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

SPONSOR Soules **ORIGINAL DATE** 02/07/13 **LAST UPDATED** **HB**

SHORT TITLE Sustainable Energy Tech Investment Tax Credit **SB** 318

ANALYST Smith

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY13	**FY14**	**FY15**	**FY16**	**FY17**		
$0.0	$0.0	($984.0)	($1230.0)	($1392.0)	Recurring	General Fund

(Parenthesis ( ) Indicate Revenue Decreases)

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY13	FY14	FY15	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
Total	$0.0	$63.0	$60.0	$123.0	Recurring	Taxation and Revenue Department

(Parenthesis ( ) Indicate Expenditure Decreases)

SOURCES OF INFORMATION
LFC Files

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

SUMMARY

Synopsis of Bill

Senate Bill 318 adds new sections to the Income Tax Act and Corporate Income and Franchise Tax Act, to provide a sustainable energy technology investment tax credit. The credit is to be allowed in an amount not to exceed twenty-five percent of not more than one hundred thousand dollars of a qualified investment made by the taxpayer ($25,000). A taxpayer may not claim the credit for more than two qualified investments in a taxable year, and the department may allow a maximum annual aggregate of two million dollars in sustainable energy technology investment tax credits.

Businesses for which the credits could be allowed would be firms that:

- maintain their principal place of business in New Mexico;
- engage in qualified research for sustainable energy technology or manufactures existing sustainable energy technology in New Mexico;
- have not issued publicly traded securities;
- is not an investment company as defined in Investment Company Act of 1940, at the time of the investment;
- have one hundred or fewer employees calculated on a full-time-equivalent basis at the time of the investment;
- gross revenues have not exceeded $5 million in any fiscal year on or before the date of investment.

The bill mandates that ED shall certify the eligibility of companies for the credit.

Effective Date: January 1, 2014;

FISCAL IMPLICATIONS

TRD notes that "the definition of sustainable energy technology includes electrical energy generation technology that "has a long-term production and commercialization potential." It will be difficult for administrators to enforce compliance with this requirement as it is a rogue and subjective definition." **Due to analysts recent experience with overly broad language, TRD's fiscal impact is tripled.**

The overwhelming majority of businesses described in this bill are not organized as C-corps under the IRS Code. Most of the impact of this deduction would flow through personal income tax revenue.

TRD's estimate uses data from a comparable tax credit, the angel investment tax credit (AITC), to calculate an expected average qualified investment amount, average credit, and growth in the number of applicants. See Estimated Revenue Impact – Detailed Discussion for an in-depth explanation of the methods used.

This bill proposes a tax credit with a structure and purpose similar to the AITC. According to New Mexico personal income tax data from 2007 through 2010, the AITC resulted in an average investment of $27,300 and an average credit of $6,825. The number of taxpayers claiming the AITC grew from 16 in taxable year 2007 to 44 in 2010. This analysis assumes that the average investment and growth in claims will mirror what happened with the AITC.

The credit proposed by this bill varies from the AITC in both its scope and its applicability. Although this bill restricts its credit to investments in sustainable energy technology, it also expands the credit such that businesses can now qualify for it under the Corporate Income and Franchise Tax Act. This means that more entities could participate under the proposed tax credit but that fewer types of investments would qualify than under AITC. The effects of these changes are assumed by this analysis to offset.

This analysis begins by assuming an average investment of $27,300 by 32 individuals and businesses for an average credit of $6,825 each. The estimate then assumes strong initial growth in the number of applicants for the credit which quickly slows over the following years considering the AITC's growth patterns.

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.

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.

ADMINISTRATIVE IMPLICATIONS

TRD reports medium impact. Development of a claim form, instruction and process will cost $3 thousand.. Additional FTE will be needed to audit and track the credits, prepare for reports and monitor the maximum annual cap, at a cost of $60 thousand per year. Department employee and taxpayer education will be needed. There would be also a small impact (120 hours) on the staffing resources of the Taxation and Revenue Department's information systems team.

TECHNICAL ISSUES

TRD notes the following technical issues:

- Page 4, line 15 and page 10, line 18, "periodic basis" should be defined.

- On page 7, line 6, "fiscal year ending" should be changed to "taxable year". This wording also appears on page 13, line 10.

This bill does not contain a sunset date. The LFC recommends adding a sunset date.

OTHER SUBSTANTIVE ISSUES

TRD points out that because qualified businesses are limited to those with gross revenues of $5 million or less, the incentive might not entice investment from venture capitalists that typically look for more established enterprises to invest in. Also, this credit appears to apply to some of the same types of technologies that are eligible for the advanced energy tax credit and the AITC. It is not clear why a new credit is needed to subsidize the same industry. The proposal adds significant complexity and creates the possibility of a "double-dip" for these different credits.

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

SS/bm