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FISCAL IMPACT REPORT

LAST UPDATED _____

SPONSOR Ortiz y Pino/Griggs/Woods/Stewart **ORIGINAL DATE** 2/7/23

BILL

SHORT TITLE Geothermal Energy Generation Tax Credit **NUMBER** Senate Bill 173

ANALYST Graeser

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY23	FY24	FY25	FY26	FY27		
	(\$1,050.0)	(\$2,100.0)	(\$3,150.0)	(\$4,200.0)	Recurring	General Fund PIT/CIT
	(\$2,130.0)	(\$2,130.0)	(\$2,130.0)	(\$2,130.0)	Recurring	General Fund (GRT/Comp)
	(\$1,420.0)	(\$1,420.0)	(\$1,420.0)	(\$1,420.0)	Recurring	General Fund (Hold Harmless)
	(\$4,600.0)	(\$5,650.0)	(\$6,700.0)	(\$7,750.0)	Recurring	General Fund Total

Parenthesis () indicate revenue decreases.

Illustration based on the installation of 10 Megawatts per year.

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

FY23	FY24	FY25	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
	(\$97.0)	(\$97.0)	(\$97.0)	Recurring	EMNRD Operating (General Fund)
\$210.0	--	--	\$210.0	NR	TRD – ITD (contractual costs)
\$8.2	--	--	\$8.2	NR	TRD – ASD

Parenthesis () indicate expenditure decreases.

Relates to Senate Bill 8

Sources of Information

LFC Files

Responses Received From

Taxation and Revenue Department (TRD)

Energy, Minerals and Natural Resources Department (EMNRD)

SUMMARY

Synopsis of Senate Bill 173

Senate Bill 173 amends the Tax Administration Act, Income Tax Act, Corporate Income and Franchise Tax Act, and Gross Receipts and Compensating Tax Act to create deductions and tax credits to assist in developing the technology to generate electricity from deep geothermal formations.

- **Section 1:** Creates a new hold harmless distribution to counties and municipalities equal to local revenue impacts of the Gross Receipts and Compensating tax deduction created in Section 4.
- **Section 2 and 3:** Creates the geothermal electricity generation income tax credit. This credit is applicable to tax years starting January 1, 2023, and ends prior to January 1, 2031. This credit is for a taxpayer who holds an interest in a geothermal electricity generation facility. The credit is an amount equal to 1.5 cents per kilowatt-hour of electricity generated in New Mexico in a taxable year by the facility. The taxpayer will apply for certification of eligibility for the credit with the Energy, Minerals, and Natural Resources Department (EMNRD). The tax credit is also available for geothermal electricity generation that takes place prior to January 1, 2031, which is generated by an existing facility, if that existing facility increases its generation capacity by at least 100 percent after July 1, 2023. The joint personal/corporate income tax credit is capped at \$5 million each calendar year. If approved, EMNRD will issue a certificate to the individual. This credit has a seven-year carry forward and is not refundable. The Taxation and Revenue Department (TRD) will be required to provide an annual report on this credit.
- **Section 4:** Creates a new deduction from gross receipts tax and compensating tax starting July 1, 2023, and ending prior to July 1, 2031. These deductions are for the sale of tangible personal property and services in connection with the construction and equipping a geothermal electricity generation facility, tangible personal property installed as part of the system used for the distribution of the electricity from the facility, and construction plant costs purchased by a person who holds an interest in a facility. Each deduction from gross receipts tax has a mirrored deduction for compensating tax. These six deductions will be required to be reported separately to TRD. TRD will be required to provide an annual report on these deductions. Currently established facilities can become eligible for the deductions if production doubles after the effective date of the act.

The effective date of the bill is July 1, 2023. The provisions of Sections 2 and 3 are applicable to tax years beginning on or after January 1, 2023. TRD requests the effective date of the bill be advanced to January 1, 2024.

FISCAL IMPLICATIONS

This bill narrows the gross receipts tax (GRT) base. Many of the efforts over the last few years to reform New Mexico's taxes focused on broadening the GRT base and lowering the rates. Narrowing the base leads to continually rising GRT rates, increasing volatility in the state's largest general fund revenue source. Higher rates compound tax pyramiding issues and force consumers and businesses to pay higher taxes on all other purchases without an exemption, deduction, or credit. In addition, due to the increasing cost of tax expenditures, revenues may be insufficient to cover growing recurring appropriations.

