FISCAL IMPACT REPORT

		ORIGINAL DATE	2/17/15		
SPONSOR	Campos	**LAST UPDATED**		**HB**	
SHORT TITLE	Frontier Communities Tax Credit			**SB**	477
				ANALYST	Graeser

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY15	FY16	FY17	FY18	FY19		
	(0.0 – $1,500.0)*	(0.0 – $1,500.0)*	(0.0 – $1,500.0)*	(0.0 – $1,500.0)*	Recurring	General Fund (PIT or CIT)

(Parenthesis ( ) indicate revenue decreases

(*) Note: There may be very little utilization of this credit. See "Fiscal Implications" below.

Some of the provisions of this bill may duplicate the angel investment credit reauthorization (HB 261 and SB 413), the rural infrastructure tax credit (HB 337), and the industrial revenue bond bill (SB 319).

SOURCES OF INFORMATION
LFC Files

Responses Received From
Economic Development Department (EDD)
Taxation and Revenue Department (TRD) – whose complete analysis is included here as an appendix.

SUMMARY

Synopsis of Bill

House Bill 477 creates the Frontier Community Investment income tax credit. The tax credit is 25 percent of a maximum $100 thousand investment made within the boundaries of "Frontier Communities," as defined and specified by EDD. There are currently at least nine designated Frontier Communities in New Mexico.

EDD describes some of the features of the bill as follows:

"The bill identifies

- A tax payer making state tax payments, that is a qualified business and makes a qualified investment into that New Mexico eligible business can apply for and claim a tax credit
- For a qualified investment of up to $100 thousand of project cost is eligible for a 25% credit.

- Bill caps total annual amount of tax credits at $750 thousand separately for PIT and CIT
- Department will issue a certificate of eligibility for the Frontier Tax Credit
- Department would promulgate rules governing the process of review of each application
- Eligibility criteria for qualifying business applicant requires
  - 3 new full time jobs, minimum 32 hours paid per week for at least forty-eight weeks;
  - Jobs created on or after July 1, 2015 and before December 31, 2016;
  - Tax credit would have to be claimed no later than one year following the end of the calendar in which the investment was made;
  - Eligible businesses must have not had gross revenue in excess of $5 million in any fiscal year ending on or before the date of the investment;
  - The credit must be used within three years;
  - Businesses are defined as a corporation, general partnership, limited partnership, limited liability company or similar entity;
  - The bill excludes government entities and non-profit organizations;
  - Family members who are employed by the business do not qualify;
  - Jobs eliminated one year prior to the application that is recreated is not eligible;
  - A job created due to a business merger or acquisition of another business are not eligible;
  - An individual investor may make up to two qualified investments per year and may claim credits for the same business or a successor business for up to three years total; and
  - The bill sunsets in 2024".

In addition, the bill provides that TRD may disclose some of the details of claimed tax credits (except for taxpayer names and addresses) to the revenue stabilization and tax policy committee and to the legislative finance committee for use in developing the required accountability reports. The bill would also allow TRD to disclose the same details to the economic development department.

The bill provides for "clawback," in case a business ceases operations for at least 180 days within any two-year period after the taxpayer has claimed a frontier community investment credit. Any tax credits claimed would have to be repaid.

The effective date of the bill is not stated – assume 90 days after adjournment or June 19, 2015. The provisions of the bill are applicable to tax years beginning on or after January 1, 2015.

FISCAL IMPLICATIONS

The bill caps the amount of Frontier Communities Tax Credit at $750 thousand per calendar year for Personal Income Tax aggregate credits and a separate $750 thousand per calendar year for Corporate Income and Franchise Tax aggregate credits. Any amounts of cap remaining unclaimed at the end of a calendar years are not rolled over. If approvals exceed the cap in any year, those projects excluded from the cap have first priority against the following year's cap.

