



*Technology Tax Incentives and Tax
Policy*

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Telecommunication Committee

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NMTRI Principles of Good Tax Policy

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N.M. Tax Research Institute is a non-profit, non-partisan member-supported organization dedicated to advancing the following principles of good tax policy in New Mexico:

- ***Adequacy***
 - Revenues should be sufficient to fund needed services
- ***Efficiency***
 - Interference with the private economy should be minimized
- ***Equity***
 - Taxpayers should be treated fairly
- ***Simplicity***
 - Laws, regulations, forms and procedures should be as simple as possible
- ***Comprehensiveness***
 - All taxes should be considered when evaluating the system
- ***Accountability***
 - Exceptions should be rare and should be carefully evaluated and justified

New Mexico General Tax Overview Relative to Other States

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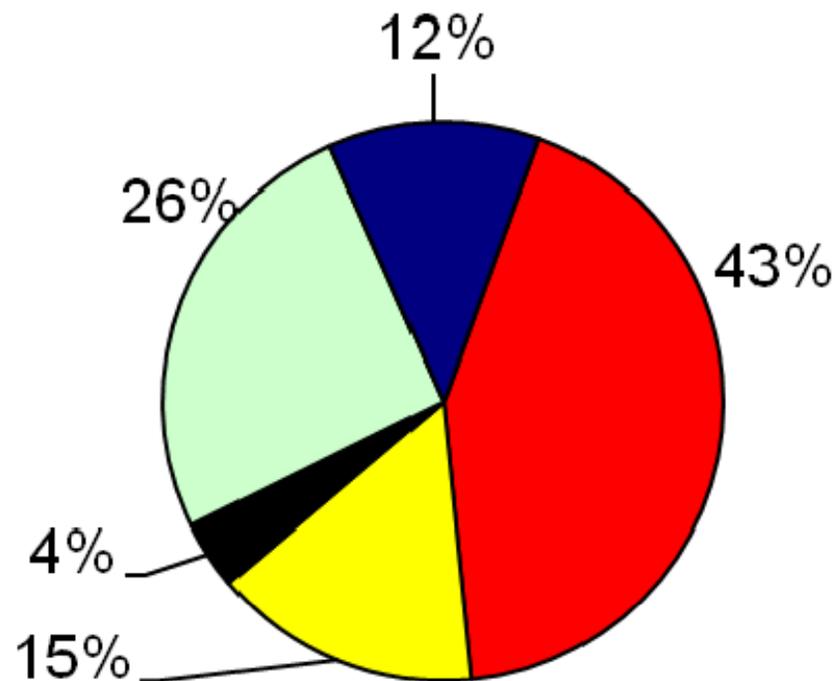
- **New Mexico imposes a fairly high tax burden on new business investment**
 - **Gross Receipts Tax**
 - ✦ Broadly imposed on many business inputs, services in particular
 - ✦ Rates increasing
 - Both aggravate “tax pyramiding”
 - **Corporate Income Tax**
 - ✦ Higher than average rate (7.6 vs. 6.7%)
 - ✦ Highest rate in region except for CA
 - ✦ No real beneficial apportionment schemes or options for exporters beyond standard 3-factor formula
 - Majority of states do offer

Source: Ernst & Young NM Business Tax Competitiveness Study 2011

Economic Environment

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FY12 General Fund Revenue



■ Sales ■ Energy ■ Other ■ Income ■ Investments

Source: Consensus Revenue Estimate

New Mexico General Tax Overview Relative to Other States

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- **New Mexico imposes a fairly high tax burden on new business investment –cont'd**
 - **Property Tax**
 - ✦ New Mexico among lowest tax rates in NM, but:
 - Albuquerque rates close to national average
 - ✦ No “split roll” system
 - **Personal Income Tax**
 - ✦ Ranges from 1.7-4.9% (hits top rate quickly)
 - ✦ Rate lower than national average rate
 - Comparable to surrounding jurisdictions that impose income taxes except California; TX and NV do not impose PIT.
 - ✦ **50% Capital Gain Exclusion**
 - More generous than competing states

Tech Tax and Incentive Policy - Historic

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New Mexico Tax Policy towards economic development of technology related business, or business in general, is very PIECEMEAL.

Most tax (i.e. GRT) legislation has been targeted at discrete specific or narrowly defined activities. Tax incentives (i.e. credits) tend to be a little more broadly applicable.

Efficacy of incentives is very difficult to determine. An optimal general tax policy is preferable to a tax incentive for every seemingly desirable or favored tax policy. New Mexico tends toward the latter. However, narrowly targeted policies can be more cost effective.

R&D, Defense and other federal spending has been intentionally targeted and legal questions have been well settled (U.S. v. New Mexico), agreements with federal agencies, etc.

Tax and Incentive Policy - Historic

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- **New Mexico corporate income tax has remained largely unchanged for decades; in contrast:**
- **New Mexico gross receipts taxes have seen explosive growth in narrow deductions and retail base erosion**
 - Retail base has been narrowed (generally not a desirable)
 - Gross receipts tax rates have increased sharply
 - ✦ Aggravates “tax pyramiding”

Economic Environment- Rate Growth and Pyramiding/Regressivity

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- What is pyramiding?
 - Pyramiding is when a general consumption or transaction tax (like a sales tax or the NM gross receipts tax) is charged on business inputs (business-to-business sales) and becomes embedded as part of the cost of the ultimate goods or services sold to the consumer.
- GRT is also regressive (hit's poorer households harder relative to income)
- State, muni's, counties and others in competition for tax base
 - Counties increasingly dependent on GRT – some now receiving more revenue from GRT than property tax.

