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

ORIGINAL DATE 1/29/19
SPONSOR Johnson / Lundstrom **LAST UPDATED** **HB** 288

SHORT TITLE Rural Infrastructure Tax Credit **SB**

ANALYST Clark

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY19	**FY20**	**FY21**	**FY22**	**FY23**		
Indeterminate, likely minimal	Up to ($10,000.0)	Up to ($10,000.0)	Up to ($10,000.0)	Up to ($10,000.0)	Recurring	General Fund

Parenthesis ( ) indicate revenue decreases

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY19	FY20	FY21	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
Total	$0.0	$100.0	$100.0	$200.0	Recurring	NMFA Operating Budget

Parenthesis ( ) indicate expenditure decreases

SOURCES OF INFORMATION
LFC Files

Responses Received From
Economic Development Department (EDD)
New Mexico Finance Authority (NMFA)
New Mexico Attorney General (NMAG)

SUMMARY

Synopsis of Bill

House Bill 288 creates a rural infrastructure tax credit that can be taken against the taxpayer's modified combined tax liability (withholding tax, gross receipts tax, compensating tax, etc.) or personal or corporate income tax liability, and the credit may be carried forward for up to 10 years.

The tax credit shall not exceed 30 percent of the total cost of a qualified investment, but the portion of the credit value associated with purchasing land or fixed assets can be no more than half the portion associated with building construction.

A taxpayer may claim this credit in an amount not to exceed $1 million per qualified investment for not more than three investments in a taxable year. Taxpayers shall apply to the New Mexico Finance Authority (NMFA) for a certification of eligibility for the credit, and NMFA may approve certificates up to an aggregate amount of $10 million per calendar year.

The tax credit is transferrable to any other taxpayer.

The bill provides the Taxation and Revenue Department (TRD) shall allow the taxpayer claiming the credit (whether or not it is the taxpayer involved with the rural infrastructure investment) to apply it against tax liability before the investment is completed or even started.

The bill defines "qualified investment" as an investment in a commercial enterprise project of at least $1 million (a) in a county other than a Class A county, (b) whose purpose is manufacturing goods for resale, extracting natural resources for sale, or processing raw materials for sale, (c) includes construction of at least one building and the purchase of land, fixed assets or both, (d) is not functionally related to another project that has received or will receives a rural infrastructure tax credit, and (e) for which a loan from a state-chartered or nationally chartered financial institution has closed. The bill does not contain any other specific performance goals for the program and provides for applications to be accepted on a first come, first served basis.

The provisions of the act apply to taxable years beginning on or after January 1, 2019.

FISCAL IMPLICATIONS

Tax credits, even with caps on certifications for the credit such as in this bill, can result in modest swings in revenue impacts between fiscal years, depending on when taxpayers claim the credit on tax filings. Additionally, the cap in this bill is on a calendar year basis, so the revenue impacts could differ from the estimates in the table.

NMFA provided the following analysis.

> NMFA estimates that a full time economist would need to be hired to perform the duties, the direct cost of which is estimated to be approximately $100 thousand per year beginning in fiscal year 2020. However, NMFA points out that it is unable to determine administrative costs to any degree of certainty because the amount of applications is undeterminable at this time. In theory, there could be ten applications ($1 million each), or hundreds (smaller amounts), whereby the amount of time reviewing applications could be a substantial burden on NMFA. The bill currently does not allow NMFA to recover its administrative costs.

This bill creates or expands a tax expenditure with a cost that is difficult to determine but likely significant. LFC has serious concerns about the significant risk to state revenues from tax expenditures and the increase in revenue volatility from erosion of the revenue base. The committee recommends the bill adhere to the LFC tax expenditure policy principles for vetting, targeting, and reporting or be held for future consideration.

This bill may be counter to the LFC tax policy principles 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

This bill attempts to encourage economic development activity in rural counties of the state, many of which have seen declining populations, economic activity, and tax revenues over time. New Mexico is so large, with such a small population and little diversity in economic activity, it can be exceedingly difficult to encourage businesses to expand or relocate to the significant portion of the state that would be classified as rural.

