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FISCAL IMPACT REPORT

SPONSOR <u>HENRC</u>	LAST UPDATED <u>2/28/23</u>
	ORIGINAL DATE <u>2/13/23</u>
SHORT TITLE <u>Oil & Gas Emission Reduction Tax Credit</u>	BILL NUMBER <u>CS/House Bill 350/HENRCS</u>
	ANALYST <u>Torres, I.</u>

REVENUE* (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY23	FY24	FY25	FY26	FY27		
Negative – likely less than (\$7,200.0)	Negative and potentially significant, capped at \$100 million annually				Recurring	General Fund

Parenthesis () indicate revenue decreases
 *Amounts reflect most recent version of this legislation.

Sources of Information

LFC Files

Responses Received From

New Mexico Environment Department (NMED)
 Taxation and Revenue Department (TRD)
 State Land Office (SLO)

SUMMARY

Synopsis of HENRC Substitute for House Bill 350

The House Energy and Natural Resources Committee substitute for House Bill 350 (HB350) creates a new section of the Corporate Income and Franchise Tax Act (Sections 7-2A-1 to -31 NMSA 1978) to establish an “oil and gas emission reduction corporate income tax credit.” A taxpayer that, on or after January 1, 2023, and before January 1, 2028, installs a purchased or leased vapor recovery unit that reduces emissions from oil and gas activity may apply for, and the Taxation and Revenue Department (TRD) may allow, a credit against the taxpayer’s tax liability imposed pursuant to the Corporate Income and Franchise Tax Act.

The amount of a tax credit allowed shall be in an amount up to \$12 thousand for the cost of a purchased or leased vapor recovery unit that is installed on a well or along the midstream sector; provided that installation of the vapor recovery unit reduces emissions from oil and gas activity that would have been emitted if not for the installation. Only one credit per vapor recovery unit installed on a well or along the midstream sector shall be allowed.

HB350 caps the aggregate amount of tax credits to \$100 million in any calendar year and applications for the credit shall include evidence that the installation has caused a reduction in emissions from a stripper well property.

This bill does not contain an effective date, and as a result, would go into effect June 16, 2023, (90 days after the Legislature adjourns) if signed. However, the credits are applicable to vapor recovery units installed after January 1, 2023.

This bill does not contain a delayed repeal date, but LFC recommends adding one.

FISCAL IMPLICATIONS

This bill creates a tax expenditure with a cost that is difficult to determine but likely significant. LFC has serious 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 action be postponed until the implications can be more fully studied.

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 Taxation and Revenue Department reports, “Information from Cimarron, an oil and gas services company, outlined costs of vapor recovery units (VRU) ranging from \$50 thousand to \$325 thousand per unit. The credit amount of up to \$12 thousand can range between 4 percent to 24 percent of the VRU costs. The fiscal impact is assumed to be negative. However, the Taxation and Revenue Department (TRD) does not have data on the number of VRUs that would be installed and approved by EMNRD, nor the timing of such installations.”

The Environmental Protection Agency reports 7,000 to 9,000 vapor reduction units are installed in the oil production sector, today.¹ Life expectancies of VRU’s vary, however, Quincy compressors quote 130 thousand hours of use. Although VRU’s do not run 24 hours a day, the life expectancy suggests a nearly 15-year life span. The current stock is, therefore, the result of 15 years of installations, or fewer. The resulting analysis suggests approximately 600 VRUs are installed per year. If 600 VRU’s qualify for the New Mexico credit each year, the resulting revenue loss would be \$7.2 million. To the extent HB350 incentivizes additional installations, the bill is likely to cost the state significantly more, though the amount is difficult to estimate.

SIGNIFICANT ISSUES

The State Land Office notes:

The bill may in part be a response to rules promulgated in 2021-22 by the Oil Conservation Commission (OCC) and the Environmental Improvement Board (EIB) to limit routine venting and flaring in the oil and gas industry and to reduce harmful emissions of ozone precursor pollutants and methane emissions from oil and gas operations, respectively.

¹ https://www.epa.gov/sites/default/files/2016-06/documents/ll_final_vap.pdf

Those rules do not mandate the installation of vapor recovery units (VRUs) though they do recognize VRUs as a technology available to reduce venting and flaring. ...

According to the United States Environmental Protection Agency, VRUs are “relatively simple systems that can capture about 95 percent of the Btu-rich [hydrocarbon] vapors for sale or use onsite as fuel.” While VRUs require additional upfront cost to install, they save a producer hundreds of thousands of dollars a year “and payback in as little as two months.” (United States Environmental Protection Agency, “Installing Vapor Recovery Units on Storage Tanks” (factsheet), Oct. 2006, *available at https://www.epa.gov/sites/default/files/2016-06/documents/ll_final_vap.pdf*)

While VRUs, thus, can yield an environmental benefit, and may help oil and gas producers stay in compliance with recent OCC and EIB rules, they also provide a substantial economic benefit to the producers, because the captured gas can be sold. VRUs have been in use by major producers for many years without a tax credit.

HB350, thus, would provide a significant and flexible subsidy to oil and gas producers for installation of a technology that is already in producers’ commercial interest. By reducing qualifying producers’ tax liabilities, the bill would reduce New Mexico’s net tax revenue.

The Taxation and Revenue Department adds:

While tax incentives may support particular industries or encourage specific social and economic behaviors, the proliferation of such incentives complicates the tax code. 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.

The credit does not have a defined end date to claim the tax credit. TRD supports sunset dates for policymakers to review the impact of tax expenditures before extending them. The credit does not have an aggregate cap. This creates uncertainty for revenue forecasting and budget decision-making. TRD supports adding an aggregate cap to add certainty to the budgetary process.

