FISCAL IMPACT REPORT

ORIGINAL DATE 2/4/15

SPONSOR Trujillo, CA **LAST UPDATED** 2/6/15 **HB** 230/aHBEC

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

ANALYST Dorbecker

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY15	**FY16**	**FY17**	**FY18**	**FY19**		
$400.0**	($2,080.0)**	($1,600.0)**	($1,600.0)**	($1,600.0)**	Recurring	General Fund

Parenthesis ( ) indicate revenue decreases

**Assumes the definition of "payroll expense" has been corrected per recommendation from TRD

SOURCES OF INFORMATION
LFC Files

Responses Received From
Taxation and Revenue Department (TRD)
Economic Development Department (EDD)

SUMMARY

Synopsis of HBEC Amendment

The House Business and Employment Committee amendment to House bill 230 adds language to clarify that "annual payroll expense" should be defined as the wages paid or payable to employees in the state by the taxpayer. The amendment also adds language to specify the "base payroll expense" should represent the wages paid or payable by the taxpayer in the taxable year prior to the taxable year which the taxpayer applies for the credit.

Synopsis of Original Bill

House bill 230 makes several amendments to the Technology Jobs Tax Credit Act to create the Technology Jobs and Research and Development Tax Credit Act. Section 7-9F-9 NMSA 1978 is amended to set forth the mechanism for claiming the basic credit, and to exclude local option gross receipts tax from taxes the basic credit may be claimed against.

The bill creates a new section to indicate the method for claiming the additional credit. It also creates a taxpayer reporting requirement so that TRD can obtain information necessary to enforce the recapture provision, and to subject the credit to recapture if the taxpayer's reporting obligations are not met.

Substantial impacts from the bill's proposed changes include: 1) the increased percentage used to calculate the credit, and 2) making the additional credit refundable to qualified research and development small businesses. See "Fiscal Implications" for a more detailed discussion. The effective date of the provisions of this act is July 1, 2015; the provisions of Section 8, as well as the provisions to taxpayers that make a qualified expenditure, apply to taxable years beginning on or after January 1, 2015.

FISCAL IMPLICATIONS

Using FY14 gross receipts tax, compensating tax, and withholding, TRD estimated the fiscal impact of the bill by updating the fiscal impact provided for HB 16 introduced during the 2014 session. TRD then determined results of the updated estimate are marginal when compared to the original and would fall well within the margin of error. TRD notes the difference between the two estimates is largely due to updated forecasts for manufacturing employment provided by UNM's Bureau of Business and Economic Research which are essentially flat over the next several fiscal years.

The credit is assumed to grow at the rate of growth of manufacturing employment, since manufacturers constitute most of the credit taken. Because the basic credit is applicable to expenses incurred after January 1, 2015, and can be taken after July 1, 2015, it is assumed that a small portion of taxpayers will wait to take a portion of the credits they could have taken in FY15 into FY16. This causes a small bump in FY16 credits which will be mostly offset by a slightly smaller decrease in FY15, because the percentage rate of the credit will be higher in FY16. Hence the positive revenue impact in FY15.

Further analysis from TRD states the additional credit is made refundable for qualified research and development small businesses (QRDSBs) in a stepped manner:

1. For QRDSBs with under $3 million in qualified expenditures, the full amount of the additional credit is refundable;
2. For those with between $3 million and $4 million two-thirds of the credit is refundable; and,
3. For those between $4 million and $5 million, one-third is refundable.

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. Table 1 shows how TRD determined the steps have minimal impact.

Table 1. Estimated Full-Year Impacts Based on FY13 Data (thousands of dollars)

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

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

The purpose of the amended credit 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.

TRD notes because the bill's proposed amendments attempt to create higher wages and more technology jobs in New Mexico, the bill and definitions used in the bill should be clearer with a higher degree of specificity specific to assure companies receiving the credit create new jobs that lead to higher wages in the state.

EDD notes under current law, the credits may only be claimed against income tax liability. Most start-up businesses and nearly all R&D businesses have no income, making the credits nearly useless to them. By making the credit refundable, the credits instantly become valuable recruiting tools for high technology and R&D related businesses.

PERFORMANCE IMPLICATIONS

According to EDD, encouraging the start-up and retention of commercialized technologies has been identified as an opportunity to diversify the state's economy and reduce our reliance on government jobs, create knowledge jobs and create paths for New Mexico graduates currently seeking employment in other states, and expand our tax base.

Many states are actively courting these early-stage companies and EDD has identified a need to increase our competitiveness to retain them. This bill provides incentives to enable New Mexico companies to participate successfully in the creation of commercially profitable high technology ventures and remain in New Mexico.

The LFC tax policy of accountability is <u>not</u> met since TRD is <u>not</u> 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

TRD reports a moderate impact. TRD's Information Technology (IT) division estimates about 400 hours would be required to implement necessary changes. Changes would include update to the GenTax and Taxpayer Access Point documents, and configuration changes to the business credit module tables. Additional reports need to be developed to summarize the annual credit details. TRD adds, modification of the forms, instructions and publications for the technology jobs tax credit would be needed. Modification of the income tax forms and creation of a mechanism for refunds of the credit could be done at no additional cost as part of the annual renewal of the tax program.

TECHNICAL ISSUES

Analysis of the bill by TRD states the proposed amendments to the definitions of "annual payroll expense" and "base payroll expense" in Section 7-9F-3(B) and (C) render the calculation necessary for eligibility for the additional credit, Section 7-9F-6(B)1, unworkable because both definitions pertain to the same taxable year. According to TRD, the way the bill is written causes taxpayers to not be able to demonstrate the wages they paid for in a single taxable year are at least $75,000 greater than the wages paid for during the taxable year for which the return is filed. TRD recommends the definition of "base payroll expense" should be referred to the "previous taxable year."

According to TRD, additional areas that would benefit from cleaning up language used in the bill include:

- Reorganized entities may not have access to the prior company's payroll posing a problem with the taxpayer providing the information for review of the credit application;
- The reporting period should be defined to assure the proper tax program and time period is defined in the statute.

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

WHAT WILL BE THE CONSEQUENCES OF NOT ENACTING THIS BILL

According to EDD, not enacting this bill will stifle the potential for New Mexico to realize the value of the intellectual property assets from laboratories and universities. The department adds, laboratories and universities will license and cooperatively develop their intellectual property assets with businesses who can financially support the projects long enough to get them to the marketplace and generate revenue. EDD believes if the bill is not enacted, the research and development talent will have to leave New Mexico to be successful, due to competing funding and financial incentives elsewhere.

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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