Fiscal impact reports (FIRs) are prepared by the Legislative Finance Committee (LFC) for standing finance committees of the Legislature. LFC does not assume responsibility for the accuracy of these reports if they are used for other purposes.

FISCAL IMPACT REPORT

		LAST UPDATED	
SPONSOR	Sharer	**ORIGINAL DATE**	1/25/2024
SHORT TITLE	Increase the Rural Job Tax Credit	**BILL NUMBER**	Senate Bill 107
		ANALYST	Faubion

REVENUE*
(dollars in thousands)

Type	FY24	FY25	FY26	FY27	FY28	Recurring or Nonrecurring	Fund Affected
PIT/CIT		($1,410.0)	($1,7010.0)	($2,080.0)	($2,530.0)	Recurring	General Fund

Parentheses ( ) indicate revenue decreases.
*Amounts reflect most recent analysis of this legislation.

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT*
(dollars in thousands)

Agency/Program	FY24	FY25	FY26	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
	-	$27.3	-	$27.3	Nonrecurring	

Parentheses ( ) indicate expenditure decreases.
*Amounts reflect most recent analysis of this legislation.

Sources of Information

LFC Files
2023 Tax Expenditure Report (TRD)

<u>Agency Analysis Received From</u>
Taxation and Revenue Department (TRD)
New Mexico Attorney General's Office (NMAG)
Economic Development Department (EDD)

SUMMARY

Synopsis of Senate Bill 107

This bill removes the carryforward and transferability provisions of the rural job tax credit, and instead makes it refundable. The credit is also increased by allowing it to apply to the first $32 thousand of wages, up from $16 thousand.

This bill does not contain an effective date and, as a result, would go into effect 90 days after the Legislature adjourns, or May 15, 2024, if enacted.

FISCAL IMPLICATIONS

The rural jobs tax credit currently authorized is 25 percent of the first $16 thousand of wages paid if the job is performed or based in a tier 1 area and 12.5 percent of the first $16 thousand of wages paid if the job is performed or based in a tier 2 area. This bill doubles the wage base, increasing it to $32 thousand.

The Taxation and Revenue Department notes the following methodology for estimating the fiscal impact:

> The Taxation and Revenue Department (TRD) reviewed the historical claims of the Rural Job Tax Credit. The average aggregate amount applied towards personal income tax (PIT), modified combined tax, and corporate income tax (CIT) liability in the last three fiscal year years is $435 thousand. Use of this credit widely varies from year-to-year with overall growth of 7.9 percent.
>
> TRD incorporated a 61 percent growth rate on the base amount of the credit to account for the newly introduced refundability of the credit. This growth rate was calculated based on the amount of credit claimed for three other credits that were amended from nonrefundable to refundable: the new solar market development income tax credit, the renewable energy tax credit, and the technology jobs and research & development tax credit.
>
> Using a sample of taxpayers that have claimed the credit between 2020 and 2022, TRD estimated the impact of doubling the credit by raising the taxable wage payments from $16 thousand to $32 thousand. TRD also applied the percentage of approved claim amounts to applied claim amounts as some claims are partially approved or denied. To account for the variability in the aggregate expenditure of the rural job tax credit, TRD assumes a growth rate of 22 percent from FY26 and forward.

Fiscal Impact:

<table>
<tr><td rowspan="7">Rural Jobs Credit</td><td>Tax Year (Calendar)</td><td>2020</td><td>2021</td><td>2022</td></tr>
<tr><td>Claims</td><td>54</td><td>14</td><td>9</td></tr>
<tr><td>Expenditure (thousands)</td><td>$737</td><td>$438</td><td>$121</td></tr>
<tr><td colspan="4"></td></tr>
<tr><td>Fiscal Year</td><td>2021</td><td>2022</td><td>2023</td></tr>
<tr><td>Claims</td><td>34</td><td>77</td><td>44</td></tr>
<tr><td>Expenditure (thousands)</td><td>$333</td><td>$2,366</td><td>$887</td></tr>
</table>

This bill creates or expands a tax expenditure. 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 Economic Development Department notes:

The rural job tax credit aligns with the Economic Development Department's mission to improve the lives of New Mexico families by increasing economic opportunities and providing a place for businesses to thrive. Despite the rural job tax credit being the only tax credit specific to the rural areas of New Mexico, the credit has not increased since its inception. Increasing the amount of wages for which the rural job tax credit may be claimed will better align the credit with the cost of creating a new job and increase economic activity in rural areas, stimulating the manufacturing industry specifically. Manufacturing job growth stimulates other sectors, such as real estate and retail, in addition to increasing tax revenue.

The rural job tax credit is one of several tax credits that the Economic Development Department utilizes to recruit business to the state, in addition to being available to existing businesses in rural areas of New Mexico. Revising the tax credit to make it refundable would increase the likelihood of the credit being utilized by a rural business and make manufacturing in rural areas more attractive, in addition to reducing the administrative burden of implementing the credit.