Finally, the Environment Department highlights:

HB350’s oil and gas emission reduction corporate income tax credit incentivizes the installation of vapor recovery units. Installation of these vapor recovery units aligns with EMNRD’s and New Mexico Environment Department’s (NMED) respective methane and ozone rules. NMED does not anticipate a fiscal impact.

The bill does not predicate the tax credit on compliance nor does the bill contain a clawback provision should EMNRD or NMED determine that the facility is in violation of the substantive compliance requirements. For example, the U.S. Environmental Protection Agency (EPA) and NMED have frequently observed vapor recovery units that are installed but fail to capture and route emissions to a control device. This problem has been so prevalent that the U.S. EPA issued a national compliance alert discussing this exact issue (see: <https://www.epa.gov/sites/default/files/2015->

[09/documents/oilgascompliancealert.pdf](#)).

Limiting the tax credit to taxpayers that meet NMED’s definition of “small business facility” may better incent use of this tax credit and meaningfully support emission reductions. Per NMED’s rule a “Small business facility” means “a source that is independently owned or operated by a company that is not a subsidiary or a division of another business, that employs no more than 10 employees at any time during the calendar year, and that has a gross annual revenue of less than \$250 thousand. Employees include part-time, temporary, or limited-service workers.”

ADMINISTRATIVE IMPLICATIONS

Administrative and Compliance Impact: TRD will need to make information system changes and update forms, instructions, and publications. Staff training to administer the credit will need to take place. These changes will be incorporated into annual tax year implementation.

This bill will have a low impact on TRD’s Information Technology Division (ITD), approximately 100 hours, or about 1 month, for an estimated staff workload cost of \$5,554. TRD’s Administrative Services Division (ASD) will be required to test credit sourcing and other system testing. It is anticipated this work will take approximately eight hours and require 1 existing FTE for a cost of \$500.

Currently, all certifications for tax credits issued by external agencies must be entered manually, so increasing the number of any new tax credit claims would increase the administrative workload for TRD’s Revenue Processing Division (RPD). TRD assumes that electronic transfer of credit information will not occur before the effective date of the bill and, thus, one additional full-time employee will be required to process additional credit claims. The recurring budget estimate for the Revenue Processing Division (RPD) is based on an account auditor-A.

TRD expects to be able to absorb the impact of these changes, as outlined in this standalone bill, with 1 additional FTE. However, if several bills with similar effective dates become law there will be a greater impact to TRD and additional FTE or contract resources may be needed to complete the changes specified by the effective date of each bill.

Estimated Additional Operating Budget Impact*				R or NR**	Fund(s) or Agency Affected
FY2023	FY2024	FY2025	3 Year Total Cost		
--	\$5.6	--	\$5.6	NR	Tax & Rev – ITD Staff Workload
--	\$0.5	--	\$0.5	NR	Tax & Rev – ASD Staff Workload
--	\$80	\$80	\$160	R	Tax & Rev – RPD one FTE
--	\$10	--	\$10	NR	Tax & Rev – RPD one FTE one-time costs

* In thousands of dollars. Parentheses () indicate a cost saving. ** Recurring (R) or Nonrecurring

TECHNICAL ISSUES

SLO notes, “The bill states that it applies to ‘leased’ VRUs. As the bill is currently drafted, a company could theoretically sign a new lease every year for a VRU and receive a new tax credit every year. It is not clear if this kind of double, triple, and quadruple-dipping is intended by the

bill’s sponsors.”

TRD finds “the credit is permitted for VRUs that ‘reduce’ emissions from oil and gas activity. However, no threshold amount of reduction is specified. A VRU that only caused a minimal amount of reduction in emissions would be eligible for the credit.” TRD suggests the legislation set a minimum threshold of emission reduction that a VRU must achieve to qualify for the credit.

TRD recommends adding the following language to Section 1 to receive certificates from EMNRD:

The energy, minerals and natural resources department shall provide the taxation and revenue department appropriate certification information for all eligible taxpayers to whom certificates are issued to in a secure manner on regular intervals agreed upon by both taxation and revenue department and the energy, minerals and natural resources department.

The term “vapor recovery unit” in the legislation is defined as “equipment that reduces emissions from oil and gas activity by capturing fugitive natural gas vapors through a compressor at the wellhead or along the midstream sector and eliminates the need to vent or flare gas.” Vapor recovery units and other technologies, like fuel cells, are permissible uses to control emissions to stem ozone formation. Eliminating the need to vent or flare gas may not be the sole or exclusive reason to control emissions. Therefore, additional technologies for the purpose of controlling emissions outside of stemming the need to address venting and flaring would not be eligible for this tax credit.

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

Does the bill meet the Legislative Finance Committee tax expenditure policy principles?

1. **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.
2. **Targeted:** The tax expenditure has a clearly stated purpose, long-term goals, and measurable annual targets designed to mark progress toward the goals.
3. **Transparent:** The tax expenditure requires at least annual reporting by the recipients, the Taxation and Revenue Department, and other relevant agencies.
4. **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.
5. **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.
6. **Efficient:** The tax expenditure is the most cost-effective way to achieve the desired

results.

LFC Tax Expenditure Policy Principle	Met?	Comments
Vetted	✘	
Targeted	✘	The bill contains no purpose statements, goals, or targets.
Clearly stated purpose	✘	
Long-term goals	✘	
Measurable targets	✘	
Transparent	✔	The data will be published by TRD.
Accountable		
Public analysis	✔	
Expiration date	✘	
Effective		
Fulfills stated purpose	✘	
Passes “but for” test	✘	
Efficient	✘	
Key: ✔ Met ✘ Not Met ? Unclear		

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