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

SPONSOR Hemphill/Griggs/ Chandler/Harper **ORIGINAL DATE** 03/30/21 **LAST UPDATED** ______ **HB** ______

SHORT TITLE LEDA Changes **SB** 1/ec

ANALYST Iglesias

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY21	FY22	FY23	FY24	FY25		
This provision creates a tax expenditure that is difficult to determine but likely significant.					Recurring	General Fund and Local Governments (GRT and Compensating Tax Sharing on Certain LEDA projects)

Parenthesis ( ) indicate revenue decreases

SOURCES OF INFORMATION
LFC Files

Responses Received From
Economic Development Department (EDD) – from duplicate HB308 in 2021 regular session

SUMMARY

Synopsis of Bill

Senate Bill 1 expands the Local Economic Development Act (LEDA) to allow a permanent mechanism for tax revenue sharing for certain new large LEDA projects. The bill allows 50 percent of some state and local gross receipts tax (GRT) and compensating revenue from large LEDA projects (over $350 million in construction and infrastructure costs) to be placed into the LEDA fund to help with recruitment of those large projects. Only costs associated with new construction of the project will be subject to this provision, and EDD and all local governments affected must agree to the revenue sharing.

The bill also provides additional reporting requirements for EDD for these projects and requires clawback of funds if the company does not reach the $350 million minimum by the end of the 10-year period. This clawback can be proportional just as with the existing clawback provision.

This bill contains an emergency clause, and the provisions relating to the recovery grants would become effective immediately on signature by the governor.

FISCAL IMPLICATIONS

This permanent GRT sharing provision, effective in FY22, pertains to new LEDA projects with large construction costs (over $350 million), requiring that GRT and compensating taxes generated from those construction costs be shared between the LEDA fund and state and local governments.

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.

Effectively, this creates a new 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.

Assuming one-third of the construction costs would be taxable, the state would give up at least $2.5 million in tax revenue each year for a single qualifying project with $350 million in construction costs, and local governments would give up at least $1.5 million.[1] Alternatively, the state would give up over $7 million on a project with $1 billion in construction and infrastructure costs.

Notably, however, the relative cost to the state and local governments of this provision hinges on whether the project meets the "but for" question – see item #5 of the LFC tax expenditure policy principles provided on the last page of this report. EDD argues that, in theory, this would only be a negative cost to the state and local governments if the project would occur anyway, regardless of public support.[2] However, if lack of public support meant the project would be lost, then EDD presumes the public funding necessary to secure the project would result in a gain to the state.

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[1] Calculation of potential cost = $350 million construction costs * one-third taxable * average state effective GRT rate of 4.3 percent * 75 percent distribution to LEDA fund. Note the cost for local governments would be similar but calculated with an average effective GRT rate of 2.6 percent and a 56.25 percent distribution to the LEDA fund.

[2] If the project would occur regardless of public funding, then the state and local governments could reasonably expect to receive the GRT and compensating taxes from that project. Therefore, any agreement to provide revenues to the LEDA fund to support that project would be a net loss to the state and local governments of the revenue it could have received. However, if the public support is necessary to secure that project, then the project would not exist "but for" the tax expenditure. See #5 of the LFC tax policy principles provided on the last page of this FIR.

EDD believes this provision will be a net positive for the state by assuming that such funding would occur only if this tax expenditure were made available. According to EDD:

> "The GRT sharing mechanism should result in net positive revenues for the state and local governments because the requirement that all parties agree to the terms would answer the "but for" test for incentives. If the project were going to happen anyway, or if it was a net negative deal for the local governments, they would decline. Only if the project would not happen "but for" this incentive structure would they agree to the revenue sharing."

Notably, EDD's argument that these projects would pass the "but for" question relies on an assumption that local governments would not participate in the project (and would not give up tax revenue) if they were aware the project would occur anyway. However, the state and local governments have historically demonstrated a willingness to forego tax revenues in the name of job creation, and local governments' willingness to participate in the agreement is not evidence in itself that the deal would not happen regardless of public support.[3]

SIGNIFICANT ISSUES

The LEDA expansion of this bill is permanent, creating a mechanism allowing sharing of gross receipts tax (GRT) and compensating tax revenues with companies for very large projects with significant construction and infrastructure expenses exceeding $350 million. If such a project gets approval through a written agreement with the Economic Development Department (EDD), the county, and the municipality in which the project is located (if in a municipality, otherwise only the county), it allows 50 percent of the state and local GRT and compensating tax revenues from the project construction would flow to the LEDA fund and would then be used through the traditional LEDA process to assist that project. No portion of these tax revenues transferred to the LEDA fund may be used for other projects. If one or both local governments decline to enter into this agreement, the project would not be eligible for this funding mechanism.

