# LEGISLATIVE EDUCATION STUDY COMMITTEE
# BILL ANALYSIS

**Bill Number:** **<u>SB 373</u>** **<u>51st Legislature, 1st Session, 2013</u>**

**Tracking Number:** **<u>.190764.1</u>**

**Short Title:** **<u>New Market Income Tax Credit</u>**

**Sponsor(s):** **<u>Senator Phil A. Griego</u>**

**Analyst:** **<u>Ian Kleats</u>** **Date:** **<u>February 26, 2013</u>**

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**<u>Bill Summary</u>:**

Applicable to taxable years beginning on or after January 1, 2014, SB 373 adds new sections to the *Personal Income Tax Act* and the *Corporate Income and Franchise Tax Act* providing a tax credit for qualified equity investments in qualified community development entities.

The purposes of the tax credit are to attract affordable capital to small businesses in low-income communities, to create private sector jobs, and to expand businesses.

Among its provisions, the bill:

- defines relevant terms, including qualified equity investment, qualified low-income community investment, and qualified community development entity;
- sets the amount of the credit equal to 58 percent of a qualified equity investment that may be claimed in the following proportions:

    - 0.0 percent in the year the investment was made and the year following;
    - 12 percent in the third, fourth, and fifth years after the investment; and
    - 11 percent in the sixth and seventh years after the investment;

- provides for an application process through which a qualified taxpayer may establish eligibility for the credit, including a $5,000 application fee payable to the Economic Development Department (EDD);
- allows for the recapture of the tax credit if certain conditions are not met; and
- requires that EDD annually report to the interim Revenue Stabilization and Tax Policy Committee and any other appropriate legislative committee on the effectiveness of the new market tax credit.

SB 373 also provides maximum aggregate caps between both tax programs of:

- $125.0 million for qualified equity investments across all fiscal years;
- $72.5 million for new market income tax credits across all fiscal years; and
- $10.0 million for new market income tax credits in any one fiscal year.

Finally, the bill provides a mechanism whereby:

- taxpayers may carry forward unused tax credits against future liabilities; and
- tax credit claims in excess of the annual cap may be administered.

**Fiscal Impact:**

SB 373 does not contain an appropriation. The revenue impact, as estimated by Legislative Education Study Committee (LESC) staff, is illustrated in the table below.

| Estimated Revenue Impact* | | | | R or NR** | Fund(s) Affected |
|---|---|---|---|---|---|
| FY 14 | FY 15 | FY 16 | FY 17 | | |
| 0 | 0 | 0 | (3,700) | R | General Fund |

* In thousands of dollars. Parentheses ( ) indicate a revenue loss.
** Recurring (R) or Non-Recurring (NR).

According to the Department of Finance and Administration (DFA) bill analysis, Finance New Mexico, LLC (FNM), which is run by the New Mexico Finance Authority, has provided funding in the form of loans or investments of approximately $124.3 million for nine projects since 2008.

The LESC staff estimate assumes that qualified investment would occur on a similar trend of approximately $31.0 million per year. On the basis of that assumption, the first credits would be claimed for taxable year 2016 at 12 percent of the invested amount, or approximately $3.7 million. The fiscal impact of the credit would continue to increase until the $10.0 million aggregate cap is reached in FY 19, reflecting credits for taxable year 2018.

**Fiscal Issues:**

The annual maximum aggregate cap and total maximum aggregate cap of SB 373 could reduce General Fund revenue by $10.0 million in any given fiscal year and $72.5 million in total.

Based on *General Appropriation Act* appropriations for the last five years, the Legislature has appropriated approximately 43.5 percent of General Fund revenue for public education. The reduction of revenue from the General Fund as proposed in this bill could result in decreased annual appropriations of $4.35 million for public education and an overall reduction in public education funding of approximately $31.5 million over the life of the tax credit.

**Substantive Issues:**

The social benefit of any tax expenditure should be judged relative to multiplier effects from the likely use of the foregone government revenue. General Fund appropriations comprise many diverse uses, with the largest proportion going to fund public education. Without strong evidence to the contrary, an assertion that this tax credit has a social benefit larger than that associated with public education or any other governmental program might be considered speculative.

However, the new market income tax credit may have a different effect. Stanford University suggests that a significant portion of the academic achievement gap can be attributed to socioeconomic factors like family income. Because it provides an incentive for economic development targeted at low-income communities, the tax credit could promote an environment that is conducive to the academic success of students.

That being stated, New Mexico's State Equalization Guarantee education funding formula implies that over 40 percent of government revenue would be spread equitably across the state, affecting small rural communities in a proportionate level to larger urban communities. It is unclear whether this credit could ensure the same equitable impact to all communities that public school funding would provide, even absent any discussion of the relative social benefit of the tax policy.

Moreover, the DFA analysis suggests that New Mexico already has numerous incentive programs designed to enhance economic development in all regions of the state, including an existing community development entity, which is run by the New Mexico Finance Authority.

The EDD analysis also states that, by allowing a taxpayer to offset its income tax or corporate income tax liability up to 58 percent of qualified investments made in addition to receiving a federal tax credit (which offers a 39 percent tax credit for the same transaction) the credit proposed by SB 373 "excessively sweetens the pot for a limited number of users."

**Technical Issues:**

If the aggregate investment cap of $125 million is reached in a single year, the maximum amount of potential tax credits would equal $15.0 million starting in the third year after the investment. The maximum annual aggregate cap of $10.0 million would prevent this amount from being realized, but it could also limit the incentive afforded by the tax credit.

The EDD analysis suggests that provisions of SB 373 may conflict with a number of taxpayer confidentiality provisions. Although such a concern could be important, LESC staff understands that taxpayer confidentiality typically extends only to information in tax returns. Insofar as the reporting requirements may be satisfied by information furnished through the application process for certificates of eligibility, confidentiality concerns could be minimized.

**Committee Referrals:**

SCORC/SFC

**Related Bills:**

None as of February 26, 2013.