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

SPONSOR Soules **ORIGINAL DATE** 01/26/22 **LAST UPDATED** **HB**

SHORT TITLE Geothermal Heat Pump Tax Credits **SB** 68

ANALYST Graeser

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY22	FY23	FY24	FY25	FY26		
	($1,490.0) to ($16,000.0)	($1,510,0) to ($16,000.0)	($1,520.0) to ($16,000.0)	($1,530.0) to ($16,000).0	Recurring	General Fund (PIT)

Parenthesis ( ) indicate revenue decreases

Note: the ($16,000.0) estimate is included in the bill as a cap. It is unlikely this cap would be reached at any point.

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

FY22	FY23	FY24	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
	$15.5	0.0	$15.5	Nonrecurring	TRD Operating (ITD)
	$60.0		$60.0	Nonrecurring	EMNRD Operating
	Significant	Significant	Significant	Recurring	EMNRD Operating (Additional Staffing)

Parenthesis ( ) indicate expenditure decreases

SOURCES OF INFORMATION

LFC Files

Responses Received From

Taxation and Revenue Department (TRD)

Energy, Minerals and Natural Resources Department (EMNRD

SUMMARY

Synopsis of Bill (contributed by EMNRD)

Senate Bill 68 (SB68) amends the Income Tax Act, Section 7-2-18.24 NMSA 1978, and the Corporate Income and Franchise Tax Act, Section 7-2A-24 NMSA 1978, to restore and extend the termination date of the Geothermal Ground-Coupled Heat Pump Tax Credit from January 1, 2022, to December 31, 2032. The geothermal ground-coupled heat pump tax credit is a credit against personal and corporate income tax liability for 30 percent of the purchase and installation of an eligible system up to $9,000. The credit can be refunded to the taxpayer. The heat pumps are certified by the EMNRD. Under SB68, the credits are capped at $16 million annually, while the expired credit cap was $2 million annually.

SB68 also amends the definition of geothermal ground-source heat pump in the Corporate and Franchise Tax Act to match the definition in the Income Tax Act. A taxpayer eligible for a tax credit pursuant to the Corporate and Franchise Tax Act shall now report the amount of the credit to the department as required by the department. SB68 would make the credit refundable to individuals seeking the credit under the income tax.

TRD is required to compile an annual report and analysis for presentation to the Revenue Stabilization and Tax Policy Committee and the Legislative Finance Committee on the cost of the tax credit including the number of taxpayers approved to receive the credit, the aggregate amount of credits approved and any other information necessary to evaluate the credit.

The effective date of this bill is not stated -- assume May 18, 2022. The provisions of the act apply to taxable years beginning January 1, 2022.

FISCAL IMPLICATIONS

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.

The current credit has been underutilized. Data from several editions of the TRD Tax Expenditure Report shows minimal expenditures.

Geothermal Ground-Coupled Heat Pump Credit against PIT and CIT						
Tax Year (Calendar)	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**
Claims	265	334	243	185	205	174
Expenditure (thousands)	$762	$882	$498	$407	$497	$365
Average Per Claim	$2,875	$2,641	$2,049	$2,200	$2,424	$2,098
Average Per Installation	$9,585	$8,802	$6,831	$7,333	$8,081	$6,992

EMNRD provided a three-year history of credit approvals, stating: "The maximum potential annual revenue impact to the general fund is $16 million under the proposed cap. However, historically under the expired credit, the amount certified by EMNRD had not reached the cap in any year (or come anywhere close)." From 2018-2020, the expenditures in the highest year were only about 50 percent of the $2 million cap. Agency analysis found the tax credit may lead to increased costs for EMNRD and the reinstituted credit will likely impact the budget, however the specific amount may vary (see table 1).

Year	Amount	Claims
2018	$561,552	65
2019	$1,037,732	123
2020	$680,495	78

"EMNRD will also have a fiscal impact associated with staff support necessary 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 have been reassigned to other programs or duties. If the credit were reinstated staffing would be needed. 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 $60 thousand, for program design and development, administrative, and legal support. Ongoing staff resources once reinstated are required to effectively manage, provide system reviews, certify systems for tax credit eligibility, collect data, and maintain a database. Those costs are not estimated here."

