NOTE: As provided in LFC policy, this report is intended for use by the standing finance committees of the legislature. The Legislative Finance Committee does not assume responsibility for the accuracy of the information in this report when used in any other situation.

FISCAL IMPACT REPORT

SPONSOR Lujan DATE TYPED 3/5/97 HB 49/aHTRC
SHORT TITLE Investment Credit Act Extension SB
ANALYST Groepler

REVENUE*

Estimated Revenue		Subsequent	Recurring	Fund
FY97	FY98	Years Impact	or Non-Rec	Affected
$ 0.0	$ 0.0	$(8,500.0)*	Non-Recurring	General Fund

*** This figure is supplied by TRD and applies to both FY99 and FY00. In FY94 the negative impact on the general fund revenue reached a peak of $24 million. See Fiscal Implications section of this FIR for risks to the TRD estimate.**

(Parenthesis ( ) Indicate Revenue Decreases)

Relates to HB309.

SOURCES OF INFORMATION

Taxation and Revenue Department (TRD)
New Mexico Economic Development Department (NMEDD)
LFC files

SUMMARY

Synopsis of HTRC Amendment

The HTRC amendment to HB49 changes some of the provisions of the Investment Credit Act (ICA). Section 7-9A-8 NMSA 1978 of the ICA (Claiming The Credit For Certain Taxes) is amended. Under the existing statute, if the manufacturer had paid for construction services on the plant and that price included gross receipts tax (GRT) paid by the contractor, then the manufacturer could claim a refund from the amount of the available credit. The amendment removes this provision. Refunds for compensating tax paid are likewise removed.

The amendment also specifies that claims may not exceed 85 percent of the combined GRT, compensating tax, and withholding tax liability due in any reporting period.

A new Section of the ICA is added, which applies on the date that the changes to the provisions of the ICA become effective limiting the amount of qualified equipment that may be claimed and increasing employment requirements with respect to qualifying equipment. Unclaimed credits earned before the effective date of the changes in the ICA may be claimed after that date. Claims made but unapproved prior to the effective date will be allowed. Claims made after the effective date for equipment in the state prior to the effective date will be approved under the previous rules. Claims submitted after the effective date on equipment not yet in the state will be subject to the new rules. See the technical issues section of this FIR for why the language in this section is ambiguous.

Significant Issues of HTRC Amendment

The HTRC amendment will reduce the fiscal impact from the ICA in two ways. The first is the limiting to 85 percent of combined GRT, compensating tax, and withholding tax liability the amount of credits that may be used in any reporting period. The second is that refunds will no longer be allowed for compensating tax paid or for GRT paid on construction services.

Synopsis of Bill

This bill is sponsored by Representative Lujan for the Revenue Stabilization and Tax Policy Committee.

This bill proposes to extend the sunset date of certain provisions of the Investment Credit Act (ICA) for two years from January 1, 1998 to January 1, 2000. Without the extension, there is a $100.0 per firm cap on the amount that a firm may claim in investment credits (ICs, which are sometimes referred to as investment tax credits, or ITCs) after January 1, 1998.

Significant Issues

The ICA was originally enacted as a way to refund amounts of New Mexico gross receipts tax (GRT) or compensating tax that manufacturers paid on manufacturing equipment. This was because many other states did not charge the tax on the equipment in the first place. Accordingly, it was thought of as a way for New Mexico to compete in attracting large manufacturing firms. The ICA has local employment requirements for companies to qualify for the IC, both pre and post sunset.

A 1991 amendment to the ICA, effective January 1, 1991, allowed firms using industrial revenue bonds (IRBs) to purchase equipment to qualify for the credit. This effectively changed the IC from a credit for taxes paid to a credit for taxes not paid by IRB users. In effect, it became a cash subsidy for IRB users. This is sometimes referred to the "double dip" because it is a rebate for taxes not paid. Please note that 80 percent of the impact is due to the "double dip" according to TRD.

According to TRD, before the "double dip," the largest amount of claims in any one calendar year was $268.2 in CY89. The largest amount of claims after the "double dip" were made in CY95, which totaled $29,769.1. Total cumulative claims through October, 1996 were $88,534.1 according to TRD. The TRD has also calculated that the average claim per job created is $37.2 over the life of the ICA through October, 1996. Data supplied by TRD on the ICA claims and credits is supplied as a attachment B.

