Fiscal impact reports (FIRs) are prepared by the Legislative Finance Committee (LFC) for standing finance committees of the Legislature. LFC does not assume responsibility for the accuracy of these reports if they are used for other purposes.

FISCAL IMPACT REPORT

		LAST UPDATED	
SPONSOR	Correa Hemphill	**ORIGINAL DATE**	3/2/23
SHORT TITLE	Hotel Renovation Tax Credit	**BILL NUMBER**	Senate Bill 403
		ANALYST	Faubion

REVENUE*
(dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY23	FY24	FY25	FY26	FY27		
	(Up to $60,000.0)	(Up to $60,000.0)	(Up to $60,000.0)	(Up to $60,000.0)	Recurring	General Fund – PIT/CIT

Parenthesis ( ) indicate revenue decreases
*Amounts reflect most recent version of this legislation.

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT*
(dollars in thousands)

	FY23	FY24	FY25	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
	$250.0	$250.0	$250.0	$750.0	Recurring	Tourism
	$5.5	$13.5		$19.0	Nonrecurring	TRD
		$80.0	$80.0	$160.0	Recurring	TRD
Total	$255.5	$343.5	$330.0	$929.0		

Parentheses ( ) indicate expenditure decreases.
*Amounts reflect most recent version of this legislation.

Sources of Information

LFC Files

Responses Received From
Tourism Department
Office of the Attorney General (NMAG)
Taxation and Revenue Department (TRD)

SUMMARY

Synopsis of Senate Bill 403

Senate Bill 403 (SB403) creates the hotel renovation personal income tax (PIT) credit and the hotel renovation corporate income tax (CIT) credit at 20 percent or 30 percent of qualifying costs for a hotel renovation, provides stipulations for eligibility, and assigns the Tourism Department and Taxation And Revenue Department with tasks related to the administration of the credits. The total amount of credits that may be certified in each calendar year is $30 million against PIT and $30 million against CIT.

This bill does not contain an effective date, and as a result, would go into effect June 16, 2023, (90 days after the Legislature adjourns) if signed. The provisions of this bill apply to taxable years beginning on or after January 1, 2023 and prior to January 1, 2033.

FISCAL IMPLICATIONS

SB403 sets an annual cap of the number of credits allowed under each the hotel renovation PIT credit and hotel renovation CIT credit at $30 million, for a maximum general fund impact of $60 million per year. While this credit does expire at the end of tax year 2032, it is considered recurring as the sunset is well beyond the forecast period. Credits that exceed a taxpayers liability may be carried forward for five years.

It is difficult to determine if this credit may be under-utilized as data on investment in hotel renovations is scarce.

Taxation and Revenue Department (TRD) notes the following regarding the fiscal impact:

> Some unknown aspects do not allow TRD to estimate a precise fiscal impact. First, it is unknown how many hotels will initiate renovation projects and the size of those projects. Second, TRD cannot anticipate how much taxpayers will invest in renovation projects and therefore how much credit they may potentially claim against either their income tax or corporate tax liability, since it depends on whether the process to claim a credit and the amount of the final credit will incentivize projects. Finally, the credit is dependent on the total cost of the renovation project and then claimed at either 30 percent or 20 percent of costs, depending on the hotel LEED certification. Based on these limitations of information and ability to make assumptions, TRD determined the fiscal impact is negative but unknown. Per the bill, the maximum amount of the credits would not exceed $30 million each for credits claimed under Personal Income Tax (PIT) and Corporate Income Tax (CIT).

This bill creates or expands a 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 action be postponed until the implications can be more fully studied.

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

A taxpayer may claim a credit equal to 30 percent of qualifying costs for a hotel that receives a certification level of LEED-NC silver or 20 percent of qualifying costs. This is a significant tax credit for hoteliers and investors, many of whom are likely very high-income, out-of-state residents. Hotels are typically purchased and renovated as a medium to long-term investment and may not need a sizeable tax credit to make them attractive investments.

TRD notes the following:

The bill aims to stimulate hotel renovation and, therefore, the tourism industry. These renovation projects' economic imprints will also be seen in the local construction industry, boosting general economic activity and employment. New Mexico's tourism industry makes a sizable contribution to local income and tax revenue. However, the full extent of both the costs and benefits of this credit is unknown.

According to data from New Mexico Economic Development Department, the arts, entertainment, recreation, accommodation, and food services sector has shown dynamic economic activity during the last year and contributed significantly to Matched Taxable Gross Receipts. The Bureau of Economic Analysis reports that during 2019-2021 this sector represented 4.3 percent of all private industry gross domestic product (GDP) in New Mexico. The positive economic impact of these credits will be felt only if the proposed tax incentive is sufficient to trigger generalized renovation projects and if it is accompanied by other strategies.

