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

ORIGINAL DATE 1/28/19
SPONSOR L. Trujillo **LAST UPDATED** ____ **HB** 184

SHORT TITLE Apprenticeship Program Income Tax Credits **SB** ____

ANALYST Graeser

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY19	FY20	FY21	FY22	FY23		
	($2,700.0)*	($2,800.0)*	($2,900.0)*	($3,000.0)*	R**	General Fund (PIT & CIT)

Parenthesis ( ) indicate revenue decreases
* See Fiscal Implications for an alternative estimate from TRD.
** The program is applicable for taxable years beginning January 1, 2019 and ending for taxable years December 31, 2023. This is a five-year pilot program. For the purpose of this FIR, this program is considered recurring.

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY19	FY20	FY21	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
Total		$207.0	$28.6	$235.6	Recurring*	General Fund

Parenthesis ( ) indicate expenditure decreases

DWS estimates $81,000 for infrastructure modifications and $28,600 annually for on-going maintenance.

SOURCES OF INFORMATION
LFC Files

Responses Received From
Department of Workforce Solutions (DWS)
Taxation and Revenue Department (TRD)

SUMMARY

Synopsis of Bill

House Bill 184 creates apprenticeship program income tax credits applicable to both the Income Tax Act and the Corporate Income and Franchise Tax Act. A taxpayer who is not a dependent of another individual who is participating in a Workforce Solutions ***registered*** apprenticeship program that employs a qualified apprentice in New Mexico is eligible for the credit. The credit allowed per "qualified apprentice" is $1,000 for a full year or $2,000 for a full year if the qualified apprentice received a high school diploma or high school equivalency credential less than four years prior to the apprenticeship. If the qualified apprentice is employed for less than the full taxable year but was employed for at least seven months during that year they are eligible for the credit but can only claim part of the credit based on the amount multiplied by the fraction of the full year the apprentice was employed.

This credit is limited for each qualified apprentice at five calendar years from their date of hire. This credit is not refundable and any credit that exceeds a taxpayer's tax liability in a taxable year may be carried forward for up to three taxable years. Note that five year limit somewhat conflicts with the restriction that the whole program effectively sunsets January 1, 2024, or five years from initiation.

Pursuant to the provisions of the bill, the Taxation and Revenue Department (TRD) will adopt rules establishing a procedure to certify that the taxpayer is a participating employer in a registered apprenticeship program that that the employee is a qualified apprentice for the purposes of obtaining this credit. TRD will also have to compile an annual report on the credit and shall provide the number of taxpayers approved for the credit, the aggregate amount of credit approved, and any other information necessary to evaluate the effectiveness of the credit. This report shall be presented annually to the legislative committees specified.

Effective Date: Date not specified; 90 days following adjournment (June 14, 2019). Applicable to taxable years beginning on or after January 1, 2019. Although there is no delayed repeal of the credits, the bill will deny credits earned after December 31, 2023.

FISCAL IMPLICATIONS

This bill creates or 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.

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.

This bill provides an excellent example of this revenue estimating difficulty. TRD has estimated the fiscal cost of this apprenticeship tax credit as follows:

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY19	**FY20**	**FY21**	**FY22**	**FY23**		
	(22,868)*	(23,153)*	(23,443)*	(23,736)*	R**	General Fund (PIT & CIT)

TRD describes its methodology for estimating the revenue impact: "TRD reviewed Department of Workforce Solutions (DWS) 2017 labor market and apprenticeship program data. There are forty-eight programs covering twenty-two trades currently in effect. The language of the bill can be interpreted to allow all current employees enrolled in an apprenticeship program to qualify the employer for the tax credit. If the ratio of journeyman to apprentice is 1:1, then the number of qualifying employees is approximately 15,000. The average credit amount is estimated as $1,500. DWS estimates employment growth of 6.7 percent over the period 2016-2026."

In contrast, LFC obtained an estimate from DWS Apprenticeship Bureau Chief that the current number of registered apprentices is 1,519. Historically, since 2012 the number has averaged from 1,250 to 1,650 apprentices. Assuming that the average apprentice's wages would be approximately the national average of $14.50 per hour, the most likely effect of the program would be to encourage employers to hire apprentices that would quality the employers for the $2,000 credit. The additional employment of apprentices would be approximately 100. These assumptions lead to the estimate shown in the revenue table on page 1.

SIGNIFICANT ISSUES

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.

TRD notes that the stated purpose is to incentivize employers "…create and participate in registered apprenticeship programs…." This does not guarantee the creation of new jobs; existing employees would qualify if they entered an apprentice program.

