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

ORIGINAL DATE 02/13/10
SPONSOR Jennings **LAST UPDATED** **HB**

SHORT TITLE Limit Certain Tax Credits & Deductions **SB** 248

ANALYST Clifford

REVENUE (dollars in thousands)

Estimated Revenue			Recurring or Non-Rec	Fund Affected
FY10	**FY11**	**FY12**		
	$45,100.0	$63,600.0	Recurring	General Fund
	$1,800.0	$1,900.0	Recurring	Local Governments

(Parenthesis ( ) Indicate Revenue Decreases)

SOURCES OF INFORMATION
LFC Files

Responses Received From
Taxation and Revenue Department (TRD)
Department of Finance and Administration (DFA)
Economic Development Department (EDD)
Energy, Minerals and Natural Resources Department (EMNRD)

SUMMARY

Synopsis of Bill

Senate Bill 248 would make the following changes in various tax credits and deductions:

- Renewable energy tax credits would be capped at $5 million per year.
- Film production tax credits would be capped at $50 million per year.
- Gross receipts tax credits for hospitals, which are scheduled to increase under present law, would be frozen at their current levels for three years at the same rate as applies in FY10.
- Investment credits allowed in a fiscal year would be limited to $7 million.
- The laboratory partnership with small business credit would be limited to $1.2 million per lab per year rather than $2.4 million under present law.
- Technology Jobs tax credits would be limited to $5 million per year.
- High wage jobs tax credits would be limited o no more than $10 million per year.
- The angel investor tax credit would be repealed.
- The back-to-school GRT tax holiday would be repealed.

Provisions are effective July 1, 2010.

FISCAL IMPLICATIONS

Details of the fiscal impact calculation are illustrated in the following table.

Estimated General Fund Fiscal Impacts of SB 248

	FY11 Fiscal Impacts (Million Dollars)			FY12 Fiscal Impacts (Million Dollars)		
Description:	**Present Law**	**Proposed Law:**	**Savings:**	**Present Law**	**Proposed Law:**	**Savings:**
Repeal angel investor tax credit	$0.2	$0.0	$0.2	$0.2	$0.0	$0.2
Cap film production credit at $50 million	$71.5	$50.0	$21.5	$78.7	$50.0	$28.7
Cap high wage jobs credit at $10 million	$17.4	$10.0	$7.4	$19.1	$10.0	$9.1
Cap technology jobs tax credit at $5 million	$6.6	$5.0	$1.6	$6.9	$5.0	$1.9
Cap investment credit at $7 million	$8.7	$7.0	$1.7	$9.1	$7.0	$2.1
Cap renewable energy production credit at $5 million	$8.0	$5.0	$3.0	$11.0	$5.0	$6.0
Freeze hospital GRT credit at FY10 level	$20.0	$15.0	$5.0	$26.9	$16.1	$10.8
Eliminate GRT back to school tax holiday	$2.7	$0.0	$2.7	$2.7	$0.0	$2.7
Reduce lab small business partnership credit	$4.0	$2.0	$2.0	$4.0	$2.0	$2.0
Total	**$139.1**	**$94.0**	**$45.1**	**$158.7**	**$95.1**	**$63.6**

In addition to the general fund impacts, TRD notes that local governments will receive about $2 million more per year.

SIGNIFICANT ISSUES

The proposal would limit the state's foregone revenue from a variety of so-called "tax expenditures." These expenditures are designed to subsidize certain activities by private parties that are deemed to have benefits for the public.

Arguments in favor of tax incentives:

- State and local governments should use their revenue system to attract capital investment, with the hope that added capital will increase both employment and average wages.
- An economic theory called "optimal tax theory" supports reducing tax burdens on firms that are most likely to respond, i.e. "footloose" capital. Evidence from some multi-state studies suggests that this principle is in fact being applied by many states.
- 1997 Business Tax Competitiveness Study found that Industrial Revenue Bonds (IRB's) had a significant effect in reducing New Mexico's business tax burden. New Mexico's competitive position among 9 western states improved from 7th to 5th when the advantages of IRB financing were applied. This was mainly due to the sharp reduction of property tax, and to a lesser extent GRT on business purchases. The study concluded that business incentives had little impact on the relative ranking of the other states in the comparison.
- Although taxes may not be the most important factor in plant location/expansion for large businesses, they may be more important to small & medium firms. An example is service sector companies that experience large severance and retraining costs when they move.

- Targeted incentives offer a tool to address some of these problems cheaply when compared with broad-based tax cuts.

Arguments against tax incentives:

- Incentives create inequity within the tax system. This inequity may cause existing businesses and workers to be less welcoming to new development.
- State taxes are a small part of total costs and state-to-state differences are even smaller. Thus, they probably do not have much impact on rate of return variation across states. Since state and local taxes are deductible for Federal income tax purposes, this further reduces the significance of state-to-state differences.
- Differences in tax burdens may be offset by differences in the quality of public services provided.
- If all states allow incentives, relative positions may not change. The result of all states' incentives is simply to reduce the national tax on investment.
- Economic models are not able to predict the ultimate beneficiaries of incentives. Benefits may flow to the owners of capital, to local laborers, to consumers or to landowners depending on the mobility of capital and labor across state lines.
- Relocation incentives do not address the treatment of retained investment. Investment and employment by existing firms is probably much more important to growth than relocations. Most of New Mexico's current incentives are targeted at newly-relocating firms. This provides no incentive to the population of taxpayers most likely to invest in New Mexico.
- Transferable tax incentives are very poorly targeted because the taxpayer receiving the tax benefits usually pays significantly less than their full value to the taxpayer who engaged in the qualified activity. The difference is a waste of public funds.
- We can never know with certainty the answer to the "but for" question, i.e. whether an investment would not have taken place "but for" the incentive.
- Incentives increase complexity – for taxpayers and for TRD – especially when they are not well crafted.
- The fiscal cost of incentives is difficult to control, they function like entitlement programs in the sense that they are not budgeted annually but rather the state must allow the incentive to any business that meets the criteria for the incentive regardless of the state's budgetary.
- Tax incentives may violate the anti-donation clause.