Pyramiding Illustration

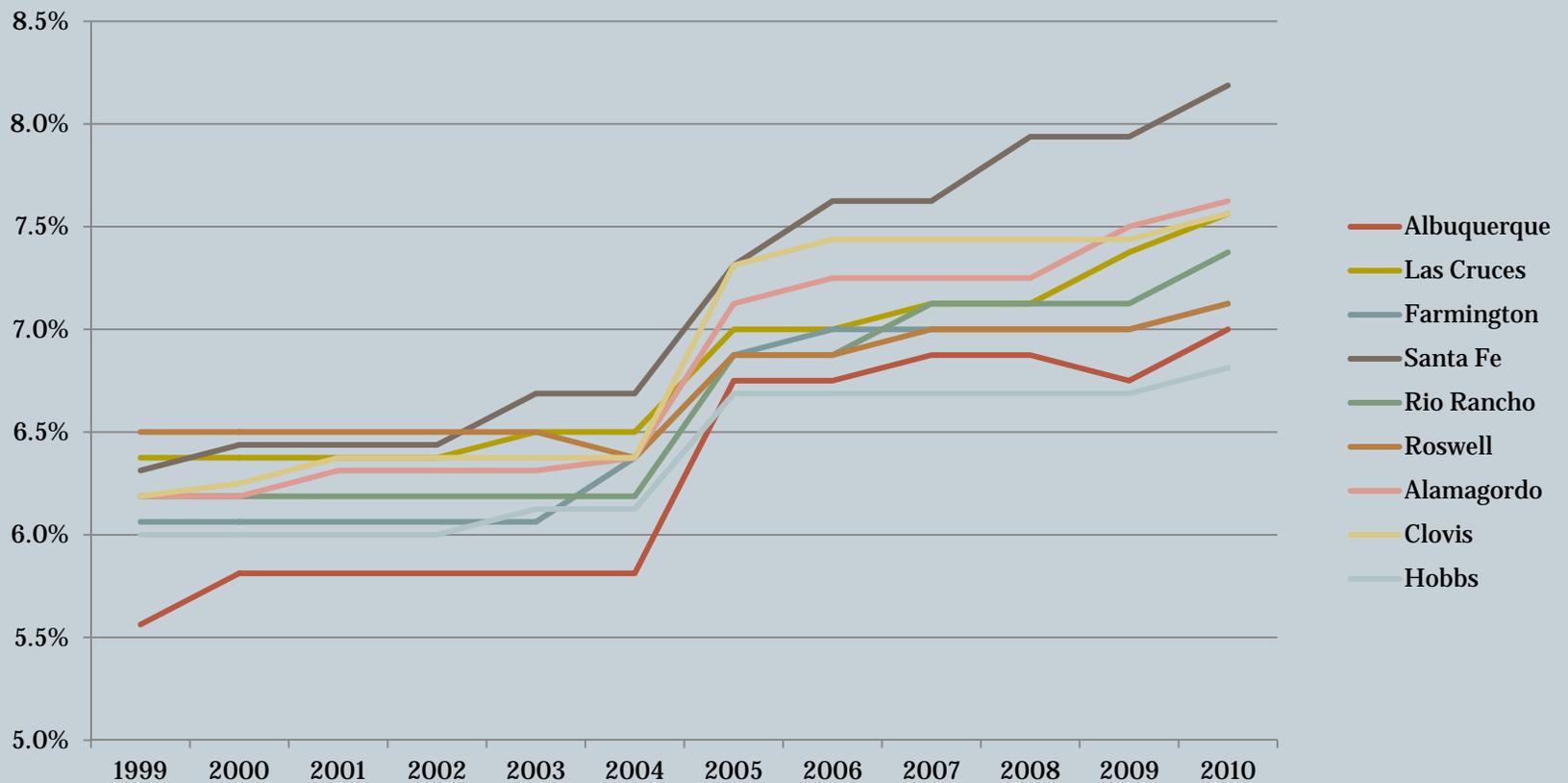
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	Sales	GRT
Drilling contractor	\$100	\$7.40
Natural gas producer	\$200	\$14.80
Electric Utility	\$400	\$29.60
Commercial power consumer	\$800	\$59.20
Total final value/Tax	\$800	\$111.00
Effective tax rate		13.88%

Pyramiding can raise effective tax rates sharply, creating strong incentives to avoid tax by importing, or bringing operations in-house.

Economic Environment- Rate Growth and Pyramiding

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EY Study Results Without Incentives

