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FISCAL IMPACT REPORT

		ORIGINAL DATE	02/08/21		
SPONSOR	Tallman	**LAST UPDATED**	03/08/21	**HB**	
SHORT TITLE	Economic Development Incentive Reports			**SB**	98/aSFC
				ANALYST	Iglesias/Graeser

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

Agency	FY22	FY23	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
TRD – ITD Staff Workload	$7.7	$7.7	$15.4	Recurring	General Fund
TRD – Additional FTE	$87.7	$87.7	$165.4	Recurring	General Fund
EDD	Moderate	Moderate	Moderate	Recurring	General Fund

Parenthesis ( ) indicate expenditure decreases

SOURCES OF INFORMATION

LFC Files

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

SUMMARY

Synopsis of SFC Amendment

The Senate Finance Committee amendment to Senate Bill 98 removes the $192 thousand appropriation. The House Appropriation and Finance Committee substitute for House Bill 2 contains a $200 thousand appropriation to the Taxation and Revenue Department for this purpose.

Synopsis of Original Bill

Senate Bill 98 does the following:

(1) Adds reporting requirements for Local Economic Development Act (LEDA) recipients;
(2) Requires the Taxation and Revenue Department (TRD) to continue publishing the annual tax expenditure report required by an executive order from the prior administration; and,
(3) Requires TRD to perform an objective assessment every three years of economic development tax incentives with an estimated cost of more than $10 million per fiscal year.

LEDA Reporting Requirements. This bill requires qualifying entities that receive LEDA funds to report to the Economic Development Department (LEDA) specifics related to employment, salaries and capital investments made in a previous calendar year. The department would compile the information from the qualifying entities and submit an annual report to LFC and the Revenue Stabilization and Tax Policy Committee.

Tax Expenditure Budget Report. This bill puts in statute the requirement of TRD to publish an annual tax expenditure budget report that identifies deviations from the tax code, the year of enactment and changes, a description of the deviation and its intended purpose, an estimate of foregone revenues for deviations identified as tax expenditure, the data sources and methodology for the estimates, and the number of taxpayers claiming the tax expenditure. In effect, this codifies TRD's current practice of publishing its annual *Tax Expenditure Report*, which is currently required pursuant to Executive Order 2011-071.

Evaluation of Economic Development Incentives. If TRD determines a tax expenditure has a purpose of economic development and a cost greater than $10 million per fiscal year, then the bill requires TRD to perform an objective assessment and an economic analysis of the expenditure. The bill states EDD and LFC staff are to provide support and assistance in the assessment and analysis.

The bill requires that, if an economic analysis cannot be performed on a tax expenditure that is deemed to have a purpose of economic development, then TRD must report recommendations on statutory changes and reporting requirements to perform or improve the economic analysis.

The bill gives authorizes TRD to request information from an executive or a local government agency to complete the tax expenditure budget or assessment of a tax expenditure that is deemed to have a purpose of economic development. The bill requires compliance from any agency that is requested information.

The effective date of this bill is July 1, 2021.

FISCAL IMPLICATIONS

This bill appropriates $192 thousand from the general fund to TRD in FY22 to assist the department in evaluating tax expenditures and other economic development incentives. Presumably, this funding would need to be used to acquire dynamic tax modeling software. Any unexpended or unencumbered balance remaining at the end of fiscal year 2022 shall revert to the general fund.

Economic Development Incentives. A review of the 2029-2020 TRD *Tax Expenditure Report* indicates the economic development incentives that exceed $10 million are the film production credit ($148 million in 2019), high wage jobs credit ($46 million in 2016), and manufacturer's single-weighted sales apportionment ($35 million in 2016). Arguably the locomotive fuel GRT and compensating tax deduction is also an economic development tax incentive. Although TRD classifies it as a "highly specialized industry," the amount of the tax expenditure was over $20 million in 2018. Outside of the tax expenditures reported and estimated by TRD, the largest incentives are probably attributable to industrial revenue bonds (IRBs) issued by municipal and county governments. Reporting to the state on IRBs has historically been limited, although it is possible they are now being reported by local governments pursuant to Governmental Accounting Standards Board Statement 77. (See discussion in "Other Substantive Issues.")