However, the bill is quite narrow in scope and the credit may not be utilized at all, let alone at the levels permitted by the cap. Note the following features that may inhibit utilization:

- "a new full-time job" means a job created by a business between July 1, 2015 and December 31, 2016;

- in order to qualify for the tax credit, the business must create three full-time jobs during that narrow time window;
- any economic development project tends to have a relatively long latency, so there may be very few investments that create jobs in the Frontier Communities within the required time frame;
- the investment must be passive, so that the investor may not receive compensation for services rendered for at least one year after the investment has been made; and
- the investment must be equity and not a loan.

SIGNIFICANT ISSUES

EDD notes that this bill is narrowly targeted at small, rural communities:

> "The state has a limited array of financing tools for rural New Mexico businesses. The bill seeks to stimulate additional private sector reinvestment that results directly in job creation. A "Frontier community" was defined by the state legislature through amending the New Mexico MainStreet Act in 2013 as a community with a population under 7,500. The MainStreet program resides in the Economic Development Department that through this bill is responsible for administering the Frontier Tax Credit. It is unclear if the bill intends to support just communities affiliated through the MainStreet Frontier Program which serves a limited number of communities or wishes to establish another threshold for defining "Frontier Community" which could lead to confusion between the two programs. It is unknown how many businesses in Frontier Communities would qualify for such a tax credit based on a minimum of creating three jobs within a given period of time."

Laws 2013 Chapter 60 created the Frontier Communities program in Statute (Section 3-60B-1 NMSA 1978). The FIR of these bills indicated that a qualifying community would have a population not exceeding 5,000 people. The paragraph above indicates that the current restriction on Frontier Communities is a population of 7,500. This may be a defect in the bill, since a "Frontier Community" is not defined except as it is designated by EDD on the basis of its economic and rural characteristics.

There are several confusing aspects to this bill:

- the taxpayer eligible for the tax credit is an individual, partner or shareholder in a corporation where the taxpaying entity makes an equity investment in a qualified business located in a Frontier Community. The tax credit is based on 25% of an equity investment in the underlying business. The investor may not be an employee of the business for at least one year after the investment has been made. Apparently, the purpose of the credit is provide an incentive for wealthier members of a small community to buy equity shares in fledgling businesses in these smaller communities;
- the list of projects proposed by 2014 applicant communities overwhelmingly create public spaces. Only one community -- Anton Chico – proposes an essentially commercial project, which is the renovation of a historic school house, which the community wishes to adapt to fit the needs of a business incubator and commercial kitchen;
- a conceptual failing of this bill may be that it intends to provide investment incentives outside the usual organic method of building businesses in smaller communities. The organic method is to start a business using life savings and borrowing from friends and family, work hard for a few years to become successful, hire a few workers, then expand the business to other areas or offerings. This bill will not provide tax credits for this or-

ganic growth, since the business owner is (probably) taking a draw as soon as the business can afford it, which may well be within a year of the investment;
- The narrow time window, where a "new full-time job" means a job created by a business between July 1, 2015 and December 31, 2016; in order to qualify for the tax credit, the business must create three full-time jobs during that narrow time window. If that narrow window for job creation is intended, why does the bill sunset for investments after December 31, 2024?

PERFORMANCE IMPLICATIONS

The bill requires EDD, with the assistance of TRD, to report to RSTPC in 2020 and 2024 on the utilization, cost and impact of credits paid.

ADMINISTRATIVE IMPLICATIONS

EDD notes that administering this credit will be in addition to the duties assigned to the MainStreet team. Depending on utilization, the Department would have to develop administrative procedures which would require an allocation of staff time to develop an intake, review and issuance of a certificate to the applicant and establish tracking and performance reporting process that measures ROI.

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

Some of the provisions of this bill may duplicate the angel investment credit reauthorization (HB 261 and SB 413), the rural infrastructure tax credit (HB 337), and the industrial revenue bond bill (SB 319).

TECHNICAL ISSUES

Is the narrow time window for the creation of three full-time jobs from July 1, 2015 to December 31, 2016 intended?

While the bill creates a reporting process beginning 2020 and every four years thereafter, the timeline seems to establish eligibility criteria only from July 1, 2015 to December 31 2016. This period of reporting eligibility stands outside of a traditional fiscal year process. The bill does not specifically define and extend each additional period of eligibility.

