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

SPONSOR Padilla

ORIGINAL DATE 03/01/13
LAST UPDATED

HB

SHORT TITLE New Business Tax Credit & Assessment

SB 293

ANALYST van Moorsel

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY13	**FY14**	**FY15**	**FY16**	**FY17**		
		($18,200.0)	($18,900.0)	($19,300.0)	Recurring	General Fund

(Parenthesis ( ) Indicate Revenue Decreases)

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY13	FY14	FY15	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
Total		$66.0	$60.0	$126.0	Recurring	TRD Operating Fund

(Parenthesis ( ) Indicate Expenditure Decreases)

SOURCES OF INFORMATION
LFC Files

Responses Received From
Taxation and Revenue Department (TRD)

SUMMARY

Synopsis of Bill

Senate Bill 293 amends the refundable Corporate Income and Franchise Tax Act to create the “commercial activity corporate income tax credit.” The credit allows a new business in which the taxpayer invested $25 million that creates economic-based jobs in New Mexico to claim a tax credit against the taxpayer's corporate income tax (CIT) liability of thirty-five percent of the excess above CIT and gross receipts taxes (GRT) taxes paid by the business in the base year. The credit may be claimed for tax years 2014 through 2020. The credit may be claimed for seven consecutive years beginning with the first taxable year in which the taxpayer is eligible, and the maximum aggregate amount claimed for that period may not to exceed 35 percent of the increase in state revenue above the first base year for which the taxpayer has claimed the credit.

The bill states the purposes of the new commercial activity corporate income tax credit are to:

- encourage corporations to start up in or relocate to New Mexico and invest significant amounts of capital in the state to start up or relocate;
- increase the number of economic-based jobs available to New Mexico residents in New Mexico; and
- generate new state revenue from construction, employment and business activity developed in New Mexico.

Senate Bill 293 provides claiming this credit would make the taxpayer ineligible for the high-wage jobs tax credit or a rural job tax credit. In addition, the credit is not available for an economic-based job that a new business creates that was:

- created within 180 days of a business merger, acquisition, association, affiliation, disposition or other change in organization or management affecting the new business; and
- performed by the person or another person who performed the job or its functional equivalent, prior to the change in organization or management.

A taxpayer is also not eligible for a credit if the economic-based job created is due to a new business contracting or subcontracting with a governmental entity that replaces one or more entities performing functionally equivalent services unless the job is a new economic-based job that was not being performed by an employee of the replaced entity.

The bill requires the TRD and the EDD to adopt rules to implement the provisions governing the tax credit. To claim a credit, a corporation must apply to the EDD for a certificate of eligibility that must be submitted to the TRD with the taxpayer's CIT return. The taxpayer must also provide the EDD with:

- evidence of expenditures to establish a new business in New Mexico;
- evidence that the business created at least 100 economic-based jobs in the base year;
- evidence of one full year of operation in New Mexico, including evidence of paying at least 100 eligible employees within the taxable year for which the credit is to be claimed;
- evidence of payment of taxes in the taxable year pursuant to the Corporate Income and Franchise Tax Act and the Gross Receipts and Compensating Tax Act;
- evidence that the business is located and operating in New Mexico at the time the credit is claimed; and
- statements signed by the taxpayer authorizing the EDD and the TRD to reveal to the legislature and its agencies information from the taxpayer's tax returns needed to evaluate the effectiveness of the credit.

The bill defines economic-based job, eligible employee, and new business.

The effective date of this bill is July 1, 2013. The sunset date of this bill is December 31, 2020.

FISCAL IMPLICATIONS

The Taxation and Revenue Department notes its estimate of the impact of SB 293 is uncertain. The department used 2010 New Mexico corporate income tax data that shows there are approximately 120 corporations that potentially could invest $25 million and hire 100 employees in a new entity based on their "apportioned New Mexico taxable income" with a total tax liability of approximately $168 million. Assuming 80 percent of these corporations transfer 20 percent of their income to the new corporation and claim the 35 percent of the "excess" income in this credit, the impact in 2010 would have been approximately $10 million, or approximately 5 percent of total revenue. (However, if 30 percent of their income is transferred, the impact would be approximately 7%.) TRD grew these numbers in proportion to February consensus forecast estimates.

The Taxation and Revenue Department (TRD) notes it is unable to estimate the amount of credit claimed by "new" businesses that are starting up or relocating to the state that are not affiliated with existing corporations currently filing New Mexico CIT returns. The analysis performed is based on the assertion that firms already doing business in New Mexico would recognize the benefits of the tax expenditure, and leverage its current operations into "new" corporate formations that would be eligible for the credit. There is no basis to identify wholly "new" enterprises that would locate in New Mexico and take advantage of the credit.

This bill may be counter to the LFC tax policy principle of adequacy, efficiency and equity. Due to the increasing cost of tax expenditures revenues may be insufficient to cover growing recurring appropriations.

Estimating the cost of tax expenditures is difficult. Confidentiality requirements surrounding certain taxpayer information create uncertainty, and analysts must frequently interpret third-party data sources. The statutory criteria for a tax expenditure may be ambiguous, further complicating the initial cost estimate of the expenditure's fiscal impact. Once a tax expenditure has been approved, information constraints continue to create challenges in tracking the real costs (and benefits) of tax expenditures.

SIGNIFICANT ISSUES

TRD notes SB 293 aims to create an incentive for new businesses to relocate to or incorporate in New Mexico and make significant investments and create new jobs. However, existing New Mexico corporations could also qualify for this credit by incorporating a new affiliate entity. TRD adds that the bill contains language that might appear to discourage formation of an "affiliate enterprise" by an existing New Mexico corporation, but the department cautions that the legislation may not provide an adequate foundation to prevent that from occurring.

TRD adds that 2010 New Mexico corporate income tax data indicates many corporations may be able to invest $25 million and hire over 100 employees and incorporate a new (subsidiary) business, thus qualifying for the credit. Further, the corporations could transfer income from the parent or the existing corporation to the newly created corporation in such a way that the base year tax would be close to zero and the subsequent year tax liability would be significant, thus claiming a "large" credit amount.

ADMINISTRATIVE IMPLICATIONS

TRD reports SB 293 may have a high impact on its operations. The credit claim and the calculation of the credit amount coincide with the receipt of the income tax return, meaning TRD will need to quickly review all claims to avoid the payment of interest on the refunds. To turn the refunds around quickly, especially during peak filing periods, TRD will need additional dedicated audit personnel at a cost of $60,000 per year. The computation and approval of the credit will need to be manual and would take time to ensure that the claimed amount is correct and valid. The development of the new form and instructions could be as much as $6,000. Modifications to the corporate income tax returns, forms, instructions and related publications could be handled with existing resources. Finally, TRD adds that the burden of compiling an annual report is placed on TRD even though the department may not currently have access to all the information requested.

PERFORMANCE IMPLICATIONS

The LFC tax policy of accountability is met with the bill's requirement to report annually, beginning in 2016, to an the interim Revenue Stabilization and Tax Policy committee regarding the data compiled from the reports from taxpayers taking the credit and other information to determine whether the credit is meeting its purpose.

CONFLICT

Conflicts with SB 59, SB 277, SB 293, SB 319, SB 373, SB 508, SB 538, SB 545,
SB 568, HB 182, HB 507, HB 596, and HB 616.

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

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