Job Creation Instruments:

JTIP, LEDA Grants, and Economic Development Tax Expenditures

Legislative Finance Committee

August 23, 2012

NEW MEXICO
ECONOMIC DEVELOPMENT DEPARTMENT

Economic Development Incentives Are Necessary

- New Mexico's Tax Climate Is Poor
  - 38th in *2012 Tax Foundation State Business Climate Index* despite lowest per capita property tax in the nation
  - Ernst & Young Study: highest tax burden on new business investment in the nation

Tax Climate

State	Overall Rank	Corporate Income Tax	Individual Income Tax	Sales Tax	Unemployment Insurance	Property Tax
Arizona	27	28	17	50	1	5
Colorado	16	20	16	44	23	9
Nevada	3	1	1	42	42	16
New Mexico	38	38	33	45	14	1
Oklahoma	33	7	38	39	2	12
Texas	9	37	7	35	15	31
Utah	10	5	14	22	24	3

Tax Climate

- Numerous incentives are only necessary because New Mexico taxes goods and services that surrounding states do not

Tax Climate

State	Manufacturing Machinery	Utilities	Transportation Services	Repair Services	Professional & Personal Services	Custom Software
Arizona	Exempt	Taxable	Taxable	Exempt	Exempt	Exempt
Colorado	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt
Nevada	Taxable	Taxable	Exempt	Exempt	Exempt	Exempt
New Mexico	Taxable*	Taxable	Taxable	Taxable	Taxable	Taxable
Oklahoma	Exempt	Exempt	Taxable	Exempt	Exempt	Exempt
Texas	Exempt	Exempt	Exempt	Taxable	Taxable	Taxable
Utah	Exempt	Exempt	Taxable	Taxable	Exempt	Exempt

*Investment Credit Act cannot be taken against GRT

Tax Climate

- EDD uses Capital Outlay for LEDA Grants, JTIP, and Tax Incentives as a Substitute for Tax Reform
  - Capital outlay creates infrastructure that remains in the state.
  - JTIP trains New Mexicans, thereby improving our workforce.
  - A revised tax code, rather than tax credit incentives, sends a clear message and would avoid the costs of assessing them annually and continuing this debate.

Tax Climate

- Tax Foundation
  - "It is widely recognized that reforming tax code is significantly more effective than tax credit incentives."
  - Savvy site selection consultants generally believe that tax credits are "covering for a bad business tax climate."
  - Tax credits directed at certain industry sectors are commonly viewed as "political micromanagement" and an obvious disincentive to businesses not included within the sectors.
  - A good business tax climate creates a level playing field and avoids resentment over foregone tax revenues when a company leaves or closes.

Tax Climate

- According to the Tax Foundation, many states that utilize the gross receipts tax do so <u>in place of a corporate income tax</u>.
- New Mexico
  - Has both GRT and CIT
  - Has a high maximum CIT rate
  - Is one of only 16 states that utilize graduated CIT brackets
- New Mexico's CIT brackets are not indexed for inflation
  - Creates a de facto tax increase on the nominal increase in income due to inflation

State	CIT Rates	State	CIT Rates
Arizona	6.968%	North Dakota	1.68% - 5.15%
California	8.84%	Oklahoma	6%
Colorado	4.63%	South Dakota	None
Idaho	7.6%	Texas	None
Montana	6.75%	Utah	5%
Nevada	None	Washington	None
New Mexico	4.8% – 7.6%	Wyoming	None

Economic Development Incentives Are Necessary

- Anti-Donation Clause prohibits direct contributions to companies
- New Mexico is surrounded by states with large closing funds
  - Arizona
  - Colorado
  - Texas
    - > $400 million
    - State of Texas, City of Austin, and Travis County committed $30 million in cash to locate an Apple assembly facility that will create 3,600 jobs over ten years
  - Oklahoma
    - Writes checks to companies for creating new jobs

JTIP Mission

- NMSA 1978, § 21-19-7
  - Establish quick response classroom training
  - On-the-job training
  - Skill enhancement training to furnish qualified resources for new or expanding industries and non-retail service sector businesses that require skills which are unique to those industries

JTIP Board

- Establishes policies and promulgates rules for the administration of appropriated funds
- Provides review and oversight to assure funds expended will generate business activity and give measurable growth to the economic base of New Mexico
- Considers and takes action on all funding requests

Policy/Rulemaking Process

- Conducted annually in the spring
- Board holds a public hearing and amends rules to adapt to the changing economic climate
- While adopting policies the board considers EDD's overall strategic plan and its targeted industries.
  - Its primary focus is the current business climate and immediate job creation needs, however.

