

Fiscal impact reports (FIRs) are prepared by the Legislative Finance Committee (LFC) for standing finance committees of the NM Legislature. The LFC does not assume responsibility for the accuracy of these reports if they are used for other purposes.

Current and previously issued FIRs are available on the NM Legislative Website (www.nmlegis.gov) and may also be obtained from the LFC in Suite 101 of the State Capitol Building North.

FISCAL IMPACT REPORT

ORIGINAL DATE 1/16/2014
SPONSOR Trujillo, Ca & Padilla **LAST UPDATED** 1/30/2014 **HB** 96

SHORT TITLE Tech Jobs & Research Development Tax Credit **SB** _____

ANALYST Dorbecker

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY14	FY15	FY16	FY17	FY18		
\$400.0	(\$2,100.0)	(\$1,650.0)	(\$1,660.0)	(\$1,665.0)	Recurring	General Fund

Parenthesis () Indicate Revenue Decreases

SOURCES OF INFORMATION

LFC Files

Responses Received From

Department of Finance and Administration (DFA)
 Economic Development Department (EDD)
 Taxation and Revenue Department (TRD)

SUMMARY

Synopsis of Bill

House Bill 96 amends the name and purpose of the Technology Jobs Tax Credit Act to include “Research and Development” to be known as the “Technology Jobs and Research and Development Tax Credit Act.” It adds several definitions to the act, raises both the basic and additional credit amounts from four to five percent, and adds two new sections related to claiming the additional credit and required reporting by taxpayers who claim the credit.

Specifically, HB 96 increases the amount of the basic and the additional credit available in the existing Technology Jobs Tax Credit from 4 percent to 5 percent of qualified expenditures, and increases the employment threshold definition of small business from the existing Small Business R&D Tax Credit from 25 employees to 50 employees. The bill also expands the definition of "rural areas" in the existing Technology Jobs Tax Credit to allow more businesses to claim the higher credit of 10 percent in rural areas, and allows refundability of a portion of the additional credit to small businesses based on their size.

The legislation defines "qualified research and development small business" as a taxpayer that employs 50 or fewer employees, had total qualified expenditures of no more than \$5 million and did not have more than 50 percent of its controlling interest owned by another business.

The bill excludes mergers as a source of eligible payroll growth, limits the carry forward provision to 3 years, and adds reporting requirements for taxpayers to better allow the Taxation and Revenue Department (TRD) to enforce the recapture provision.

Finally, the bill excludes local option gross receipts tax from those taxes against which the credit can be applied, and cleans up existing language for clarity. The legislation also repeals the Small Business R&D Tax Credit, and provides a transition procedure for current claims outstanding.

The refundability of the additional credit to small businesses applies to taxable years beginning on or after January 1, 2014. The provisions of this bill apply to qualified expenditures that are made on or after January 1, 2014.

The effective date of this bill is July 1, 2014

FISCAL IMPLICATIONS

TRD reports substantial impacts of HB 96 are expected to come from:

1. Increased percentage used to calculate the credit, and
2. Making the additional credit refundable to qualified research and development small businesses (QRDSBs).

The additional credit is made refundable in a tiered schedule for QRDSB taxpayers. The bill indicates the total qualified expenditures for the taxable year for which the claim is made will observe one of the following options:

- 1) If the amount is less than \$3 million, the excess additional credit will be refunded to the taxpayer;
- 2) If the amount is greater than or equal to \$3 million and less than \$4 million, two-thirds of the excess additional credit will be refunded to the taxpayer;
- 3) If the amount is greater than or equal to \$4 million and less than or equal to \$5 million, one-third of the excess additional credit will be refunded to the taxpayer.

According to TRD, over the past two fiscal years, less than three taxpayers that would have been likely QRDSBs had over \$3 million in qualified expenditures in a year, so the tiers have minimal impact.

