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

ORIGINAL DATE 2/20/19
SPONSOR McQueen/Akhil **LAST UPDATED** ______ **HB** 520

SHORT TITLE Property Tax On Certain Solar Systems **SB** ______

ANALYST Graeser

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY19	FY20	FY21	FY22	FY23		
		Indeterminate but not significant because of the action of bond rate setting procedures			Recurring	General Obligation Bond revenues
		Indeterminate but not significant			Recurring	General Obligation Bond capacity
		Indeterminate but not significant because of the action of yield control			Recurring	County, Muni, School, Hospital & Special District Revenue
		Indeterminate but not significant			Recurring	County, Muni, School, Hospital & Special District GO Bond capacity
		Indeterminate, initially less than 500.0; could grow to 1,000.0 over time			Recurring	Amount of taxes possibly shifted to residential taxpayers with solar systems to those without.

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		Could be significant over time		Indeterminate	Recurring	County Assessors

Parenthesis ( ) indicate expenditure decreases

SOURCES OF INFORMATION
LFC Files

Responses Received From
Energy, Minerals, Natural Resources Department (EMNRD)

SUMMARY

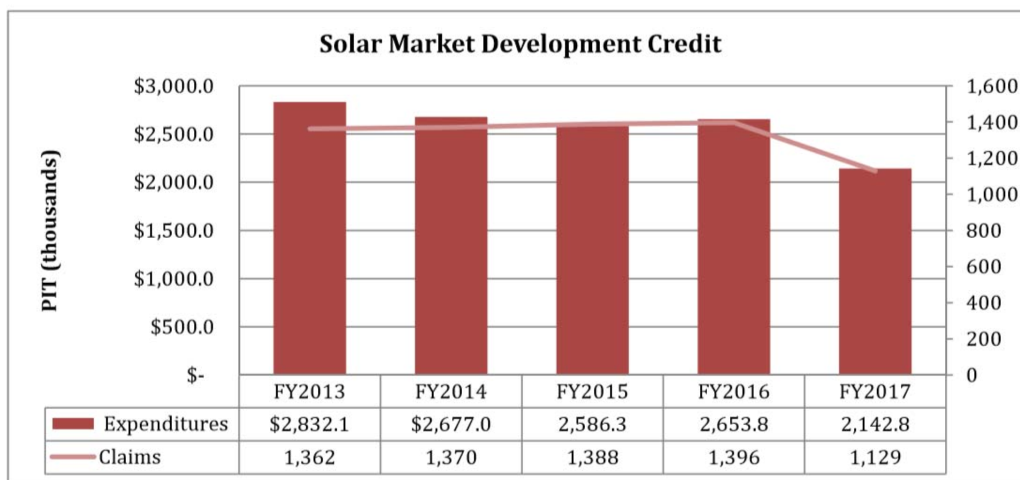
Synopsis of Bill

House Bill 520 extends the initial property tax exemption for the value of a solar system to the owner of a home who has a solar system installed on that home. Under current law, this property tax exemption is effective for the duration of the tenancy of the original owner as detailed in 7-36-20 NMSA 1978. This bill extends the property tax exemption by classifying solar systems as nonbusiness tangible personal property and, hence, exempt from property tax valuation for a subsequent owner when a property sells. To qualify for this exemption, the solar system must be installed "on" a residence with a floor area no larger than 3,000 square feet.

There is no effective date of this bill. It is assumed the effective date is 90 days after this session ends (June 14, 2019). The provisions would affect revaluation following sale or for new construction for the 2020 property tax year.

FISCAL IMPLICATIONS

TRD has tracked Solar Market Development Tax Credit claims since the January 1, 2006, advent of the credit effective for installations. An extract from the TRD 2017 *Tax Expenditure Report* shows that claims have averaged just under the $3 million annual limit for solar photovoltaic systems. This implies that individuals in the state have installed about $300 million in solar systems. Assuming cost approximates the market value increase of the property when sold and that homes that qualify for the exemption sell on average every seven years, then the initial impact of this new exemption would be around $450,000 in the first few years. Eventually, virtually every property with a solar system would have sold, more properties would have been installed and the eventual value of the exemption would approach $1 million. This exemption amount would be shifted to property owners that did not have solar systems installed through the action of yield control and the general obligation bond rate setting procedures.



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.

SIGNIFICANT ISSUES

The Legislature in HB233 of the 2010 session (2010, ch. 30, § 1) enacted a property tax exemption for the original owner of any solar system. This bill passed the house (65-1) and the Senate (30-6). At the time, TRD noted that despite the exemption for the original owner of the

solar system, the house would be valued at the sales price when sold. Presumably, the sales price would be higher than for other similar properties because of the installed solar system. What this bill would do is to classify the solar system as tangible property, and thus, the value reported to the assessor would exclude the value of the solar system. This would, presumably, extend the exemption for many years and many subsequent sales of each property.

The provisions of this bill may be somewhat ineffective in excluding the value of a solar system from revaluation to market when a property with an installed solar system changes ownership. According to industry sources, most assessors in the state use CAMA systems. These are computer-aided mass appraisal systems. CAMA systems use data provided by realtors and others to populate a comparable sales database. This database is then used to revalue properties that have sold since the last property tax year valuations were set. The direct report of sales price is probably not used to value the property. CAMA systems do not separately account for the additional value that solar systems give to homes with such systems. All sales are lumped together without differentiation. Thus, in the property tax world as currently administered, the addition of a solar system does not automatically raise assessed value on sale above the CAMA-determined value.

This bill may be a response to reports that some assessors are separately increasing the assessed value of homes with solar systems on sale outside of the CAMA estimates. In 2010's SB233, which first established a property tax exemption for solar systems when first installed on an existing home, the FIR contains a comment from TRD that when homes with solar systems would sell, the specific nature of the statutory exemption would no longer be effective and the solar system would not be excluded from the revaluation on property sale.

