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

ORIGINAL DATE 02/24/13
SPONSOR SCORC **LAST UPDATED** 03/4/13 **HB**

SHORT TITLE New Market Premium Tax Credit **SB** 373/SCORCS

ANALYST van Moorsel

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY13	**FY14**	**FY15**	**FY16**	**FY17**		
			($15,000.0)	($15,000.0)	Recurring	General Fund

(Parenthesis ( ) Indicate Revenue Decreases)

SOURCES OF INFORMATION

LFC Files

Responses Received From
Economic Development Department (EDD)
New Mexico Finance Authority (NMFA)

SUMMARY

Synopsis of Bill

Senate Corporations Committee Substitute for Senate Bill 373 amends the Insurance Code to create the nonrefundable and nontransferable “new market premium tax credit” to attract affordable capital to small businesses in low income communities, to create private sector jobs and to expand businesses. The bill also amends the Insurance Code to provide that a taxpayer who receives the new market premium tax credit is not required to pay additional taxes pursuant to the reciprocity provision of the Insurance Code.

The bill allows a taxpayer who makes a qualified equity investment in a qualified community development entity (CDE) on or after July 1, 2013 and prior to January 1, 2017 to claim a tax credit against the taxpayer's premium tax liability equal to 58 percent of the qualified equity investment applied in the corresponding seven consecutive calendar years in an amount equal to:

- zero percent of the qualified equity investment in calendar years in which the first and second credit allowance date occurs;
- 12 percent of the qualified equity investment in calendar years in which the third, fourth and fifth credit allowance date occurs; and

- 11 percent of the qualified equity investment in calendar years in which the sixth and seventh credit allowance date occurs.

The bill caps the maximum aggregate of qualified equity investments that may be made on or after July 1, 2013 and prior to January 1, 2017 for the purposes of obtaining a new market premium tax credit $125 million. The maximum aggregate of credits against liability, then, is $72.5 million. The maximum credit that the insurance division may allow in one year is $15 million, exclusive of any carry forwards. The credit may be carried forward five years.

To be eligible for the credit, the taxpayer must submit an application to the Economic Development Department (EDD). A taxpayer may submit an application prior to making a qualified equity investment in a qualified CDE to determine eligibility. The EDD must grant or deny the application within 30 days of receiving a completed application. The taxpayer must provide:

- the name, address, tax ID number and certification as a federally qualified CDE, including evidence that the CDE's service area in which the taxpayer made a qualified equity investment includes New Mexico;
- a copy of the allocation agreement executed by the qualified CDE and the federal community development financial institutions fund;
- a certificate executed by an officer of the qualified CDE attesting that the allocation agreement remains in effect and has not been revoked or canceled by the federal community development financial institutions fund, and stating the cumulative amount of allocations awarded to the taxpayer by the federal community development financial institutions fund;
- a description of the amount and structure of the qualified equity investment;
- a nonrefundable application fee of $5 thousand per application, paid to the EDD;
- the refundable performance fee of $500 thousand provided by the qualified CDE;
- examples of the types of qualified low-income community investments made by the qualified CDE with its federal allocation; and
- any other information used to determine eligibility.

The bill also requires a qualified CDE that receives a qualified equity investment to provide the EDD with detailed records with respect to qualified low-income community investments made with the proceeds of qualified equity investments in qualified active low-income community businesses in New Mexico; and information about each qualified active low-income community business required by the EDD to assess the effectiveness of the credit. The CDE must continue to submit that information to the EDD on December 31 of each year for seven consecutive years after the initial credit allowance date.

The bill provides that the Insurance Division of the PRC must recapture a tax credit allowed from a taxpayer if:

- any amount of a federal tax credit available with respect to a qualified equity investment is recaptured under Section 45D of the Internal Revenue Code; provided that the recapture amount shall be proportionate to the federal recapture with respect to that qualified equity investment;
- the CDE redeems or makes principal repayment of a qualified equity investment prior to

the seventh taxable year following the taxable year in which the investment is made; provided that the recapture amount shall be proportionate to the amount of the redemption or repayment of that qualified equity investment;

- the qualified CDE fails to invest an amount equal to at least 85 percent of the qualified equity investment in qualified low-income community investments in New Mexico within 12 months of the date the qualified equity investment is made, or maintain an amount equal to at least 85 percent of the qualified equity investment in qualified low-income community investments in New Mexico through the seventh taxable year following the year in which the qualified equity investment is made; provided that a qualified equity investment shall be deemed held by a qualified CDE, even if that investment is sold or repaid, if an amount equal to the capital returned or recovered from the original investment, exclusive of any profits realized, is invested in another qualified low-income community investment within 12 months of the receipt of that capital; or
- at any time prior to the seventh calendar year following the year in which the qualified equity investment is made, the qualified CDE uses the investment to make qualified low-income community investments in any one qualified active low-income community business, exclusive of reinvestments of capital returned or repaid with respect to earlier investments in that community business and its affiliates, in excess of 25 percent of the investment.

The bill also creates the new market performance guarantee fund. A qualified CDE that proposes to receive a qualified equity investment from a taxpayer must pay a $500 thousand performance fee to the EDD for deposit in the new market performance guarantee fund. The performance fee is held in that fund until all qualified CDEs with the same controlling entity comply with the provisions the bill as determined by the EDD. The qualified CDE may request a refund of the performance fee 30 days after the EDD makes this determination.