Top Ten Economic Development Tax Incentives

Tax Expenditure	5-Year Avg. Cost
Film Production Tax Credits/Film and Television Tax Credits	$70.5*
Apportionment Election of CIT (double/single sales - manufacturing or computer processing facility)	$27.8
High-Wage Jobs Tax Credit against GRT, Comp, WH, ITGRT, 911 and relay service surcharges (except Local Option)	$16.4
Locomotive Engine Fuel GRT and Comp Tax Deduction	$16.1
Tax Increment for Development District Tax "Dedication" of GRT Increments Collected (state portion only)	$6.2
Laboratory Partnership with Small Business Tax Credit against GRT (except Local Option)	$4.7
Technology Jobs and Research and Development Tax Credit against GRT, Comp or WH and PIT or CIT	$2.8
Jet Fuel GRT and Comp Tax Deduction	$1.9
Rural Job Tax Credit against PIT, CIT or GRT, Comp, WH, ITGRT, 911 and relay svc surcharges (except Local Option)	$1.7
Software Development Services GRT Deduction	$1.6

Source: TRD 2020 Tax Expenditure Report
*The film tax credit was expanded in the 2019 session and is estimated to reach a cost of $145 million annually by FY23.

SIGNIFICANT ISSUES

There is a growing movement across the country to regularly evaluate tax expenditures, but staffing, modeling software, and access to data are often impediments that must be addressed. While some New Mexico tax expenditures require an analysis of the effectiveness of the expenditure, the reporting can be inconsistent and such analysis is not covered in TRD's current *Tax Expenditure Report*.

In a 2017 study of state tax incentive evaluations, Pew Charitable Trusts rates New Mexico as trailing other states in its evaluation of tax incentives because it lacks a well-designed evaluation plan. Although the Taxation and Revenue Department's annual *Tax Expenditure Report* provides information on estimated costs and number of claimants, Pew notes the report lacks detailed economic analysis.[1] Pew notes states leading in tax incentive evaluations have well-designed plans to regularly evaluate tax incentives, including measuring economic impacts and developing processes for informing policy decisions (see Attachment 2). This bill creates an evaluation plan for high-costs economic development incentives, providing a starting point for the state in developing a more intentional process for tax expenditure evaluations.

There are very few statutory requirements for an economic analysis of the costs and benefits of the state's tax expenditures. The most comprehensive requirement, passed in the 2019 session (Chapter 87, SB2) pertains to the film tax credit, which requires EDD to perform an economic

[1] Pew Charitable Trusts, "How States Are Improving Tax Incentives for Jobs and Growth", May 2017, https://www.pewtrusts.org/en/research-and-analysis/reports/2017/05/how-states-are-improving-tax-incentives-for-jobs-and-growth

assessment of the credit along with support from LFC and TRD staff. This bill would require similar economic analyses of other high-cost economic development tax incentives.

Recently, the Legislature has added a statutory requirement for TRD to report the "information necessary for evaluating the effectiveness" of certain tax expenditures; however, the department's annual tax expenditure report only includes the number of claimants and estimated total cost of an expenditure. While useful, the descriptive data included in TRD's tax expenditure report is generally insufficient to verify whether a tax expenditure is resulting in the desired effect. The report does not focus on outcomes and does not cover information that could be vital to determining effectiveness, such as the number of jobs created. This is due in part to a lack of sufficient reporting requirements from those claiming certain tax incentives and because many tax expenditures do not contain a clearly stated purpose in the statute, making it difficult to evaluate outcomes when the intent of a tax expenditure is unclear.

To this end, TRD suggests any intended purpose of a tax expenditure be clearly written into law to assist TRD in assessing effectiveness of each tax expenditure. A new proposed subsection to the bill could read as follows: "On and after January 1, 2020, any bill that creates a new tax expenditure or extends an expiring tax expenditure shall include a legislative declaration stating the intended purpose of the tax expenditure." The suggested language is from Colorado's statute, C.R.S 39-21-304. While the intended purpose of a tax expenditure should be reported, statutory language is not always clear, and TRD may not correctly infer legislative intent.

TRD also notes the current tax expenditure report prepared by TRD economists limits the analysis to estimates of foregone revenue in completed fiscal years and does not forecast future revenue impacts. The department should forecasat future impacts as a matter of good research and policy. However, if TRD is required to include forecasted amounts, the department states there would be administrative impacts. With new analysis and reporting on expenditures over $10 million, additional staffing and support will be needed.