TRD provided the estimated revenue impact of this bill stating: "TRD used data from applications for the recently expired Geothermal Income Tax Credit. TRD used a 5-year average of applications for the credit as the base, excluding Tax Year 2020 due to impacts caused by the Covid-19 pandemic. First, the fiscal impact takes the base and grows it by 1 percent year-over-year based on market analysis conducted by Grand View Research[1]…the firm estimates a 7.2 percent growth in the geothermal heat pump market between 2020 and 2027. Additionally, TRD applied an 83 percent growth rate between FY22 and FY23 to account for the new refund ability of the credit. This credit was made refundable for projects that first began operating after 2008 and used to estimate the initial change in the growth rate for the refundable Geothermal Tax Credit."

LFC staff found the lower estimates shown in the table and analysis may be too large after analyzing the data and comparing EMNRD credit approval data to the TRD estimate and comparing this credit to the heavily utilized solar market development tax credit. The minimum amounts, obtained from EMNRD approvals, imply a claimed credit in the range of $850 thousand. However, TRD indicates there are carryover credits of about $2.2 million. See TECHNICAL ISSUES for an analysis of whether these carryover credits would be extinguished by the provisions of this bill.

SIGNIFICANT ISSUES

This bill reinstates a tax expenditure with a difficult to determine but likely significant cost. LFC has 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. TRD voiced similar concerns: "…Adding more tax incentives: (1) creates special treatment and exceptions to the code, growing tax expenditures and/or narrowing the tax base, with a negative impact on the general fund; and, (2) increases the burden of compliance on both taxpayers and TRD. Adding complexity and exceptions to the tax code does not comport generally with the best tax policy."

EMNRD points out some technical/definitional issues with the provisions of this bill: "The definition in SB68 of a geothermal ground-coupled heat pump removes the condition that a heat pump provide both heating and cooling and thus eliminates half of the consumer benefit of having a geothermal ground coupled heat pump. Most of the systems submitted historically for certification under the tax credit program were only cooling systems, which are allowed under statute, but these systems do not meet the strict definition of a heat pump. The current legislation allows installation of heating only systems or cooling only systems. EMNRD proposed amendments that conform SB68's definition to track the strict definition of a heat pump to maximize potential consumer benefits."

[1] https://www.grandviewresearch.com

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 credit and other information to determine whether the credit is meeting its purpose.

ADMINISTRATIVE IMPLICATIONS

TRD continues to have concerns regarding the administration of various tax credits that require certification by another state agency. "Paragraph H on page 4, line 3 through line 10 requires TRD to report approved tax credits. Certification of tax credits is done by EMNRD. To have all relevant information, it is important to receive taxpayer certification data in a timely manner. TRD recommends adding language that requires electronic information sharing of certificates awarded by EMNRD to TRD."

TRD also stated: The proposal will have an impact on TRD's Information Technology Division of approximately 300 hours or about 2 months of development work at approximately $15,492 to update forms, instructions, and associated publications. These updates will be incorporated into annual tax program revisions.

EMNRD expressed some concerns with the administration of these jointly administered tax credit programs
(1) "EMNRD will continue to face challenges implementing this tax credit without the proposed clarifications to the existing statute. EMNRD was regularly challenged under the old credit regard the interpretation of this law as it pertains to heat pump definitions";
(2) 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. EMNRD has proposed amendments to address both issues"; and
(3) "In addition to annual revenue impacts, EMNRD will also have a fiscal impact associated with staff support necessary 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 or duties. If the credit were reinstated staffing would be needed."

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

SB68 is a duplicate of HB35 and is duplicative of the 2021 Sustainable Building Tax Credit law which contains a credit for ground source heat pumps. Applicants could apply for a tax credit for the same system under both laws should this bill be enacted.

TECHNICAL ISSUES

There is currently $2.2 million in carryover credits booked in the GenTax system. By repealing the language that allows up to a 10-year carryover in favor of current refund ability, there is a question of whether this would extinguish the carryover credits without allowing refund ability. A safer approach would be to establish a new credit rather than reinstating an old credit. TRD expands on this idea:

As the previous credit already sunset as of December 31, 2020, TRD would recommend instead of amending the old credit, that a "new" credit be created as was done recently with the Solar Market Development and Sustainable Building credits to allow smoother administration by TRD. The current credit permits the taxpayer to carryforward their credit amounts up to 10 years. A new credit adds complexity in needing to separately track credits that are refundable and nonrefundable. Taxpayers who have carryforwards under the existing law would not be permitted to claim a refund. There are approximately $2.2 million in pending carryforwards for the recently expired credit in the GenTax system. However, the language of the carryforward provision on page 2 lines 16 through 19 is repealed under this proposal. The repeal could create legal issues for TRD should taxpayers who installed a system between 2010 and 2020 submit a credit claim and expect to carry it forward to future tax years.

