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

ORIGINAL DATE 02/15/17
SPONSOR Lewis/Harper **LAST UPDATED** **HB** 366

SHORT TITLE High-Wage Jobs Tax Credit Applications **SB**

ANALYST Clark

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY17	**FY18**	**FY19**	**FY20**	**FY21**		
$0	($500.0) – ($4,000.0)	($500.0) – ($4,000.0)	($500.0) – ($4,000.0)	($500.0) – ($4,000.0)	Recurring	General Fund

Parenthesis ( ) indicate revenue decreases

*These estimates are very rough numbers intended to show the wide possible range of potential impacts; an estimate based on historical data relating to the specific provisions of the bill would require detailed analysis by the Taxation and Revenue Department (see Fiscal Implications)

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY17	FY18	FY19	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
Total	$0	$65.0	$65.0	$130.0	Recurring	Taxation and Revenue Department

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

House Bill 366 amends the high-wage jobs tax credit, which was changed in numerous ways during the 2016 special session to reduce the skyrocketing cost of the credit. The changes made by this bill generally make the credit available to more potential applicants but also increase required reporting. Specifically, the bill:

- Requires the employer to report the percentage of goods and non-retail services sold and delivered to persons outside New Mexico during the qualifying period for each location where the credit is claimed;
- Reduces from five years to three years the limitation on submitting new applications after a disqualifying event;
- Changes the disqualifying event of reducing FTE after submitting an application from a 5 percent reduction in FTE to a 10 percent reduction; and
- Includes as a qualifying employer a corporate entity's regional or national corporate headquarters.

The provisions of the bill apply to reporting periods beginning on or after July 1, 2017.

FISCAL IMPLICATIONS

The bill creates a negative fiscal impact by making the credit available to more potential applicants. The fiscal impact shown is a very rough estimate; there is no way to accurately estimate the impact without a detailed analysis of new applications – an analysis only the Taxation and Revenue Department (TRD) would be able to perform and only after more time has passed since the 2016 special session changes took effect.

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 high-wage jobs tax credit is a refundable credit intended to incentivize urban and rural businesses to create new, high-wage economic-based jobs. It requires the state to pay companies even if they have no tax liability through a credit to the employer of 10 percent of an employee's wages.

Use of this credit exploded in the last several years from a cost in FY10 of $4.6 million to $66 million in FY15 and $58 million in FY16, but many of the companies claiming the credit were receiving refunds due to loopholes in the statute. Legislation enacted during the 2016 special session closed the known loopholes and imposed additional reporting and eligibility requirements. These requirements reduce the projected cost of the credit and help prevent exploitation of the credit by companies that do not continue to add net new employees. As a result of this legislation, the consensus revenue estimating group projects the long-term cost of the credit will average $10.6 million annually.

The bill's inclusion in "qualifying employer" of a corporate entity's regional or national corporate headquarters will necessarily increase the cost of the tax expenditure, but it is in

keeping with the general intent of the credit to recruit businesses to the state and create new jobs. Headquarter operations would be considered economic-based jobs, and they often provide high wages relative to average wages across New Mexico.

The Economic Development Department (EDD) provided the following analysis.

> This legislation modifies or clarifies provisions of SB6 from the 2016 second special session. The high-wage jobs tax credit portion of SB6 ties the tax credit eligibility, in part, to eligibility for the Job Training Incentive Program (JTIP). JTIP is a division of EDD. However, SB6 failed to include corporate headquarters, which are JTIP eligible.
>
> In addition, if an employer loses eligibility, the employer was barred for reapplying for five years. This legislation reduces the ineligibility period to three years.
>
> SB6 also states an employer may also lose eligibility for the credit by a reduction in the workforce of 5 percent. To assist small businesses, EDD requests the percentage be raised to 10 percent.
>
> A provision is also added that requires an applicant-employer to certify the percentage of goods and non-retail services sold and delivered to persons outside New Mexico.

TRD provided the following analysis.