Reporting Requirements and Data Sharing. The bill will contribute to the state's understanding of its tax incentives and assist the Legislature in determining whether certain incentives are meeting their intended purposes. Specifically, the bill tasks TRD with continuing its annual *Tax Expenditure Report* and determining if a tax expenditure has a purpose of economic development. TRD will then be required to perform an effectiveness and economic analysis study on any expenditure that has an economic development component and a cost greater than $10 million per fiscal year. TRD has been given the authority to request any information related to the expenditure and requires the information to be supplied.

The provisions in this bill that allow for information sharing with TRD will help the department gather useful data to evaluate high-cost economic development incentives. If the information is not reported or available, the bill requires TRD (along with EDD and LFC staff) to make recommendations to interim legislative committees on statutory or other changes needed to get the necessary data for evaluation.

EDD notes that, while the information may be necessary to evaluate tax expenditures, taxpayer data availability and reporting is a balancing act between the desire to maintain a high level of taxpayer confidentiality and the desire to provide public accountability, oversight, and evaluations of tax expenditures and economic development incentives for effectiveness and efficiency. EDD states there are benefits and drawbacks to any attempt at this balancing act, and there can always be valid concerns about access to confidential taxpayer and client information.

EDD states the department currently collects and reports a lot of the information required in this bill. In effect, the bill codifies this reporting requirement for LEDA recipients and requires EDD to share information with TRD that would be necessary for evaluating certain economic development incentives. EDD states the department is supportive of constructive ways to better track and monitor the success of its programs in a manner that supports and protects the proprietary and confidential information of the job creators. EDD also notes evaluating one tax incentive at a time is challenging, even though overall it can be a useful tool, and states evaluating one incentive in isolation can be problematic because some are used individually while others are sometimes used in combination.

PERFORMANCE IMPLICATIONS

The LFC tax policy principle of accountability is met with the existing annual reporting provided, the increased reporting in this bill, and detailed studies evaluating the effectiveness and other attributes of other tax expenditures.

New Mexico is falling behind other states for evaluating tax incentives. Pew Charitable Trusts recently reported 28 other states now perform regular tax incentive evaluations. The primary obstacle for New Mexico, as it was for many other states, is access to taxpayer data for the evaluations, but TRD also does not currently have funding necessary for the dynamic modeling software and additional staff or contract economists to perform these evaluations. Granting access to key data and providing TRD economists with the needed resources would allow a gradual process of evaluating tax expenditures and economic development incentives with the goal of eventually providing a holistic picture of the costs and benefits to the state of each job created in a particular industry – not just the cost of an individual incentive program, but the additive (or stacked) costs of all the incentives available for a particular job – along with estimated additional revenues and other benefits resulting from that job.

ADMINISTRATIVE IMPLICATIONS

TRD states, currently, the Information Technology Division (ITD) supports the *Tax Expenditure Report* as produced by the economists with reports and access to necessary data to complete analyses. Without a definitive scope of additional support, ITD assumes an annual effort of approximately 150 hours of effort, or approximately one month, to create additional reports or assist in data gathering to meet the new requirements of this bill.

TRD anticipates the workload by the staff of career economists in the Office of the Secretary to support new forecasts within the *Tax Expenditure Report* and annual collaborative analyses of expenditures over $10 million to require an additional economist-advanced.

Although the bill makes an appropriation to TRD to complete the requirements of the bill, it does not make an appropriation to other agencies tasked with supporting the analysis. EDD notes there could be a moderate impact on EDD staff depending on the volume of requests and the effort necessary to complete the reporting requirements, effectiveness and economic analysis.

TECHNICAL ISSUES

TRD identified the following technical issues:

> [Section 1]
> The term "public support" is referred to on page 1, line 23, and page 2, lines 1 and 19. TRD suggests specifying in the language that this refers to public funds.
>
> [Section 2]
> TRD suggests adding to the lists of definition "baseline of a tax" as listed on page 5, line 24. As taken from the 2020 TRD Tax Expenditure Report, this definition may state: "baseline tax system created by specific tax law provisions."
>
> Under sub-part D, TRD is to report on expenditures that are "identified by the department as having an economic development purpose." TRD would suggest that "economic development" be defined so as to not be subjectively defined by the department.
>
> Under sub-part D, TRD is to report at least every 3 years on the effectiveness of the identified expenditures. Subsection D(3) requires that TRD report every year by October 15th. TRD suggests removing "every year" so as to not conflict with the 3-year reporting requirement.
>
> The requirement to report on all expenditures by October 15 of each year coincides with the requirement for an in-depth analysis of tax expenditures over $10 million. TRD may not have time to complete the in-depth analysis by the same date the entire report is due because TRD will not know with certainty which tax expenditures are over $10 million until it completes the report.