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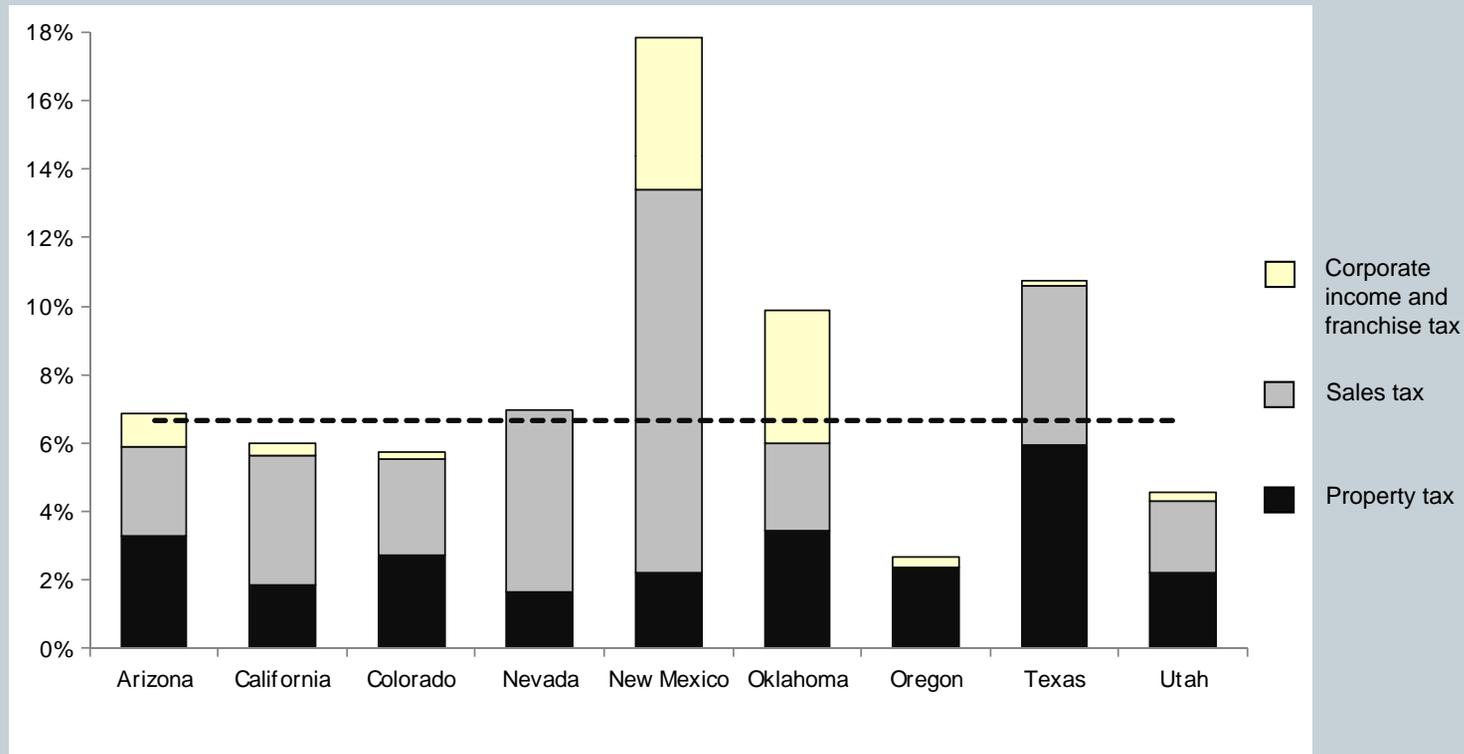
Effective Tax Rate Ranking Before Incentives

Industry	NM's Effective Rate
Headquarters	1 st Highest
Research and Development	1 st Highest
Renewable Energy Equipment Manufacturing	1 st Highest
Business Support Services	1 st Highest
Food Products Manufacturing	1 st Highest
Computer & Electronics Manufacturing	1 st Highest
Electrical Equipment Manufacturing	1 st Highest
Aerospace Products and Parts Manufacturing	1 st Highest
Management, Scientific and Tech. Consulting Services	1 st Highest

Results Without Incentives

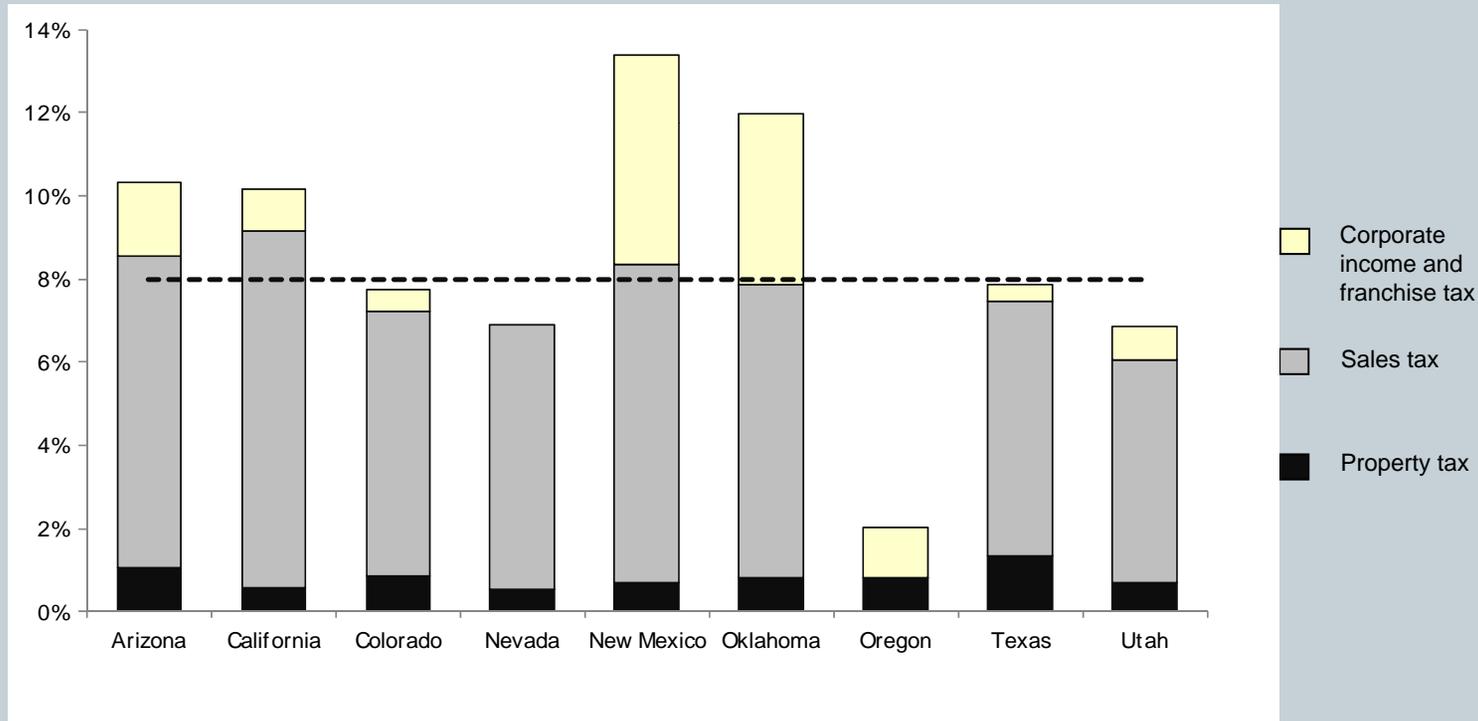
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Average Effective Tax Rates for Manufacturing Industries