The qualified CDE must forfeit the performance fee if the qualified CDE or any other qualified CDE with the same controlling entity fails to issue the total amount of qualified equity investments certified by the EDD, or meet the investment requirement of the bill by the second credit allowance date.

The bill makes several definitions, including: “qualified active low-income community business,” "qualified community development entity,” "qualified equity investment," and "qualified low-income community investment." Each of these terms is defined as they appear in Section 45D of the Internal Revenue Code.

The effective date of the provisions of this act is July 1, 2013.

FISCAL IMPLICATIONS

The provisions of SB 373 provide that a taxpayer may begin to claim a new market premium tax credit in the year in which the third credit allowance date occurs. A qualified investment may be made beginning in fiscal year 2014, and therefore the fiscal impact would begin to be realized in fiscal year 2016 and onward. This analysis assumes that the annual cap of $15.0 million is reached in FY 16 and in subsequent fiscal years.

At the time of this writing, the Public Regulation Commission had not prepared a fiscal impact report for SCORC/SB 373. Because the LFC staff have no information pertaining to potential claims for this credit, it is assumed that the $15 million annual cap will be reached, and that the net general fund impact over the life of the credit will be the maximum $72.5 million.

The bill could affect the general fund in several ways. **The most significant impact would be through the reduction in the transfer of insurance premium taxes to the general fund. However, premium taxes are distributed in such a way that a reduction resulting from this credit could also result in a smaller reversion to the general fund from the fire protection fund and the law enforcement protection fund, depending on the types of premiums that would be affected by the credit. In addition to reduced general fund reversions, reductions in distributions to the fire protection fund and the law enforcement protection fund would have a negative impact on the agencies that rely on these funds.** For example, approximately one in six public project revolving fund loans are secured by fire protection funds, and it is important that these funds remain available for this purpose.

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

SCORC/SB 373 appears creates a state-level credit similar to the federal New Markets Tax Credit Program. Enacted by Congress as part of the Community Renewal Tax Relief Act of 2000, the New Markets Tax Credit (NMTC) Program is incorporated as section 45D of the Internal Revenue Code. This section permits individual and corporate taxpayers to receive a credit against federal income taxes for making qualified equity investments (QEIs) in qualified community development entities (CDEs). These investments are expected to result in the creation of jobs and material improvement in the lives of residents of low-income communities. Examples of expected projects include financing small businesses, improving community facilities such as daycare centers, and increasing home ownership opportunities.

Proceeds from the sale of the tax credits can be invested into many types of for-profit or not-for-profit business, including development of commercial, industrial, and retail real estate projects. Section 45D of the Internal Revenue Code excludes tax credit proceeds from being invested in residential rental property that derives 80 percent or more of its gross rental income from housing; private or commercial golf courses; country clubs; massage parlors, hot tub facilities or suntan facilities; racetracks or other gambling facilities; stores where the principal business is the sale of alcoholic beverages for consumption off premises; and farming businesses if the aggregate unadjusted basis of assets (owned or leased) exceeds $500 thousand. The provisions of SCORC/SB73 mirror these requirements and exclusions.

A "low-income community" is defined as any population census tract where the poverty rate for such tract is at least 20 percent or in the case of a tract not located within a metropolitan area, median family income for such a tract does not exceed 80 of statewide median family income, or in the case of a tract located within a metropolitan area, the median family income for such tract does not exceed 80 percent of the greater of statewide median family income or the metropolitan area median family income. According to data from the Community Development Financial Institutions Fund, the federal entity charged with overseeing the allocation and compliance of the federal credit, 46 percent of New Mexico's census tracts would qualify under the requirements of the federal tax credit program. Thus, the tax credits could only be used for investments in 46 percent of the state's census tracts, meaning not all areas of the state would be eligible to receive any benefits of the qualified equity investments.

The bill's provisions governing the distribution of the tax credit do not require the CDE to target the credits toward projects that will stimulate the economy, and do not make the tax credits contingent on job creation or other indicators of economic development. Job creation in low-income areas could be better promoted if the credit were tied to job creation requirements. Further, provisions requiring the EDD to claw back credits if the investment does not meet job creation requirements could further help create incentives that investments are made in areas with a chance of improving the low-income community.

According to a February, 2011 Bloomberg article, the New Markets Tax Credit (NMTC) Program hasn't always been used to finance development projects in poor neighborhoods. According to the article, developers use 10-year-old census data to claim a neighborhood is low-income and deserving of a jobs-creating development. Many of the neighborhoods receiving taxpayer assistance have since become upscale. Some of the projects being financed are among the most luxurious of their kind. One such project is the Blackstone Hotel, in downtown Chicago, which offers rooms for as much as $699 a night. Prudential Financial, which financed the development, received $15.6 million from the U.S. Treasury.

PERFORMANCE IMPLICATIONS

The LFC tax policy of accountability is met with the bill's requirement to report annually to an interim legislative 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.

ADMINISTRATIVE IMPLICATIONS

Administering and monitoring is a complex task, and it appears the one-time application fee of $5,000 may not be sufficient for EDD to offset the costs of performing these duties. The department may require additional staff to administer the credit and ensure compliance. In its analysis of the bill, EDD indicates the mandate in one section of the bill alone will require a substantial increase in EDD's budget to administer, monitor and report.

The New Mexico Finance Authority reports SCORC/SB 373 will have no impact on the agency.

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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