OTHER SUBSTANTIVE ISSUES

Tax Expenditures Often Have Unintended Consequences. By narrowing the state's tax base, tax expenditures have contributed to rising tax rates in efforts to maintain revenue levels. Tax incentives are often used to address the problem of rising gross receipts tax rates by lowering the tax burden for specific industries. However, such incentives may ultimately end up worsening the pyramiding problem by reducing the tax base, which then puts upward pressure on tax rates.

Additionally, unlike other forms of spending, tax expenditures are often not reduced in lean times similar to other budgets. This results in a fiscal obligation that must be met regardless of the state's fiscal circumstances. The only way to control the outflow of revenue by way of tax expenditures is to amend the statutes, but the state typically lacks the information needed to craft the appropriate amendments. Also, it is often difficult to determine whether tax expenditures actually incentivize certain decisions or act as rewards for actions that would have occurred anyway. The economic analyses of certain high-costs economic development tax incentives required in this bill is a step in the direction of providing the Legislature and the public an opportunity to determine if these tax expenditures are fulfilling their intended purposes.

Potential IRB Reporting. Government Accounting Standards Board Statement 77 (GASB 77) was promulgated in August 2015. This directive requires state and local governmental financial statements to require the following:

This Statement requires governments that enter into tax abatement agreements to disclose the following information about the agreements:

- Brief descriptive information, such as the tax being abated, the authority under which tax abatements are provided, eligibility criteria, the mechanism by which taxes are abated, provisions for recapturing abated taxes, and the types of commitments made by tax abatement recipients;
- The gross dollar amount of taxes abated during the period; and,
- Commitments made by a government, other than to abate taxes, as part of a tax abatement agreement.

However, despite this requirement, the Legislature does not receive regular reporting on IRBs.

