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

ORIGINAL DATE 02/26/21
SPONSOR Hickey/Dixon **LAST UPDATED** 02/28/21 **HB**

SHORT TITLE Angel Investors Tax Credit Changes **SB** 402

ANALYST Graeser

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY21	FY22	FY23	FY24	FY25		
	up to ($8,000.0)	up to ($8,000.0)	up to ($8,000.0)	up to ($8,000.0)	Recurring	General Fund

Parenthesis ( ) indicate revenue decreases.

Estimated Operating Budget Impact*				Recurring or Nonrecurring**	Fund(s) or Agency Affected
FY21	FY22	FY23	3 Year Total Cost		
--	$10.3	--	$10.3	Nonrecurring	TRD/ITD – Staff Workload
--	$15.0	$15.0	$30.0	Recurring	TRD/RPD – Staff Workload

SOURCES OF INFORMATION
LFC Files

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

SUMMARY

Synopsis of Bill

Senate Bill 402 amends Section 7-2-18.17 NMSA 1978 to increase the amount of angel investment credit from 25 percent to 50 percent of the investment and makes this tax credit refundable. The bill also increases the maximum annual aggregate from $2 million to $10 million. An eligible company for investing remains one with one hundred or fewer employees, but the annual gross income is increased from $5 million to $10 million.

There is no effective date of this bill. It is assumed the effective date is 90 days after this session ends (June 18, 2021). The provisions of the bill are applicable to qualified investments made after January 1, 2021.

FISCAL IMPLICATIONS

The revenue impact table on page 1 shows a loss of $8 million for all years, a reflection of the proposal to increase the aggregate annual cap from $2 million to $10 million.

TRD, however, bases its revenue estimate on the history of this tax credit.

Estimated Revenue Impact*					R or NR**	Fund(s) Affected
FY2021	FY2022	FY2023	FY2024	FY2025		
--	($2,500)	($1,000)	($1,000)	($1,000)	R	General Fund

* In thousands of dollars. Parentheses ( ) indicate a revenue loss. ** Recurring (R) or Non-Recurring (NR).

> The legislation increases the credit benefit from 25 percent of the value of the qualified investment to 50 percent; however, it retains a maximum credit amount of $62,500 per investment. The legislation also allows for a broader set of investments to qualify for the angel investment tax credit. Currently, investments must be made to businesses with $5 million or less in annual revenues; the legislation increases this cap to $10 million or less. The increase in the percentage benefit of the cap and looser qualifications for qualified investments are considered in the revenue impact.
>
> The legislation allows for the credit to be refundable. TRD assumes an acceleration of credit claims through refund requests in FY22 for previously approved credits that did not have sufficient tax liability to claim the full credit. In addition to this, previously the credit had no benefit to investors that did not have New Mexico tax liability to claim the credit against. The refundability significantly opens the credit up to new investors without New Mexico tax liability, including those from outside of New Mexico. Due to this, and the increased cap, there is the potential for this expenditure to exceed the estimated revenue impact.

Because of the TRD note, the table on page 1 details the maximum extent of fiscal impact that could result from the refundability.

Over the past five years, the tax credits applied against personal income tax (PIT) liabilities have averaged $616 thousand, having leveraged over $12 million in investments in New Mexico small businesses. Approximately half of this activity is probably attributed to NM Angels Investors. On the https://nmangels.com website, NM Angels claims to have supervised the investment of over $20 million since 1999 in 48 projects with 55 investors.

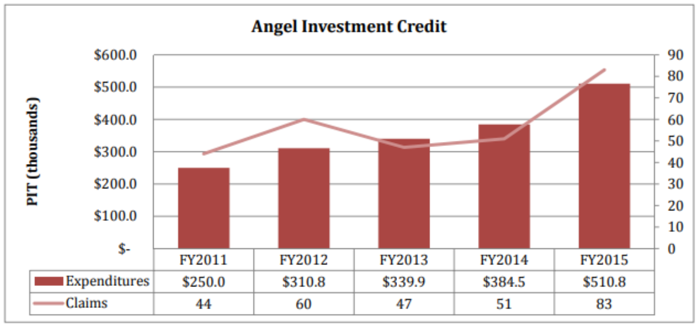
Angel Investment Credit against PIT	Tax Year (Calendar)	2015	2016	2017	2018	2019
	Claims	95	98	126	145	43
	Expenditure (thousands)	$638	$499	$798	$906	$254