For instance, since the credit is non-refundable, it is possible that the taxpayer may not receive the benefit of the entire credit—they have little incentive to undertake a renovation project if they have little or no New Mexico tax liability to offset. During a large renovation project, a hotel may have negative taxable income and net operating losses that reduce or eliminate their tax liability, causing the incentive to go unused. However, the credit may be carried forward for up to five years, and therefore be available if the hotel has positive taxable income in future years.

The credit has a defined aggregate claim limit and an end date of tax year 2033. TRD supports fiscal limits and sunset dates for policymakers to review the impact of tax expenditures before extending them. This is critical to this bill as at the current moment the fiscal impact is unknown.

While tax incentives may support particular industries or encourage specific social and economic behaviors, the proliferation of such incentives complicates the tax code. Adding more tax incentives: (1) creates special treatment and exceptions to the code, growing tax expenditures or narrowing the tax base, with a negative impact on the general fund; and, (2) increases the burden of compliance on both taxpayers and TRD. Adding complexity and exceptions to the tax code does not comport generally with the best tax policy.

The Tourism Department notes the following:

Creating a hotel renovation tax credit serves several purposes, all beneficial to the tourism industry and the state economy as a whole. Primarily, this credit can help to incentivize companies in the hotel space to invest and develop infrastructure in disadvantaged areas where immediate construction incentives are not available. A tax credit for renovation projects (an ongoing need for hotels to remain competitive and often a requirement for franchise hotels) could prove incentive over time where there is no short-term incentive.

For many hotels outside of corporate chains, access to capital can be challenging. Lending has become more conservative for lodging over time as it is considered a specialized industry. Traditional loan to value ratios for financial institutions were 75

percent to 80 percent, but now the standard is 50 percent to 60 percent, meaning that initial investment is considerably higher. Approval for funding and credits is often limited as well, as with US Bank, the financial entity associated with New Market's Tax Credit declaring that lending to hotels will not be approved. Often hotel expansion, renovation and new construction is financed on secondary markets, with higher-than-normal interest rates and restrictive conditions. This can make opening new lodging businesses or renovating current ones less attractive for investors, with long-term consequences for New Mexico.

Hotel renovation tax credits can therefore create value for marginal projects in the longer-term, allowing New Mexico to remain attractive and competitive. It is important for traditional lodging to grow along with visitation throughout New Mexico, especially in areas where there is an abundance of short-term rentals. Traditional lodging options can house more visitors, opening up local economies. More pertinently, short-term rentals can cause displacement of workers and locals and drive up housing costs, particularly in communities with a lack of traditional lodging options.

Customer satisfaction (including satisfaction with facilities) is one of the biggest determinants of repeat visitation to a business. Studies have found that online reviews and ratings are notable drivers of decision-making for customers of hospitality businesses. In the hospitality industry, a study by Choi and Chu (2001) examined the relative importance of hotel factors in relation to travelers' overall satisfaction levels with their hotel stays in Hong Kong and the likelihood of returning to the same hotels in their subsequent trips. In order of importance, staff service quality, room qualities, and value were the three most influential factors in determining travelers' overall satisfaction levels and their likelihood of returning to the same hotels.

It is therefore advantageous for hotels and restaurants to maintain updated facilities in order to drive repeat travel, not just for the individual business, but for the industry as a whole. This bill also incentivizes modernization to sustainable/green standards.

PERFORMANCE IMPLICATIONS

The LFC tax policy of accountability is met with the bill's requirement to report annually to an interim legislative committee regarding the data compiled from the reports from taxpayers taking the credit and other information to determine whether the credit is meeting its purpose.

ADMINISTRATIVE IMPLICATIONS

The administration of the tax credits by the tourism department will require 2 FTEs for a total of approximately $250 thousand per year while the credit is in place.

TRD will need to update forms, instructions, and publications and make information system changes. This bill will have an impact on TRD's Information Technology Division (ITD) of approximately one month for an estimated staff workload cost of $5,554. Additionally, TRD's Administrative Services Division (ASD) will be required to test the system changes. It is anticipated this work will take approximately 60 hours, split between two existing full-time employees (FTE). Finally, TRD's Revenue Processing Division (RPD) anticipates the

implementation of this bill will require one additional FTE to process additional credit claims. The FTE costs are based on an Account Auditor-A. TRD expects to be able to absorb the impact of the bill with one additional FTE. However, if several bills with similar effective dates become law there will be a greater impact to TRD and additional FTEs or contract resources may be needed to comply by the effective dates of each bill.

TECHNICAL ISSUES

TRD notes the following technical issues:

There is a time limit for when a taxpayer must apply for the certification of the credit from the Tourism Department, but there is no limit on when the taxpayer must claim the credit on a tax return. Adding a deadline will help keep the $30 million certification cap for both PIT and CIT claimed consistent over each tax year. TRD suggests adding language at page 3, line 11, stating that the tax credit must be claimed starting in the year that the credit is certified as eligible by the Tourism Department. TRD suggests the following language: "A taxpayer who receives a certificate of eligibility shall claim the credit commencing in the first eligible tax year stated in the certificate of eligibility."

