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

SPONSOR:	Leavell	DATE TYPED:	02/04/00	HB	
SHORT TITLE:	Agricultural Processing Cluster Pilot Project			SB	246
			ANALYST:	Eaton	

REVENUE

Estimated Revenue		Subsequent Years Impact	Recurring or Non-Rec	Fund Affected
FY00	**FY01***			
	$ (488.0)		Recurring	General Fund
	$ (192.0)		Recurring	Local Governments

(Parenthesis ( ) Indicate Revenue Decreases)

* Maximum first year impact.

Duplicates HB 283

SOURCES OF INFORMATION

Taxation and Revenue Department (TRD)

SUMMARY

Synopsis of Bill

This bill establishes a pilot project for up to six applicants a year. The Secretary of Economic Development is charged with approving and notifying successful applicants. The credit amount, limited to $30,000 per applicant per year is determined by investments in "productive capital" and ranges from 25% of productive capital if the investment is made in the first year of operation to 5% if the investment is delayed until the fifth year of operation. "Productive capital" is defined as equivalent to investments in machinery, computers and the like which are integral to the processing operation. Investments may be stacked in successive years, although the credit percentages decline. The total amount of credit earned or applied in any year may not exceed $30K. The credit may be deducted from corporate or personal income tax liability. Any pilot project plant must be located in a "rural" area as defined in the bill, must be in an enterprise zone, or must be located in an area with a local economic development plan developed pursuant to the Local Economic Development Act (enacted in 1999 to implement the revision of the anti-donation clause passed by the voters in 1995). In addition to being granted credits up to 25% of the value of machinery and other tangible personal property installed in the plant, the bill also provides a gross receipts tax deduction for the construction of the plant, the value of the machinery and installation thereof. However, this provision is defective - see Technical Issue #1 below. This bill also amends last year's "rural job tax credit" bill, (compiled as 7-2E-1) to include the six pilot projects per year within this generous job credit. This new tax credit for agricultural processing clusters is not mutually exclusive with the existing Investment Credit Act, and there is no job requirement or "living wage" requirement.

FISCAL IMPLICATIONS

This bill has an estimated negative impact on the general fund in FY01 of $488.0 and a negative impact on local governments of $192.0.

TRD estimates that the average annual impact by 2006 is estimated to be $1,194.0 on the general fund, $295.0 to local governments, and an additional $673.0 due to rural jobs credit and $231.0 due to Investment credit, assuming investment is made to take maximum practical use of credits and deductions in the first four years after qualification.

ADMINISTRATIVE IMPLICATIONS

TRD estimates that a full time clerk ($40.0, recurring) will be needed to audit the three credits.

The Economic Development Department reports that it will not be able to administer this legislation with existing resources.

TECHNICAL ISSUES

1. Section 3 grants gross receipts tax deductions for receipts from sale of agricultural processing equipment, sale of construction tangible personal property, sale of construction services and receipts from installation of agricultural processing machinery. However, it then takes the deduction away by allowing the deduction to "an agricultural processing operation." The seller has the gross receipts tax liability, not the agricultural processing operation. The best method to grant the deduction without crippling it is to delete the two lines "An agricultural processing operation that is a qualified entity may deduct from gross receipts." Then, the definition of "qualified entity" must be used within the substantive deductions. Refer to HB-18.

2. Failure to add either "clawback" or jobs requirements may be cataclysmic. "Clawback" refers to recovering tax credits if the firm fails to keep the jobs or production implicit in granting credits and deductions. Without much effort it is possible to create a legal "tax credit farming" scenario that will provide no production and no real jobs, while costing state and local governments over $40,000. This "tax credit farming" could be minimized but not eliminated by "clawback" and employment limits.

3. The bill fails to address the problem of successor in business. Do the credits persist across change in ownership? Conversely, can a new owner use any purchase price to trigger new credits?

4. "Productive capital" is clearly defined. It is limited to depreciable tangible personal property with a life of at least three years and used exclusively as an integral part of the agricultural processing process.

5. The essential requirement under the Local Economic Development Act is the establishment of a plan. It is possible that, under the terms of that act, all areas of the state, including Albuquerque and environs, Las Cruces and environs and Santa Fe and environs may qualify for tax credits under this bill. This includes changing the "rural jobs credit" into an universal jobs credit, at least for agricultural processing.