However, this bill has significant negative tax policy implications. First, the tax credit may be claimed prior to any investment on which the credit is supposed to be based. This would appear to be unprecedented in providing a donation from the state to a taxpayer for economic development purposes prior to any economic development activity occurring. For example, state Local Economic Development Act (LEDA) funds reimburse for land, buildings, and infrastructure as a taxpayer expends funds as part of the relevant economic development project. The Job Training Incentive Program (JTIP) reimburses a portion of employee wages after the completion of a set number of hours of training paid for by the company. The high-wage jobs tax credit and many other economic development incentives may be claimed by a taxpayer after meeting specified job creation or investment requirements.

Second, this credit is transferrable. Transferrable credits diminish the benefit intended to be bestowed upon the recipient by the state compared with refundable credits. In order to sell a credit, a taxpayer must reach an agreement with another party and almost necessarily share the benefit. The other party is likely to provide the initial taxpayer with a fraction of the value of the credit. The cost to the state is 100 percent of the credit, but a credit sold to another party provides the intended recipient with some smaller benefit, making this an inefficient way to incentive economic development. Good tax policy would discourage making credits transferrable, either requiring the intended recipient alone to take the credit against tax liability or making the credit refundable.

Third, the first two implications combine to create a potential issue if the need arises to "claw back" credits. Because the credit is transferrable, and it can be claimed prior to completion of the economic development project, a taxpayer might sell the credit to a third party and for one of innumerous reasons, fail to complete the project. If the third party claimed the credit, a reading of the bill would seemingly make that third party liable to repay up to the full value of the credit to TRD. This places a significant risk on the third party.

Fourth, while the state incentive is provided up front, and seemingly the intent of the bill is for the project to be completed within 12 months, the bill allows taxpayers to request, and TRD to grant, an unlimited number of six-month extensions as long as “meaningful and measureable progress” is made. This could potentially lead to projects that take years to complete.

This economic development incentive is seemingly unique in its applicability to the extractives industry, which is usually specifically excluded from such incentives.

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

NMFA is currently staffed with professionals whose expertise is in making loans and grants. The duties outlined in the bill are outside the current expertise of NMFA and would require new personnel or contractors to fulfill the duties.

The bill gives to NMFA responsibilities currently housed at EDD for state funding, such as LEDA grants. Currently, NMFA relies on EDD to determine economic impacts of projects funded under the Statewide Economic Development Finance Act.

TRD will have to develop applications forms and a process that can be used to review the applications and certificates of eligibility that are submitted in order to claim the credit. TRD is also responsible for creating and issuing a document that awards the credit. The department will also have to create a process for oversight for those credits that are sold, transferred, or exchanged and to notify taxpayers if their project has not been substantially completed. This bill implies that TRD will oversee completion of projects that have been awarded the tax credit. This could place a significant administrative burden on the agency and means the department may also have to come up with deadlines for completion of certain phases of construction, etc.

TECHNICAL ISSUES

NMFA notes the bill does not exempt from the Inspection of Public Records Act any proprietary information submitted as part of the application for rural infrastructure tax credits. Additionally, the bill contains ambiguous language where it states a “qualified investment *that is likely to produce quantifiable benefits.*” Suggested language would simply be to say “*that will produce quantifiable benefits.*”

The wording in the bill related to the split of the credit between funding for land and fixed assets compared with building construction is confusing and led to multiple interpretations by analysts. This could lead to protests unless the wording is clarified.

OTHER SUBSTANTIVE ISSUES

NMFA notes EDD currently conducts economic impact analyses for projects seeking funding directly or indirectly from the state. EDD uses a proprietary computer model developed for them by Impact DataSource, an Austin, Texas economic consulting and research firm. This customized economic model projects anticipated short and long-term impacts of business development projects. This bill has NMFA conducting a similar analysis to determine "quantifiable benefits." This duplication sets up a potential conflict, namely a project receiving both LEDA funds and a rural infrastructure tax credit that may have different projected economic impacts.

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	-	Partially – it was vetted and endorsed by the Economic and Rural Development Committee but was not vetted by the Revenue Stabilization and Tax Policy Committee
Targeted		
Clearly stated purpose	✓	
Long-term goals	✘	
Measurable targets	✘	
Transparent	?	
Accountable		
Public analysis	?	
Expiration date	✓	
Effective		
Fulfills stated purpose	?	
Passes "but for" test	?	
Efficient	✘	
Key: ✓ Met ✘ Not Met ? Unclear		

JC/al