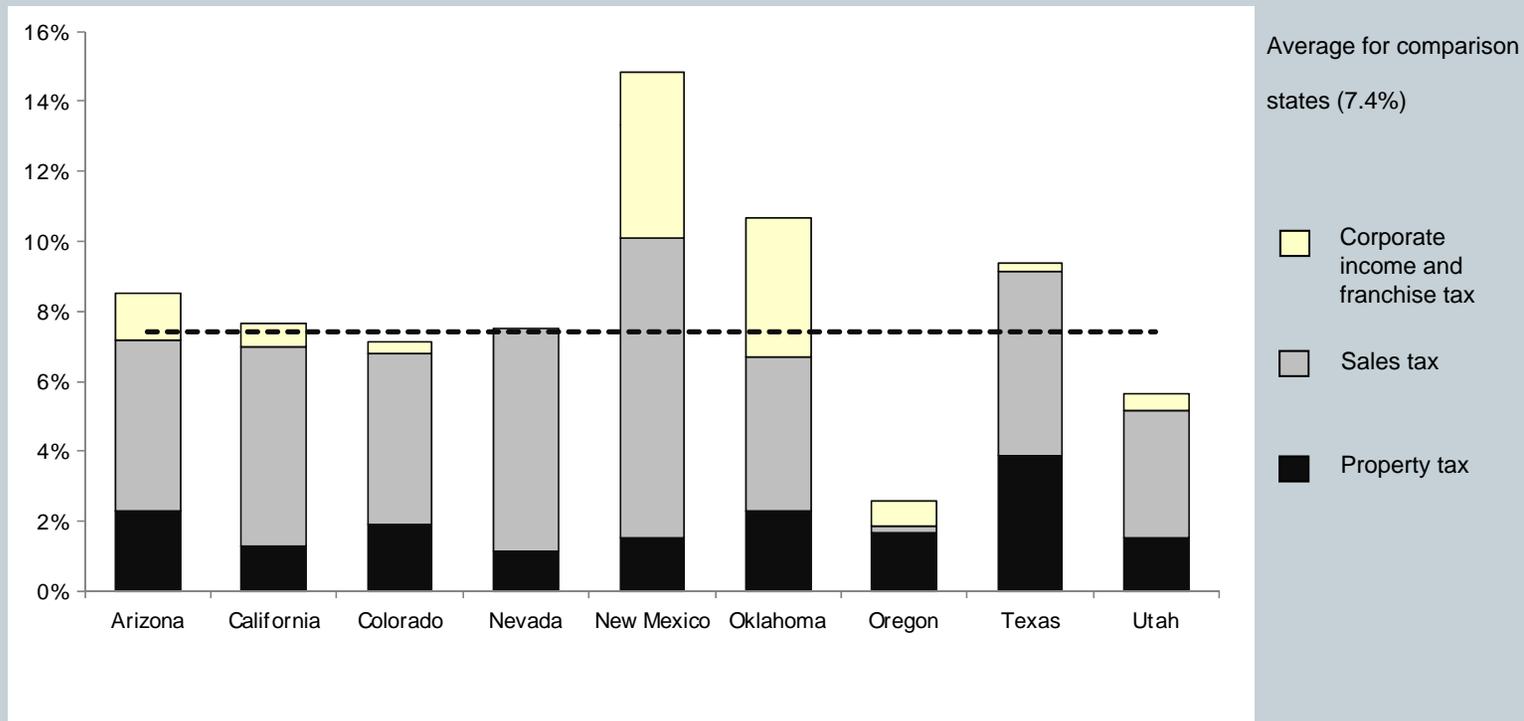
Results Without Incentives

Average Effective Tax Rates for Services



Results Without Incentives

Overall Average Effective Tax Rates for All Included Industries



New Mexico Tax Incentives - General

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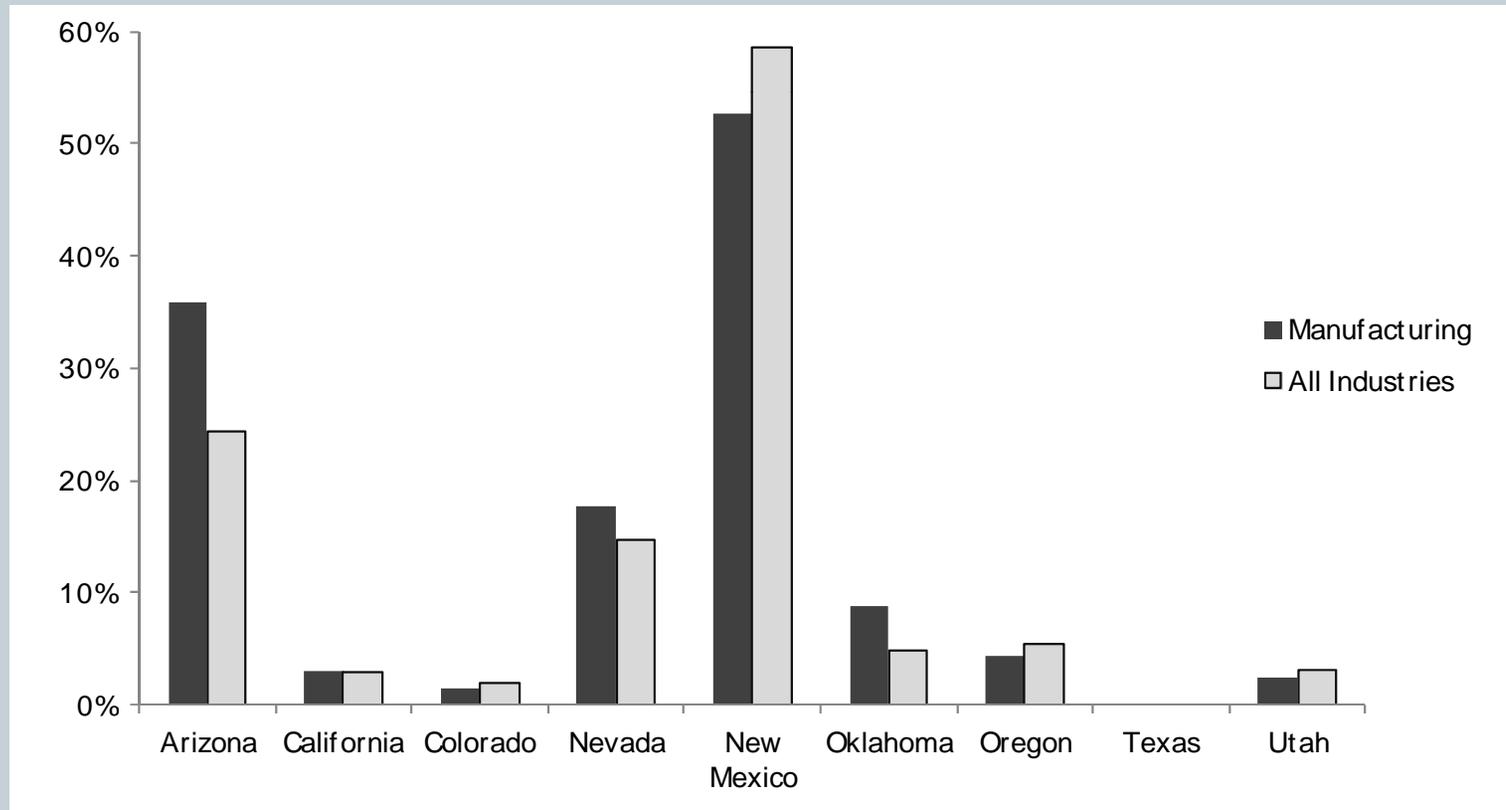
- New Mexico relies on incentives to greater extent than other states to reduce the otherwise high effective tax rate imposed by general tax structure.
 - Consistently true (see 1997 KPMG Berents Group Study)
- “Business tax credits in New Mexico increase the competitiveness of the tax system by reducing the overall state and local tax burden by an average of more than 55%. Including the effects of statutory credits, New Mexico’s business tax ranking varies from 1st for headquarters, renewable energy equipment, food product and electrical equipment manufacturing to 9th for research and development, aerospace products and parts manufacturing and management, scientific, and technical consulting services. However, the current tax credits vary significantly in their impact by industry and financial characteristics of a taxpayer’s operations in New Mexico.”

Source: Ernst & Young NM Business Tax Competitiveness Study 2011

EY Results With Incentives

