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

SPONSOR Sweetser **ORIGINAL DATE** 1/23/19 **LAST UPDATED** 3/11/19 **HB** 165/aHFl#1

SHORT TITLE Modifying High Wage Jobs Tax Credit **SB**

ANALYST Clark

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY19	FY20	FY21	FY22	FY23		
NFI	Negative, likely minimal	Indeterminate, possibly ($1,000.0) to ($3,333.0)	Indeterminate, possibly ($3,333.0) to ($6,667.0)	Negative, indeterminate but likely up to ($10,000.0) long term	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 HFl#1 Amendment

The House Floor Amendment #1 brings the sunset date three years closer, setting the period for which newly created jobs qualify for the credit to prior to July 1, 2026 instead of July 1, 2029 in the original bill. It also creates a definition for “new job” to mean “a job that is occupied by an employee who has not been employed in New Mexico by the eligible employer in the three years prior to the date of hire.”

Synopsis of Original Bill

House Bill 165 amends the high-wage jobs tax credit, which was changed in numerous ways during the 2016 special session to reduce the skyrocketing cost of the credit. The changes made by this bill reduce the percent value of the credit from 10 percent to 8.5 percent but increase the annual per-job maximum by $750 (see Fiscal Implications), remove all business eligibility requirements (including the term “economic base”) other than eligibility for the Job Training

Incentive Program (JTIP), reduce the number of weeks a job must be held from 48 to 44, and make minor modifying language.

The bill also removes most of the current restrictions preventing businesses from using the credit if they shed other jobs, and it reduces from five years to two years the restriction on claims by companies that previously ceased business operations.

The bill allows a high-wage job to qualify for the credit in future periods (if it meets the requirements in those periods) even if it does not qualify for the credit in a period following the initial period. Current statute requires that once a job falls out of qualification, it cannot qualify for any potential remaining periods.

The bill removes the qualifiers related to the time the Taxation and Revenue Department (TRD) has to process applications, requiring a determination in 180 days.

The bill extends the period for which newly created jobs qualify for the credit from the current termination prior to July 1, 2020 to July 1, 2029.

The provisions of this bill apply to qualifying periods beginning on or after January 1, 2019.

FISCAL IMPLICATIONS

The fiscal impact of this bill is very difficult to estimate without detailed information from TRD. However, the language in many ways remains more restrictive than the language in place before the cost of the credit exploded over $10 million and then grew to many tens of millions of dollars. Therefore, the long-term cost once the delayed repeal date in existing statute would prevent qualifying periods from accruing (as early as FY24 – three years after new jobs cease to qualify) is estimated at up to $10 million annually – the upper end of the credit prior to exploitation of loopholes in the language. However, depending on job creation dates and the number of qualifying periods for some jobs, it is possible this impact could be reached by FY23.

In FY21 and FY22, the cost will grow beyond the current level (the current cost is unknown as TRD did not supply the FY18 or FY19 year-to-date costs in its analysis), gradually rising toward the long-term cost of up to $10 million. This uncertainty and gradual increase in costs explains the wide ranges shown for those two fiscal years in the table on the first page.

The cap on the credit per employee per qualifying period would be increased from $12 thousand to $12,750; however, the value of the credit, a percent multiplied by the wages distributed to the employee, would be decreased from 10 percent to 8.5 percent. Therefore, this part of the bill should have a positive fiscal impact. Most of the other aspects of the bill broaden eligibility for the credit and therefore have negative fiscal impacts.

See Technical Issues for possible alternate interpretations of the bill that could significantly alter the fiscal impact.

This bill expands a tax expenditure with a cost that is difficult to determine but likely significant. LFC has serious concerns about the significant risk to state revenues from tax expenditures and the increase in revenue volatility from erosion of the revenue base. The committee recommends the bill adhere to the LFC tax expenditure policy principles for vetting, targeting, and reporting or be held for future consideration.

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 high-wage jobs tax credit is a refundable credit intended to incentivize urban and rural businesses to create new, high-wage economic-based jobs. It requires the state to pay companies even if they have no tax liability through a credit to the employer of 10 percent (4.9 percent through this bill and under current PIT rates) of an employee's wages.

Use of this credit exploded for several years from a cost in FY10 of $4.6 million to $66 million in FY15 and $58 million in FY16, but many of the companies claiming the credit were receiving refunds due to loopholes in the statute. Legislation enacted during the 2016 special session closed the known loopholes and imposed additional reporting and eligibility requirements. These requirements reduce the projected cost of the credit and help prevent exploitation of the credit by companies that do not continue to add net new employees.

However, economic developers report the new requirements were too stringent and make the credit almost unusable, although prior to the 2016 changes, this credit was often cited as one of the best tax incentive tools for recruiting businesses, along with the JTIP and state grant money.

The bill eliminates the "economic base" requirement as a qualification factor for companies to obtain the tax credit and makes all applicants meet the FY19 JTIP requirements, which already defines economic based jobs. Below is the language from these guidelines regarding company eligibility

> Companies that increase the economic base of New Mexico are eligible to be considered for JTIP funds. They are broken out into two broad categories: manufacturers and companies that provide services that are non-retail in nature and export at least 50 percent of the services to a customer base outside New Mexico. The company must be creating new jobs as a result of expansion, startup, or relocation to the State of New Mexico. Companies that have been funded previously by JTIP must have at least as many total employees as when they last expanded under JTIP. Financial strength is also a primary consideration in funding decisions. The company should be financially stable to ensure long-term employment for JTIP trainees.

PERFORMANCE IMPLICATIONS

This bill was vetted by general discussion of the concepts at the Revenue Stabilization and Tax Policy Committee and discussion of many specific provisions with legislative staff, but neither the bill nor the existing statute adhere to the LFC targeting and reporting requirements.

The LFC tax policy of accountability is not met since TRD is not required in the bill to report annually to an interim legislative committee regarding the data compiled from the reports from taxpayers taking the deduction and other information to determine whether the deduction is meeting its purpose.

TRD reported the following:

> TRD recommends the following metrics to standardize the administration of business credits: 1) credits should not be refundable, thereby limiting the State's investment to the economic value created by the taxpayer; 2) credit programs should sunset within five years so the efficacy of the incentive can be evaluated; 3) credits should have carry forward periods not exceeding three years to limit the fiscal expenditure and the term of the program; 4) programs requiring administration through multiple agencies other than TRD should employ E-Systems; 5) applications for business credits shall be submitted electronically in a form prescribed by the Department; and 6) application for business credits shall be made within one tax year of eligibility to limit the administrative and fiscal impacts of the expenditure.

WHAT WILL BE THE CONSEQUENCES OF NOT ENACTING THIS BILL

Jobs created on or after January 1, 2020 that would otherwise qualify for this credit will no longer qualify.

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		No, but seems very reasonable to assume it is to incentivize the creation of high-wage jobs
Clearly stated purpose	?	
Long-term goals	✗	
Measurable targets	✗	
Transparent	✗	
Accountable		
Public analysis	✗	
Expiration date	✓	
Effective		
Fulfills stated purpose	?	
Passes "but for" test	?	
Efficient	?	
Key: ✓ Met ✗ Not Met ? Unclear		

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