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

ORIGINAL DATE 02/09/16
SPONSOR Campos **LAST UPDATED** **HB**

SHORT TITLE Frontier Community Tax Credits **SB** 206

ANALYST Alejandro

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY16	**FY17**	**FY18**	**FY19**	**FY20**		
($326.0)	($330.0)	($335.0)	($340.0)	($343.0)	Recurring	General Fund

Parenthesis ( ) indicate revenue decreases

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

FY16	FY17	FY18	3-Year Total	Recurring or Nonrecurring	Fund Affected
$52.0	$0.0	$0.0	$52.0	Nonrecurring	TRD Budget

Parenthesis ( ) indicate expenditure decreases

SOURCES OF INFORMATION

LFC Files

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

SUMMARY

Synopsis of Bill

Senate Bill 206 would enact a new section of the Income Tax Act and the Corporate Income and Franchise Tax Act that would create a tax credit for qualified businesses making investments in frontier communities. The tax credit is 25 percent of a maximum $100 thousand investment. The bill includes annual PIT and CIT caps of $750 thousand each, for a maximum $1.5 million per taxable year.

The stated purpose of the bill is to encourage residents of frontier communities to invest locally, and to create new jobs and provide needed services to those communities.

The bill provides for "clawback," in case a business ceases operations for at least 180 days within any two-year period after the taxpayer has claimed a frontier community investment credit. Any tax credits claimed would have to be repaid.
As the bill does not include an effective date, it is assumed that the effective date is 90 days after the close of the session (May 18, 2016). The bill includes a sunset date of December 31, 2025.

FISCAL IMPLICATIONS

In order to evaluate this bill, the Taxation and Revenue Department (TRD) obtained information from the Economic Development Department (EDD) that included the amounts of private reinvestment from the Main Street Program. To estimate the fiscal impact, TRD took a three-year average of total investment from the communities with population below 7,500. The estimated future investments were then calculated using population growth rates provided by the University of New Mexico, Geospatial and Population Studies from October 2012. Population growth was used as the measure for future investment, assuming that investment would be driven by increasing demand. Lastly, the 25 percent individual cap per $100 thousand investment was applied.

While the estimated impact is lower than the caps outlined in the bill, if this credit creates the intended investment, the aggregate caps may be reached.

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.

POLICY IMPLICATIONS

According to TRD, this bill raises policy issues of efficiency. Its stated goals are to encourage residents of frontier communities to invest in their own communities and to create jobs and available services. As an initial note, the credit is not scoped to its first stated purpose, as it would seem that any taxpayer, not just those who reside in frontier communities, would qualify for the credit. More importantly, serious consideration should be given to credit exclusivity and potential overlap. The angel investment credit, the proposed small business investment credit, the investment tax credit, as well as several other credits could apply to the same investment. Additionally, other non-investment-related credits, such as the high-wage jobs tax credit and rural jobs tax credit could also apply to business in which the investment was made. Other existing or proposed zone-based credits could also apply depending on zone designations.

PERFORMANCE IMPLICATIONS

The bill requires EDD, with the assistance of TRD, to report to the Revenue Stabilization and Tax Policy Committee in 2021 and 2026 on the utilization, cost and impact of credits paid.

TECHNICAL ISSUES

TRD provides the following analysis:

There are several technical issues with this bill that merit consideration. First, as stated above, because there are other credits available for investments, there is significant potential for unintended overlap. TRD recommends consideration of credit exclusivity that would preclude taxpayers that claim this credit from claiming any other credit that is available triggered by investment.

Second, there is a potential conflict within the bill. If the annual certification cap is reached under Subsection F and eligible taxpayers are placed into a queue (p.3;ll. 8-20 (PIT)), it may be impossible for a taxpayer to claim the credit within one year of the calendar year in which the investment was made, as required by Subsection D (p.2;ll.19-22 (PIT)).

Third, TRD recommends clarity with respect to hiring residents (p.6;ll.9-11 (PIT)). The term is not defined for purposes of this credit. TRD believes the intent is to require the hiring of people that are domiciled in New Mexico at the time of hire. The language of the bill does not achieve that result, as there is no "at the time of hire" requirement and the term "resident," as defined in PIT statutes, includes more than people domiciled in New Mexico.

Fourth, the provision allowing for allocation to pass-through entities owners needs revision, as entities are not taxed as limited liability companies for federal income tax purposes. Suggested language: "a taxpayer who is a co-owner of a business that is treated as a pass-through entity for federal income tax purposes, including a partner in a partnership, a member of a limited liability company, or a shareholder in an S corporation as defined in section 1361 of the internal revenue code, may claim a credit in proportion to the taxpayer's ownership interest in the business entity; provided that the business entity meets all requirements to be eligible for the credit and the total combined credit amount claimed by all owners of the business entity shall not exceed the amount allowed in Subsection C."

TRD offered the following additional technical comments:

(p.9;l.11, and p.17;l.1) TRD recommends defining "an entity affiliated" for clarification.

(p.8;l.6) The time frame in which the 48 weeks have to be worked is missing. TRD recommends that the 48 week time frame be defined to a calendar year.

(p.2;l.13) The bill states the taxpayer must hire 3 employees. TRD recommends that a time frame be added as to define when the 3 employees may be hired.

(p.16;l.22) The term "qualified investment for equity" should be explained further. This term may be interpreted to include depreciable equipment, vehicles, land, or buildings.

ADMINISTRATIVE ISSUES

TRD estimates a low to moderate impact from this bill. An application and claim form would need to be developed for this credit, and coordination between TRD and EDD would be needed both initially and on an ongoing basis to administer the credit. Changes to the GenTax system for processing and capturing in the business credit manager will be needed. The costs of publications and instructions changes related to the personal income tax and corporate income tax programs can be absorbed with the annual renewal of these tax programs. Additionally, a ¼ of a full-time employee will be needed to record, approve, and manage the credit and track the operations of the applicant. Other changes include changes to PIT, CIT and Taxpayer Access Point documents.

TRD believes that the credit may be subject to the financial statement disclosure requirements per Governmental Accounting Standards Board (GASB) Statement No. 77. GASB 77 disclosure requirements are effective for financial statements for periods beginning after December 15, 2015. An assessment of the credit against the tax abatement criteria specified in GASB 77 would need to be performed by TRD. If the credit meets the tax abatement criteria, then disclosure would be required in TRD's financial statements for the fiscal year ending June 30, 2017. The Tax Policy Office would need to provide TRD's Financial Distribution Bureau with the assessment and note disclosure for financial reporting and external audit purposes.

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

Some of the provisions of this bill may duplicate the small business investment tax credit bill (SB 133), and the rural infrastructure tax credit bill (HB 108).

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