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

ORIGINAL DATE 1/27/09
SPONSOR Lujan **LAST UPDATED** **HB** 75

SHORT TITLE Manufacturing and Investment Tax Credits **SB**

ANALYST Francis

REVENUE (dollars in thousands)

Estimated Revenue			Recurring or Non-Rec	Fund Affected
FY09	FY10	FY11		
		($2,100.0)	Recurring	General Fund
	* See narrative for out-year impacts			

(Parenthesis ( ) Indicate Revenue Decreases)

SOURCES OF INFORMATION
LFC Files

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

SUMMARY

Synopsis of Bill

House Bill 75 extends the "double weighted sales factor" apportionment method for manufacturers, extends certain provisions of the Investment Tax Credit (ITC) until 2020. Both statutes have sunset dates of 2011.

Under current law, until tax year 2010, manufacturers apportion their income for the purposes of corporate income tax liability by a formula that uses a payroll factor, a property factor and twice a sales factor divided by four. All other taxpayers use payroll, property and sales divide by three. HB 75 extends the special treatment for manufacturers until 2020.

Under current law, the method to value equipment for the purposes of the ITC is the adjusted basis per the US Internal Revenue Code of 1986. Beginning 2011, the method changes to be the purchase price of the equipment or the reasonable value if the equipment has been owned for over a year with a maximum value allowed of $2 million. HB75 extends the time for the current law valuation until 2020.

To qualify for the ITC, current law requires the taxpayer to have hired an additional employee for every $500 thousand of qualified equipment up to a value of $30 million and an additional employee for every $1 million for equipment valued over $30 million. Beginning 2011, the taxpayer is required to employ one additional person for every $100 thousand claimed. HB75 extends the current employment requirements to tax year 2020.

The bill has no effective date so will become effective June 19, 2009.

FISCAL IMPLICATIONS

TRD reports that the impact will be a $2.1 million reduction in general fund revenue in FY11 because the change takes place in January 1, 2011. The full year impact is $16,100, $5.6 from the ITC and $10.5 from the extension of the apportionment method.

Changing the dates on the ITC and the apportionment factor will not have an impact until FY11. Under current law, the ITC would have decreased significantly because of the tighter employment requirements. The current amount of the credit fluctuates based on investment cycles but the average is approximately $7 million. When a manufacture makes a major expansion or investment, the credit tends to increase dramatically. If a company makes a million dollar investment now, it would need to hire 2 additional employees to qualify for the credit (which would be worth $50,000). In 2011, the company would have to hire 10 additional employees when making a one million dollar investment.

SIGNIFICANT ISSUES

ITC. The ITC has been a central tool used to promote New Mexico with major manufacturers and has been cited as a reason to pick NM. Intel’s NM managers have repeatedly reported that the credit is crucial to defending investment decisions and keeping major investments coming to New Mexico. When paired with the industrial revenue bond (IRB), the incentive is significant. Designed to offset the compensating tax on imported equipment, set at 5 percent, it is allowable even when equipment is purchased with an IRB. In other words, if a company uses IRB financing, it saves the compensating tax because a local government is technically purchasing the equipment and it also can apply for the ITC, yielding a net credit of 10 percent of the equipment value.

Double-weighted sales factor. Apportioning corporate income using a double-weighted sales factor favors large manufacturers that sell most of their products outside the state. All other companies that have to apportion part of their income to New Mexico and part to other states use a formula made up of three factors: property, payroll and sales. By doubling the sales factor and dividing by four, it weights the other factors more heavily when apportioning income. In the example below, similarly situated companies but from different industries have different tax impacts because of the double-weighted sales factors.

Example

	NonManufacturer	Manufacturer
Payroll	0.5	0.5
Property	0.5	0.5
Sales	0.1	0.1
Apportionment	37%	30%
Total Income	100,000.00	100,000.00
NM Income	36,666.67	30,000.00
Tax rate	4.80%	4.80%
Tax	1,760	1,440

WHAT WILL BE THE CONSEQUENCES OF NOT ENACTING THIS BILL

Valuation and employment requirements will become more stringent in 2011 for the ITC and manufacturers will no longer have a preferential apportionment factor.

NF/mc

The Legislative Finance Committee has adopted the following principles to guide responsible and effective tax policy decisions:

1. ***Adequacy:*** *revenue should be adequate to fund government services.*
2. ***Efficiency:*** *tax base should be as broad as possible to minimize rates and the structure should minimize economic distortion and avoid excessive reliance on any single tax.*
3. ***Equity****: taxes should be fairly applied across similarly situated taxpayers and across taxpayers with different income levels.*
4. ***Simplicity****: taxes should be as simple as possible to encourage compliance and minimize administrative and audit costs.*
5. ***Accountability/Transparency:*** *Deductions, credits and exemptions should be easy to monitor and evaluate and be subject to periodic review.*

More information about the LFC tax policy principles will soon be available on the LFC website at www.nmlegis.gov/lcs/lfc