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## FISCAL IMPACT REPORT

SPONSOR Romero / Dow ORIGINAL DATE 1/28/20  
LAST UPDATED \_\_\_\_\_ HB 178  
SHORT TITLE Make Angel Investment Credit Refundable SB \_\_\_\_\_  
ANALYST Torres

### REVENUE (dollars in thousands)

Estimated Revenue			Recurring or Nonrecurring	Fund Affected
FY20	FY21	FY22		
	(\$1,567.2)	(\$1,567.2)	Recurring	General Fund

(Parenthesis () Indicate Revenue Decreases)

Relates to HB158

### SOURCES OF INFORMATION

LFC Files

#### Responses Received From

Economic Development Department (EDD)

### SUMMARY

#### Synopsis of Bill

House Bill 219 makes the angel investment tax credit refundable. Currently, the credit may only be deducted from income tax liability and carried forward up to five years.

There is no effective date of this bill, but the provisions apply to taxable years beginning on or after January 1, 2020.

### FISCAL IMPLICATIONS

The bill makes the angel investment tax credit more attractive and useable by allowing it to be refunded rather than carried forward against future liability. Significantly, this would allow people with no income tax liability in New Mexico, including non-residents, to make investments and claim the credit. While this could increase investments (up to a ceiling, due to the existing \$2 million annual cap on the credit), it would also proportionally increase the cost of the credit.

Using the Taxation and Revenue Department's *2018 Tax Expenditure Report*, the cost of the credit reached a peak of \$615 thousand in FY16, and has averaged \$432.8 thousand over the last six years of reporting. The estimates assume claims and expenditures will rise due to the increased attractiveness and usability of the credit, with the maximum possible cost for FY21 through FY23 being the difference between the average level from FY12-FY17 and the \$2 million cap on the credit. LFC analysis assumes that it will take time for investments to grow and reach the cap, but in FY21 the otherwise carry-forward credit amounts are assumed to be refunded, reaching the cap. The expected growth in investment is assumed to hit the cap by FY22.

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.

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 angel investment tax credit provides a 25 percent credit, up to a maximum of \$62.5 thousand, against each qualified investment. Economic developers and small business startups often report difficulty in funding new businesses in the state, and venture capital companies have noted New Mexico lacks the amount of early-stage funding available to businesses in many other states. Theoretically, a well-designed incentive may improve this situation.

The Economic Development Department (EDD) reports the following issues related to administration of the credit:

By making the credit refundable it is safe to assume that the credit would become a more attractive incentive mechanism, thus allowing more money to flow from investors into in-state businesses. This type of investment can be a catalytic driver for economic diversification. By making the credit refundable, we would see a greater volume of investment but could run into challenges with the cap not being adjusted to reflect the possible additional demand.

The bill leaves the administrative duties associated with the approval, tracking and reporting with the Economic Development Department, but the agency does not have any individuals on staff that have the expertise in accounting or tax law to administer this credit, nor does the department have the software necessary to track the qualified investments made by qualified investors over the life of the credit. With the complexities of the credit, trained professionals with experience in reviewing and auditing tax credits need to be on staff in order to ensure the credit is being administered correctly in complete accordance with statute. Rather than add an entirely new staff function to EDD, along with that associated cost, EDD request that

any bill that amends the angel investment tax credit also transfer administration of the credit to TRD, as this is a core expertise at TRD.

Existing statute requires the Economic Development Department (EDD) to review and certify applications for the credit and also requires annual reporting on effectiveness (see Performance Implications); however, with current data made available to LFC staff, there is no way to determine if this particular credit has increased the level of investment or proven to be cost-effective.

## PERFORMANCE IMPLICATIONS

The LFC tax policy of accountability is met on paper with the existing statutory requirement for EDD to report annually to LFC on this credit and its effectiveness; however, *accountability is not met* due to no record of LFC receipt of any annual report from EDD on this credit as required by law until the release of the agency’s FY18 annual report. However, that report fails to include most of the information EDD is required by statute to publish annually related to this credit.

## RELATIONSHIP

This bill is related to HB158. Both bills amend the same sections of statute in different locations.

### 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.

<b>LFC Tax Expenditure Policy Principle</b>	<b>Met?</b>	<b>Comments</b>
<b>Vetted</b>	✘	
<b>Targeted</b>		
Clearly stated purpose	?	No, but the intent appears clear
Long-term goals	✘	
Measurable targets	✘	
<b>Transparent</b>	✘	By statute it is, but not in actual reporting
<b>Accountable</b>		
Public analysis	✘	
Expiration date	✓	
<b>Effective</b>		
Fulfills stated purpose	?	
Passes “but for” test	?	
<b>Efficient</b>	?	
Key:    ✓ Met    ✘ Not Met    ? Unclear		

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