compensating tax revenues.

A report by the Rodey law firm on this subject includes the following information on PILOTs:

> PILOT terms can vary greatly. Historically, PILOTs have ranged from very low, symbolic amounts to as much as 50 percent of what the total property tax bill would have been without the exemption. Some issuers wish to receive all or the lion's share of a PILOT, while others have imposed PILOTs only for the benefit of the local school district or community college, on the assumption that the increased employment associated with the project will result in increased enrollment and associated increased costs. Rio Rancho, for example, requires a PILOT that is equal to the amount of property tax revenue the school district would have received but for the IRB exemption.
>
> With one exception, PILOTs are not mandated by statute, but rather are entirely a matter of negotiation between the benefiting company and the issuer. The exception pertains to IRBs for electrical generating facilities, which may not be issued without the approval of the local school district, and without the benefiting company, the issuer, and the local school district having agreed upon an annual PILOT to be paid to the district.

County Vs Municipality IRBs

One key difference between county and city IRBs that has prompted criticism from local companies and residents in the past is that municipalities may offer IRBs to companies that provide direct competition to existing, local companies. Counties, however, cannot provide IRBs to direct local competitors, and the statute provides a method for local companies to object to the

issuance of an IRB to the state Board of Finance. Municipalities are allowed to offer IRBs within, or not more than 15 miles outside of, the municipal limits.

A project a few years ago that received criticism related to this issue was the offer of an IRB by Dona Ana County to CN Wire, a foreign copper wire manufacturer that chose to locate within about one mile from an existing copper wire manufacturer, Omega Wire, Inc. The local company objected, but the IRB was not rescinded; rather, the offer switched from Dona Ana County to the Town of Anthony to avoid the non-compete statute.

On this topic, the Board of Finance reported, "A key difference between the County IRB Act and the municipal IRB Act is that the County IRB Act allows IRBs to be issued by counties for retail businesses, whereas retail is not an allowable use of municipal IRBs. One could infer that perhaps the [Legislature intended] to protect existing retail businesses from IRB-subsidized competition, since retail businesses could be argued to be more likely to compete for a share of a finite local market. Manufacturers may have been seen as competing in a statewide, national, or international marketplace."

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

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

1. **Vetted**: The proposed new or expanded tax expenditure was vetted through interim legislative committees, such as LFC and the Revenue Stabilization and Tax Policy Committee, to review fiscal, legal, and general policy parameters.
2. **Targeted**: The tax expenditure has a clearly stated purpose, long-term goals, and measurable annual targets designed to mark progress toward the goals.
3. **Transparent**: The tax expenditure requires at least annual reporting by the recipients, the Taxation and Revenue Department, and other relevant agencies.
4. **Accountable**: The required reporting allows for analysis by members of the public to determine progress toward annual targets and determination of effectiveness and efficiency. The tax expenditure is set to expire unless legislative action is taken to review the tax expenditure and extend the expiration date.
5. **Effective**: The tax expenditure fulfills the stated purpose. If the tax expenditure is designed to alter behavior – for example, economic development incentives intended to increase economic growth – there are indicators the recipients would not have performed the desired actions "but for" the existence of the tax expenditure.
6. **Efficient:** The tax expenditure is the most cost-effective way to achieve the desired results.

JC/sb/al