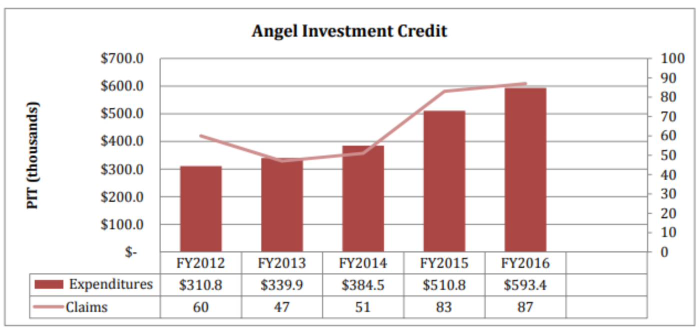
The following charts and graphs have been extracted from various editions of TRD's tax expenditure reports.

Table 16: VENTURE CAPITAL INVESTMENT TAX CREDITS -- FILED TAX CLAIMS ($thousands)

	FY2007		FY2008		FY2009		FY2010		FY2011	
	Claims	Amount	Claims	Amount	Claims	Amount	Claims	Amount	Claims	Amount
Venture Capital Investment Tax Credit	0	$0.0	0	$0.0	0	$0.0	0	$0.0	NA	NA
Angel Investment Tax Credit	0	$0.0	16	$145.0	28	$157.8	32	$200.8	17	$80.8
TOTAL	0	$0.0	16	$145.0	28	$157.8	32	$200.8	17	$80.8

	FY2008		FY2009		FY2010		FY2011		FY2012	
	Claims	Amount	Claims	Amount	Claims	Amount	Claims	Amount	Claims	Amount
Venture Capital Investment Tax Credit	0	$0.0	0	$0.0	0	$0.0	0	$0.0	not avail.	not avail.
Angel Investment Tax Credit	16	$145.0	28	$157.8	32	$200.8	45	$251.8	63	$392.5
TOTAL	16	$145.0	28	$157.8	32	$200.8	45	$251.8	63	$392.5





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. In general, estimating the cost of tax expenditures is difficult. However, the angel investment credit is separately reported so that no estimation is necessary.

SIGNIFICANT ISSUES

There is a critical need for early-stage venture capital. This may be particularly true in New Mexico, where the national laboratories generate technology spinoffs, but the developers are physically remote from the large venture capital firms. Larger venture capital firms are rarely interested in initial (first-round) funding but get more interested in second-round and subsequent financing.

According to TRD's analysis in the *2020-2019 Tax Expenditure Report*, this tax credit is "being used as intended."

Additionally, TRD comments:

> The increase in the benefit and the looser restrictions on qualified investments may result in increased use of the credit, and therefore investment in New Mexico businesses. The 2019 and 2020 New Mexico TRD Tax Expenditure Report indicates the credit is not currently being fully utilized.
>
> The legislation may increase the cost of the credit. Tax expenditures narrow the base and may result in lower levels of governmental services, an increase in taxes, or both.
>
> Currently, several other business credits that incentivize economic development are fully refundable, such as the film and high wage job tax credits. Other business credits such as the investment credit are only partially refundable and only under specific circumstances. If this credit is refundable it will accelerate how quickly some businesses may claim the credit and induce more investment, however at an increased short-term cost to the General Fund, as the credit is used and refunded immediately, whereas under the existing refunding structure for this credit, it will be used solely to offset future tax liability. It may be reasonable to weigh the benefits of this credit against those of business credits that receive fully refundable treatment, are conditionally or partially refundable, and those that are not refundable to determine whether this credit merits a fully refundable status. Additionally, the refundable deduction may be taken by investors that reside outside of the state, and while this may help to induce investment from out of state, it also results in money leaving the state in the form of the credit.

EDD notes the following:

> Tax credits, particularly economic development incentives, are typically used to change or incentivize behavior. It is unknown if the changes made in this bill to the angel investment tax credit would primarily act as a reward for continuing existing behavior or if the changes would primarily incentivize changes to behavior and result in more startup companies in New Mexico receiving more early-stage funding.
>
> If there is information to show this could incentivize changes in behavior, this could be a welcome asset to improve the state's entrepreneurial ecosystem and diversify and strengthen the private sector economy. If it would reward existing behavior, the result would be a greater cost to taxpayers with little or no added benefit.