EDD and the local governments would track taxable expenses on a monthly basis and require the company to provide tax information as documentation. On a quarterly basis, EDD would work with the local governments to calculate an estimated total amount of tax revenue generated for each government entity and send those totals, along with all documentation, to the Taxation and Revenue Department (TRD) for verification the estimates were performed correctly. TRD would then subtract the appropriate amounts from the next scheduled monthly transfers to the general fund and the local governments. The bill instructs TRD to attempt to implement a method to report these tax revenues as a separate tax type to make this process easier, and the first process described here would be eliminated. If TRD cannot implement a different tax type, or until the agency is able to do so, the first process would be used.

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[3] For example, the major aerospace Project Orion is a planned $10 billion investment in Albuquerque to build an 80-acre site adjacent to the Sunport and construction of 4.1 million square feet of buildings. Under this bill, the project could also qualify for the GRT and compensating tax-sharing provisions, as long as the local governments and EDD agree. If agreed, and because this is a planned project, any state or local government tax revenue distributed into the LEDA fund from the construction of this project would be a net loss to the state and local governments in revenue they would already expect to receive.
https://www.cabq.gov/mayor/news/city-taking-steps-to-bring-major-aerospace-project-to-albuquerque

EDD provides the following discussion regarding this provision in the bill:

> "This bill expands LEDA to allow New Mexico to potentially land companies the state could not have competed for in the past. The bill allows for 50 percent of select state and local GRT and compensating tax revenues from large LEDA projects with more than $350 million in construction expenses to be placed into the LEDA fund to help with recruitment of those specific large projects. Only costs associated with new construction of the project will be subject to this provision, and EDD and all local governments affected must agree to the revenue sharing. This allows the state to compete for projects that are so large that EDD may not have enough uncommitted LEDA funds to successfully compete with offers from other states. The general fund and local governments would still get an increase of half the total new tax revenue, and the result is potential for far more private investment, jobs, and revenues for state and local governments.
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> If a company needs to decide in June where to locate, they probably will not be willing to wait until the next legislative session for a LEDA appropriation. New Mexico occasionally misses out on deals like this because we cannot compete with offers made by other states. The structure of these provisions that allows the local governments to decide whether to use this framework answers the "but for" test for incentives, so the state and local GRT revenues devoted to the project would be part of a much larger total of new revenues the state and community would not see otherwise."

There may be concerns on what types of projects would qualify for GRT and compensating tax sharing. For example, could film projects qualify? Netflix's most recent expansion promised $1 billion in production spending and $150 million in capital expenditures.[4] That capital cost level would prevent that type of project from qualifying under this bill's provision. However, should a film company promise $350 million in capital expenditures, nothing in the bill seems to preclude a film project for qualifying for the bill's cost-sharing provisions, despite the other forms of state support (notably the 25 percent to 35 percent film production tax credit) the project would already receive.

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] https://www.abqjournal.com/1520539/netflix-plans-significant-expansion-in-abq.html

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	✘	Not vetted through interim committees
Targeted		No clearly stated purpose, goals or targets, but presumably to assist the state in attracting large economic development projects with high construction and infrastructure costs.
Clearly stated purpose	✘	
Long-term goals	✘	
Measurable targets	✘	
Transparent	✓	EDD must issue a report to DFA and LFC within 30 days of executing a project participation agreement identifying the qualifying entity to receive public support, the estimated expenses related to construction, the location of the projection, and the amount of public support pledged.
Accountable		
Public analysis	?	EDD is not required to report to interim legislative committees on the effectiveness of the public support offered by this bill.
Expiration date	✘	There is no expiration date.
Effective		See discussion in Significant Issues section of this FIR.
Fulfills stated purpose	?	
Passes "but for" test	?	
Efficient	?	
Key: ✓ Met ✘ Not Met ? Unclear ⁄ Partial		

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