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## FISCAL IMPACT REPORT

<b>SPONSOR</b>	Sanchez, B.	<b>ORIGINAL DATE</b>	02/10/09	<b>HB</b>	
		<b>LAST UPDATED</b>	03/20/09		201/aSCORC/aSFC/
<b>SHORT TITLE</b>	Tax & Rev Tax Increment Changes	<b>SB</b>			aSFI#1/aHBIC
				<b>ANALYST</b>	White

### REVENUE (dollars in thousands)

Estimated Revenue			Recurring or Non-Rec	Fund Affected
FY09	FY10	FY11		
Indeterminate * See Narrative				

(Parenthesis ( ) Indicate Revenue Decreases)

Relates to SB 19, SB 249, SB 467, SB 483, SB 509, SB 576, HB392, HB451, HB470, HB791

### SOURCES OF INFORMATION

LFC Files

#### Responses Received From

Taxation and Revenue Department (TRD)

Department of Finance and Administration (DFA)

### SUMMARY

#### Synopsis of HBIC Amendment

The House Business and Industry Committee Amendment to SB 201 strikes SCORC amendment number 6, and SFC amendments 2, 3, and 4, all of which related to the mathematical formula. The amendment then inserts new language related to the formula for distribution, fixing technical errors in the original legislation and subsequent amendments.

The amendment also adds a new sub-section to the definition of “taxable gross receipts” which excludes certain receipts from being eligible for increment to TIDDs 2, 3, 4, and 8 of the Westland DevCo, LP, Upper Petroglyph tax increment development project (SunCal). Any tax receipts “reported by a business that has relocated to the district from elsewhere in New Mexico and that is a manufacturing business or any other business with more than one hundred full-time employees within the district, unless the relocation was accompanied within the twelve months immediately following the relocation by an increase of at least ten percent in the number of full-time employees” would not qualify as “taxable gross receipts” for tax increment purposes. While this amendment would help to limit the impact of “shifted” or “cannibalized” revenues on the state, the businesses identified in the amendment are rather limited. According to the U.S. Census bureau less than 6 percent of businesses in New Mexico currently have more than 100 full-time employees. Therefore this amendment will be limited in its ability to mitigate the impacts of “shifted” or “cannibalized” revenues on the state.

The House Business and Industry Committee Amendment also adds a new section prohibiting the Legislature from approving or authorizing any capital outlay projects within any TIDD during the period that any bonds are issued pursuant to the proposed legislation. Exceptions are provided in the new section including

1. public school buildings or facilities;
2. higher education buildings or facilities;
3. cultural buildings or facilities;
4. buildings or facilities, exclusive of roads, used for public safety; or
5. buildings used for other public purposes.

The new section also states that “nothing in this section prohibits the Legislature from authorizing expenditures, pursuant to law, for economic development projects within a specific tax increment district for which any tax increment development bonds are outstanding.” This language has been included in each piece of individual TIDD authorization legislation to date.

The amendment also strikes item 2 of Senate Floor Amendment number 1, and inserts a similar section stating that a “tax increment fund” be created in the Treasury in order to finance “the costs of systems modifications and administrative expenses related to tax increment development districts” within the Taxation and Revenue Department (TRD). The New Mexico Finance Authority (NMFA) would be permitted to “issue and purchase revenue bonds or obligations” to finance the fund. The total amount to be issued or purchased cannot exceed \$600,000 and the bonds will be serviced from monies within the tax increment fund. These monies will come from active TIDDs and or from “gifts and grants from other sources that the donor or grantor has given for the purposes of the tax increment fund.” The TIDDs may, under the amended legislation, pay this money through adjusted distributions from TRD. Money in the fund at the end of any fiscal year shall not revert back to the general fund.

#### Synopsis of SFI Amendment #1

Senate Floor Amendment number one for Senate Bill 201 alters language addressing the “tax increment fund” created in the SCORC amendment. The new language explicitly states that the money in the fund may be bonded against by the New Mexico Finance Authority (NMFA) in order to pay the costs of “systems modifications and data input for the Taxation and Revenue Department” (TRD).

