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FISCAL IMPACT REPORT

SPONSOR Soules ORIGINAL DATE 02/14/21 LAST UPDATED HB
SHORT TITLE Geothermal Tax Credit Changes SB 350
ANALYST Graeser

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY21	FY22	FY23	FY24	FY25		
(\$600.0)	(\$600.0)	(\$600.0)	(\$600.0)	(\$600.0)	Recurring	General Fund (PIT & CIT)

Parenthesis () indicate revenue decreases

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY21	FY22	FY23	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
Total	\$22.5	\$59.6	\$59.6	\$141.7	Recurring	General Fund

Parenthesis () indicate expenditure decreases

Relates to HB15, the Sustainable Building Tax Credit, which also provides energy conservation tax credits for ground source heat pump installations.

SOURCES OF INFORMATION

LFC Files

Responses Received From

Energy, Minerals and Natural Resources Department (EMNRD)

SUMMARY

Synopsis of Bill

Senate Bill 350 extends the delayed repeal (sunset) of the ground-source heat pump tax credit by five years to December 31, 2025 for both the personal income tax credit and the corporate income tax credit. The credit remains at 30 percent of the cost of equipment and installation, with a \$9,000 cap on each credit. The aggregate between the PIT credit and the CIT credit remains at \$2 million.

There is no effective date of this bill. It is assumed that the effective date is 90 days after this session ends. (June 18, 2021). The current credit has sunset for installations after January 1, 2020. Since the credit is in current law, the lack of an effective date is not material.

FISCAL IMPLICATIONS

This tax credit has been moderately successful since it was first enacted in 2009. The following table has been copied from the 2020-2019 edition of the TRD Tax Expenditure Report.

Geothermal Ground-Coupled Heat Pump Credit against PIT and CIT	Tax Year (Calendar)	2015	2016	2017	2018	2019
	Claims	265	333	242	181	188
	Expenditures (thousands)	\$762	\$881	\$495	\$400	\$451
	Average per claim	\$2,875	\$2,646	\$2,045	\$2,210	\$2,399

The average per claim is substantially lower than the \$9 thousand per installation allowed in statute and the aggregate expenditures are lower than the \$2 million allowed in statute.

EMNRD notes the discrepancy between tax credits approved by EMNRD and the approved claims applied on tax returns.

Calendar Year	2018	2019	2020
Claims	65	123	78
Certified Amounts (Thousands)	\$561.5	\$1,037.7	\$680.5

In particular, note that the number of applications of the tax credit to tax liabilities far exceeds the number of approvals. This is evidence that a substantial percentage of the approved credits exceed liabilities and are carried forward for up to the 10 years allowed in statute.

The revenue estimate in the table on page 1 assumes EMNRD will approve 90 applications a year for an aggregate approval of \$760 thousand per year. Because of liability limitations, there will be 250 tax credit applications annually at an average of \$2,400 per installation for \$600 thousand in aggregate applications per year. The difference will be rollovers until at least 2028.

This bill may be counter to the LFC tax policy principle of adequacy, efficiency, and equity. Due to the increasing cost of tax expenditures, revenues may be insufficient to cover growing recurring appropriations.

SIGNIFICANT ISSUES

EMNRD discusses some possible changes to improve the program:

Past experience with this program has provided a need for program improvement. As such, EMNRD recommends that SB350 use the definition of a heat pump as defined by the American Society of Heating, Refrigerating and Air-Conditioning which states that “a refrigeration

system designed so that the heat extracted at a low temperature and the heat rejected at a higher temperature may be utilized alternately or simultaneously for cooling and heating functions respectively.”

EMNRD further recommends certification by an independent nationally recognized testing laboratory of the heating and cooling equipment used for geothermal ground source heat pump systems installed for certification under the tax credit. Currently, this is not a requirement in statute. The tax credit, and thus the GSHP definition, should be limited to Air Conditioning, Heating and Refrigeration Institute (AHRI) certified (a 3rd party nationally recognized testing organization) systems that deliver both heating and cooling and provide a de-superheating coil for supplemental hot water heating during space cooling operations. In addition, ground loops should be designed for both the summer cooling and winter heating capacity of the heat pump. The previous tax credit law failed to specify these requirements and so the tax credit has resulted in the installation of self-certified systems.

El Paso Electric (EPE), serving Dona Ana County and the source of 95 percent+ of all ground source heat pump applications that have been certified, does not recognize systems for rebates if they are not AHRI certified. EPE’s requirements can be found at [Refrigerated Cooling - EPE \(epesaver.com\)](https://epesaver.com/). In short, all systems must be certified by the AHRI [Quick Search \(ahridirectory.org\)](https://ahridirectory.org/). Most systems that have received tax credits are not certified by AHRI and are thus not eligible for the EPE credit, which could benefit EPE customers that do not have a tax liability to receive a rebate from their utility.