Policy Strategies

- Broadened eligibility to encourage participation from industries which create higher-paying jobs
  - Early stage manufacturing and R&D
  - Headquarter facilities
- Tightened policies to discourage lower paying, third-party call centers
- Existing policy rewards businesses located in rural and economically distressed areas

JTIP History

- Since 1972, JTIP has assisted in the creation of over 40,000 jobs by funding over 1,000 projects
- Maintained its integrity through fluctuating appropriations and changing political climates
- For 40 years, it continues to receive bipartisan support

JTIP is an Incentive

- JTIP is considered a valuable incentive program which is widely utilized as a recruiting tool and by existing/expanding businesses.
- Indirect benefits are improved skill levels of New Mexico residents and career advancement opportunities.

JTIP Performance Standards

- Double layer of compliance and audit reviews
  - Compliance Officer conducts reviews throughout contract period
  - Approved third-party accounting firm reviews upon the completion of the contract
- Clawback language enacted in 2007 for companies which shut down or layoff
- Recapture provisions were in place even prior to the official Clawback language being included in policy.
  - Procedurally, JTIP has always recaptured funds for non-compliance, which occurs as calculation errors, ineligibility, or not meeting hiring deadlines
  - Between 2007-2011, $235,000 was recovered through the compliance process

LEDA Grants

- N.M. Const. Art. IX, § 14: "The State, counties, and municipalities may create new job opportunities by providing land, buildings or infrastructure for facilities to support new or expanding businesses if this assistance is granted pursuant to LEDA."

LEDA Grants

- LEDA (NMSA 1978, § 5-10-3(I)) allows grants to be made to:
  - an industry for the manufacturing, processing or assembling of agricultural or manufactured products
  - a commercial enterprise for storing, warehousing, distributing or selling products of agriculture, mining or industry, but, other than as provided in Paragraph (5) or (6) of this subsection, not including any enterprise for sale of goods or commodities at retail or for distribution to the public of electricity, gas, water or telephone or other services commonly classified as public utilities
  - a business in which all or part of the activities of the business involves the supplying of services to the general public or to governmental agencies or to a specific industry or customer, but, other than as provided in Paragraph (5) of this subsection, not including businesses primarily engaged in the sale of goods or commodities at retail
  - an Indian nation, tribe or pueblo or a federally chartered tribal corporation
  - a telecommunications sales enterprise that makes the majority of its sales to persons outside New Mexico
  - a facility for the direct sales by growers of agricultural products, commonly known as farmers' markets
  - a business that is the developer of a metropolitan redevelopment project
  - a cultural facility

LEDA Grants

- It's the Local Economic Development Act
  - No mention of state funds
  - No mention of state involvement
  - Local government prioritizes its projects
  - Local government negotiates terms with qualifying entity

LEDA Grants

- LFC recommendations regarding matching LEDA projects to statewide economic development plan and prioritizing projects
  - Would require statutory changes
  - Would duplicate the Statewide Economic Development Finance Act

LEDA Grants

- "The purpose of the Local Economic Development Act is to . . . allow public support of economic development to foster, promote and enhance <u>local</u> economic development efforts. . . ." NMSA 1978, § 5-10-2(B).

LEDA Grants

- “The purpose of the Statewide Economic Development Finance Act is to . . . provide one method of implementing the economic development assistance provisions of Subsection D of Article 9, Section 14 of the constitution of New Mexico for <u>state projects</u>.” NMSA 1978, § 6-25-2(B)(2).

LEDA Grants

- Generally, Legislature appropriates funds to EDD "to provide grants to political subdivisions of the state to achieve job growth by attracting new companies or expanding existing businesses pursuant to" LEDA.

LEDA Grants

- Four projects were funded with special appropriations directly from the legislature
  - Schott Solar
  - Hewlett Packard
  - Fidelity Investments
  - Santa Fe Studios

LEDA Grants

- EDD received $63.6 million in capital outlay appropriations for LEDA projects 2007-2011
- $37.9 million—59.6%—were special appropriations to those four projects
  - Circumvents EDD’s usual process for vetting LEDA projects

LEDA Grants

- Of the remaining $25.7 million appropriated for LEDA projects, all but $2,550,000 went to projects outside of Albuquerque, Rio Rancho, Las Cruces, and Santa Fe.
  - 90.1% of LEDA capital outlay funds appropriated to EDD and committed to a project through EDD's vetting process went to projects in rural areas.
  - 18 of 25 projects in rural areas
  - 11 of 18 rural projects were infrastructure