#### Synopsis of SFC Amendment

The Senate Finance Committee Amendment to Senate Bill 201 cleans up technical corrections included as part of the Corporations and Transportation Amendment and creates a new funding mechanism to finance the \$600,000 necessary to implement IT changes at the Taxation and Revenue Department (TRD). The new mechanism, the “tax increment fund,” would be set up as a “nonreverting fund in the state treasury.” The fund would be financed by tax increment development districts (TIDDs) throughout the state from incremental tax revenues dedicated to them from the state and various local governments and municipalities.

Synopsis of SCORC Amendment

The Corporations and Transportation Amendment to Senate Bill 201 corrects technical errors in the mathematical formula provided by the Taxation and Revenue Department (TRD) to properly calculate incremental revenues. The amendment also addresses concerns raised by TRD that the implementation of this calculation would cost the Department up to \$600,000 over the next few years by making a one-time appropriation in FY10 to cover those costs.

The Corporations and Transportation Amendment to Senate Bill 201 would also alter the new section included at the end of the original bill which attempts to address the issue of excess revenues. In the original piece of legislation, revenues in excess of those needed to pay debt service and principal on the outstanding TIDD bonds would be reverted back to the governments who dedicated the revenues. Under the amended legislation, only excess revenues that exist after all tax increment development district (TIDD) bonds are retired will be reverted back to the taxing governments. The reasons for this change are discussed in more detail in the technical issues section below.

Synopsis of Original Bill

Senate Bill 201 makes a number of technical changes recommended by the Taxation and Revenue Department (TRD) to the existing Tax Increment for Development Act. The majority of this legislation is intended to clarify actions already being undertaken by TRD in order to make the existing statutory language more functional from an administrative standpoint. The variety of changes included can be broken out into four pieces.

1. Senate Bill 201 ensures that TIDD revenues are calculated and distributed on an accrual basis instead of a cash basis in order to more appropriately coincide with business activity. By moving to an accrual basis, in accordance with the state's current accrual accounting practice, base year revenues will now properly reflect appropriate business activity. The bill would also allow first year base revenues to be estimated by a growth rate determined by the local government in consultation with TRD. This practice is already employed by TRD to determine base year revenue levels until final receipts can be determined and the actual base is known. This legislation also eliminates language currently allowing the base revenue level to increase each time a new tax rate is imposed in the area.
2. Senate Bill 201 changes the types of GRT counties and municipalities are currently permitted to dedicate to TIDDs. The bill removes regional transit district GRT from allowable increments, however it adds the following revenues:
  - i. quality of life GRT
  - ii. municipal regional spaceport GRT
  - iii. municipal higher education facilities GRT
  - iv. local hospital GRT
  - v. special county hospital GRT
  - vi. county fire protection excise tax revenue
  - vii. county health care GRT
  - viii. county education GRT
  - ix. county area emergency communications and emergency medical and behavioral health services taxes
  - x. water and sanitation GRT
  - xi. county correctional facility GRT.

3. Senate Bill 201 provides a new formula, the monthly adjusted GRT factor, for which TRD will make monthly distributions to TIDDs. The monthly adjusted GRT factor will allow TRD to treat TIDDs similar to normal taxpayers in order to properly address distributions. The bill also provides a provision to hold the TIDDs harmless from food and medical deductions similar to a local government or municipality, ultimately resulting in increased distributions from the State.
4. Senate Bill 201 creates a new section to the TIDD Act requiring any incremental revenues “in a debt service reserve account in excess of amounts necessary to pay the principal and interest due” on a district’s bonds within the subsequent year to be reverted back to the taxing entities from which they were dedicated. The bill further requires any balances remaining in the debt service reserve account once all of a district’s bonds have been paid off to be reverted back to the taxing entities from which they were dedicated. This change addresses a significant technical error in the existing statute.