It should be noted that there is a distinction between claims and credits used. Credits are made and approved by TRD after the company's application demonstrates that it has complied with the manufacturing equipment purchase and employment provisions of the ICA. The IC is then used as a claim against the company's GRT, compensating tax, or withholding tax due the state of New Mexico. The IC may be carried forward to future years if the taxpayer cannot use the full amount of the credit in one year.

While the GRT, and to a lesser extent compensating tax revenues, are shared with localities, localities do not bear any of the direct costs of the IC.

The Professional Tax Study Committee will be reviewing the ICA to determine if a deduction for manufacturing equipment from GRT and compensating tax would be preferable to a credit. If the IC is repealed and a deduction replaces it, the effect on the general fund will be much less, because the "double dip" will then be eliminated.

FISCAL IMPLICATIONS

While the TRD analysis projects the revenue loss to the general fund to be $10,000.0 for FY99 and FY00 if this bill is enacted, there is a possibility that the amount of impact could equal the amount of credits used in FY96, which was $24,000.0. This could occur if another Intel-like plant is built in New Mexico. In that case, the impact could extend beyond FY00 and cost additional millions of dollars. The TRD fiscal impact report is supplied as Attachment A.

CONFLICT/DUPLICATION/COMPANIONSHIP/RELATIONSHIP

HB309, which includes the use of geothermal farming from the definition of manufacturing.

TECHNICAL ISSUES

The TRD analysis states that it may be prudent to add language instructing TRD how to deal with claims made prior to the new cutoff date.

Technical Issues of HTRC Amendment

In Section 2, Subsections B, C, and D of the amended bill, the phrase "immediately prior" should be preceded by the phrase "that were in effect". This would make it clear that the previously earned credits could be claimed after the provision changes. Otherwise, the wording could be interpreted to mean all credits must be claimed immediately prior to the date the changes take effect, which is not the intent of the amendment.

OTHER SUBSTANTIVE ISSUES

Although economic development professionals claim that the ICA is crucial in maintaining New Mexico's competitive advantage in attracting manufacturing firms, others maintain that this may be overstating the case.

The NMEDD notes in its bill analysis, "Business expansion and relocation [due to the ICA extension] will result in additional tax revenues. The amount is unknown." They further state that the consequence of not enacting this bill is that: "The state of New Mexico will lose one of its most valuable incentives for increasing the tax base and employment."

In the 1996 Update to the New Mexico Tax Study, the authors note:

> Economic research has found little empirical support for the proposition that tax incentives and/or low business taxes make a difference in terms of regional economic development. Properly funded public services such as education, police, fire [protection] and roads may have as much to do with economic development. A state which erodes its business tax base in the name of economic development may find itself unable to provide these vital public services. Or residents and existing businesses will find themselves with a higher tax burden to fund public services.

Firms make location and relocation decisions based on minimizing the overall costs of doing business. These costs include wage costs, state & local taxes, capital costs, and transportation costs. Wage costs constitute about 60 percent of the costs of doing business, while state and local taxes contribute less than 10 percent of the costs of doing business, with capital and transportation costs accounting for the balance.

POSSIBLE QUESTIONS

1. New Mexico's wage rate is 20 percent below the national average and many economists and business people believe that New Mexico has a generally favorable business climate. Is it possible to separate the effects of attracting firms to New Mexico due to the ICA? If so, how?

2. Would creating a deduction for manufacturing equipment be preferable to extending the ICA sunset dates? If so, what are the advantages?

3. The fiscal impact of extending the sunset dates of certain provisions of the ICA could be reduced by up to 80 percent by eliminating the "double dip." How would this affect the recruitment of manufacturing firms to New Mexico?

RFG/jl:sb
Attachments

BILL ANALYSIS AND FISCAL IMPACT REPORT

DATE: February 26, 1997

**Submitted by: TAXATION AND REVENUE DEPT.
JOHN J. CHAVEZ, SECRETARY**

BILL NUMBER: HB-49 as amended by HTRC

SPONSOR: Representative Lujan

BILL SHORT TITLE: Extend Provisions of Investment Credit Act for Two Years.

CONFLICTS, COMPANIONS, DUPLICATES: SB-1128.