On page 5, the taxpayer claiming the credit must hire three full-time-equivalent employees in the business. However, on pps. 9 and 10, an "eligible employee" excludes any person who is working as an employee or contractor for an entity that owns the majority of the stock in the eligible business. The purpose of the exclusions is to prevent the eligible employer from hiring relatives in order to achieve the three FTEs needed to qualify for the credit. On page 12, a "qualified investment" means an equity investment, not a loan. Further, the person who makes the qualified investment may not receive any compensation from the business for at least one year after the investment was made. It is difficult to create the profile for investors and investments that would survive the multiple requirements and be eligible for a tax credit.

A "Frontier Community" should be defined in statute and not left to the EDD to determine what regions would constitute these advantaged investments.

OTHER SUBSTANTIVE ISSUES

The EDD website describes the frontier communities initiative as follows:

> "The Frontier Communities Initiative was established by the New Mexico state legislature and signed into law by Governor Martinez in 2013, as a community economic development partnership program of the Economic Development Department with a local applicant community and coordinated through the New Mexico MainStreet Program. The program provides professional technical assistance to communities selected to participate through an application process. The Frontier Communities program is not a grant program, and direct funding for selected projects is not included with services and resources provided for the project."
>
> "Communities currently affiliated with the New Mexico MainStreet Program or the New Mexico Arts and Cultural District Program are not eligible to apply for the Frontier Communities Initiative. The number of Frontier Community projects is contingent upon the annual funding appropriated by the New Mexico State Legislature."
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> "The purpose of the Frontier Community Initiative program is to provide community economic development support for small rural communities (less than 7,500 in population) to develop a catalytic economic development project within a traditional or historic commercial district (i.e. court house square, town center or village plaza) or historic commercial corridor. The proposed project should demonstrate its positive impact in job creation, business development or enhancing the economic environment for the community."
>
> "Additionally, the program hopes to plant the seeds to expand local capacity to develop "community-builders" – people continuing to work together after the project is finished to strengthen existing community development groups and support networks to continue the work of revitalization, bolster community pride and identity, preserve cultural heritage, transmit values and history, build economic and social capital and stimulate economic development."

EDD notes the following: "Unlike some rural tax credits focused on property reinvestment this bill is targeted to business re-investments that create a minimum number of jobs. The tax credit is available after job creation is certified. The entity receiving the certificate would need to have a tax liability to offset the tax credit available during the allotted time period of eligibility. There is no tie to existing technical assistance programs that might assist entrepreneurs positioning themselves for a business start up or expansion."

To date, nine communities have been designated as "Frontier Communities."

- Anton Chico: Business and facility development. Anton Chico is a community based on a land grant dating back to the 1500s. The land grant required the construction of school house, which the community wishes to adapt to fit the needs of a business incubator and commercial kitchen.
- Aztec: Aztec recognizes the potential of the Animas River Corridor to bring the community together and get people outside and active. This project will examine connecting the town to the Aztec Ruins National Monument and World Heritage site via a river path, as well as enhancing branding.

- Carrizozo: Carrizozo seeks to revitalize a proposed Historic District in downtown, with the aim of increasing community pride, and attracting people to live and conduct business. This project will address two historic buildings: the Tin Shop (built 1913) and the former Yucca Bar & Grill (built circa 1938).
- Edgewood: Edgewood has successfully organized around its heritage as an Historic Route 66 community. This project will develop a branding campaign that will create immediate recognition of the services and characteristics of the town.
- Galisteo: Galisteo seeks to address the right-of-way along New Mexico Highway 41, with particular focus on the village center. The vision for this project includes a walkable area with amenities using historic development patterns and building techniques that will incorporate the existing buildings and open space.
- Magdalena: Magdalena is revitalizing its historic Municipal Complex and Cultural Center on Main Street as part of an effort to capitalize on tourism through the area. This project will focus on the development of a concept for "The Cosmic Park," envisioned to be an interactive public art installation utilizing pieces of equipment from the famous nearby Very Large Array.
- Questa: Questa seeks to reinvest in the village center to foster community pride and invigorate the economic climate. This revitalization project will address rehabilitation and restoration of buildings, as well as providing economic development strategies.
- Tularosa: Tularosa seeks to establish a visitors center, located on the historic Granado commercial street. The building and streetscape adjoining it would benefit from revitalization, providing a focal point in the community for residents and visitors.