## FISCAL IMPLICATIONS

This legislation would create a “tax increment fund” within the Treasury in order to finance IT changes which TRD believes will be necessary to facilitate the calculation changes also included in this bill. While this would prevent the state from having to make a \$600,000 general fund appropriation, as was the case with the SCORC amendment, it does require TIDDs to use a portion of their incremental revenue streams to finance the changes. These expenses were not factored into original TIDD bond authorization amounts and could take up important capacity space in their financing plans. It is also unclear whether or not the incremental revenues can be used to directly finance the necessary changes at TRD. The current TIDD statute states that incremental revenues can only be used to service bonds, and that expenditures can only be made from bond proceeds. In order to comply with existing statute TRD may need bonds to be issued by the New Mexico Finance Authority (NMFA) as provided for in the Senate Floor Amendment, and then use the proceeds from such bonds to finance the IT changes. TRD is expected to be given \$2.3 million in additional IT funding in its FY10 budget as part of the fair share initiative. It is currently unknown whether or not the IT changes necessitated by this legislation could be taken care of out of their existing FY10 budget. This bill creates a new fund which is non-reverting. The LFC has concerns with including non-reverting language in the statutory provisions for newly created funds, as earmarking reduces the ability of the legislature to establish spending priorities.

Taxation and Revenue Department (TRD):

### **Phase 1: Food and Medical: \$100k**

- TIDD is not getting credit for food and medical sales in the district; SB 201 allows the TIDD to get credit for these sales
- Now there is a deduction on GRT for food and medical and LG is held harmless
- Per SB 201 we’d have to determine the value of the GRT on food and medical services and include it in the calculation per what distributions are made to the TIDD
- Now the program excludes the food and medical in the base and in the data used for the distributions.
- The program would have to be changed to include food and medical sales and applicable GRT for each business in the district

- This requires changes to the main application program for TIDD, which calculates the baseline and the increment for each TIDD location, to include rate types on Food and Medical.
- The changes will include code and SQL (extract query) changes.
  - Make changes to 3 TIDD reports to include the food and medical.

**Phase 2: Changes to Taxable Gross Receipts and Filing period: \$200k**

- Now the program matches the GRT paid by each business in the TIDD to the revenue that is **received** and matched for the base period and subsequent periods, for the increment
- SB 201 matches the GRT back to each return filed: this requires that all revenue must be matched to a particular return filed for a particular time period rather than the current method of handling this as an aggregated amount based on revenue received and matched
- Changes could result form things such as: an amended return, partial payments, audit assessment
- These changes will involve the main application program for TIDD and 3 reports.

**Phase 3: Base year Calculations/Recalculations: \$300k**

- SB 201 allows for the base of the TIDD to be adjusted for such things as new business into the TIDD; changes in allocation of revenue to the TIDD based on businesses that operate both in and out of the TIDD, amended returns, etc.
  - This phase will automatically make these changes
- Without this capability we'd have to download the data to an excel spreadsheet, do analysis of the adjustments that should be made; make the adjustments and hand enter the adjustments into the system. This phase automates that process and is far more accurate and appropriate.
- The recalculation will require significant code, SQL and database table changes to store the more detailed activities to track the changes.
  - Reports of baseline and increment need to change accordingly.

Other facets of this legislation could have a number of indeterminate fiscal impacts. Based on the new way of calculating TIDD distributions, amended returns could have a fiscal impact to the state if monthly over or under distributions occur. These amended returns could have both positive and negative impacts on the general fund. Also if businesses claiming food and medical deductions were to move into a TIDD after the base year's revenues are determined, they could have a positive impact on TIDD distributions and a negative impact on general fund revenues. According to TRD "the fiscal impact of this proposal will depend on future decisions by the State, local governments, and any current or future TIDDs" and therefore exact fiscal implications are uncertain.