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Potential Reduction in Total State and Local Effective Tax Rate from Statutory Credits, (Percentage Reduction in Pre-Credit Overall Effective Tax Rate)



EY Results With Incentives

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Effective Tax Rate Ranking After Incentives

Industry	NM's Effective Rate
Headquarters	1 st Highest
Research and Development	9 th Highest (Lowest)
Renewable Energy Equipment Manufacturing	1 st Highest
Business Support Services	8 th Highest
Food Products Manufacturing	1 st Highest
Computer & Electronics Manufacturing	3 rd Highest
Electrical Equipment Manufacturing	1 st Highest
Aerospace Products and Parts Manufacturing	9 th Highest (Lowest)
Management, Scientific and Tech. Consulting Services	9 th Highest (Lowest)

EY Results With Incentives

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Average Effective State and Local Business Tax Rates, After Credits by Investment Type

State	Services		Manufacturing		All Industries	
	ETR	Rank	ETR	Rank	ETR	Rank
Arizona	9.0%	3	4.4%	8	6.5%	5
California	9.8%	2	5.8%	4	7.6%	3
Colorado	7.5%	5	5.7%	6	6.5%	4
Nevada	6.3%	7	5.7%	5	6.0%	7
New Mexico	3.4%	8	8.1%	3	6.0%	6
Oklahoma	12.0%	1	9.0%	2	10.3%	1
Oregon	1.9%	9	2.6%	9	2.2%	9
Texas	7.9%	4	10.8%	1	9.5%	2
Utah	6.5%	6	4.4%	7	5.3%	8
<i>Other States' Average ETR</i>	7.6%		6.1%		6.7%	