DESCRIPTION: This bill extends the current provisions of the Investment Credit Act until January 1, 2000. This extends the current sunset for two years. The investment credit had been scheduled to revert to a maximum of 5% of $2,000,000 in qualified investment as of January 1, 1998. HTRC amendments propose two important modifications: (1) provide transition provisions in the event the January 1, 2000 repeal takes place as scheduled; and, (2) prohibit gross receipts tax refunds, and limit forward-looking credit applications to 85% of any monthly combined gross receipts, compensating tax and withholding liability. The transition rules simply codify what the Department would regulate with regard to the transition from a more generous credit to a less generous credit. The percentage limitation proposal will decrease the amount of investment credit that can be claimed in any fiscal year while allowing companies to claim the entire amount to which they are entitled over a longer period of time.

EFFECTIVE DATE: None stated; 90 days after adjournment (June 20, 1997).

FISCAL IMPACT (Thousands of dollars) Brackets indicate a revenue loss:

Estimated Impact on Revenues		Recurring or	
FY 1998 (1997-98)	**FY 1999 (1998-99)**	**Non Recurring Impact**	**Funds Affected**
0	(8,500)	Non-Recurring	General Fund***

Although investment credit approvals and applications peaked at roughly $28 million in FY 1995, the current level seems to have stabilized at about $10 million annually, largely as a result of economic limits on the base against which credits may be claimed. Companies will have earned enough carry-over credits by the current January 1, 1998, cutoff date to "spend" through the end of FY 1998. The impact of the bill is classified as non-recurring, and will extend at the FY 1999 level through FY 2000. The principal difference through HTRC amendment is limiting the applications of credit claims to a slower rate, while not decreasing the total amount which may be claimed.

*** About half of the investment credits are claimed as compensating tax credits. 20% of compensating tax net receipts are earmarked for the Small Cities Assistance and Small Counties Assistance Funds. Balances in these two funds are distributed annually to small counties and cities, with any remaining amount reverting to the General Fund. As long as the sum of the formulaic distributions from these funds is less than the total amount flowing into the funds, the reduction in revenues from granting of investment credit claims has the effect only of reducing the reversion to the General Fund and has no impact on the distributions to the cities and counties.

ADMINISTRATIVE IMPACT: none.

TECHNICAL ISSUES: HTRC amendment added temporary provision instructing the Department on how to deal with claims made or claims filed with respect to equipment installed prior to the January 1, 2000 cut-off.

OTHER ISSUES AND IMPACTS:

1. Whether the existing investment credit meets its intended goals, whether those goals are the most beneficial goals and whether any changes should be made are questions that the professional Tax Study Committee has announced

its intention to study. The Committee has asked to be continued for two more years, to allow study of economic development tax incentives, as well as income taxes, property and severance taxes. The two-year extension allows time for the study.

2. Simply extending today's version of this Act does not address issues which currently confront taxpayers. As more companies use this credit, situations arise which were not anticipated in the drafting of the Investment Credit Act. For example, whether a credit earned by a company can be transferred to an affiliated corporation is a live question not addressed by this bill.

DECEMBER 4, 1996

applications

Table 1: Investment Credit ~~Claims~~ Approved by Calendar Year

	Number of Companies	Number of Claims	Amount of Claims	Average Claim	Number of Jobs	Aver. Claim per Job	Average Claim per Company
1986	9	12	$157,404	$13,117	36	$4,372	$17,489
1987	3	4	$5,269	$1,317	3	$1,756	$1,756
1988	6	9	$158,675	$17,631	37	$4,289	$26,446
1989	5	7	$268,184	$38,312	60	$4,470	$53,637
1990	10	17	$192,179	$11,305	46	$4,178	$19,218
1991	16	23	$237,693	$10,334	22	$10,804	$14,856
1992	15	19	$13,750,350	$723,742	319	$43,105	$916,690
1993	23	32	$12,723,285	$397,603	327	$38,909	$553,186
1994	22	30	$21,423,756	$714,125	533	$40,195	$973,807
1995	18	29	$29,769,142	$1,026,522	664	$44,833	$1,653,841
1996	25	31	$9,848,160	$317,683	331	$29,753	$393,926
Total	73	213	$88,534,096	$417,614	2,378	$37,230	$1,229,640

Amounts shown in the table do not represent the actual credits as they are ~~used~~ claimed on tax returns. The exact total for the latter is difficult to compile, but the following are probably accurate within 5 to 10%:

FY1992	$2.3 million
FY1993	$7.9 million
FY1994	$12.3 million
FY1995	$17.5 million
FY1996	$24.0 million
FY1997	$7.0 million
Total to date	$71.0 million

The use of these credits is about evenly split between GRT/Compensating tax on the one hand and PIT withholding tax on the other.

ATTACHMENT B