In the last 3 years, EMNRD has received 266 applications. All these applications were received from one vendor except for one received from a different vendor in 2019. This data indicates that the credit has not incentivized additional providers to participate in the program.

PERFORMANCE IMPLICATIONS

The LFC tax policy of accountability is met with the bill’s requirement 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. TRD performs this reporting by inclusion in the annual TRD Tax Expenditure Report. One defect of this report is that TRD do not include data from partner agencies, such as EMNRD in the report.

ADMINISTRATIVE IMPLICATIONS

EMNRD will have a fiscal impact for staff support to reinstitute the tax credit program. Since the existing tax credit expired on December 31, 2020, the staff who provided the technical review and certification for this program have been reassigned to other programs. The fiscal impact for EMNRD includes staff resources to revise rules and to develop an electronic submission process for applications. There would be an estimated cost for initiation of the program of \$59.8 thousand (\$28.75/hr) for a new staff position including fringe benefits, and approximately \$30 thousand for program, administrative, legal and information technology staff. Ongoing staff resources are required to effectively manage, provide system reviews, certify systems for tax credit eligibility, collect data, and maintain a database.

LFC notes that the staff workload for FY 21 would be approximately ¼ of the amount for the full year.

EMNRD will continue to face challenges implementing this tax credit without the necessary clarification needed in the current statute. EMNRD is regularly challenged in the interpretation of this law as it pertains to heat pump definitions.

Additionally, EMNRD has received challenges on the number of heat pump systems that can be installed per property address and/or applicant. Some applicants have applied for but have not received multiple tax credits for multiple systems at one address, e.g., main house and guest house.

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

SB350 conflicts with HB15 (Sustainable Building Tax Credit) as HB15 contains a credit for heat pumps. Applicants could apply for a tax credit for the same system under both bills should both bills be enacted.

TECHNICAL ISSUES

EMNRD discusses the issues and proposes some amendments for technical problems in sections 7-2-18.24 and 7-2A-24 NMSA 1978:

Inconsistency with definitions. There are two definitions of “geothermal ground-coupled heat pump,” one in the Income Tax Act and tailored to residential systems and one in the Corporate Income and Franchise Tax Act, tailored to business applications. There should be a single definition to avoid confusion and to recognize that some business taxpayers may file personal income tax returns rather than corporate. For example, there is an efficiency requirement for heat pumps for individuals that file income tax returns, while there are no efficiency requirements for taxpayers that file corporate income tax returns.

The Income Tax Act defines a geothermal ground-coupled heat pump as: a system that uses energy from the ground, water or, ultimately, the sun for distribution of heating, cooling or domestic hot water; that has either a minimum coefficient of performance of three and four-tenths or an efficiency ratio of sixteen or greater; and that is installed by an accredited installer certified by the international ground source heat pump association.

The Corporate and Franchise Income Tax Act defines a geothermal ground-coupled heat pump as: a reversible refrigerator device that provides space heating, space cooling, domestic hot water, processed hot water, processed chilled water or any other application where hot air, cool air, hot water or chilled water is required and that utilizes ground water or water circulating through pipes buried in the ground as a condenser in the cooling mode and an evaporator in the heating mode.

EMNRD recommends that SB350 use one definition in both Acts. See Amendments below.

This bill does contain a delayed repeal date for installations on or before December 31, 2012. Delayed repeal dates for tax expenditures is an LFC recommendation.

ALTERNATIVES

Enact HB15.

AMENDMENTS

On page 3, delete lines 21-25 and on page 4, delete lines 1-3 and insert:

As used in this section, "geothermal ground-coupled heat pump" means a refrigeration system designed so that the heat extracted at a low temperature and the heat rejected at a higher temperature may be utilized alternately or simultaneously for cooling and heating functions respectively and is certified by the Air Conditioning, Heating and Refrigeration Institute (AHRI); that has either a minimum coefficient of performance of three and seven tenths or an efficiency ratio of eighteen or greater; and that is installed by an accredited installer certified by the international ground source heat pump association or equivalent certification organization.

On page 5, delete lines 20-25 and page 6, delete lines 1-2 and page 5, insert:

As used in this section, "geothermal ground-coupled heat pump" means a refrigeration system designed so that the heat extracted at a low temperature and the heat rejected at a higher temperature may be utilized alternately or simultaneously for cooling and heating functions respectively and is certified by the Air Conditioning, Heating and Refrigeration Institute (AHRI); that has either a minimum coefficient of performance of three and seven tenths or an efficiency ratio of eighteen or greater; and that is installed by an accredited installer certified by the international ground source heat pump association or equivalent certification organization.

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