On page 3, line 10, and page 7, line 20, applications for certification of the credit will not be approved if Tourism has already approved $30 million in certifications in that calendar year. But this only affects the approval process; it fails to limit what may be paid out in any given fiscal year because the credit can be carried forward to future tax years. More certainty, control, and accountability could be achieved through an amendment reflecting language found in Section 7-2-18.32 (E).

In Section 1, subsection C., a hotel shall apply for pre-certification of their project from the Tourism Department. TRD notes that a hotel that has been pre-certified for the tax credit may not receive the final certification for a credit if the maximum annual amount has been met per subsection D. and is thus not approved. This has the potential of uncertainty for the taxpayer as the pre-certification does not guarantee final certification.

The bill requires TRD to compile data for credits approved by the Tourism Department and present an annual report to the revenue stabilization and tax policy committee and the legislative finance committee with an analysis of the tax credit's cost. TRD's ability to evaluate this credit would be significantly enhanced by a requirement for the Tourism Department to upload certified taxpayer applications to TRD and include the full taxpayer social security number for taxpayer identification, the credit amount awarded, and the first year that the credit can be claimed. If agencies that issue credits are permitted to share the certificate data electronically with TRD, then TRD will have complete data that can quickly be verified with the information provided by taxpayers, which will allow faster processing and verification of credits awarded by other state agencies and a more accurate evaluation of the credits' impact.

TRD also recommends the following additions on page 3, line 10 and page 7, line 20, after "approved.": "The certification must include the taxpayer identification number, first eligible tax year, and shall be numbered for identification and declare its date of issuance and the amount of the tax credit allowed. The tourism department shall provide the taxation and revenue department appropriate information for all eligible taxpayers to

whom certificates are issued. The method of interagency certification sharing shall be in secure and performed on regular intervals agreed upon by both the taxation and revenue department and the tourism department."
These credits are separate under Income Tax and Corporate Income Tax acts. However, it is unclear whether the Tourism Department must be able to determine which tax credit the taxpayer is eligible for or intends to take. Also, the bill does not state that a taxpayer that claims a hotel renovation income tax credit pursuant to the Income Tax Act shall not also claim a hotel renovation corporate income tax credit pursuant to the Corporate Income Tax Act for the same renovation project. TRD suggests in Section 1, subsection D. and Section 2, subsection D., that the language specify one credit certification per project. Such language might read: "A taxpayer that has submitted an application for a hotel renovation corporate income tax credit with respect to a hotel renovation project may not submit an application for a hotel income tax credit with respect to the same hotel renovation project" for Section 1, subsection D, and "A taxpayer that has submitted an application for a hotel renovation income tax credit with respect to a hotel renovation project may not submit an application for a hotel renovation corporate income tax credit with respect to the same hotel renovation project" for Section 2, subsection D.

In Section 1, page 5, line 20 and Section 2, page 9, Line 17, the definition of "qualifying costs" states that the taxpayer has not received a federal credit for the same project. The bill does not detail what information will be provided to the Tourism Department to verify this condition in determining final qualifying costs and therefore the amount of the credit.

It is unclear if this hotel renovation tax credit is only available for the hotel owner or if the credit extends to a contractor who incurs "qualifying costs" as defined on page 5, line 9, and page 9, line 5. TRD suggests adding an additional condition to the definition, specifying that only "the hotel owner or principle of the ownership group" may apply for and claim the credit.

In Section 1, subsection H on page 4 and Section 2, subsection F, on Page 7, the use of "taxation and revenue department" can be shortened to "department," which is already defined in the relevant acts as the taxation and revenue department.

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.

LFC Tax Expenditure Policy Principle	Met?	Comments
Vetted	✘	This bill was not vetted through an interim committee.
Targeted		This bill has no stated purpose, long-term goals, or measurable targets.
Clearly stated purpose	✘	
Long-term goals	✘	
Measurable targets	✘	
Transparent	✓	This bill requires an annual report to RSTP and the LFC. The credit will also be reported on in the annual tax Expenditure Report.
Accountable		
Public analysis	?	While public reporting is required, there are no stated targets against which to determine effectiveness and efficiency.
Expiration date	✓	This tax credit expires at the end of tax year 2032.
Effective		There are no stated goals or targets against which to determine effectiveness and efficiency
Fulfills stated purpose	?	
Passes "but for" test	?	
Efficient	?	There are no stated goals or targets against which to determine effectiveness and efficiency
Key: ✓ Met ✘ Not Met ? Unclear		

JF/al/ne