OTHER SUBSTANTIVE ISSUES

1. Cities of over 30,000 (1998) as follows: Albuquerque (419,311), Clovis (32,394), Farmington (39,028), Las Cruces (76,102), Rio Rancho (50,041), Roswell (47,624), and Santa Fe (67,879). Los Alamos (18,344) is a class H county. Alamogordo (28,312), Carlsbad (26,315), and Hobbs (27,156) are close but have lost population since 1995. Of these, Los Alamos does not qualify as rural (explicit in the bill). Albuquerque, Las Cruces, Rio Rancho and Santa Fe and areas within ten miles of the exterior boundaries of these cities do not qualify as rural. Thus, Bosque Farms, Isleta Pueblo, Sandia Pueblo, Corrales, Los Ranchos and most other areas of Bernalillo County do not qualify. Similarly, Tesuque pueblo does not qualify, but Pojoaque, Nambe, Cochiti and Zia Pueblos do. El Dorado, La Cienega and Agua Fria do not qualify, but Cerrillos, Galisteo, Lamy and La Bajada do. It might be preferable to establish in statute a more administrable exclusion

2. Taxpayers of the state are being asked to subsidize the development of relatively few jobs at relatively high cost per job. In the fiscal suppositions, the stacking of credits produced tax incentives equal to $22,000 per full-time-equivalent jobs. These jobs are not particularly highly paid, and are typically, but not exclusively, seasonal. A traditional argument in favor of economic development tax incentives is that the taxes paid by the newly hired workers will repay the tax cost of the incentives. Because of the seasonal nature of the employment and the relatively low wages, this argument is probably fallacious in this case. Note in the example given in "Fiscal Impact", the payout of credits against additional personal income tax collections is over 22 years.

3. Most public finance economists argue that there should not be tax on manufacturing machinery. This proposal and HB-18 get to that point. In addition, both bills grants a deduction for constructing real property. Few knowledgeable public finance economists would support this deduction in a state with low to very low property taxes. Almost all areas of the state outside of Albuquerque and a few other selected jurisdictions have property tax rates well under 1% of value per year. This compares to most other competitor states where property taxes exceed 2% per year.

4. This is the perfect foil for an individual taxpayer to create a tax shelter. It would pay a wealthy taxpayer to build a building, install equipment, and produce nothing. Tax credits can be used to offset all or a portion of other taxable income. No jobs would be created. EDD will have to apply considerable control at these levels of credit to avoid empty projects.

5. The proper amount and sequence of investment to maximize the "productive capital" credit is as follows:

Year 1 $120,000 @ 25% = $30,000

Year 2 $150,000 @ 20% = $30,000

Year 3 $200,000 @ 15% = $30,000

Year 4 $300,000 @ 10% = $30,000

Year 5 $600,000 @ 5% = $30,000

Total $1,370,000 $150,000

Note that this is equivalent to an average credit of 10.9%. If investments are only made through the 4th year, total credit will be $120,000 and the average credit rate would be 15.6%.

Summary	**FY 2001**	**FY 2002**	**FY 2003**	**FY 2004**	**FY 2005**	**FY 2006**
This Year						
Total Investment	$9,528,000	$10,563,000	$11,943,000	$14,013,000	$14,013,000	$14,013,000
Jobs Created	0	96	108	120	138	138
Investment Credit	$0	$36,000	$81,000	$141,000	$231,000	$231,000
Rural Jobs Credit	$0	$468,000	$526,500	$585,000	$672,750	$672,750
Productive Capital Credit	$180,000	$360,000	$540,000	$720,000	$720,000	$720,000
GRT Deductions (State)	$308,136	$346,431	$397,491	$474,081	$474,081	$474,081
GRT Deductions (Local)	$191,544	$215,349	$247,089	$294,699	$294,699	$294,699
Cumulative						
Total Investment	$9,528,000	$20,091,000	$32,034,000	$46,047,000	$60,060,000	$74,073,000
Jobs Created	0	96	204	324	462	600
Investment Credit	$0	$36,000	$117,000	$258,000	$489,000	$720,000
Rural Jobs Credit	$0	$468,000	$994,500	$1,579,500	$2,252,250	$2,925,000
Productive Capital Credit	$180,000	$540,000	$1,080,000	$1,800,000	$2,520,000	$3,240,000
GRT Deductions (State)	$308,136	$654,567	$1,052,058	$1,526,139	$2,000,220	$2,474,301
GRT Deductions (Local)	$191,544	$406,893	$653,982	$948,681	$1,243,380	$1,538,079

JBE/gm