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

SPONSOR Small / Dow **ORIGINAL DATE** 1/18/19 **LAST UPDATED** 3/16/19 **HB** 219

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

ANALYST Clark

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY19	**FY20**	**FY21**	**FY22**	**FY23**		
	Likely up to ($700.0)	Up to ($1,400.0)	Up to ($1,400.0)	Up to ($1,400.0)	Recurring	General Fund

Parenthesis ( ) indicate revenue decreases

SOURCES OF INFORMATION
LFC Files

Responses Received From
Economic Development Department (EDD)

SUMMARY

Synopsis of Bill

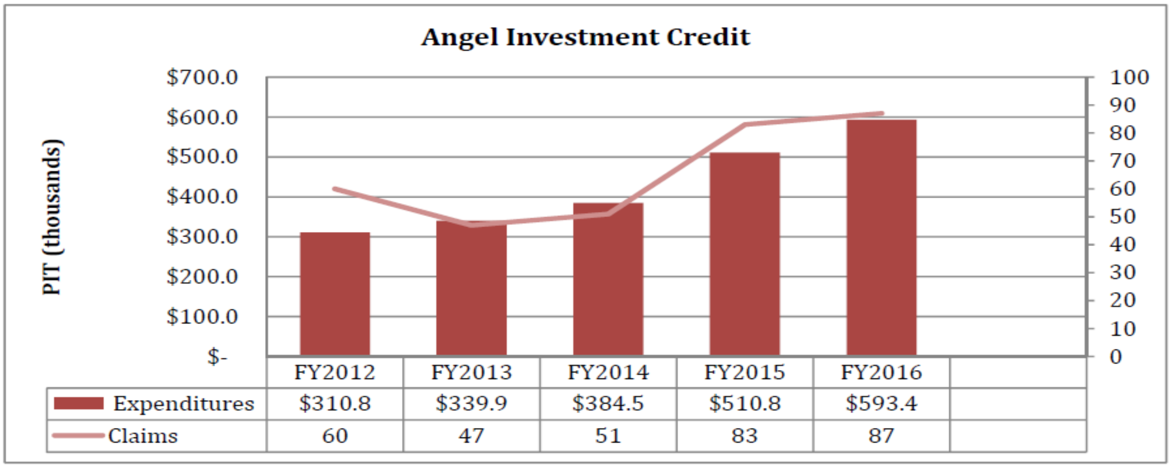
House Bill 219 makes the angel investment tax credit refundable. Currently, the credit may only be deducted from income tax liability and carried forward up to five years.

There is no effective date of this bill, but the provisions apply to taxable years beginning on or after January 1, 2019.

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 *2017 Tax Expenditure Report*, released by the Taxation and Revenue Department (TRD), includes the table below, showing the cost of the credit gradually rose over the last five years of available data, from $310.8 thousand in FY12 to $593.4 thousand in FY16. The number of claims also rose over the last four years, from 47 to 87. The estimates assume claims and expenditures will rise due to the increased attractiveness and usability of the credit, with the maximum possible cost for FY21 through FY23 being the difference between the highest expenditure level in FY16 and the $2 million cap on the credit. The estimated additional cost for FY20 is half this value, as it is reasonable to assume some period of time would be required to reach the cap.



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 principles 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.

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 of any annual report from EDD on this credit as required by law until the release of the agency's FY18 annual report. However, that report fails to include most of the information EDD is required by statute to publish annually related to this credit.

TECHNICAL ISSUES

LFC staff note this bill might raise constitutional questions because of phrasing in the anti-donation clause of the New Mexico Constitution. Staff provided a memo to the chairs of HAFC, SFC, and HTRC notifying them of concerns more broadly regarding this type of tax treatment.

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