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## FISCAL IMPACT REPORT

ORIGINAL DATE 01/30/12

SPONSOR Griego, P. LAST UPDATED \_\_\_\_\_ HB \_\_\_\_\_

SHORT TITLE Tax Credit For Certain Business Investments SB 198

ANALYST Smith

### REVENUE (dollars in thousands)

Estimated Revenue			Recurring or Nonrecurring	Fund Affected
FY14	FY15	FY16		
\$0.0	(\$2,250.0)	(\$4,750.0)	Recurring	General Fund

(Parenthesis ( ) Indicate Revenue Decreases)

### SOURCES OF INFORMATION

LFC Files

#### Responses Received From

Taxation and Revenue Department (TRD)

Department of Finance and Administration (DFA)

### SUMMARY

#### Synopsis of Bill

Senate Bill 198 creates corporate income tax and insurance premium tax nonrefundable "new market" tax credits. Credits would be allowed in the amount of 39 percent of qualified investments, to be paid out over several years. The New Mexico Economic Development Department (EDD) will determine eligibility and certification for these tax credits subject to the following limitations:

1. The maximum amount of qualified equity investments that may be certified and upon which the 39 percent corporate income tax credit or insurance premiums tax credit may be calculated shall be \$200,000,000;
2. The maximum amount of credits that may be issued in certificates of eligibility shall be \$78,000,000;
3. The EDD shall issue certificates of eligibility amounting to no more than \$16,000,000 of aggregate credits for any one calendar year; and
4. The maximum amount of a qualified low-income community investment in any one qualified active low-income community business, on a collective basis with all of the affiliates of that qualified active low-income community business, that may be counted toward the certification of a qualified equity investment, whether issued to one or several qualified community development entities, shall be \$10,000,000.

The investment must be made through a “qualified community development entity.” There is an unstated assumption that the money provided by the entity awarded the tax credits is short- or long-term debt, and must be repaid with interest by the qualified community development entity. In turn, the qualified community development entity will loan the funds to stimulate economic activity. The qualified community development entity must use a minimum of 85 percent of the invested funds for economic development. Thus, the entity could retain as much as 15 percent of the funds for their reimbursement. For purposes of this proposal a “qualified equity investment” means any equity investment in, or long-term debt security issued by, a qualified community development entity that:

(a) is acquired after the effective date of this 2012 act, at its original issuance, solely in exchange

for cash, or that was constituted a qualified equity investment in the hands of a prior holder;

(b) has at least eighty-five percent of its cash purchase price used by the qualified community

development entity to make qualified low-income community investments in qualified active low-income community businesses located in the state; and

(c) is designated by the New Mexico finance authority as a qualified equity investment not exceeding the annual cap.

The credit certificates are issued to mature over seven years from the date of the investment. The schedule is as follows:

Year 1	0%	Year 2	0%
Year 3	7%	Year 4	8%
Year 5	8%	Year 6	8%
Year 7	8%		

**Effective Date:** July 1, 2012, SB-198 has a delayed repeal of July 1, 2019.

## **SIGNIFICANT ISSUES**

DFA notes the following:

While the NMTC statute requires that projects be located in census tracts where the poverty rate is at least 20 percent or median family income does not exceed 80 percent of the area median. In New Mexico, these definitions mean that approximately two-thirds of the state’s area would be eligible for these credits. This raises questions about how well targeted the use of these funds will be. In addition, there are few limitations on the kinds of businesses in which New Markets Tax Credits may be invested. In the past, federal New Markets Tax Credits have been awarded in New Mexico to convenience stores among others; with a wide-open interpretation of what a qualified business is, this program has even fewer safeguards than the federal program. This raises the concern that the proposed credits would not necessarily be targeted toward investments with significant “multiplier” potential to improve economic development in New Mexico. This targeting could be partially achieved with a competitive allocation process, where projects could be ranked and awarded based on factors such as job creation. However, this bill promotes a first come, first serve award process. Due to the lack of targeting and competitive allocation process, this bill lays out all of the costs to the state without clearly defining what benefits the state will reap in return.

Another important point is that as with many economic development incentives, it will be difficult if not impossible to determine whether investments made using the proposed credits would have occurred in the absence of the credits.

Finally, it should be noted that the Economic Development Department is responsible for determining eligibility on all projects under the Statewide Economic Development Finance Act, including the federal New Markets Tax Credit Program. Because of this and the role of the Economic Development Department in the administration of Finance New Mexico, LLC (a CDE which would potentially be applying to receive state new markets tax credits), the EDD could be seen as having a material conflict of interest in running this program.

## **TECHNICAL ISSUES**

Page 3, line 6, the “or” between “revenue department” and “insurance division” should be “and”.

Page 34, lines 19-20 and 22 refer to the New Mexico Finance Authority and should refer to Economic Development Department.

Also, there is a \$16 million cap on credits issued for any one year, but it should be noted that this is effectively negated by the “carry forward” concept which allows the taxpayer to use the tax credit in any of the next five taxable years instead of the current year.

Page 23, paragraph F, Partnerships do not owe corporate income tax, nor do owners who are individuals, so they may not claim this credit. This paragraph seems to say otherwise.

## **OTHER SUBSTANTIVE ISSUES**

Does the bill meet the Legislative Finance Committee tax policy principles?

- **Adequacy:** Revenue should be adequate to fund needed government services.
- **Efficiency:** Tax base should be as broad as possible and avoid excess reliance on one tax.
- **Equity:** Different taxpayers should be treated fairly.
- **Simplicity:** Collection should be simple and easily understood.
- **Accountability:** Preferences should be easy to monitor and evaluate

This bill may violate the LFC tax policy principle of adequacy. According to the LFC General Fund Recurring Appropriation Outlook for FY14 and FY15 the December 2011 forecasted revenues will be insufficient to cover growing recurring appropriations. Since currently forecasted revenues in FY14 and FY15 may not be adequate to fund government services there is insufficient funds for additional tax cuts.

SS/svb