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

SPONSOR Campos   **ORIGINAL DATE** 1/31/17   **LAST UPDATED** ______   **HB** ______

SHORT TITLE Small Business Investment Tax Credit   **SB** 196

ANALYST Graeser

REVENUE (dollars in thousands)

Estimated Revenue					R or NR **	Fund Affected
FY17	FY18	FY19	FY20	FY21		
	$(450.0)	$(450.0)	$(450.0)	$(450.0)	Recurring	General Fund

Parenthesis ( ) indicate expenditure decreases. ** R = recurring; NR = non-recurring
*Estimates based on historical use of similar credits, but the cost could reach the $2 million annual maximum

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY17	FY18	FY19	3 Year Total Cost	R or NR **	Fund Affected
Total		31.0	0	31.0	Nonrecurring	TRD Operating

Parenthesis ( ) indicate expenditure decreases. ** R = recurring; NR = non-recurring

SOURCES OF INFORMATION
LFC Files

Responses Received From
Taxation and Revenue Department (TRD)
Attorney General Office (AGO)
Economic Development Department (EDD)

SUMMARY

Synopsis of Bill

Senate Bill 196 creates the “small business investment income tax credit”. The credit amount is not to exceed 25 percent of not more than $250,000 of the qualified investment against the taxpayer’s income tax liability. A taxpayer may claim the credit for no more than five qualified investments in a taxable year, and each of those investments must be in a different qualified business. The maximum credit amount for any taxpayer per taxable year is $312,500. A taxpayer who wishes to claim the credit must apply for a certification of eligibility from the Economic Development Department (EDD). Certificates of eligibility are processed only if the total amount of the credits represented by the certificates in a calendar year does not exceed $2,000,000. Taxpayers may not stack this new credit on top of the existing angel investment credit, the investment credit or the Technology Jobs and Research and Development Tax Credit.

This bill is similar to the angel investment credit in 7-2-18.17 NMSA 1978, but with a separate and additional $2,000,000 annual credit cap.

Effective date is not specified -- 90 days following adjournment (June 16, 2017); Applicable to taxable years beginning on or after January 1, 2017.

FISCAL IMPACT

The Taxation and Revenue Department (TRD) has provided an estimate of the fiscal impact of this bill. "… TRD examined taxpayer data in GenTax and compared the utilization of the Angel Investment Tax Credit and Venture Capital Tax Credit to estimate the fiscal impact. While the aggregate limit for this legislation is $2 million per year, historical usage of the existing investment tax credits averages less than $400,000 per year."

Angel Investment Credit (7-2-18.17 NMSA 1978					
	FY2010	FY2011	FY2012	FY2013	FY2014
Credit Amount	$261.6	$250.0	$310.8	$339.9	$380.9
Claims	37	44	47	47	50

There is also a "Venture Capital Investment Credit" at 7-2D-8.1 NMSA 1978 that provides a 50% credit for qualifying capital gains. This 1995 enactment is not currently utilized. From the 2015 Tax Expenditure Report.

> A taxpayer may claim a credit against PIT liability equal to a capital gain tax differential (typically 50% of the federal income tax paid by the taxpayer on qualified diversifying business net capitals gains) if the taxpayer allocates the qualified diversifying business net capital gain to New Mexico. The credit is not refundable but may be carried forward as long as it takes to use it all.

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.

SUBSTANTIVE ISSUES

This bill is very similar to the angel investment credit (7-2-18.17 NMSA 1978) with an additional $2 million of cap. There is also a venture capital investment credit, that has no current claims. It is difficult to understand from where demand for the credit of this bill arises, since the existing credits are underutilized against their caps.

TRD notes as follows: "… the bill implicates principles of efficiency and simplicity. The bill's stated purpose is to stimulate investment in small and emerging businesses. The bill is very similar to the angel investment credit. But, there are several differences: (1) the angel investment credit is limited to research and manufacturing businesses, whereas the bill would apply to other business types that are not excluded; and (2) the angel investment credit limits investments by investment round, whereas this credit allows for investments in the same company for three years. Otherwise, the two credits are remarkably similar. While the angel investment credit was being utilized, as originally enacted, it was perceived as too limited, and was therefore amended during the 2015 session to broaden credit availability."

"In this legislation the definition of "qualified business" excludes "…any other service the practice of which requires a license…" and "…wholesale or retail trade…." This may preclude investment in healthcare industry start-ups, and it specifically excludes niche entrepreneur businesses such as specialty retailers (e.g. high-end bicycle shop). The former may be attractive to professional and institutional investors but for the exclusion, while smaller or family investors are excluded by the latter. Similarly, the definition of "qualified investment" precludes individuals and families from earning this tax credit if, by taking entrepreneurial risk and making an investment, the taxpayer receives compensation from the business."

"From an efficiency perspective, it may be prudent to collect data and study the effectiveness of the angel investment credit before enacting a broader duplicate at the same credit amounts and thresholds. From a simplicity perspective, it would seem that the goals of this bill could be accomplished through amendments to the angel investment credit, rather than enacting an entirely new credit. Consideration should be given to amending to reduce administrative and compliance burdens for taxpayers and the administering agencies (TRD and EDD)."

ADMINISTRATIVE IMPLICATIONS

TRD and EDD note a duplication of administrative effort for this credit, the angel investment credit and the Venture capital investment credit. Minimal Impact. Forms and systems will need to be updated in conjunction with annual tax year updates to support this credit program.

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.

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

TECHNICAL ISSUES

TRD notes the following technical issues: The legislation is exclusive from Section 7-2-18.17 NMSA 1978 Angel Investment Tax Credit and NMSA 7-9F Technology Jobs and R&D Tax Credit. However, these references are not clear (page 2, Subsection E). However, it is not exclusive to NMSA 7-2D Venture Capital Investments. Administering the proposed limitation may be onerous. Rules, regulations, policies, and procedures will be necessary to manage eligibility, carry-forwards, and other aspects of the program."

"There is tension in the statutory language that should be corrected. Subsection D (p. 2; ll. 13-16) prescribes that the claim must be made within one year of making the investment. Yet, Subsection G (p. 3; ll. 22-25) contemplates and allows a queue that may render the one-year claim limitation impracticable."

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

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 (RSTP), 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	✓	
Long-term goals	✗	
Measurable targets	✗	
Transparent	✓	
Accountable		
Public analysis	✓	
Expiration date	✓	
Effective		
Fulfills stated purpose	?	
Passes "but for" test	?	
Efficient	?	
Key: ✓ Met ✗ Not Met ? Unclear		

LG/jle