Estimated Full Year Impacts Based On FY13 (dollars in thousands)

Size of Company (New QRDSB Definition)	Increased Percentage from 4% to 5%	Add. Credit Refundable for Qualified Small R&D	Total Estimated Impact
Large (over \$5 million)	\$1,202	\$0	\$1,202
Small (\$5 million or less)	\$108	\$300	\$408
Grand Total	\$1,310	\$300	\$1,610

The impact of the percentage increase is a simple calculation. The credit is estimated to increase at the rate of growth of manufacturing employment, since manufacturers historically represent most of the credit recipients. Because the basic credit is applicable to expenses incurred after January 1, 2014 (claimed after July 1, 2014), it is assumed that a small number of taxpayers will wait to take a higher portion of credits taken between FY2014 and FY2015. This causes a small increase in FY2015 credits which will be mostly offset by a slight decrease in FY2014 because the credit will be higher in FY2015 hence the positive revenue impact in FY2014.

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

According to the Department of Finance and Administration (DFA), the expansions provided by this bill allow a greater benefit to small and large businesses alike and encourage greater participation. The agency states that under current law, these credits provide incentive for businesses to invest in technology that could improve their productivity. However, the existing Small Business R&D Credit has been underutilized by small businesses, as it can only be claimed if other credits are not claimed and it is not refundable.

According to the 2013 New Mexico Tax Expenditure report, claims for the Small Business R&D Tax Credit have dried up in recent years, while the Technology Jobs Tax Credit continues to be popular.

New Mexico High Technology Tax Credits – Filed Claims (dollars in thousands)

	FY2008		FY2009		FY2010		FY2011		FY2012	
	Claims	Amount	Claims	Amount	Claims	Amount	Claims	Amount	Claims	Amount
Research & Development Small Business Tax Credit	56	\$133.1	82	\$107.1	5	\$0.7	0	\$0	0	\$0
Technology Jobs Tax Credit	174	\$1,909.8	346	\$6,042.6	398	\$6,267.7	334	\$4,601.9	286	\$6,695.2
Total	230	\$2,042.9	428	\$6,149.7	402	\$6,268.4	334	\$4,601.9	286	\$6,695.2

POLICY ISSUES

The purpose of the Technology Jobs and Research and Development Tax Credit Act is to provide a favorable tax climate for technology-based businesses engaging in research, development, and experimentation and to promote increased employment and higher wages in those fields in New Mexico.

PERFORMANCE IMPLICATIONS

In terms of taxpayer reporting requirement, HB 96 creates a new section of the Technology Jobs and Research and Development Tax Credit to indicate taxpayers claiming the basic or additional credit will file reports with TRD on or before June 30 of the year following a calendar year and by June 30 of each of the two succeeding years. These reports will contain information describing the taxpayer's business operations in New Mexico.

The LFC tax policy of accountability is not met since TRD is not required in the bill to report annually to an interim legislative committee regarding the data compiled from the reports from taxpayers taking the deduction and other information to determine whether the deduction is meeting its purpose.

ADMINISTRATIVE IMPLICATIONS

According to TRD, HB 96 will have a minimal impact in terms of modifying the forms, instructions and publications for the technology jobs tax credit; modifying the income tax forms and to create a mechanism for the refund process of the credit on the forms at no additional cost as part of the annual renewal of the tax program.

TECHNICAL ISSUES

DFA notes on page 2, subsection C as drafted is unclear. If it is the intent that "base payroll expense" establish a baseline from which the increase in payroll expense needed to qualify for the additional credit is calculated, line 21 should be amended to say "in the taxable year, one year prior to the taxable year for which." As written, the annual payroll expense and base payroll expense occur in the same year.

This bill does not contain a sunset date. The LFC recommends adding a sunset date.

OTHER SUBSTANTIVE ISSUES

The table below from DFA compares the definition of non-rural areas in existing legislation to that proposed in this bill.

Definition of "Urban Areas"

Current Law		HB 96	
Class A county	Bernalillo	Incorp Muni w/Pop > 30,000	State Fairgrounds
	Dona Ana		Albuquerque
	San Juan		Las Cruces
	Sandoval		Rio Rancho
Class B county w/NTV > 3b	Santa Fe		Santa Fe
	Eddy		Roswell
	Lea		Farmington
	Rio Rancho		Clovis
			Hobbs
	Area within 3 miles of Class A county		Alamogordo
			Area within 3 miles of Incorp Muni w/pop > 30,000

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

HD/jl