FISCAL IMPACT REPORT

ORIGINAL DATE 01/30/18
SPONSOR Trujillo, CA / Small **LAST UPDATED** **HB** 201

SHORT TITLE Make Angel Investment Credit Refundable **SB**

ANALYST Clark

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY18	**FY19**	**FY20**	**FY21**	**FY22**		
	Up to ($1,600.0)	Up to ($1,600.0)	Up to ($1,600.0)	Up to ($1,600.0)	Recurring	General Fund

Parenthesis ( ) indicate revenue decreases

SOURCES OF INFORMATION
LFC Files

Responses Received From
Taxation and Revenue Department (TRD)
Economic Development Department (EDD)

SUMMARY

Synopsis of Bill

House Bill 201 makes the angel investment tax credit refundable. Currently, the credit may only be deducted from income tax liability and carried forward up to five years.

There is no effective date of this bill, but the provisions apply to taxable years beginning on or after January 1, 2018.

FISCAL IMPLICATIONS

This bill makes the credit more useable by more people by allowing it to be refunded rather than carried forward against future liability. In particular, this would allow people with no income tax liability in New Mexico, including non-residents, to make investments and claim the credit. While this could increase investments (up to a ceiling, due to the existing $2 million annual cap on the credit), it would also proportionally increase the cost of the credit. The Taxation and Revenue Department (TRD) provided the following analysis.

> TRD reviewed GenTax expenditures to estimate the fiscal impact. The law – both current and proposed – will limit the expenditure to $2 million per year. The three-year average for this tax credit is approximately $400 thousand per year; approximately 67 taxpayers participate annually. In tax year 2016, the most recent full period available, usage was down significantly from the prior two years, likely attributed to a lack of attractive and qualifying investment opportunities in New Mexico during that year. The estimates assume claims will increase enough to utilize the full $2 million cap on this credit.

This bill may be counter to the LFC tax policy principle of adequacy, efficiency, and equity. Due to the increasing cost of tax expenditures, revenues may be insufficient to cover growing recurring appropriations.

Estimating the cost of tax expenditures is difficult. Confidentiality requirements surrounding certain taxpayer information create uncertainty, and analysts must frequently interpret third-party data sources. The statutory criteria for a tax expenditure may be ambiguous, further complicating the initial cost estimate of the expenditure's fiscal impact. Once a tax expenditure has been approved, information constraints continue to create challenges in tracking the real costs (and benefits) of tax expenditures.

SIGNIFICANT ISSUES

The angel investment tax credit provides a 25 percent credit, up to a maximum of $62.5 thousand, against each qualified investment. Economic developers and small business startups often report difficulty in funding new businesses in the state, and venture capital companies have noted New Mexico lacks the amount of early-stage funding available to businesses in many other states. Theoretically, a well-designed incentive may improve this situation.

Existing statute requires the Economic Development Department (EDD) to review and certify applications for the credit and also requires annual reporting on effectiveness (see Performance Implications); however, with current data made available to LFC staff, there is no way to determine if this particular credit has increased the level of investment or proven to be cost-effective.

TRD provided the following additional analysis.

> The proposed legislation will refund up to $62.5 thousand for each qualifying investment and up to $312 thousand to a single taxpayer. To put the scale of the refund in perspective, a taxpayer would need to invest over $1.25 million in New Mexico taxable income to incur a tax liability of $62.5 thousand.
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> Making the angel investment tax credit refundable allows non-resident investors, who may not have sufficient New Mexico tax liability, to take advantage of the credit as an enticement to invest. Since this credit is a clear example of a tax expenditure, some kind of periodic evaluation of its effectiveness is warranted.

PERFORMANCE IMPLICATIONS

The LFC tax policy of accountability is met on paper with the existing statutory requirement for EDD to report annually to LFC on this credit and its effectiveness; however, *accountability is not* *met* due to no record of LFC receipt over the last several years of any annual report from EDD on this credit as required by law. The agency stated, “EDD may need additional staff in order to comply with the reporting aspect.”

Does the bill meet the Legislative Finance Committee tax policy principles?

1. **Adequacy**: Revenue should be adequate to fund needed government services.
2. **Efficiency**: Tax base should be as broad as possible and avoid excess reliance on one tax.
3. **Equity**: Different taxpayers should be treated fairly.
4. **Simplicity**: Collection should be simple and easily understood.
5. **Accountability**: Preferences should be easy to monitor and evaluate

Does the bill meet the Legislative Finance Committee tax expenditure policy principles?

1. **Vetted**: The proposed new or expanded tax expenditure was vetted through interim legislative committees, such as LFC and the Revenue Stabilization and Tax Policy Committee, to review fiscal, legal, and general policy parameters.
2. **Targeted**: The tax expenditure has a clearly stated purpose, long-term goals, and measurable annual targets designed to mark progress toward the goals.
3. **Transparent**: The tax expenditure requires at least annual reporting by the recipients, the Taxation and Revenue Department, and other relevant agencies.
4. **Accountable**: The required reporting allows for analysis by members of the public to determine progress toward annual targets and determination of effectiveness and efficiency. The tax expenditure is set to expire unless legislative action is taken to review the tax expenditure and extend the expiration date.
5. **Effective**: The tax expenditure fulfills the stated purpose. If the tax expenditure is designed to alter behavior – for example, economic development incentives intended to increase economic growth – there are indicators the recipients would not have performed the desired actions "but for" the existence of the tax expenditure.
6. **Efficient:** The tax expenditure is the most cost-effective way to achieve the desired results.

LFC Tax Expenditure Policy Principle	Met?	Comments
Vetted	?	
Targeted		
Clearly stated purpose	✓	No, but the intent appears clear
Long-term goals	✗	
Measurable targets	✗	
Transparent	✗	By statute it is, but not in actual reporting
Accountable		
Public analysis	✗	
Expiration date	✓	
Effective		
Fulfills stated purpose	?	
Passes "but for" test	?	
Efficient	?	
Key: ✓ Met ✗ Not Met ? Unclear		

JC/sb/al