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

		ORIGINAL DATE	02/04/14		
SPONSOR	Gentry	**LAST UPDATED**	02/19/14	**HB**	204/aHAFC
SHORT TITLE	Transfer of Tax Credits Between Taxpayers			**SB**	
				ANALYST	van Moorsel

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY14	**FY15**	**FY16**	**FY17**	**FY18**		
$0.0	($190.0-$270.0)	($210.0-$300.0)	($230.0-$330.0)	($250.0-$360.0)	Recurring	General Fund

(Parenthesis ( ) Indicate Revenue Decreases)

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY14	FY15	FY16	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
Total	$0.0	$24.25	$24.25	$48.5	Recurring	TRD

(Parenthesis ( ) Indicate Expenditure Decreases)

SOURCES OF INFORMATION
LFC Files

Responses Received From
Taxation and Revenue Department (TRD)

SUMMARY

Synopsis of HAFC Amendment

The House Appropriations and Finance Committee amendment adds reporting requirements and sunsets to the credits in the bill:

- The Qualified Business Facility Rehabilitation Credit sunsets January 1, 2021;
- the Job Mentorship Tax Credit against PIT sunsets July 1, 2020;
- the Job Mentorship Tax Credit against CIT sunsets January 1, 2021; and
- the Angel Investment Tax Credit sunsets January 1, 2021.

Synopsis of Original Bill

House Bill 204 authorizes the sale, exchange, or other transfer of certain tax credits. Specifically, the bill allows the transfer of:

- Qualified Business Facility Rehabilitation credits against personal income tax (PIT) and corporate income tax (CIT);
- Job Mentorship Tax Credits against PIT and CIT; and
- Angel Investment Credits against PIT.

As part of this new provision, the Taxation and Revenue Department (TRD) must issue to the applicant a dated and numbered document granting the tax credit and stating the amount of the credit. These credits are amended to require the person qualifying for the credit to apply for the credit within three years of the end of the year in which the person performed the qualifying business activity.

The transfer of the credits is permitted, provided that the amount of the credit is reduced by 10 percent, and that the parties to the transaction notify TRD of the sale within ten days of the transaction.

The provisions of the bill apply to taxable years beginning on or after January 1, 2014.

There is no sunset date. The LFC recommends adding sunset dates to the credits.

FISCAL IMPLICATIONS

It is assumed that not all tax credits can be claimed, as the taxpayer may not have a tax liability against which to claim the credit. Information on the number of taxpayers who qualify for the credit but who have not claimed it would allow for a more accurate analysis of the bill's fiscal impact. In the absence of this data, it has to be estimated. The 2013 New Mexico Tax Expenditure Report shows the following claims for the credits included in HB 204:

Claims of Tax Credits Included in HB 204	FY08	FY09	FY10	FY11	FY12
Angel Investment Tax Credit	$145.0	$157.8	$200.8	$251.8	$392.5
Job Mentorship Tax Credit	$25.1	$13.9	$12.7	$13.7	NA
Qualified Business Facility Rehabilitation Tax Credit	$0.0	$0.0	$0.0	$0.0	$0.0

SOURCE: NM 2013 Tax Expenditure Report

Based on historical trends in the claims for these credits, an average growth rate of 25 percent was used in the first two years (tax year 2012 and 2013) then reduced to 20 percent in 2014, 15 percent in 2015, and 10 percent in 2016 through 2018. TRD assumed that 35 percent of the credits will be sold, exchanged, or transferred to another taxpayer at a 10 percent reduction. Five percent of the total credits after discount were attributed to business facility rehabilitation credit and added back, since there have been no claims for this credit between tax years 2006 and 2012.

The LFC assumes taxpayers that can claim the tax credit would not transfer it (at a loss of at least ten percent of the credit). It is unknown what percentage of all potential claims is represented by actual claims. Changing to 50 percent TRD's assumption that a further 35 percent of currently claimed credits could be transferred would increase the fiscal impact by over 40 percent.

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

Selling, exchanging, or transferring the credit potentially does two things: 1) allows the taxpayer who sold the credit to receive money more quickly (particularly when he does not – and will not for some time – have the tax liability against which to apply the credit), and 2) allows a taxpayer who acquires the credit to reduce his tax liability.

In July, 2012 the Wall Street Journal reported[1] on the burdensome nature of some federal tax breaks due to the complexity of the administrative requirements of compliance. The article notes that "[i]n some cases, the cost of obtaining [a] tax benefit is greater than the benefit itself[.]" As a result, tax consultants estimate that eligible businesses obtain as little as five percent of the main domestic tax breaks to which they are entitled. The article also mentioned that the high administrative burden of many tax breaks has contributed to the rise of a cottage industry of tax credit consultants that charge fees ranging from 15 to 30 percent of savings. A representative of the industry in New Mexico reported brokers in the state charge fees of ten percent of the credit. While the article concerned federal tax breaks, there is an administrative cost to claiming existing tax credits in New Mexico, and complying with further regulatory requirements of transferability of tax credits could add to this existing administrative burden. This additional cost, as well as the price of tax credit consultants to manage the paperwork, could erode some of the potential benefit and deter some potential transfers.

Given the reduction in the tax credit upon transfer and the fees charged by brokers to tax credit claimants, the person performing the activity for which the credit qualifies will not see the full financial benefit of the credit. Making these credits fully refundable would allow claimants to accrue 100 percent of the benefit and cut out the middle man.

PERFORMANCE IMPLICATIONS

The LFC tax policy of accountability is met since TRD is required in the bill to report 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

TRD would need to develop a new application form and a transfer form will need to be created for each credit. Coordination will be needed between TRD and EDD. Taxpayer and TRD

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[1] McKinnon, John D. "Firms Pass Up Tax Breaks, Citing Hassles, Complexity." *Wall Street Journal*

employee education will be needed. Publications and income tax form instructions can be modified with existing resources as part of the annual tax program renewals.

TECHNICAL ISSUES

TRD notes several technical issues in the bill:

- On page 2, line 19, Section 1, subparagraph B may need to read, "A taxpayer shall apply for approval ***and claim*** the tax credit within three years following the end of the calendar year in which the restoration, rehabilitation, or renovation was completed." The "and claim" language may need to be included if it is not obvious by the application process; otherwise it doesn't seem to have a statute of limitation on when to file a claim. This language is used in the corporate income tax provision on page 16, line 13 as well; if a change is made to one section, it should be made in the other. It is also used on page 6, line 6 and page 21, line 16 (Job Mentorship Tax Credit sections). This suggested change also applies to line 2, page 6; line 12, page 18; and line 16, page 21. ***This issue is addressed in the HAFC amendment.***

- Section 2, subparagraph B may need to include the word ***first*** on page 6, line 4, when it states, "A taxpayer shall apply for approval for the tax credit within three years following the end of the calendar year in which the qualified student is employed by the business". However, this may be addressed later in the paragraph, which states: "Each credit is deemed to originate on the hiring date for each qualified student." This language is duplicated on page 21, lines 15-18.

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

PvM/ds