EY Results With Incentives

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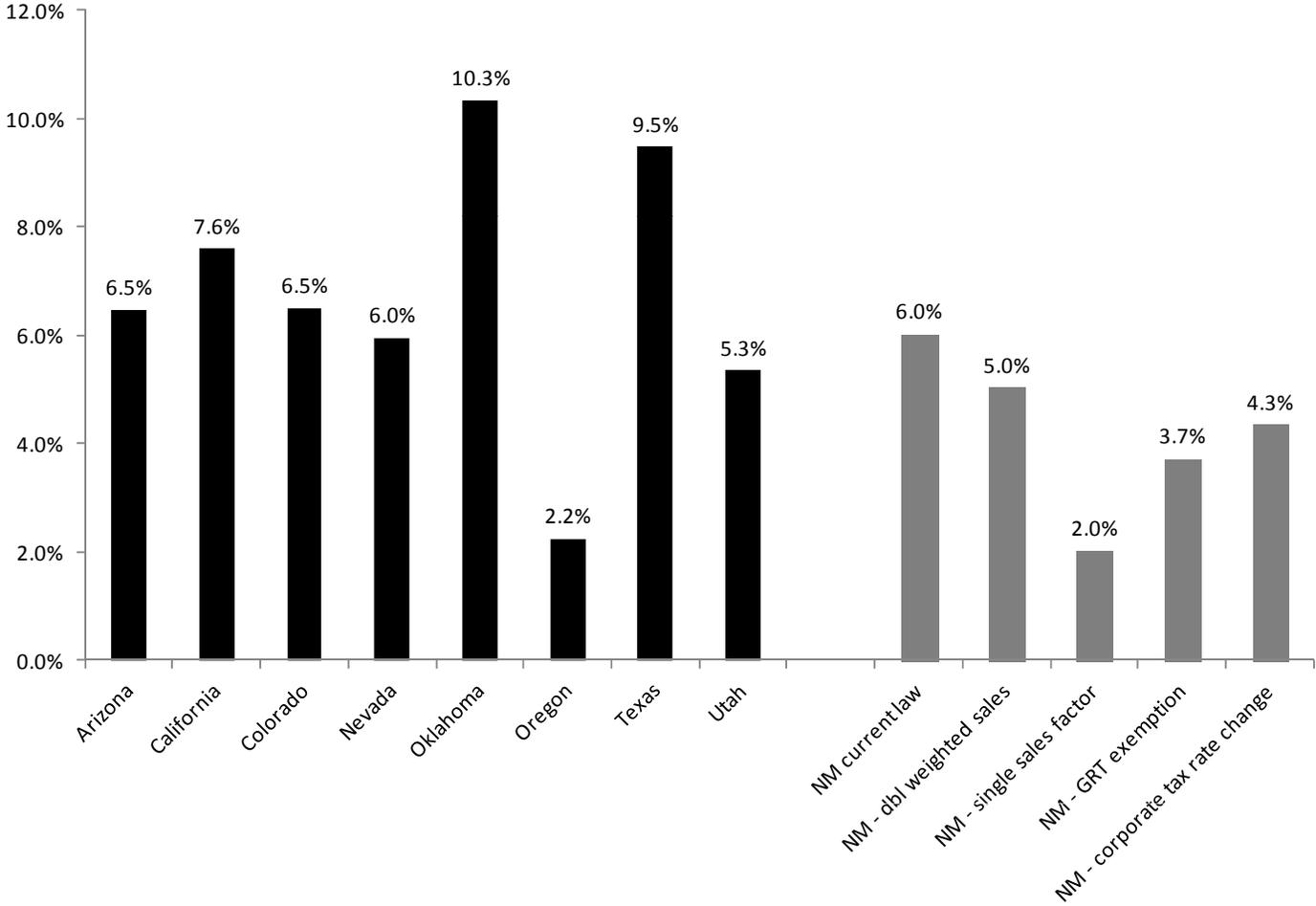
State and Local Effective Tax Rates Net of Statutory Credits, by Industry and State

State	Headquarters	Research and Development	Renewable Energy Equipment Manufacturing	Business Support Services	Food Products Manufacturing	Computer & Electronics Manufacturing	Electrical Equipment Manufacturing	Aerospace Products and Parts Manufacturing	Management, Scientific, and Technical Consulting Services
Arizona	1.3%	8.1%	3.7%	15.9%	3.5%	5.2%	5.4%	4.3%	10.8%
California	0.7%	8.9%	5.1%	17.8%	4.6%	6.7%	6.1%	6.6%	11.8%
Colorado	0.5%	7.2%	4.3%	13.4%	6.3%	5.5%	6.2%	6.1%	9.0%
Nevada	0.2%	5.2%	6.0%	11.8%	5.2%	5.7%	5.7%	5.9%	7.8%
New Mexico	4.7%	-0.7%	8.3%	11.5%	11.2%	7.1%	13.5%	0.6%	-1.9%
Oklahoma	4.4%	11.4%	7.8%	18.0%	7.2%	9.6%	9.6%	10.9%	14.2%
Oregon	0.4%	3.3%	2.3%	2.8%	2.4%	1.7%	3.5%	2.9%	0.9%
Texas	0.4%	8.3%	7.9%	13.6%	6.5%	10.1%	13.1%	16.1%	9.2%
Utah	0.4%	6.4%	3.6%	11.6%	3.4%	5.0%	5.0%	5.2%	7.4%
<i>Other States' Avg.</i>	1.0%	7.4%	5.1%	13.1%	4.9%	6.2%	6.8%	7.3%	8.9%