An unusual feature of the proposed changes is to make the credits refundable. There are very few tax credits that are currently either transferable or refundable. In most cases where credits are refundable, the eligible population is low to moderate income. This population frequently does not have a tax liability large enough to cover even modest levels of credit or rebate. A "qualified investor" must meet the criteria show in the box to the right.[1] Individual investors can claim up to $62.5 thousand in tax credits per

Criteria for qualified and accredited investors

In order to be classified as a qualified or accredited investor, you must meet one of two criteria:

- You must have earned income exceeding $200,000, or $300,000 when combined with a spouse, during each of the previous two full calendar years, and a reasonable expectation of the same for the current year. The same method (single or joint) must be applied to the income test in all three years.
- You must have a net worth greater than $1 million (either by yourself or combined with a spouse), excluding your primary residence.

[1] https://www.fool.com/investing/2018/02/14/what-is-a-qualified-investor.aspx

project with a limit of five projects per year. Thus, an investor could claim up to $312.5 thousand in credits per year. Very few New Mexico taxpayers would have liability sufficient to consume the full amount of the credit. In current statute, any excess of credits over liability could be carried forward for up to five years. If any credits are still unused after five years, they expire.

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. This reporting is done annually in TRD's *Tax Expenditure Report*.

ADMINISTRATIVE IMPLICATIONS

TRD expects minimal impact from these changes.

> The Information and Technology Division (ITD) reports that implementation of the legislation will take approximately 1.5 months at a cost of $10,328 in FY22 from staff workload.
>
> The Revenue and Processing Division (RPD) of TRD estimates that implementation will cost $15 thousand per year in staff workload for administration of the credit and to process refund approvals.

Estimated Additional Operating Budget Impact*				**R or NR****	**Fund(s) or Agency Affected**
FY2021	**FY2022**	**FY2023**	**3 Year Total Cost**		
--	$10.3	--	$10.3	NR	ITD – Staff Workload
--	$15.0	$15.0	$30.0	R	RPD – Staff Workload

* In thousands of dollars. Parentheses ( ) indicate a cost saving. ** Recurring (R) or Non-Recurring (NR).

This is an expansion of a current program but should cause TRD relatively modest expenditures.

TECHNICAL ISSUES

TRD notes a technical issue that could require an amendment to the bill:

> Page 2, line 23- This section is existing language added when the certification of this credit was transferred to TRD from Economic Development Department (EDD). Taxpayer information cannot be shared with EDD for this tax credit as it is not indicated under Section 7-1-8.8. NMSA 1978(Q). which only permits TRD to share with the secretary of economic development, or the secretary's designee, return information concerning a credit pursuant to the Film Production Tax Credit Act. It is recommended that this section be updated to include the Angel Investment Credit so that information may be shared with EDD about this credit. Currently, the TRD application for credit advises the taxpayer to submit a copy of the application to EDD. Compliance for this requirement cannot be confirmed to EDD by TRD due to statutory restriction. Page 2, line 23 does not direct TRD to share application information with EDD. ("E.

> Applications and all subsequent materials submitted to the [taxation and revenue] department related to the application shall also be submitted to the economic development department.")
>
> If granted authority in this section, TRD can share application information with EDD without placing a burden on the taxpayer to submit duplicate applications. Application information sent by the taxpayer to EDD does not include TRD certification and amount awarded.

This bill does not contain a delayed repeal date. LFC recommends adding a delayed repeal date. The angel investment tax credit was initially enacted in 2007 with a delayed repeal date of January 1, 2013. TRD documents this history on page 48 of the 2020-2019 edition of the *Tax Expenditure Repor*t.

> Originally enacted in 2007 with a delayed repeal date of January 1, 2013. The credit was amended in 2012, 2015 and 2020. The 2012 amendment eliminated the delayed repeal and extended the date before which an investment must be made to qualify for the credit. The 2015 amendment changed the qualified investment amount, relaxed the limits on the number of investments, increased the annual cap and extended the carry forward period. The 2020 amendment moved the review and approval of the credit from EDD to TRD and clarified the statute.

OTHER SUBSTANTIVE ISSUES

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

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