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

ORIGINAL DATE 02/27/19
SPONSOR Campos **LAST UPDATED** **HB**

SHORT TITLE Frontier Community Investment Tax Credit **SB** 474

ANALYST Iglesias

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY19	FY20	FY21	FY22	FY23		
$0.0	($750.0)	($750.0)	($750.0)	($750.0)	Recurring	General Fund

Parenthesis ( ) indicate revenue decreases

SOURCES OF INFORMATION
LFC Files

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

SUMMARY

Synopsis of Bill

Senate Bill 474 creates new sections of the Income Tax Act and the Corporate Income and Franchise Tax Act to allow taxpayers who are qualified and make a qualified investment to claim a credit in the amount of up to $25 thousand per qualified investment with an aggregate amount in a taxable year of not more than $100 thousand.

The purpose of the credits is stated to be to encourage residents of frontier communities to invest in their communities and create new jobs and provide needed services for frontier communities. The aggregate amount of credits allowed in a year is not to exceed $750 thousand, and the Economic Development Department (EDD) is responsible for issuing certificates of eligibility related to the credits. The bill contains a claw-back provision that applies if a business ceases operations for at least 180 consecutive days within any two-year period after the taxpayer has claimed the credit.

There is no effective date of this bill. It is assumed the effective date is 90 days after this session ends. Provisions of the bill are applicable to taxable years on or after January 1, 2019.

FISCAL IMPLICATIONS

The Taxation and Revenue Department (TRD) estimated the fiscal impact as the aggregate cap, which the bill sets as $750 thousand each fiscal year. The barrier to reaching the cap is the availability of qualifying investment opportunities in defined "frontier" communities, undefined in SB474.

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

This credit may be used in conjunction with other credits like the Rural Job Credit to further benefit taxpayers in frontier communities.

The bill's definition of a qualified investment, which specifies the investment must be between the bill's effective date and January 1, 2028, creates a type of sunset date for the credit. Although, the credit could be claimed after January 1, 2028, it would only apply to investments made prior to that date.

EDD notes neither the legislation in or state statute defines "frontier community". The definition will be determined by EDD. Currently, EDD defines frontier community as 7,500 people or less in the MainStreet program. However, in the JTIP program, it is defined as 15,000 people or less. According to New Mexico Municipal League data, 65 percent to 85 percent of New Mexico's incorporated municipalities may be frontier communities, depending on how the phrase is defined by EDD.

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

This bill requires a new tax credit for both personal income tax and corporate income tax. TRD will need to establish communication with EDD to share certification information. TRD will also need to create new publications, forms, and regulations, as well as implement audit procedures complete with associated training.

TECHNICAL ISSUES

According to TRD, the way in which a backlog of credits is maintained specified in sections 1-E and 1-F of the bill could result in more than $750 thousand being paid out in a given year. Because certificates can be issued as long as the aggregate total is below $750 thousand, the total could be just below that and then a certificate for a large credit still issued for the year, making the total payout well over $750 thousand. TRD recommends a backlog of approved credits be maintained similar to the film credit in Section 7-2F-12 NMSA 1978, such that the total payout for a given year does not exceed the cap.

EDD points out that, while the bill creates a reporting process, it is not specific about when it begins the timeline seems to establish criteria only from July 1, 2019, to December 31, 2029. This period of reporting eligibility stands outside of a traditional fiscal year process, and the bill does not specifically define and extend each additional period of eligibility.

EDD also identifies the following issue:

> The taxpayer claiming the credit must hire three full-time-equivalent employees in the business. However, on pages 14 and 15, a qualified investment "eligible employee" excludes any person who is working as an employee or contractor for an entity that owns the majority of the stock in the eligible business. The purpose of the exclusions is to prevent the eligible employer from hiring relatives in order to achieve the three FTE's needed to qualify for the credit. On page 17, a "qualified investment" means an equity investment, not a loan. Further, the person who makes the qualified investment may not receive any compensation from the business for at least one year after the investment was made. It is difficult to create the profile for investors and investments that would survive the multiple requirements and be eligible for a tax credit.

OTHER SUBSTANTIVE ISSUES

TRD recommends adding language that requires electronic information sharing for certificates awarded by EDD. Receiving electronic files of awarded certificates data improves return processing efficiency and accuracy and supports annual reporting.

According to EDD, Native American communities have expressed a concern the phrase "frontier community" is culturally insensitive.

ALTERNATIVES

EDD states "frontier" could be based on geographical areas and not based on size of population. Consideration of geographic zones used in other states like Colorado may be an alternative.

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 (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	✘	Bill not presented to RSTP or LFC
Targeted		
Clearly stated purpose	✔	The bill states the purpose of this credit is to encourage investment in frontier communities and to create new jobs and provide needed services in those communities.
Long-term goals	✔	
Measurable targets	✘	None.
Transparent	✔	Annual reporting required by EDD and TRD.
Accountable		
Public analysis	✔	Reporting required on the number of taxpayers claiming the credit, aggregate amount of credits approved, and number of eligible employees hired by the taxpayers receiving the credit.
Expiration date	✔	Credit only applies to qualified investments from the bill's effective date to January 1, 2028.
Effective		
Fulfills stated purpose	?	Unable to determine if this credit will incentivize investment and job creation in frontier communities.
Passes "but for" test	?	Unable to determine if investment and/or job creation occurring after this credit would not have occurred but for the credit.
Efficient	?	Unable to determine if this credit is the most cost efficient way to achieve investment and spur job creation in these communities.
Key: ✔ Met ✘ Not Met ? Unclear		

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