In addition, Cloudcroft was apparently named as a Frontier Community in December 2014.

On the following pages, the TRD analysis is include in its entirety.

LG/bb/je

BILL ANALYSIS AND FISCAL IMPACT REPORT
Demesia Padilla, Secretary, Taxation and Revenue Department

February 20, 2015

Bill: SB-477 **Sponsor:** Senator Pete Campos

Short Title: Frontier Community Investment Tax Credit

Description: SB-477 amends Section 7-1-8.8 NMSA 1978 of the Tax Administration Act to include legislative committees. SB-477 also creates a new section of the Income Tax Act and the Corporate Income and Franchise Tax Act for taxpayers that are qualified businesses and make qualified investments to claim a credit in the amount not to exceed twenty-five percent of not more than one hundred thousand dollars of the qualified investment. The income tax credit is the Frontier Community Investment Income Tax Credit and corporate income tax credit is called the Frontier Community Investment Corporate Income Tax Credit.

The purposes of the credit are to encourage residents of frontier communities to invest in their communities and create new jobs and provide needed services for frontier communities. The Economic Development Department will be required to compile an annual report on the Frontier Community Investment Income Tax Credit to evaluate the effectiveness of the tax credit.

Effective Date: Not specified; 90 days following adjournment (June 19, 2015); The provisions of this act apply to taxable years beginning on or after January 1, 2015.

Estimated Revenue Impact*					R or NR**	Fund(s) Affected
FY2015	**FY2016**	**FY2017**	**FY2018**	**FY2019**		
	(1,200)	(1,200)	(1,500)	(1,500)	R	General Fund

* In thousands of dollars. Parentheses ( ) indicate a revenue loss. ** Recurring (R) or Non-Recurring (NR).

This bill is structured similar to the angel investment tax credit. While the angel investment tax credit is claimed against qualifying investment in a high-technology or manufacturing businesses, the frontier community investment credit is claimed against qualified investments in areas designated by Economic Development Department (EDD) as “frontier community” on the basis of its economic and rural characteristics which is not clearly defined in this bill. To fully utilize the credit, it takes 30 individuals and 30 corporations assuming they each make an investment of $100,000. According to data provided by EDD on retail trade that would qualify as frontier communities there are approximately 700 taxpayers that would currently qualify for the credit in 16 counties featured in the data extract. A taxpayer may claim the frontier community investment income tax credit for not more than two qualified investments and not more than three taxable years. Given these provisions, the available data, and the maximum claims allowed. TRD is assuming that the credit can easily be fully utilized. The credit is non-refundable and may only be deducted from the taxpayer's income tax liability, for this reason, TRD believes that most taxpayers may not have a tax liability of $25,000 given that the credit targets rural areas. TRD is assuming that 80 percent of the credit will be utilized in the first two fiscal years and fully utilized thereafter.

TRD used EDD’s Frontier Communities Initiative definition of “frontier community” as “small rural communities (less than 7,500 in population)” for this analysis.

Policy Issues: The bill amends Section 7-1-8.8 NMSA 1978 to allow the department to share tax return information with the Legislative Finance Committee (LFC) and the EDD. The department currently has a federal tax information sharing agreement with the federal government that allows the department to receive federal tax information. The sharing agreement provides strict guidelines as to what tax information can be shared with other state agencies. As part of the sharing agreement, the department is audited every year by the federal internal revenue service to assure the proper safeguards and procedures are in place to protect federal tax information. The federal tax information received by the department provides an important tool to the department to assure compliance by taxpayers on their New Mexico income tax returns. The sharing of tax return information proposed by this bill may jeopardize the department’s ability to receive federal tax information under its sharing agreement with the federal government.