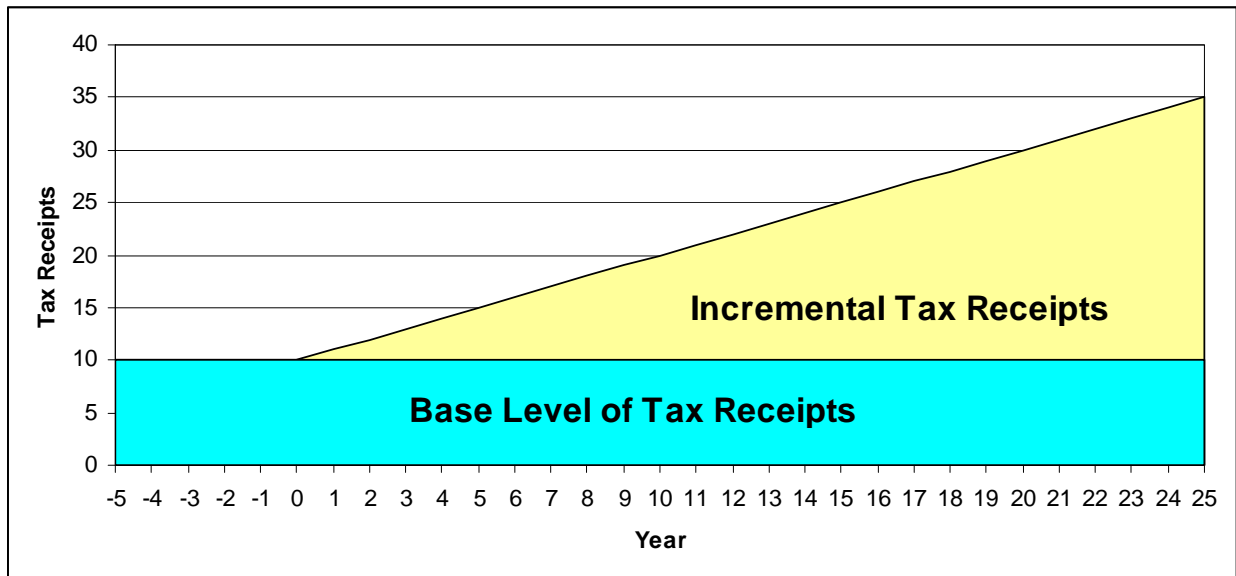
**SIGNIFICANT ISSUES**

**Tax Increment Financing**

The Tax Increment for Development Act was enacted in 2006. This act allows property owners within an area that is a subset of a city or county to form a tax increment development district (TIDD). A district can propose a plan of infrastructure investments that would encourage economic development among other goals that would be paid for out of the increased revenue from the development. This increment, as shown in Figure 1, is derived from the difference between the stagnant base level of tax receipts in year zero and the increasing level of receipts during the life of the TIDD.

The state is then not losing out on any tax revenues that it is already receiving but rather giving up a certain percentage of the incremental or increased tax receipts that are a result of increased business activity within the TIDD.

**Figure 1:**



Senate Bill 201 addresses a number of issues, brought to light by TRD, that are not addressed in any other TIDD reform legislation currently before the legislature. Moving to a monthly distribution based upon tax filing periods, will allow TRD to better gauge the incremental TIDD revenues in comparison with actual business activity. This is a necessary change from a tax administration standpoint to ensure that the TIDDs are working properly and that they are truly exceeding base revenue levels. Senate Bill 201 also clarifies the calculation of the increment for those districts with existing taxpayers (primarily infill or redevelopment districts), and corrects the list of local option taxes which can be dedicated for tax increment development.

Senate Bill 201 also addresses some of the technical problems currently in the Tax Increment for Development Act, particularly the reversion of excess funds once bonds are retired and the state increment has by definition expired. There are a number of other issues however, which need to be addressed concerning the existing TIDD statute. Currently the state has no oversight or input in Tax Increment Development Districts (TIDDs) after their increments are dedicated from BOF and they are given bonding authority by the legislature. Of particular worry is the fact that the state currently has no presence on TIDD governing boards despite being in most cases the projects' largest investor. Language has been inserted into a number of TIDD bills before the legislature which attempt to give the state greater oversight after bonding authority is approved including the prohibition of capital outlay projects during the life of bonds, and mandatory consultation with the New Mexico Finance Authority (NMFA) and or Board of Finance (BOF) before issuing bonds or amending master development agreements. Despite the use of these requirements in individual TIDD legislation, a comprehensive reform bill is needed to ensure that the state has sufficient oversight in TIDD projects to protect its investment. House Bill 451, endorsed by the NMFA Oversight Committee, addresses the majority of these issues by giving the state a more appropriate level of oversight.