LFC staff note that the most likely effect of this credit would not be to create more and new apprenticeship slots, but to encourage employers to select younger apprentices that would qualify the employers for the $2,000 tax credit. LFC staff note that this credit has a problem long noted by economists. This is known as "buying the base." If the tax credit or deduction rewards current taxpayers without creating new jobs or economic opportunities, then the marginal state cost of the program per new job created can easily exceed $30,000 per job for jobs that, perhaps, pay no more than $30,000 annually and generate feedback increases in personal income tax revenue from the newly hired of, perhaps, $1,500 per year. Thus, this program can never repay the general fund costs.

DWS notes that the agency has long administered a registered apprenticeship program. This program includes an Apprenticeship Council, with members appointed by the Division Director. The Apprenticeship Council is made up of three business owners, three union people and three public members.

Central New Mexico Community College has apparently taken a lead in promoting apprenticeship opportunities. CNM does not sponsor apprenticeships but does provide the classroom training required for many apprentice programs. These include trade apprenticeships, information technology programs promoted by the New Mexico Information Technology Apprenticeship Program (NMITAP) and, in the future, Healthcare and Advanced Manufacturing Apprenticeships. There may be opportunities for apprenticeships in the film production industry. This tax credit could be a material aid in making these new apprenticeship programs successful.

PERFORMANCE IMPLICATIONS

The LFC tax policy of accountability is met with the bill's requirement 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 will be able to report on the number of taxpayers taking the credit and the general fund costs. However, the bill should require DWS to contribute a companion report on whether the apprenticeship programs are growing or staying relatively stable. It would also be useful if DWS were required to measure and note the LFC staff expectation that the number of slots would not increase dramatically, but that the employers might shift to hiring apprentices that would qualify the employer for the larger credit.

ADMINISTRATIVE IMPLICATIONS

To administer the tax credit program, DWS would need a staff member to monitor the tax credit and generate the necessary reports. NMDWS does not currently capture dates of high school diploma or high school equivalence. The current IT system would need to be modified to include a field to capture the high school graduation date or the date of a high school equivalency credential. The system would also need to be modified to capture the tax credit information so as to track and report accurately.

Staffing requirements for effort (4 month costs):
$28,800 for a project manager
$21,000 for 2 business analysts/testers
$16,000 for 2 developers
$10,800 for a database architect
$3,600for 2 network administrators
$1,600 for a technician
Total: $81,800 for infrastructure modifications

Ongoing costs:
$18,200 for a Business analyst
$10,400 for 4 on-call technicians
Total: $28,600 on-going maintenance

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

HB 183 proposes a high school graduation credit to students that participate in apprenticeship programs

TECHNICAL ISSUES

DWS reports a confusion that could be rectified through amendment:

> Under the Income Tax Act, specifically defined in section7-2-2(D) and the Corporate Income and Franchise Tax Act in section 7-2A-2(F), "the department" means the taxation and revenue department. Section 1 of HB 184 is an addition to the Income Tax Act and Section 2 adds a new section to the Corporate Income and Franchise Act. This bill uses "department" to imply the department of workforce solutions at times and may use "department" to mean the department of taxation and revenue at other times. For example, it is unclear from the text of the bill whether the tax credit shall be reported to the department of taxation and revenue or the department of workforce solutions in subsections H & J. It appears that DWS is the department that shall be responsible to adopting rules establishing procedures to certify taxpayers that are participating in a

registered apprentice program and certifying that employees are qualified apprentices. However, it is unclear from the bill how the taxpayer reports the tax credit to the taxing authority.

DWS also notes the following:

The definition of "registered apprenticeship program" is inconsistent between HB 183, HB 184, and the current statute in NMSA 21-19A-5. The definition of "qualified apprentice" is inconsistent with the process of identifying qualified individuals. Current procedure is for an interested individual to apply with a qualified program to become an apprentice. If accepted, the individual registers with the department of workforce solutions as an apprentice.

TRD similarly notes the confusion over the use of "Department" to refer both to TRD and DWS. "Some of the language creates confusion. For example, on page 2, lines 5-7, the value of the credit is not well defined. Additionally, the statute uses "department" to refer to Taxation and Revenue as well as Workforce Solutions. These persist in Section 2."

OTHER SUBSTANTIVE ISSUES

Taxation and Revenue recommends the following metrics to standardize the administration of tax 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 tax credits shall be submitted electronically in a form prescribed by the Department; and 6) application for tax 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

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

Arguably, the provisions of this bill violate all of these principles: adequacy, efficiency, equity and simplicity are invoked with virtually any tax credit. In this case, accountability suffers because it takes two agencies, working in concert, to adequately report of whether the program meets the goal of increasing the number of apprentices.

LG/al