DI/LG/al/rl

ATTACHMENT 1

Top 10 Economic Development Tax Expenditures

Tax Expenditure	5-Year Avg. Cost
Film Production Tax Credits/Film and Television Tax Credits	$70.5*
Apportionment Election of CIT (double/single sales - manufacturing or computer processing facility)	$27.8
High-Wage Jobs Tax Credit against GRT, Comp, WH, ITGRT, 911 and relay svc surcharges (except Local Option)	$16.4
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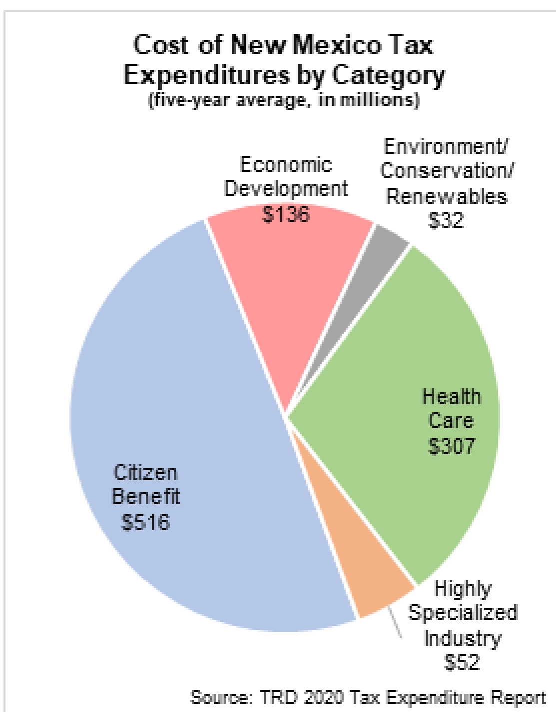
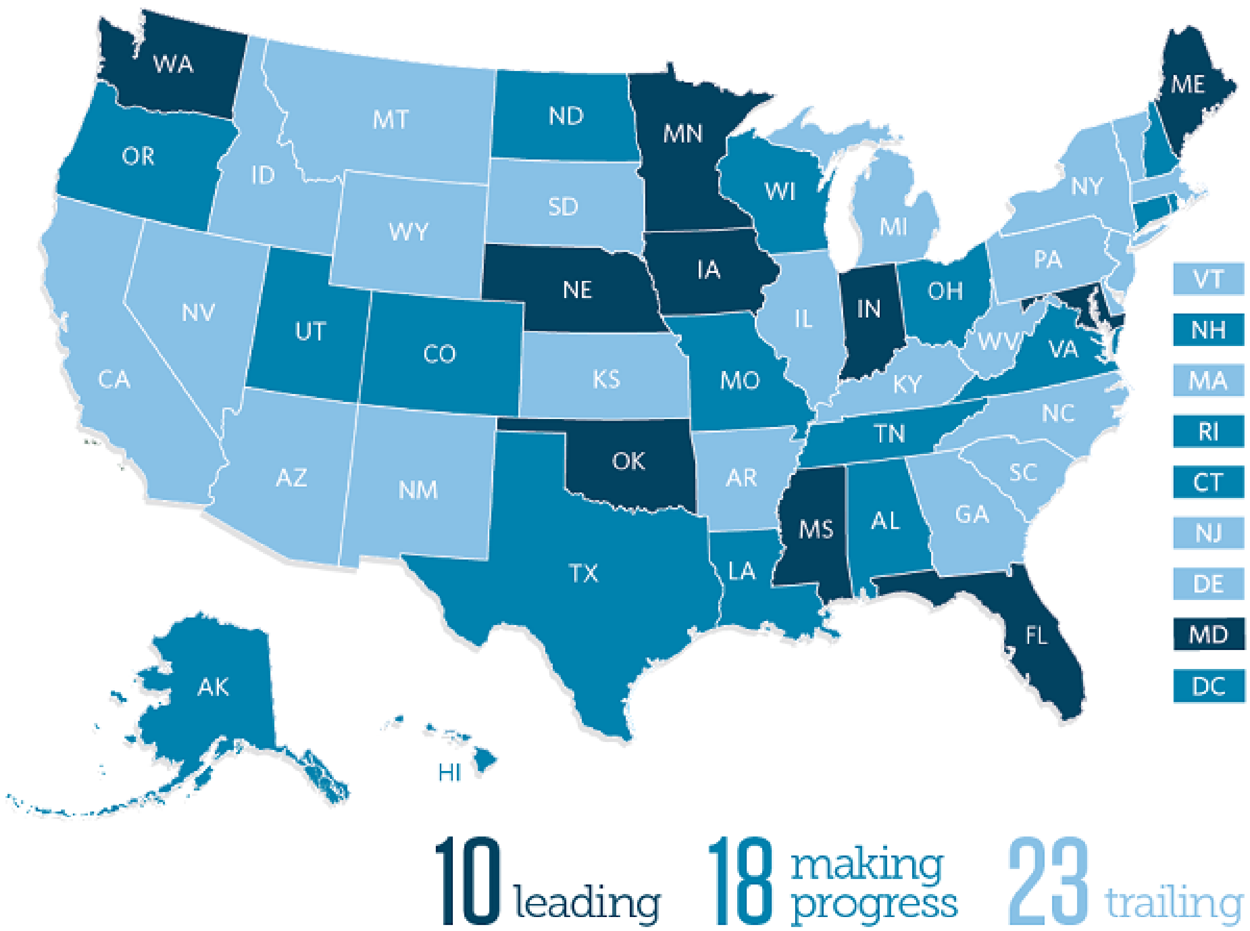
Source: TRD 2020 *Tax Expenditure Report*
*The film tax credit was expanded in the 2019 session and is estimated to reach a cost of $145 million annually by FY23.



ATTACHMENT 2

Figure 1

State Tax Incentive Evaluation Ratings



Note: The leading states have well-designed plans to regularly evaluate tax incentives, experience in producing quality evaluations that rigorously measure economic impact, and a process for informing policy choices. The states that are making progress have made a plan by enacting a policy that requires regular evaluation of major tax incentives. The trailing states lack a well-designed plan to regularly evaluate major tax incentives.

Source: Pew analysis based on interviews with state officials and a review of tax incentive evaluations and evaluation statutes