## ADMINISTRATIVE IMPLICATIONS

According to TRD “this proposal will have a moderate initial impact to the Department as new distribution rules are incorporated,” however after the initial changes are made the impact should be positive.

**TRD has revised its position on this legislation and now believes that their will be a significant impact on its information technology unit. Preliminary estimates place the additional impact at approximately \$600,000 thus necessitating the creation of the “tax increment fund.”**

## RELATIONSHIP

SB201 relates to SB19, SB249, SB467, and HB470, which all authorize various existing TIDDs to issue bonds secured by incremental tax revenues.

SB201 also relates to and at times conflicts with SB483, SB509, SB 576, HB451, and HB 791 which all seek to amend the current TIDD statute.

## TECHNICAL ISSUES

Department of Finance and Administration (DFA):

Limiting the balance in a debt service account to the amount necessary to pay debt service over the next 12 months may have unintended consequences. TIDDs by nature often generate a large amount of gross receipts tax revenue from construction in the early phase, and then revenues generated in the later phases depend on how successful efforts are to recruit jobs. For this reason, one should not expect revenues dedicated to TIDDs to be stable over time. A TIDD could end up reverting large balances during times when more revenue is generated, but then could be unable to make debt service payments at other times when revenue is lower. This change could increase risk of TIDD bonds and increase costs of issuance.

LFC staff agrees with the DFA response in that the language requiring a district to revert revenues back to taxing entities while bonds are outstanding should be stricken from the bill. The New Mexico Finance Authority (NMFA) has also voiced concern regarding this language. However, it is imperative that Paragraph B of the newly created section remain, as there is currently no statutory mechanism for the districts to revert excess revenues once bonds are retired and the increments have by definition expired.

**This issue has been resolved with the adoption of the SCORC amendment which allows excess revenues to be reverted back to the taxing government once all TIDD bonds have been retired but not while bonds are still outstanding.**

Department of Finance and Administration (DFA):

Consider amending Section 5-15-15 (E) and (F) so that resolutions of local governments and the state board of finance shall become effective only on January 1 or July 1 following legislature authorization of bonds for the project. This amendment would prevent a district from receiving distributions of state and local tax revenue unless the district receives legislative authorization to issue bonds. Without this change, if a district receives a dedication but does not receive legislative authorization to issue bonds, it is unclear what happens to the dedicated revenue. The State Board of Finance included a similar contingency in its resolutions approving dedications of state gross receipts tax to the Las Cruces Downtown Revitalization project and the Winrock/Quorum project, but putting this requirement in statute would clarify the process for applicants and strengthen protections for the state and local entities.

This amendment would also help to address a significant technical oversight in the existing Tax Increment for Development Act. Under current statute, if a TIDD that has been approved by the State Board of Finance (BOF) fails to receive legislative bonding authorization the TIDD will continue to receive incremental tax revenues from the state that it cannot use. There is no contingency in the language requiring this money to be held back until bonding authority is granted or to revert the funds back to the taxing entities should bonding authority never be attained.

According to the Taxation and Revenue Department (TRD) “the formula for the calculation of the monthly gross receipts tax increment on page 6 lines 13 and 25 has a technical omission issue that needs to be corrected.” TRD staff is currently working to develop amended language designed to fix this technical issue.

**The SCORC and SFC amendments addresses this issue by correcting technical problems with the mathematical formula included in the beginning of the original bill.**

#### **ALTERNATIVES**

A number of TIDD reform bills have been introduced during this legislative session, and therefore a reasonable alternative to this legislation may be a combination of this bill and pieces of one or more other reform bills.

#### **WHAT WILL BE THE CONSEQUENCES OF NOT ENACTING THIS BILL**

If this legislation is not enacted, a number of technical problems with the Tax Increment for Development Act will persist as currently outlined in statute.

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