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

ORIGINAL DATE 2/5/18
SPONSOR Campos **LAST UPDATED** **HB**

SHORT TITLE Frontier County Investment Tax Credits **SB** 198

ANALYST Iglesias

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY18	FY19	FY20	FY21	FY22		
--	($750.0)	($750.0)	($750.0)	($750.0)	Recurring	General fund

Parenthesis ( ) indicate revenue decreases

SOURCES OF INFORMATION
LFC Files

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

SUMMARY

Synopsis of Bill

Senate Bill 198 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 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 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 (EDD) is responsible for issuing certificates of eligibility related to the credits.

The bill requires EDD to compile an annual report on the new credit including the number of taxpayers taking the credit, the aggregate amount of credits approved, the number of eligible employees hired by taxpayers claiming the credit, and any other information necessary to evaluate the effectiveness of the bill. While the bill requires EDD to compile the report annually, the bill only requires the annual report to be presented to interim legislative committees beginning in 2023 and every five years thereafter.

There is no effective date of this bill. It is assumed that the effective date is 90 days after this session ends. The tax credit applies to taxable years on or after January 1, 2018.

FISCAL IMPLICATIONS

The fiscal estimates were provided by the Taxation and Revenue Department (TRD), which estimates the fiscal impact as the aggregate cap. The barrier to reaching the cap is the availability of qualifying investment opportunities in the prescribed regions. As an aside, this credit would compete with the existing Angel Investment Tax Credit.

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.

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.

SIGNIFICANT ISSUES

According to EDD, 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 15,000 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.

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.

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

ADMINISTRATIVE IMPLICATIONS

TRD points out that it administers over 40 different business credit programs across all tax regimes. During tax year 2014 the department processed over 7,400 taxpayer claims for business credits. This estimate excludes exemptions and deductions taken by taxpayers across the various tax regimes. TRD has requested a recurring appropriation for the creation of a Business Credit Bureau of $350 thousand. The creation of this bureau will allow TRD to optimize the business credit claims process as well as create capacity to administer newly proposed credit programs. However, TRD indicates no separate estimated additional operating budget impact due to this bill.

TECHNICAL ISSUES

TRD indicates there are technical issues that need to be addressed: defining a "frontier community;" eligibility period for application; and management of the aggregate cap. TRD states,

> The Economic Development Department has two standards defining frontier communities. The Job Training Incentive Program standard is more inclusive than the main street standard. Which definition is applied will impact the availability of qualifying investment opportunities.
>
> The bill proposes a two-year grace period to apply for certification and then stipulates an aggregate cap by calendar year. The bill then provides up to an additional year to make the claim, which could be extended an additional year. The bill is ambiguous regarding the tax year liability that the credit may be applied. TRD recommends that taxpayer make application for certification within one year, and that the claim be applied to the tax liability the qualifying investment was made. The value of the credit should be aligned to the tax year of the investment. This facilitates more efficient and equitable management of the aggregate cap as well.

This bill contains no delayed repeal date. Based on LFC's tax expenditure policy principle of accountability, LFC recommends adding a delayed repeal date.

OTHER SUBSTANTIVE ISSUES

According to EDD, Native American communities have expressed a concern that the phrase "frontier community" is culturally insensitive.

ALTERNATIVES

According to EDD, 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 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	✘	Bill was not presented to interim legislated committees.
Targeted		
Clearly stated purpose	✘	None.
Long-term goals	✘	None.
Measurable targets	✘	None.
Transparent	✓	Annual reporting required by EDD.
Accountable		
Public analysis	✓	Annual reporting required by EDD, with public presentation to interim committees required every 5 years.
Expiration date	✘	None.
Effective		
Fulfills stated purpose	?	Difficult to determine, as there is no stated purpose.
Passes "but for" test	?	
Efficient	?	
Key: ✓ Met ✘ Not Met ? Unclear		

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