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

		ORIGINAL DATE	1/24/22		
SPONSOR	HCEDC	**LAST UPDATED**	02/02/22	**HB**	80/HCEDCS
SHORT TITLE	Angel Investment Credit Refundable			**SB**	
				ANALYST	Faubion

REVENUE (dollars in thousands)

Estimated Revenue				Recurring or Nonrecurring	Fund Affected
FY23	FY24	FY25	FY26		
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 ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

FY22	FY23	FY24	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
--	$5.2	--	$5.2	Nonrecurring	TRD/ITD – Staff Workload
--	$33.3	$33.3	$66.6	Recurring	TRD/RPD – ½ FTE
$1.0	$1.0	$1.0	$3.0	Recurring	TRD/RPD – Phone line
$3.0	--	--	$3.0	Nonrecurring	TRD/RPD – FTE equipment

Parenthesis ( ) indicate expenditure decreases

SOURCES OF INFORMATION

LFC Files

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

SUMMARY

Synopsis of Bill

The House Commerce and Economic Development Committee Substitute for House Bill 80 (HB80) amends Section 7-2-18.17 NMSA 1978 to increase the amount of angel investment credit from 25 percent to 40 percent of the investment and makes this tax credit refundable. For a qualified investment in a majority women- or person-of-color-owned business, the credit is 50 percent of the qualified investment instead of the proposed 40 percent for other businesses. The bill charges TRD with establishing rules and procedures for determining if a business is majority women- or person-of-color-owned, possibly relying on federal or state certifications and information that relate to the ownership of a business.

The bill also increases the maximum annual aggregate from $2 million to $10 million. An eligible company for investing remains one with 100 or fewer employees, but the maximum annual gross revenues 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. The provisions of the bill are applicable to qualified investments made after January 1, 2022.

FISCAL IMPLICATIONS

The revenue impact table on page 1 shows a maximum loss of $8 million for all years, a reflection of the proposal to increase the aggregate annual cap from $2 million to $10 million. Over the past five years, the tax credits applied against personal income tax (PIT) liabilities have averaged $777 thousand.

Angel Investment Credit against PIT	Tax Year (Calendar)	2016	2017	2018	2019	2020
	Claims	98	126	145	133	65
	Expenditure (thousands)	$499	$798	$907	$954	$318
	Fiscal Year	2017	2018	2019	2020	2021
	Claims	88	104	143	139	145
	Expenditure (thousands)	$528	$618	$919	$904	$919

TRD estimates that the impact will be between $1.2 million and $2.1 million, noting the following:

> Between 2017 and 2020, an average of $1.2 million in angel investment credits were approved each year and on average 60 percent of those were claimed on taxpayer tax returns. The legislation allows for the credit to now be refundable, so it is expected that 100 percent of approved credits will be claimed each year. Taxation and Revenue Department (TRD) assumes an acceleration of credit claims through refund requests in FY23 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.

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 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 *2021 Tax Expenditure Report*, this tax credit is "being used as intended." Additionally, TRD states that 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 2021 New Mexico TRD Tax Expenditure Report indicates the credit is not currently being fully utilized.

Currently, TRD states that 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.

It is unknown at this time if the refundability of the tax credits could violate the state anti-donation clause. As TRD notes above, there are other business credits, such as the film credit, and high wage job tax credits that are fully refundable.

EDD notes that the bill may result in additional economic development opportunity throughout the state by catalyzing angel investment which may support the expansion and location of new businesses, job creation, and innovation in research and development. The growth of businesses receiving angel investment may increase the tax base. Making the angel investment credit more robust may provide a valuable tool to investors and could make launching a startup and doing business in New Mexico more attractive. The combination of the updated "accredited investor" definition by the U.S. Securities and Exchange Commission and the HB80 provision enabling a tax refund to the taxpayer could broaden the possible pool of angel investors and include more out-of-state investors.

New Mexico is striving to diversify its economy and have targeted investments in New Mexico-based growth oriented small businesses and startups. Increasing the scope of the angel investment credit may incentivize new investment and may provide risk mitigation for supporting new and emerging technologies and innovation.

> **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.

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 shown in the box to the right. Individual investors can claim up to $62.5 thousand in tax credits per project with a limit of five projects per year[1]. 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

LFC's tax policy of accountability is met with the bill's requirement to report annually to the revenue stabilization and tax policy committee and the Legislative Finance Committee regarding the data compiled from the reports from taxpayers utilizing the credit and other information to determine whether the credit is meeting its purpose. This reporting is done annually in TRD's *Tax Expenditure Report* as well.

ADMINISTRATIVE IMPLICATIONS

The Information and Technology Division (ITD) of TRD reports that implementation of the legislation will take approximately 1 month at a cost of $5,164 in FY23 from staff workload.

Due to the separation of duties, the refundable portion of the credit will likely be subject to various levels of refund approval, if the refund is over $10,000. The Revenue and Processing Division (RPD) of TRD estimates that if other refundable credits are passed, this puts a strain on resources that can issue refunds. As a result, half additional full-time employee (FTE) will be required to process the refunds. The recurring budget estimate for the Revenue Processing Division (RPD) is based on a Tax Auditor II position.

The HCEDC sunstitute may add some administrative costs to TRD, but the fiscal impact is unknown at this time.

TECHNICAL ISSUES

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

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

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) in 2019. Taxpayer information cannot be shared with EDD for this tax credit because this credit is not indicated under Section 7-1-8.8. NMSA 1978(Q), which only permits TRD to share with EDD return information concerning the film production tax credit. 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 this credit advises the taxpayer to submit a copy of their 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. 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 2021 edition of the *Tax Expenditure Report*.

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.

JF/acv