E&Y Policy Options

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Comparison of After-Tax Effective Tax Rate for Comparison States and New Mexico under Selected Policy Options



E&Y Conclusions

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- However, the results show a large variance in the industry-by-industry impacts of New Mexico's credits on business tax competitiveness. In some cases New Mexico's credits fall short of overcoming the states' relatively high ETRs, and in other cases the credits more than offset the state's competitive tax disadvantage.
- **The findings demonstrate how difficult it is to use targeted tax credits that are sensitive to the economic and financial characteristics of specific firms to provide the more uniform tax reductions across all industries needed to overcome New Mexico's non-competitiveness.**
- **Firms considering new investments in New Mexico must navigate through a complex and uncertain tax credit and incentive system in order to determine the net business taxes that New Mexico imposes on the initial investments and on-going operations of firms investing in the state.**

E&Y Conclusions

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New Mexico's state and local business tax system is almost certainly impeding economic growth. Because new capital investment is the channel through which innovative, competitive technology is added to the state's economic base, it is ultimately the source of growth in New Mexico's economy. Importantly, the expanded capital base is also a key driver of the labor productivity that generates a higher standard of living for New Mexico's citizens. With corporate income and sales taxes that are out-of-line with comparison states, New Mexico risks deterring new investment and added jobs.

NMTRI Conclusions – EY Tax Study

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New Mexico is uncompetitive without incentives.

With Incentives, New Mexico is more or less competitive depending on industry/facts

- New Mexico is more reliant on incentives to manage effective tax rate
- If facts and law don't provide for incentive eligibility, a NM business faces high ETR's

Numerous options, targeted or broad based, can reduce the ETR, however other trade-offs, costs, and policy issues arise

And Then the Session Happened...

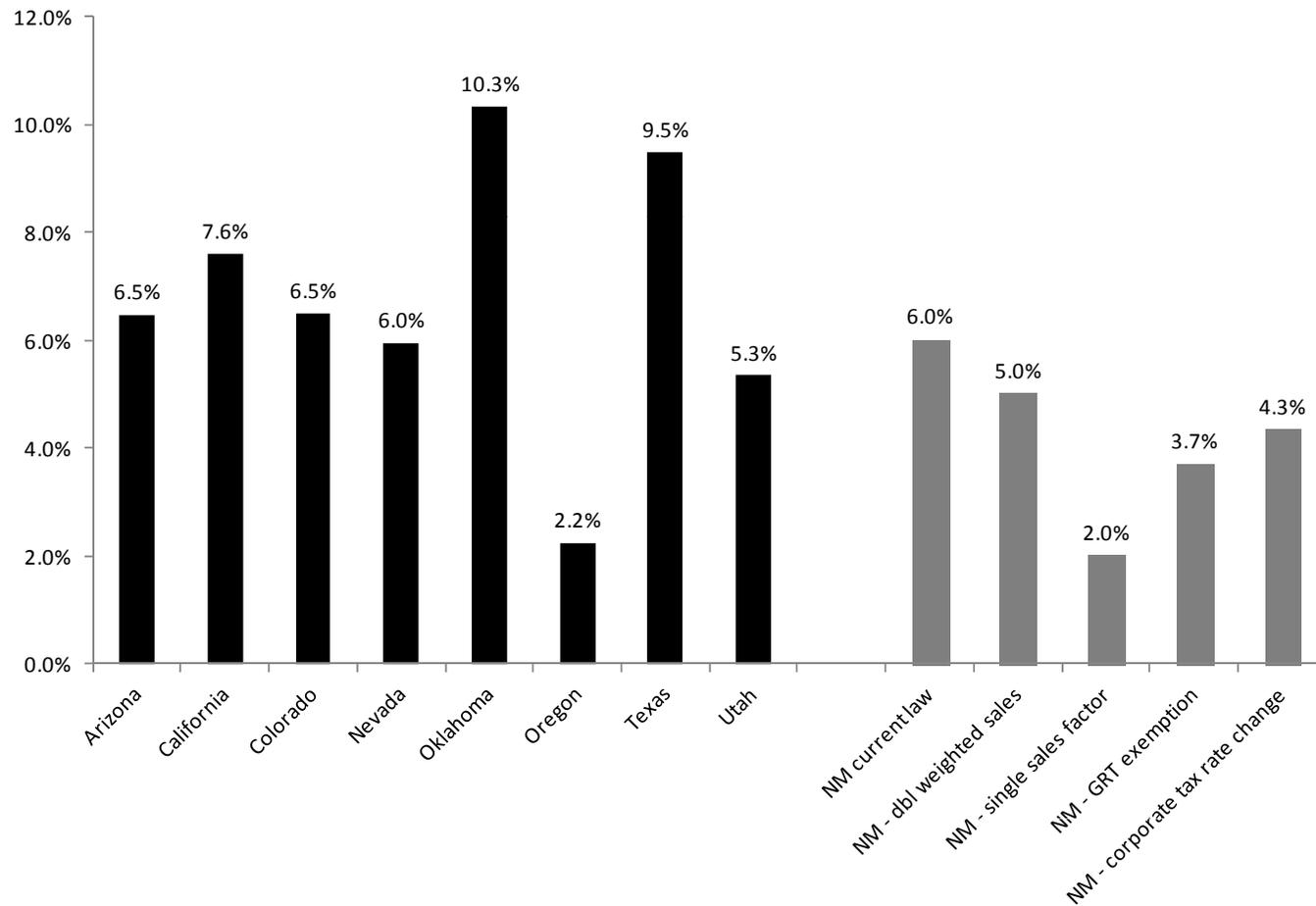
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- **HB 184CS – Doyle – Construction Service for Gross Receipts**
 - CS includes provisions from Rep James' HB 256
 - Expands current manufacturing inputs GRT deduction to include “consumables”
 - ✦ i.e. electricity, natural gas, industrial gases, cleaning solvents, etc.
 - ✦ Phased-in over 5 years in 20% increments
 - ✦ Manufacturing definition in GRTA quite broad
 - Expands current construction services deduction to include project related non-construction services
 - ✦ i.e. architectural, engineering, security, sanitation
 - Creates new deduction for leasing equipment associated with construction projects
 - ✦ i.e. generators, saws, scaffolding, backhoes, etc.
- **Addresses “pyramiding” and represents a significant change in NM law/policy**