Does the demand for incentives indicate the need for tax reform?

New Mexico's single biggest tax policy problem is the GRT on business purchases. This creates inefficiency and inequity in the tax system. Incentives like IRB's and Investment Credits are clearly in response to this problem. Other examples include targeted exemptions and deductions within the GRT itself: Solar energy systems; Renewable electricity transmission; Biomass equipment; Military transformation systems; Uranium processing; Film production; Biodiesel facilities.

The proliferation of these policies suggests that policy makers agree with business that the GRT is imposing an excessive burden, but that they prefer to address the problem in a piecemeal fashion rather than address pyramiding systematically. Incentives may actually make the pyramiding problem worse because they reduce the tax base, putting upward pressure on tax rates. The correct solution to these problems is to address pyramiding directly.

Accountability

Although everyone agrees that accountability is desirable, in practice it is very difficult to achieve.

- The State has very limited resources for enforcing accountability. Higher priorities at the Tax Department and other departments mean this function has traditionally received less attention than it should. If the State plans to add more incentives, and even to administer the ones it already has, it needs to add personnel to oversee them.
- Any reporting requirements must balance the State's need for information with the taxpayer's need for privacy and for certainty in claiming a tax incentive. Statutes should be as clear as possible about the criteria by which a business earns an incentive, and the purpose for which reported information will be used.
- Even with detailed information about employment, investment, etc., we can almost never conclude with certainty that a particular incentive was needed to bring a business to the state.

TECHNICAL ISSUES

TRD notes:

The limits during a particular fiscal year include both approvals and refunds, which will cause a credit that is approved one year and refunded the next to contribute to the limits in both years. For example, if a film production tax credit is approved for $2 million in June of a particular year but the return is not filed until August of the next fiscal year, the credit will count toward the limit in the fiscal year ending June 30 and will also count toward the limit in the fiscal year beginning July 1.

If a taxpayer is entitled to a refund of taxes in part due to claiming one or more of the credits amended by this bill, the Department will be required to determine the portion of the refund that results from claiming the amended credit(s). Such a determination will only be possible for taxpayers who have no tax liability prior to claiming refundable credits.

Sections 1 and 2 (limitations on the renewable energy production tax credit): The bill is silent as to how the credit limit affects the 10-year eligibility limitation and the variable amounts of credit that can be obtained in the various years of eligibility. For example, if as a result of the aggregate credit limit a taxpayer cannot claim the credit during the 6th year of the taxpayer's eligibility, delaying until the next year results in a lower per-kilowatt-hour credit amount and the loss of one year of eligibility.

Section 7-1-29.2 states that if a credit request is not acted upon within 180 days, it is deemed approved. The bill states that if the limit has been reached, then the Department shall not approve but hold "in abeyance" until the next fiscal year; therefore, 7-1-29.2 would need to be amended so that the Department can administer this bill.

OTHER SUBSTANTIVE ISSUES

EDD notes:

Business incentive tax credits are intended to promote economic development, encourage development and use of alternative energy sources, or to meet some other goal. Placing a cap on an investment stunts the potential for economic investment. Limiting the credits, limits potential return. For example, with a capped credit a new or expanding business will hire to the maximum of the credit. Where there is a small cap, the company will choose to hire less workers than should there be no cap. Where the cap is expended, companies may not choose to hire. Generally, return for investment is a better means of evaluating a project and allocating resources than an arbitrary cap…. In the last 8 years, thousands of jobs have been recruited to the state through these tax credits. Placing caps means limited or no recruitment of new jobs to the state. Because of the national recession, New Mexico has lost close to 40 thousand of jobs, limiting these incentives will slow New Mexico's recovery significantly. Overall by placing low limits on the tax credits, businesses will become uncertain as to their ability to take advantage of them. This will lead them to discount the credit, undermining their value as economic development incentives. The predictability and certainty in accessing a published credit is the only way to ensure that they serve the desired purpose of stimulating economic development. This bill will mean that New Mexico cannot attract new companies from out of state and encourage new businesses to expand in state. Each of these credits provide a positive multiplier effect to the economy. The result of this legislation is that tax revenues to the General Fund will be reduced.

EMNRD notes:

SB 248 would impede the Energy, Minerals and Natural Resources Department's (EMNRD) efforts to achieve its goal of New Mexico being the leader in the development of renewable energy resources. Specifically, a major incentive in support of utilities meeting New Mexico's Renewable Portfolio Standard (RPS) would be impacted. Out of total retail electricity sales, investor-owned utilities must provide 20% with renewable resources by 2020, while rural electric cooperatives must meet a 10% target by 2020. Reducing the PTC incentive would greatly hamper New Mexico's activity in utility-scale renewable energy power plants at a critical juncture, when New Mexico is attempting to meet the higher RPS requirements of the future.

TC/mt