> There are several policy issues that arise from this bill. Allowing "corporate headquarters" to be eligible for the credit expands the scope of the credit beyond existing law, which became effective January 1, 2017 under Senate Bill 6 from the 2016 Special Session. As such, credit claims may increase. However, according to the Economic Development Department, many corporate headquarters qualify for JTIP and were eligible for this credit before Senate Bill 6. Senate Bill 6 was intended to restrict eligibility, but TRD believes policy makers were focused on eliminating certain businesses that must operate in New Mexico, but continue to make the credit available for businesses that elect New Mexico and increase employment in the state.
>
> Corporate headquarters, while eligible for JTIP, may not meet the sales threshold tests that were retied to JTIP by Senate Bill 6; corporate headquarters may not be selling or manufacturing from a New Mexico location. Rather, they may be performing the centralized management functions for the entire, or a regional part, of the entire corporate structure. Most often, these types of headquarters are still economic-based because the salaries are paid from revenue earnings outside the state.
>
> With any credit, deduction, or incentive, there is potential for unintended consequences. However, in tying corporate headquarters to the definition in Section 7-4-10 NMSA 1978, the bill restricts eligibility to those business the legislature has already shown a statutory desire to incentivize.
>
> Senate Bill 6 added another significant restriction to the credit. It added express requirements that:
>
> (1) Eligible employers retain the increased job numbers throughout the life of the credit.

In short, if an applicant adds 20 jobs in year one and then lays off three of those employees in year three, the remaining credit on all jobs in lost;
(2) All wage, hour, and residency requirements must be met for all four years of the credit for the particular job. In other words, if those requirements are not met in year two, the remainder of that credit is extinguished for years three and four; and
(3) It required any claimant to maintain at least 95% of its total full time workforce in New Mexico during the lifespan of any claimed credits.

If any one of these requirements was not met, the applicant not only lost eligibility for the lifespan of existing credits, but could not re-apply for the credit for five years. The proposed bill would shorten the reapplication to three years and lower the percentage of required total full-time employment to 90%. The proper scoping of these time frames and thresholds is outside the Taxation and Revenue Department's (TRD) area of expertise, but should be considered by policy-makers.

PERFORMANCE IMPLICATIONS

The LFC tax policy of accountability is met with the requirement in existing statute 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

The bill would have a minimal impact. Based on the new information required to be submitted on the application for this credit, changes will need to be made to the existing forms as well as programming changes in the GenTax system to capture and accommodate the new information requirements.

This bill would also allow for taxpayers to reapply more often if they had previously lost eligibility for the credit. The Department should expect an increase of applications, and because this is such a complex credit, The Audit and Compliance Division would require at least one additional full time employee at pay band 65 to work the expected influx.

TECHNICAL ISSUES

TRD's technical concern relates to the corporate headquarters reference. To make the election under 7-4-10, the taxpayer must be a multi-state taxpayer. TRD believes that this is what is intended by the proposed bill, but notes it could be made more explicit.

This bill does not contain a delayed repeal date. LFC recommends adding a delayed repeal date.

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

Does the bill meet the Legislative Finance Committee tax expenditure policy principles?

1. **Vetted**: The proposed new or expanded tax expenditure was vetted through interim legislative committees, such as LFC and the Revenue Stabilization and Tax Policy Committee, to review fiscal, legal, and general policy parameters.
2. **Targeted**: The tax expenditure has a clearly stated purpose, long-term goals, and measurable annual targets designed to mark progress toward the goals.
3. **Transparent**: The tax expenditure requires at least annual reporting by the recipients, the Taxation and Revenue Department, and other relevant agencies.
4. **Accountable**: The required reporting allows for analysis by members of the public to determine progress toward annual targets and determination of effectiveness and efficiency. The tax expenditure is set to expire unless legislative action is taken to review the tax expenditure and extend the expiration date.
5. **Effective**: The tax expenditure fulfills the stated purpose. If the tax expenditure is designed to alter behavior – for example, economic development incentives intended to increase economic growth – there are indicators the recipients would not have performed the desired actions "but for" the existence of the tax expenditure.
6. **Efficient:** The tax expenditure is the most cost-effective way to achieve the desired results.

LFC Tax Expenditure Policy Principle	Met?	Comments
Vetted	✘	It does not appear this bill was vetted, but it was in response to legislation enacted during the 2016 special session
Targeted		
Clearly stated purpose	✔	
Long-term goals	✘	
Measurable targets	✘	
Transparent	✔	The bill improves upon the existing reporting requirements in statute
Accountable		The required reporting allows minimal external analysis, but currently the reporting is not detailed enough to determine effectiveness and efficiency
Public analysis	✘	
Expiration date	✘	
Effective		Historically, this credit often did not fulfill its stated purpose due to loopholes and exploitation, but the expectation is the credit will fulfill its purpose moving forward
Fulfills stated purpose	?	
Passes "but for" test	?	
Efficient	?	
Key: ✔ Met ✘ Not Met ? Unclear		

JC/al