Remember this? We Did the 4th one...

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Comparison of After-Tax Effective Tax Rate for Comparison States and New Mexico under Selected Policy Options



Results With Incentives

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Effective Tax Rate Ranking After Incentives with HB 184

Industry	NM's Effective Rate Before HB 184	NM's Effective Rate After 184
Headquarters	1 st Highest	1 st Highest
Research and Development	9 th Highest (Lowest)	9 th Highest (Lowest)
Renewable Energy Equipment Manufacturing	1st Highest	8th Highest
Business Support Services	8 th Highest	8 th Highest
Food Products Manufacturing	1 st Highest	1 st Highest
Computer & Electronics Manufacturing	3rd Highest	8th Highest
Electrical Equipment Manufacturing	1st Highest	3rd Highest
Aerospace Products and Parts Manufacturing	9 th Highest (Lowest)	9 th Highest (Lowest)
Management, Scientific and Tech. Consulting Services	9 th Highest (Lowest)	9 th Highest (Lowest)

New Mexico Technology Related Tax Incentives

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Industrial Revenue Bonds	1977	General
Investment Credit	1978	Manufacturers
Rural Job Tax Credit	1999, 2007	Manufacturers, other exporters
Technology Jobs Tax Credit	2000	High tech
High Wage Jobs Tax Credit	2004	Manufacturers, other exporters
R&D Small Business Tax Credit	2005	R&D
Alternative Energy Product Manufacturers Tax Credit	2007, 2011	Alternative energy

New Mexico Technology Related Tax Incentives

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7-9-62.1: Aircraft services	2000	Aircraft refurbishers
7-9-57.2: Rural software development	2002	Software developers
7-9-56.3: Border trade-support firms	2003	International trade brokers
7-9-54.4&54.5: Test articles	2003-04	Government contractors
: Military transformation RDT&E	2005	Defense contractors
: Biomass equip & materials	2005	Alternative energy
7-9-54.2: Spaceport/USAF space-related RDT&E	2007	Defense/aerospce contractors
7-9-114: Solar energy systems	2007	Alternative energy

New Mexico Technology Related GRT

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7-9-62.1: Aircraft services	2000	Aircraft refurbishers
7-9-57.2: Rural software development	2002	Software developers
7-9-56.3: Border trade-support firms	2003	International trade brokers
7-9-54.4&54.5: Test articles	2003-04	Government contractors
7-9-94 Military transformation RDT&E	2005	Defense contractors
7-9-98 Biomass equip & materials	2005	Alternative energy
7-9-54.2: Spaceport/USAF space-related RDT&E	2007	Defense contractors
7-9-62 Aircraft parts & services	2007	Aircraft manufacturers
7-9-112: Solar energy systems	2007	Alternative energy

Tax and Incentive Policy – Path Forward

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- **New Mexico will be increasingly reliant and relatively small non-gov't related private sector**
 - Federal spending growth will continue to slow
 - Natural resources historically volatile
- **New Mexico tax policy work well in the 1960's but world has changed.**
 - Business and capital are more mobile
 - ✦ More tax sensitive
 - Changes in gov't contracting practices have changed
 - National and international competition greater than ever

Tax and Incentive Policy – Path Forward

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- **First, DO NO HARM**
 - Avoid further retail GRT base erosion
 - Avoid GRT rate growth
- **New Mexico tax policy work well in the 1960's but world has changed.**
 - Impact of GRT tech services should be carefully reviewed
 - Overall tax structure should be thoughtfully reviewed in light of current business practices

Tax and Incentive Policy – Path Forward

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- **Second, make changes based on thoughtful review of the current state. Options include:**
 - Making corporate tax structure more competitive
 - GRT reform, such as:
 - ✦ “every other sale” requirement
 - ✦ B to B services
 - ✦ Rate reduction
 - Avoid unnecessarily giving away revenue/tax base
- **Review incentives**
 - Incentives should be well-reasoned and effective (i.e. HWJTC).
- **Develop long term ED/Tax Policy plan**

Tax and Incentive Policy – Path Forward

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- **Remember,**
 - Taxes and incentives are not the answer to every problem
 - ✦ Bad tax policies can certainly make things worse;
 - ✦ Well reasoned and structured incentives can be effective
 - Non-tax issues and efforts can be as or more important than tax, and should be considered in conjunction with one another
 - ✦ Workforce, education, regulation, etc.
 - ✦ Collaboration (i.e. labs, universities, private companies, leverage, tech transfer can all be part of the solution to help technology based business grow and thrive).

NMTRI Conclusions

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INCREMENTAL TAX REFORM ANYONE?

Comprehensive improvement can be made affordably over time. A plan need be developed and implemented.

Questions

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