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

ORIGINAL DATE 2/16/18
SPONSOR Martinez, J **LAST UPDATED** **HB** 582

SHORT TITLE Investment Tax Credit Changes **SB**

ANALYST Clark

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY19	**FY20**	**FY21**	**FY22**	**FY23**		
$0	($1,000.0)	($1,000.0)	($1,000.0)	($1,000.0)	Recurring	General Fund

Parenthesis ( ) indicate revenue decreases

Conflicts with HB579

SOURCES OF INFORMATION
LFC Files

Responses NOT Received From
Taxation and Revenue Department (TRD)

Responses Received From
Economic Development Department (EDD)

SUMMARY

Synopsis of Bill

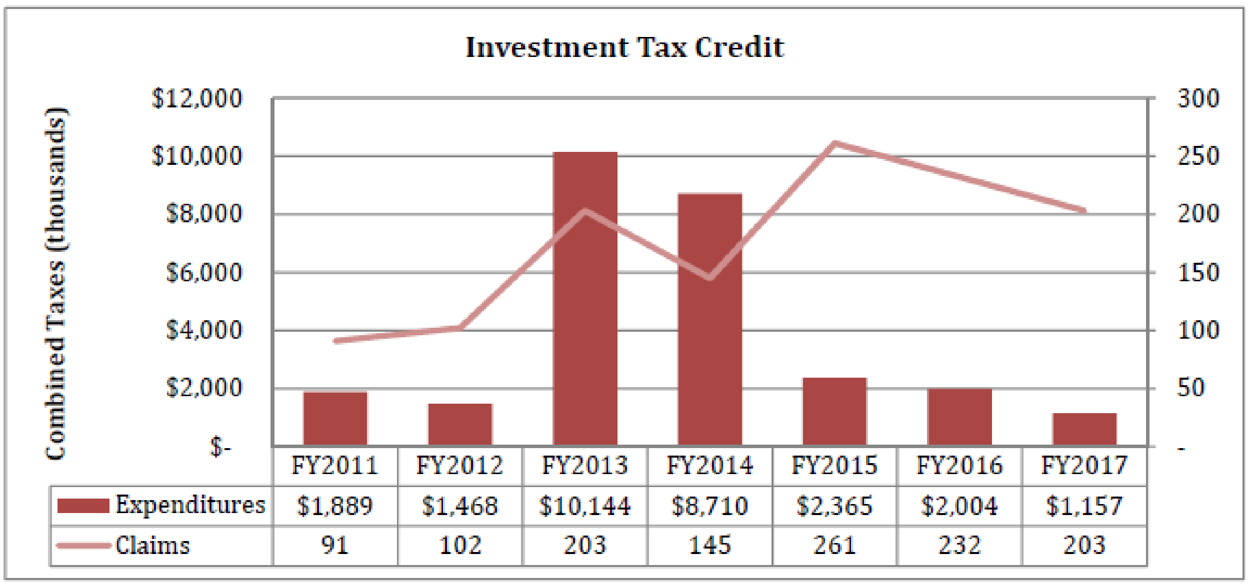
House Bill 582 amends the investment credit for manufacturers, which allows a credit equal to the compensating tax rate on qualified equipment purchased or brought into the state. It delays by 10 years provisions that would otherwise take effect beginning July 1, 2020 to make the investment credit more restrictive in two ways. One delayed item would be the annual cap per taxpayer claiming the credit of $2 million, now leaving no cap until July 1, 2030. The other delayed item would be the more restrictive employment requirement of one new FTE per $100 thousand in value of qualified equipment. Until that delayed provision takes effect, the bill would require one new FTE per $750 thousand of equipment, up to $30 million, and one new FTE per $1 million of equipment over $30 million.

In addition, the bill would change the rate of the credit to equal the effective gross receipts tax (GRT) rate if the equipment would be subject to GRT. The compensating tax rate is lower, so this can result in a higher rate for the credit.

The effective date of this bill is July 1, 2019.

FISCAL IMPLICATIONS

Allowing the credit rate to equal the GRT rate if the equipment would be subject to GRT would increase the general fund cost, because the state bears the entire cost of credits, with no cost to local governments. The graph below is from the Taxation and Revenue Department (TRD) *2017 Tax Expenditure Report* and shows historical costs.



To estimate the fiscal impact of the bill, LFC staff used a four-year average of historical costs. As the graph shows, expenditures can fluctuate significantly, so a multi-year average is a reasonable approach. While this results in an average higher than the last three years, the inability to score the impact of delaying the $2 million cap per claimant and delaying the more restrictive employment requirements lends credence to using this slightly higher average.

The average of $3,559.0 thousand was then multiplied by 0.3 to account for the increased rate possible by applying the GRT rate (currently averaging more than 2 percent above the compensating tax rate) and the increasingly likelihood the equipment would be subject to the GRT instead of the compensating tax (assume 75 percent probability). The resulting estimated cost compared with current law would be a little over $1 million annually, but the estimates are imprecise enough the fiscal impact table rounds the cost to $1 million.

This bill narrows the GRT revenue stream. See *Significant Issues* for more information.

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

It is important to note the 10-year delay proposed by this bill for two of the provisions nearly replicates the delay enacted in 2009 that set the current dates, so in effect, this is moving a sunset date forward, with the primary difference being the application of the GRT rate in certain circumstances.

The credit, and the bill, attempt to bring the state's taxation of manufacturing equipment more in line with the rest of the country. Most states do not tax manufacturing equipment, but New Mexico's broader GRT and compensating taxes would apply unless the equipment is purchased through an industrial revenue bond, in which case it is exempt.

This bill narrows the GRT revenue stream. Many of the efforts over the last few years to reform New Mexico's taxes focused on broadening the GRT base and lowering the rates. Narrowing the base leads to continually rising GRT rates, increasing volatility in the state's largest general fund revenue source. Higher rates compound tax pyramiding issues and force consumers and businesses to pay higher taxes on all other purchases without an exemption, deduction, or credit.

PERFORMANCE IMPLICATIONS

The LFC tax policy of accountability is <u>not</u> met since TRD is <u>not</u> required in the bill 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.

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

Conflicts with HB579, which has a delayed repeal of this credit and replaces it with a similar deduction.

ALTERNATIVES

A good tax policy alternative could be to repeal the credit and create a deduction. This would make it universally available to all taxpayers who would otherwise pay the tax, and New Mexico would no longer show up on maps and lists of states that tax manufacturing equipment.

Furthermore, it would avoid duplication and stacking of credits by manufacturers using industrial revenue bonds, which exempts them from paying the tax, who would then receive this credit despite no tax obligation.

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	-	Interim discussions but no vetting of bill
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/