LEDA Grants

- 2 Types of Projects
  - Infrastructure
  - Economic Development

LEDA Grants

- Infrastructure Projects
  - Benefit an entire community or region
  - Provide basic services to general population
    - Water
    - Sewer
    - Wastewater
    - Roads

LEDA Grants

- Economic Development Projects
  - Land or a building
  - For a specific company
  - For a specific purpose

LEDA Grants

- Both Infrastructure and Economic Development Projects Build Capacity
  - State funds are used for larger-scale projects that build capacity
  - Investment has worth even if tenant abandons

LEDA Grants

- Neither Infrastructure nor Economic Development Projects Allow for "Clawbacks" as LFC Report Envisions Them
  - EDD's contractual relationship is with the local government, not the company
  - EDD grants funds to a local government, not the company
  - EDD reimburses the local government for work after it is performed

Clawbacks

- For infrastructure projects, there is nothing to claw back
  - The State has funded a project that builds capacity
  - The project will remain whether or not the tenant for which it was created utilizes it
- E.g., Santa Teresa water and wastewater project

Infrastructure Projects

- Funds for LEDA grants are capital outlay
- Capital outlay funds
  - Used to build infrastructure
  - Are not clawed back because the infrastructure remains in the community

Schott Solar

- In 2008, the legislature appropriated $7.5 million from the General Fund to EDD specifically for Schott
- In 2008, the legislature appropriated $7 million from the General Fund to EDD for LEDA grants
  - $500,000 went to Schott
- In 2009, the legislature appropriated $6 million from Severance Tax Bonds to DFA specifically for Schott

Hewlett Packard

- “The LFC estimates $238,000 in penalties could be returned to the state if a clawback provision was in place for its contribution.”

Santa Fe Studios

- "The Santa Fe Studios $28 million project could prove to be a risky investment to the state with its $10 million contribution."

Tax Incentive Accountability History

- Determining a process to annually assess the effectiveness of New Mexico’s tax incentives has been studied and discussed for at least a decade.
- The 2012 LFC Report states that the LFC made recommendations in 2009 and the majority of their recommendations have not been addressed.
- In 2006, EDD completed and presented to LFC a *Survey of Business Incentives Assessment Methodologies and Best Practices.*

2006 Task Force Participants

- NMEDD, TRD, DFA, and LFC staff
- Private sector representatives, including two tax accountants

Suggested Research Goals in the 2006 Survey

- The overall public costs and benefits of the incentives studied
- The percentage of companies meeting the basic compliance standards or stated employment, training, capital investment and others
- The perspective of eligible companies who have and who have not used the incentive, with an objective of helping to improve the incentive or to determine whether a different incentive or other support strategy would be more effective
- How consistent each incentive is with New Mexico's economic development strategy and the good of the state
- What impediments there are regarding gathering and reporting data on the part of businesses participating in the incentive(s) and determine if small businesses and rural areas will be impacted disproportionately with large corporations in urban areas
- Combining company feedback and listening to the opinions of economic professionals regarding their experience in marketing their regions using the tax incentives would inform the State and determine whether the complexity of the number of incentives in the tax structure decreases its overall effectiveness and would help us identify why eligible companies do not participate.

2006 Recommendations

- Legislative changes will likely be required where proprietary information is necessary for a full assessment.
- A “total system” approach needs to be taken, commencing with the language of the legislation, and continuing through the division of responsibility and commitment of resources, smart information technology decisions and working closely with the private sector.
- The language of the legislation needs to be clear as to information-sharing requirements among agencies and the reporting goals.
- Any reporting requirements should be simple, increasing the chances of getting accurate data.
- The legislation should include an adequate appropriation in order to achieve an optimal product. “Benchmark” states, like those mentioned in the LFC report, spend hundreds of thousands of dollars producing a reliable assessment of their tax incentive programs annually.

State of Washington

Joint Legislative Audit & Review Committee

- Report is completed by Joint Legislative Audit & Review Committee staff
- Data sharing agreements with Employment Security and Revenue Departments
- Two dedicated FTEs, ½ attorney's time, and one summer legal intern
- Annual budget of $400,000 plus overhead

Tax Foundation

- “Taxes matter to business. Business taxes affect business decisions, job creation and retention, plant location, competitiveness, the transparency of the tax system, and the long-term health of a state’s economy. Most importantly, taxes diminish profits. If taxes take a larger portion of profits, that cost is passed along to either consumers (higher prices), employees (lower wages or fewer jobs), or shareholders (lower dividends or share value). Thus a state with lower tax costs will be more attractive to business investment, and more likely to experience economic growth.”