FISCAL IMPACT REPORT

		LAST UPDATED	2/4/23
SPONSOR	Serrato/ Dixon/ Hernandez	**ORIGINAL DATE**	1/26/23
SHORT TITLE	Angel Investment Credit Changes	**BILL NUMBER**	House Bill 69/aHCEDC
		ANALYST	Torres, I

REVENUE* (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY23	FY24	FY25	FY26	FY27		
-	($300.0)	($900.0)	($900.0)	($900.0)	Recurring	General Fund

Parenthesis ( ) indicate revenue decreases
*Amounts reflect most recent analysis of this legislation.

Relates to HB178 of the 2020 Regular Session

Sources of Information

LFC Files

Responses Received From
Taxation and Revenue Department (TRD)
Economic Development Department (EDD)
State Ethics Commission (SEC)

SUMMARY

Synopsis of HCEDC Amendment

The House Commerce and Economic Development Committee amendment to House Bill 69 strikes the language from the bill that would make the credit refundable, leaving the credit to be carried forward as under current law.

Synopsis of Original House Bill 69

House Bill 69 (HB69) amends the angel investment tax credit to extend the expiration date, increase the expenditure cap, and allow for refundability.

The angel investment tax credit sunset is extended for qualified investments made by taxpayers from December 31, 2024, to December 31, 2030. The aggregate cap of credits allowed in each calendar year is increased from $2 million to $5 million. And finally, the bill requires any credit remaining unused at the end of the taxpayer's taxable year be refunded to the taxpayer, removing the provision the credit would be carried forward for five consecutive years.

This bill does not contain an effective date, and as a result, would go into effect June 16, 2023, (90 days after the Legislature adjourns) if signed. However, the changes are applicable to applications for an angel investment credit made on or after January 1, 2023.

FISCAL IMPLICATIONS

The Taxation and Revenue Department (TRD) and LFC staff reviewed historical claims and credit amounts reported in the 2022 Tax Expenditure Report. On average in the last four fiscal years, $900 thousand in credits were applied toward personal income tax (PIT) liability. Of that, approximately $300 thousand is associated with initial credit claims. The other $600 thousand per year is associated with carry-forwards. Currently, there is $4 million in carry-forward waiting to be claimed by taxpayers in future years.

If the incentive were made a refundable credit, as proposed in the unamended bill, TRD projected the $5 million cap would be reached beginning for tax year 2023 and thus impact FY24 and forward. Following the HCEDC amendment, the fiscal impact is estimated to be reduced to $900 thousand. The estimate follows the precedent set in 2015 when raising the credit cap resulted in doubling of the tax expenditure. TRD assumes an additional $900 thousand in credit claims and assumes the weighting of initial claims versus carry-forward as seen with current credits. Therefore, in FY24, there is only a $300 thousand impact, which increases to $900 by FY25.

This bill creates or expands a tax expenditure that is likely significant. LFC has concerns about the risk to state revenues from tax expenditures and the increase in revenue volatility from erosion of the revenue base. The committee recommends the bill adhere to the LFC tax expenditure policy principles for vetting, targeting, and reporting.

SIGNIFICANT ISSUES

Economic Development Department Highlights:

The bill is likely to make the angel investment tax credit more popular among qualified investors since the credit will become refundable. It also has the potential to significantly expand to potential qualified investor pool because as a refundable credit, investors outside the state with no tax liability could still take advantage of the credit.

Historically, New Mexico businesses have lagged businesses in other states in receiving investments. This lag of investment has encouraged businesses to look to other states for investors which leads to a loss of employers and startups.

The Economic Development Department identified in its recently released 20-year strategic plan that partnerships between our universities, national labs and startups could drive economic diversification. By increasing the angel investment tax credit from $2 million to $5 million and making it refundable, we are likely to see these partnerships continue to grow due to the increase in available capital.

From the Taxation and Revenue Department:

To be eligible for this credit, individuals need only file an individual New Mexico tax return and meet the investment criteria specified in Section 7-2-18.17 NMSA 1978. The incentive of a refundable credit will increase the near-term return on investment for investors who do not need to be residents of the state. This will continue to create an environment that is conducive to the creation and growth of research and manufacturing among small businesses.

Personal income tax represents a consistent source of revenue for many states. While this revenue source is susceptible to economic downturns, it is also positively responsive to economic expansions. New Mexico is one of 42 states, along with the District of Columbia, that impose a broad-based PIT. The PIT is an important tax policy tool that has the potential to further both horizontal equity, by ensuring the sa2/me statutes apply to all taxpayers, and vertical equity, by ensuring the tax burden is based on taxpayers' ability to pay.

While any taxpayer may apply for this credit, most of the financial benefit of this credit will be realized by high earning individuals. This credit is meant to encourage taxpayers to invest in the state with an assumed benefit to the economy of the state. The broader economic benefit to the state of these investments is hard to measure though and it is unclear if it exceeds the loss of PIT revenue.

The bill continues to maintain a sunset date of December 31, 2030, applicable to the date the investment must be made by. TRD supports sunset dates for policymakers to review the impact of a credit before extending it. Given the expansion of the cap for this credit and the additional cost to the state, a sunset date would force an examination of the benefit of this credit versus the cost.

The State Ethics Commission Notes:

The initial version of House Bill 69 proposed to change the currently existing angel investment credit from a non-refundable credit to a refundable tax credit, which likely runs afoul of Article IX, Section 14 (the "Anti-Donation Clause"). As amended, however, House Bill 69 proposes to extend the timeframe for eligibility and increase the aggregate cap, but does not change the non-refundable nature of the credit. The current angel investment tax credit (which is maintained in the amended bill) likely does not run afoul of the Anti-Donation Clause, because non-refundable tax credits likely do not violate the Anti-Donation Clause. This conclusion is based on the way courts have analyzed tax exemptions. So long as a tax exemption operates prospectively, is not an unconstitutional remission of tax liability because it occurs during the calculation of a tax liability, before the tax liability accrues. See Asplund v. Alarid, 1923-NMSC-079, ¶¶ 19-20. A non-refundable tax credit operates similarly to a tax exemption, just at a later stage in the calculation of the tax liability: once the ex ante tax liability is determined, a non-refundable tax credit is applied and the tax liability reduced thereby—perhaps all the way to zero. If, as has been long-established, the Constitution does not prohibit an exemption (which is part of the calculation leading to a determination of tax liability), it is unlikely that the Constitution prohibits a non-refundable tax credit (which is also part of the calculation leading to a determination of tax liability, just occurring at a later stage of the calculation). Nevertheless, the New Mexico Supreme Court has held that even a non-refundable tax credit violates the Anti-Donation Clause when it is a specifically targeted subsidy to a particular, discrete industry. See Chronis v. State ex rel. Rodriguez, 1983-

NMSC-081, ¶ 30 (holding a non-refundable tax credit was "an unconstitutional subsidy to the liquor industry" in violation of the Anti-Donation Clause).

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

Relates to House Bill 1778 of the 2020 session.

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, 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	✘	Was not vetted by interim committees.
Targeted		
Clearly stated purpose	✘	
Long-term goals	✘	
Measurable targets	✘	
Transparent	✓	Reporting requirements are included in the bill.
Accountable		
Public analysis	✓	
Expiration date	✓	
Effective		
Fulfills stated purpose	?	Without the appropriate purpose statement, it will not be possible to determine the effectiveness of the changes.
Passes "but for" test	?	

Efficient	?	
Key: ✓ Met ✗ Not Met ? Unclear		

IT/al/ne/mg/hg/mg