The credit is based on the rural location within the state of New Mexico, with the rural area divided into two tiers:

- Tier 2 = Non-metro area municipalities that exceed 15 thousand in population: Alamogordo, Carlsbad, Clovis, Gallup, Los Lunas, Sunland Park, and Hobbs; and
- Tier 1 = Everywhere else in a rural area.

TRD notes the following:

While tax incentives can support specific industries or promote desired social and economic behaviors, the growing number of such incentives complicate the tax code. Introducing more tax incentives has two main consequences: (1) it creates special treatment and exceptions within the code, leading to increased tax expenditures and a narrower tax base, which negatively impacts the General Fund; and (2) it imposes a heavier compliance burden on both taxpayers and TRD. Increasing complexity and exceptions in the tax code is generally not in line with sound tax policy.

The Rural Job Tax Credit is only available to taxpayers in rural areas. This will continue to affect horizontal equity in state income taxes by offering one taxpayer a competitive advantage over another. Historically, the number of taxpayers that apply for this credit can be as little as one and the aggregate credit amount of the credit has fallen since 2019. There is a possibility that awareness of this credit has dwindled over time. It is also possible that the compliance requirements are offsetting the attractiveness of the credit. However, increasing the maximum wages and adding refundability may increase its attractiveness to employers.

The bill does not have a sunset date. TRD supports sunset dates for policymakers to review the impact of a credit before extending them. Given the increase in wages for this credit and the uncertain cost to the state, a sunset date would force an examination of the benefit of this credit versus the cost.

PERFORMANCE IMPLICATIONS

The removal of the carryforward and transferability provisions would simplify TRD administration.

The LFC tax policy of accountability is met with the bill's requirement to report annually in the Tax Expenditure Report regarding the data compiled from the reports from taxpayers taking the credit and other information to determine whether the credit is meeting its purpose.

ADMINISTRATIVE IMPLICATIONS

TRD will make information system changes and update forms, instructions, publications. These changes will be included in annual tax year changes. TRD's Administrative Services Division (ASD) will test credit sourcing, update reports and perform other systems testing. It is anticipated this work will take approximately 40 hours split between 2 Full-Time Equivalent (FTE) of a pay band 70 and pay band 80 at a cost of approximately $2,900.

Implementing this bill will have a moderate impact on TRD's Information Technology Division (ITD), approximately 440 hours or 3 months and $24,420 of staff workload costs. There is a slight impact for the TRD's Revenue Processing Division (RPD) workload, which will include refund work. However, this workload is offset by reducing the number of claims processed for multiple periods for carryforward.

OTHER SUBSTANTIVE ISSUES

The Attorney General's Office notes the following:

> SB107 does not explicitly address the value, if any, of a Rural Job Tax Credit document transferred before the date this act would take effect, and from the credit claimant to another
> party. It is not clear whether the holder of such a document would be able to use it to offset its tax liability following the enactment of this bill. (Part of this confusion arises from a deletion and substitution of text in Subsection G: the change from "holder of the tax credit document" to "taxpayer." It is not clear if "taxpayer" here refers to the "eligible employer" and "taxpayer" referred to in the immediately preceding Subsection F, or instead refers to any taxpayer, including one who holds a tax credit document.)
>
> The bill also appears to arbitrarily give a slight advantage to a particular class of taxpayer: those with personal and corporate income tax liability, as opposed to those with modified combined tax liability. According to Section 2 of the act, those in the first class may start earning the credit six months sooner than those in the second class.
>
> The bill uses the terms "taxpayer," "eligible employer" and "businesses" at times interchangeably. Consistency in the use of the terms would help avoid confusion.

In assessing all tax legislation, LFC staff considers whether the proposal is aligned with committee-adopted tax policy principles. Those five principles:

- **Adequacy**: Revenue should be adequate to fund needed government services.

- **Efficiency**: Tax base should be as broad as possible and avoid excess reliance on one tax.
- **Equity**: Different taxpayers should be treated fairly.
- **Simplicity**: Collection should be simple and easily understood.
- **Accountability**: Preferences should be easy to monitor and evaluate.

In addition, staff reviews whether the bill meets principles specific to tax expenditures. Those policies and how this bill addresses those issues:

Tax Expenditure Policy Principle	Met?	Comments
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.	✗	
Targeted: The tax expenditure has a clearly stated purpose, long-term goals, and measurable annual targets designed to mark progress toward the goals. Clearly stated purpose Long-term goals Measurable targets	?	There is a stated purpose but no stated goals or targets.
Transparent: The tax expenditure requires at least annual reporting by the recipients, the Taxation and Revenue Department, and other relevant agencies	✓	The credit is reported annually in the Tax Expenditure Report.
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. Public analysis Expiration date	?	No expiration date.
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. Fulfills stated purpose Passes "but for" test	?	No clear passage of the "but for" test. No evidence of effectiveness or efficiency.
Efficient: The tax expenditure is the most cost-effective way to achieve the desired results.	?	
Key: ✓ Met ✗ Not Met ? Unclear		

JF/al/ne