EMNRD suggests adding language to clearly define eligible systems. Specifically, that: (1) SB68 use the latest definition of a heat pump as defined by the American Society of Heating, Refrigerating and Air-Conditioning to both the Income Tax Act and the Corporate and Franchise Income Tax Act. See Amendments below; and (2) only systems certified under EPA's Energy Star program be eligible for the tax credit, as is the case for the 2021 Sustainable Building Tax Credit."

EMNRD also points out that taxpayers might be able to claim credits pursuant to the provisions of this bill and simultaneously claim credits pursuant to the 2021 Sustainable Building Tax Credit."

OTHER SUBSTANTIVE ISSUES

LFC staff note that despite a comparably high total federal and state tax credits, this credit has been underutilized. The federal geothermal heat pump credit which is currently (2022) at 26 percent, will be reduced to 22 percent for 2023. There is money in "Build Back Better," but the passage of that federal support is uncertain. Uncertainty regarding the federal credits may depress the market for geothermal heat pump installations. With a total of up to 56 percent tax credits (26 percent federal and 30 percent state), it is somewhat surprising that the expired credit did not stimulate more claims. From the EMNRD data regarding approvals, on average, 46 percent of any particular year's approvals were claimed on income tax returns.

There has been a significant amount of public acceptance and purchase/installation of air source heat pumps, also known as "mini-splits". These mini splits are eligible for the federal renewable energy tax credits, but not state credits.

TRD SUGGESTED AMENDMENTS

1. Consider leaving the carryover provisions from the original Geothermal Heat Pump tax credits bill intact by enacting a "New Geothermal Ground-Coupled Heat Pump Tax Credits" with refund ability provisions.
2. Prohibit tax credit claims pursuant to both this act and the 2021 Sustainable Building Tax Credit.
3. On page 2, line 9, after ($9,000) insert: "…at any one address owned by the taxpayer."
4. On page 4, delete lines 11-18 and insert: "As used in this section, "geothermal ground-coupled heat pump" means a refrigeration system designed to 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 refrigeration system shall be an EPA Energy Star Certified Geothermal Heat Pump and the complete ground loop system shall be installed by an accredited installer certified by the international ground source heat pump association or equivalent certification organization."

5. On page 5, line 9, after ($9,000) and insert: "…at any one address owned by the taxpayer."
6. On page 6, delete lines 21-25 and page 7, delete lines 1-4 and insert: As used in this section, "geothermal ground-coupled heat pump" means a refrigeration system designed to 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 refrigeration system shall be an EPA Energy Star Certified Geothermal Heat Pump and the complete ground loop system shall be installed by an accredited installer certified by the international ground source heat pump association or equivalent certification organization."

WHAT WILL BE THE CONSEQUENCES OF NOT ENACTING THIS BILL

The geothermal ground-coupled heat pump income tax credit will remain expired and not be available to taxpayers.

POSSIBLE QUESTIONS

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

LFC Tax Expenditure Policy Principle	Met?	Comments
Vetted	✓	The original credit was enacted in 2010 and expired in 2020. This constitutes vetting for this purpose.
Targeted Clearly stated purpose Long-term goals Measurable targets	 ✗ ✗ ✗	This credit has no clearly stated purpose, no long-term goals or measureable targets.
Transparent	✓	The proposed reinstated tax credit will be fully transparent.
Accountable Public analysis Expiration date	 ✓ ✓	The claims and expenditures are reported annually in TRD's Tax Expenditure Report The reinstated credit expires in 2032/
Effective Fulfills stated purpose Passes "but for" test	 ✗ ✗	This credit has no clearly stated purpose. Judging from the modest take-up of this credit, despite a very high joint federal and state credit, the industry would survive at the current level without credits.
Efficient	✗	
Key: ✓ Met ✗ Not Met ? Unclear		

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