Technical Issues: The bill as drafted may not be usable by an individual as a credit against their personal income tax as set forth in Section 2 of the bill. The bill provides that a taxpayer that is a qualified business may claim a credit against its personal income tax liability. Business is defined in the bill as a "corporation, general partnership, limited partnership, limited liability company or other similar entity." This definition does not appear to include a sole proprietorship. Based on the definition of "business," an individual taxpayer will never qualify as a qualified business. The department believes the intent of the bill is to allow members, partners, or shareholders of a qualified business to take the credit. If this is indeed the intent of the bill, the department suggests an amendment be made to include a provision similar to Subsection H of Section 7-2-18.18 NMSA 1978, which provides a method of allocating the credit to an owner of a business that is taxed for federal income tax purposes as a partnership. Additional technical issues are addressed below in the Technical Issues – Detailed Discussion section.

Other Issues: The bill defines "new full-time job" to mean "a job created by a business on or after July 1, 2015 but before December 31, 2016." This time limitation placed on when a full-time job needs to be created appears to conflict with the ability of a taxpayer to make qualified investments up to December 31, 2024.

If the $750,000 annual cumulative cap is reached, economic development cannot issue certificate of eligibility which could potentially prevent taxpayer from claiming the credit within one year following the calendar year in which the qualified investment was made.

Administrative & Compliance Impact: Moderate impact (400 hours) – Requires changes to the personal income tax, corporate income tax, GenTax, and Taxpayer Access Point documents, and configuration changes to the Business Credit Module. Additional reports need to be developed to summarize the annual credit details. Coordination between TRD and EDD is required and would be much easier to manage if the certification forms can be received electronically. TAP and MeF changes would be needed. TRD can modify publications and instructions related to the personal income tax and corporate income taxes with the annual renewal of tax programs.

Tracking of this credit to see if a business ceases operation for one hundred eighty days within two years of claiming the credit will be difficult and would require assessment of the credit previously claimed and approved. This could be a function of the Audit & Compliance Division.

Estimated Additional Operating Budget Impact*				R or NR**	Fund(s) or Agency Affected
FY2014	FY2015	FY2016	FY 14-16		
0	32	0	32	NR	Taxation and Revenue

* In thousands of dollars. Parentheses ( ) indicate a cost saving. ** Recurring (R) or Non-Recurring (NR).

Related Bills:

Technical Issues – Detailed Discussion: Subsection C of Sections 2 and 3 provides that a taxpayer, which is a qualified business, can make not more than two qualified investments in a taxable year so long as the qualified investments are in different qualified businesses. This language appears to conflict with subsection A of Sections 2 and 3 as subsection A appears to only require the taxpayer, which is a qualified business, to make a qualified investment. The bill's language may need to be amended to clarify whether a taxpayer must make qualified investments in qualified businesses other than the taxpayer's business.

Subsection C of Sections 2 and 3 may be in conflict with subsection D. Subsection D provides that a taxpayer may claim the credit no later than one year following the end of the calendar year in which the qualified investment was made. Subsection C may be interpreted to give the taxpayer three years to claim the credit. The department believes the language in Subsection C regarding claiming the credit within three years refers to how long the taxpayer can carryforward the credit when excess credit remains after application to the taxpayer's tax liability as set forth in subsection J. The language in subsection C may not be necessary and should be stricken to prevent confusion.

References to 26 U.S.C. § 152(a) paragraphs (1) through (8) and (9) found in the definition of "eligible employee" under both Sections 2 and 3 are incorrect as 26 U.S.C. § 152(a) only has two paragraphs. The proper reference should be determined and the bill should be amended.

The bill creates a tax credit for businesses locating and hiring at least three unrelated employees in "frontier communities." "Frontier communities" are defined by EDD based on the economic and rural characteristics of the community. The bill does not provide a definition of what “economic characteristics” means. The bill also does not define what is rural.

The credit does not seem to require that the new hires have their principal place of work in the “frontier community.”