However, there is one clear effect of the provisions of this bill. If a new home is built and a solar system included in the installation, then the exception from the 3 percent valuation cap of 7-36-21.1 NMSA 1978 is not valid. The provisions of this bill would then apply and the assessor could then exclude the cost or value of the solar system from the initial property tax assessment.

It should be noted that the 7-36-21.2 NMSA 1978 exemption did not explicitly define a solar system installed on an existing property as tangible personal property. The legal status is simply that the solar system should not be considered property at all for the purpose of the 3 percent cap on valuation increase.

This bill proposes that a solar system should be considered as tangible personal property providing that the solar system is installed ***on*** the residence, that the residence is less than 3,000 square feet and that the electricity, heat, or heated water is used in the residence on which the system is installed. This brings up a number of questions:

- Clearly rooftop solar electric systems are installed "on" a residence. Does that mean that a ground-mount solar electric system is to be valued as real property?
- When a residence is remodeled and the additions take the residence over 3,000 square feet, will the assessor be able to disallow the solar system without extensive modification of the CAMA system?
- If the residence has a separate detached guest house, shop, garage, or storage building and the solar system provides electricity, heat or heated water to these separate buildings as well as to the residence, would this disallow the exclusion?

PERFORMANCE IMPLICATIONS

The LFC tax policy of accountability is not met because TRD is not 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.

ADMINISTRATIVE IMPLICATIONS

This bill sets up an incentive for sellers of homes with solar systems to couch the sale terms assigning a, perhaps, unrealistically high value of the solar system, which would be considered as tangible property in the contract. It would be similar to including a refrigerator in the sale and assigning it an arbitrarily high value. This sort of overstatement would be virtually impossible to audit. Local assessors would have no choice but to take the contract at its face value. TRD might be able to regulate some standard price based on the type of installation, its size in kilowatts and its age. However, the bill does not give TRD the ability to overturn a seller's declaration of value.

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

The provisions of this bill may directly conflict with HB656, which broadens a gross receipts tax deduction that currently requires the solar system to provide heat, hot water, or electricity to the property in which it is installed. The unmodified definition of solar system is identical to that used in 7-36-21.2 NMSA 1978. The amendment would make these two definitions differ.

There have been an unusual number of bills this session affecting property taxes.

HB332 establishes a separate class of undeveloped land used for conservation purposes.
HB429 increases the property tax valuation freeze of 7-36-21.3 NMSA 1978 from $32 thousand modified gross income to $50 thousand modified gross income.
HB520 redefines solar systems as tangible personal property under certain circumstances and creates a property tax exemption for qualifying systems.
HB596 redefines the structure housing the data center, the HVAC systems, special cabling and wiring as tangible personal property and proposes a special method of valuation that equals 5 percent of initial cost.
HB647 proposes limiting the 3 percent valuation cap to owner-occupied properties.
HJR2 proposes a property tax freeze for low-income elderly, with household income less than $15 thousand.
HJR3 proposes a property tax freeze for low-income 100 percent disabled, with household income less than $15 thousand.
SB220 proposes an increase in the income cap for the property tax valuation freeze of 7-36-21.3 NMSA 1978 from $32 thousand modified gross income to $35 thousand modified gross income.
SB-352 is a duplicate of HB596.

TECHNICAL ISSUES

1. The provisions of this bill provide different treatment for the purpose of the 3 percent cap and the purposes of reclassifying some solar systems as tangible personal property. This

could result in future confusion and substantial additional work for the assessors. At issue are the requirement that the solar system be installed on a residence, that the electricity, heat or hot water only be used in the residence and that the residence be no larger than 3,000 square feet. These are bright lines for the construction of new residences with installed solar systems but not so bright lines for resale of existing homes with solar systems. It might be necessary to change the definition in 7-36-21.2 NMSA 1978 to conform to these 7-36-8 NMSA 1978 provisions or broaden the provisions in this bill.

2. Because this bill redefines tangible personal property and then creates an exemption, it comes under the terms of the New Mexico Constitution at Article VIII, Section 3. This section requires a vote of three-fourths of each chamber.
3. Since some solar systems will not qualify for the exemption here, either for initial construction or for resale, TRD should be required to build a database to value a solar system as tangible personal property using metrics of kilowatts, construction (rooftop or ground-mount), age, and initial price (if known). These data will then be used to value the exclusion and to fairly assess the properties that do not qualify for this exclusion.
4. This bill defines a solar system as tangible property, even when the common standard of real property is generally determined by the six-factor test set forth in *Whiteco Industries, Inc. v. Commissioner.* Those tests consist of six questions that probe such matters as the nature of affixation, the removability of the asset after fixation and the intent of permanency when installed. The Internal Revenue Code itself does not define "real property," but rather the working definition is found in the regulations, which include two components: (i) the asset must be deemed permanent (either as a structure or a structural component of such structure) and (ii) it must not be an accessory to the operation of a business.[1] By any common definition, the six-factor test and the IRS two-components test both rooftop collectors and ground-mount collectors, are real property. As such, it would require a constitutional amendment to overturn the current and correct standard ensconced in Article VIII, Section 1, of the New Mexico Constitution.
5. With the attention that the provisions of this bill may bring, the exclusion for solar systems from the revaluation triggers of 7-36-21.2 NMSA 1978 into review. An argument could be made that a solar system installed on residential property is not a separate class and thus, the exclusion of solar property on existing homes may violate the equal treatment provision of Article VII, Section 1 of the New Mexico Constitution.

LG/al

[1] https://taxlawjournal.columbia.edu/article/tax-matters-vol-4-no-1/defining-real-property-and-its-consequences/