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

SPONSOR Campos **ORIGINAL DATE** 2/16/17 **LAST UPDATED** **HB**

SHORT TITLE Frontier Community Investment Tax Credits **SB** 326

ANALYST Iglesias

REVENUE (dollars in thousands)

Estimated Revenue					R or NR **	Fund Affected
FY17	FY18	FY19	FY20	FY21		
***	***	$(1,500.0)	$(1,500.0)	$(1,500.0)	Recurring	General Fund

Parenthesis ( ) indicate expenditure decreases. ** R = recurring; NR = non-recurring

*** It is assumed the bill will become effective 90 days following adjournment. Therefore, no fiscal impact for FY17. While there may be some fiscal impact to tax year 2017 for FY18, the full effect will not begin until tax year 2018, which will impact FY19.

SOURCES OF INFORMATION
LFC Files

Responses Received From
Taxation and Revenue Department (TRD)
Economic Development Department (EDD)
Department of Cultural Affairs (DCA)

SUMMARY

Synopsis of Bill

Senate Bill 326 creates new sections of the Income Tax Act and the Corporate Income and Franchise Tax Act for taxpayers that are qualified businesses and make qualified investments to claim a credit in the amount not to exceed 25 percent of not more than $100 thousand of the qualified investment. The income tax credit is the "Frontier Community Investment Income Tax Credit" and the corporate income tax credit is called the "Frontier Community Investment Corporate Income Tax Credit."

The purpose of the credits is stated to be to encourage residents of frontier communities to invest in their communities and to create new jobs and provide needed services for frontier communities. The aggregate amount of credits allowed in a year is not to exceed $750 thousand, and the Economic Development Department is responsible for issuing certificates of eligibility related to the credits.

There is no effective date of this bill. It is assumed that the new effective date is 90 days after this session ends.

FISCAL IMPLICATIONS

The Taxation and Revenue Department (TRD) consulted with the Economic Development Department (EDD) to ascertain the anticipated definition of "frontier community." To better align economic development incentives EDD indicates that a population of 15 thousand is synchronous with existing programs.

There are two aggregate caps in the bill, one of $750 thousand for the Income Tax Act, and another of $750 thousand for the Corporate Income and Franchise Tax Act. The two caps add up to $1.5 million per taxable year. TRD estimates the fiscal impact as the sum of these caps. However, there exist other economic development incentives that have not been fully utilized. As awareness of these incentives has grown, EDD and TRD expect the statutory caps in these programs to be reached. Consequently, TRD expects a similar result with this incentive.

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

A "Frontier Community" is undefined in the legislation or in state statute. The definition will be determined by EDD. Currently, EDD defines frontier community as 7,500 persons or less in the MainStreet program. However, in the JTIP program, it is defined as 15 thousand persons or less. According to New Mexico Municipal League data, 65 percent to 85 percent of New Mexico's incorporated municipalities may be frontier communities; depending upon how the phrase is defined by EDD.

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 and utilization.

PERFORMANCE IMPLICATIONS

The LFC tax policy of accountability is met with the bill's requirement 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

EDD states administrative implications are unknown, but may include the need for additional staff.

TRD estimates a low to moderate impact from this bill. An application and claim form would need to be developed for this credit. 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 one-quarter 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 personal income tax, corporate income tax, 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 each fiscal year.

TECHNICAL ISSUES

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

While the bill creates a reporting process beginning 2022 and every four years thereafter, EDD points out the timeline seems to establish criteria only from July 1, 2017 to December 31, 2018. This period of reporting eligibility stands outside of a traditional fiscal year process. The bill does not specifically define and extend each additional period of eligibility.

TRD identifies several technical issues with this bill that merit consideration. First, as stated above, 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, the bill limits benefit to family owned and operated enterprises through its definition of "eligible employee" and "qualified investment." While one intent of the legislation is to create new jobs, the exclusion of family members as employees may adversely impact portions of the entrepreneur community. Similarly, family members (although not-defined) are excluded from making a "qualified investment."

According to EDD, it is difficult to create the profile for investors and investments that would survive the multiple requirements and be eligible for a tax credit. The taxpayer claiming the credit must hire three full-time-equivalent employees in the business. However, on pgs. 9 and 10, a qualified investment "eligible employee" excludes any person who is working as an employee or contractor for an entity that owns the majority of the stock in the eligible business. On page 12, a "qualified investment" means an equity investment, not a loan. Further, the person who makes the qualified investment may not receive any compensation from the business for at least one year after the investment was made.

TRD has additional technical comments, as follow:

- "Eligible employee" excludes family members by reference to 26 USC Section 152(a). TRD recommends this definition be extended to define "immediate family member" as used in the definition of "qualified investment."
- The time frame in which the 48 weeks have to be worked is missing. TRD recommends the 48 week time frame be defined to a calendar year.
- The bill states the taxpayer must hire three employees. TRD recommends that a time frame be added as to define when the three employees may be hired, subsequent to the qualifying investment.

OTHER SUBSTANTIVE ISSUES

EDD points out Native American communities have expressed a concern that the phrase "frontier community" is culturally insensitive.

ALTERNATIVES

EDD states frontier could be based on geographical areas and not based on size of population. Consideration of geographic zone designations may be an alternative used in other states like Colorado.

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 (RSTP), 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	?	
Targeted		To encourage residents of frontier communities to invest in their communities, and to create new jobs and provide needed services for frontier communities
Clearly stated purpose	✓	
Long-term goals	✗	
Measurable targets	✗	
Transparent	✓	EDD shall compile an annual report; Beginning 2022 and every 5 years thereafter, the reports shall be presented to LFC and RSTP.
Accountable		Reporting includes number of taxpayers receiving the credit, aggregate amount of credits approved, number of employees hired by companies receiving the credit, and "other information necessary" to evaluate the effectiveness.
Public analysis	✓	
Expiration date	✗	
Effective		Seems as though any taxpayer, not just those in frontier communities, could claim the credit.
Fulfills stated purpose	?	
Passes "but for" test	?	
Efficient	?	Potential overlap with other credits – taxpayers could claim multiple credits for the same investment.
Key: ✓ Met ✗ Not Met ? Unclear		

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