TRD notes the following:

According to information from EMNRD, there is one geothermal electricity generating facility in the state, located approximately 15 miles southwest of Lordsburg. The facility

has a net generating capacity of 10 megawatts. Currently, there is no information available about planned expansions, or any other independent investments. With the absence of data, the impact of this legislation is unknown. Sections 1, 2, 3, and 4 would have a negative impact to the General Fund should there be a qualifying project and associated taxpayers. Section 4 will have a direct negative impact to local governments for the new deduction, but this would be offset by the hold harmless distributions in Section 1.

The personal/corporate income tax credit of 1.5 cents per kilowatt-hour means the \$5 million credit will be associated with the generation of over 300 thousand megawatt-hours of electricity, enough to power 120 thousand to 270 thousand homes for a year. Assuming an 80 percent duty cycle and 24/7 production, this represents about 40 megawatts capacity that will be creditable. Solar capital costs currently run about \$1.15 per watt. This relatively unproved technology will probably start with capital costs something in excess of \$5/watt. Assuming the industry will install 10 megawatts of capacity a year. Based on these assumptions, see below for estimated tax credit costs:

	FY24	FY25	FY26	FY27
Initial Installation (Watts)	10,000,000	10,000,000	10,000,000	10,000,000
Cost per Watt	\$5	\$5	\$5	\$5
GRT/Comp Deduction (\$1,000)	\$50,000	\$50,000	\$50,000	\$50,000
7.10%	\$3,550	\$3,550	\$3,550	\$3,550
60%	(\$2,130)	(\$2,130)	(\$2,130)	(\$2,130)
40%	(\$1,420)	(\$1,420)	(\$1,420)	(\$1,420)
Cumulative Production				
Annual Hours (80% Duty Cycle)	7,008	70,080,000	140,160,000	210,240,000
Tax credit per watt-hour	\$0.015	(\$1,050)	(\$2,100)	(\$3,150)
				(\$4,200)

SIGNIFICANT ISSUES

TRD notes:

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 has a defined end date to claim the tax credit and thus a sunset date. TRD supports sunset dates for policymakers to review the impact of tax expenditures before extending them. Additionally, it may be prudent to cap a single facility so one taxpayer does not take up the aggregate cap on the credit.

The proposed hold harmless distribution to local governments significantly complicates the administration of this credit. Additionally, it shifts the entire revenue loss associated with incentivizing geothermal energy to the state, although the cities and counties in which such activity occurs will benefit from the economic development. TRD recommends eliminating the hold harmless provision and instead allowing cities and counties to participate in incentivizing economic development within their local areas.

EMNRD comments:

Geothermal electricity production is reliable baseload power that is dispatchable at any time, produces near-zero carbon emissions, and has a small physical footprint. The Geothermal Energy Association (a trade association of geothermal industry entities) estimated New Mexico could produce 11 percent of its energy from geothermal energy sources. Currently, there is one utility-scale geothermal electricity generation facility operating in the state: Lightning Dock in Hidalgo County, which has a capacity of approximately 15 MW of electricity. Many other sites in New Mexico have promising geothermal development potential, including sites in Rincon, Radium Springs, and San Diego Mountain in Dona Ana County; Hillsboro in Sierra County; McGregor in Otero County; and Lower Frisco Hot Springs in Catron County, as well as many other sites along the Rio Grande.

The now-expired Renewable Energy Production tax credit program was very helpful in developing wind and solar photovoltaic energy resources in New Mexico. Geothermal resource development is more capital-intensive and riskier than either wind or solar development as it requires exploration onto a largely unknown resource. EMNRD believes this tax credit would be an effective incentive.

The bill requires EMNRD stop certification of applications once the annual cap of \$5 million is exhausted. This amount would have the potential to provide tax credits for a little over 300 GWh of annual geothermal electricity generation. Current generation in the state is 40 GWhs, which demonstrates room to grow.

PERFORMANCE IMPLICATIONS

EMNRD notes: “Adding new tax credit certification obligations to EMNRD without providing for staff to administer them will slow down processing for all tax credits, especially the New Solar Market Development tax credit and the Sustainable Buildings tax credit.”

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 deduction and other information to determine whether the credit and deduction are meeting their purpose.

ADMINISTRATIVE IMPLICATIONS

EMNRD notes its operating budget impact to administer these tax credits:

SB173 will require at least one additional FTE to administer the geothermal electricity generation tax credit. This FTE is needed for EMNRD to a) establish rules; b) develop applications for the credit; c) review and certify the applications; and d) conduct continuous annual monitoring and appropriate allocation of the credit at each geothermal electricity facility. The FTE would need to be technically qualified to perform these actions, placing them in pay band 75, with a total recurring cost of \$97,000 per year, including benefits.

EMNRD calculated this fiscal impact based on its experience administering the Renewable Energy Production Tax Credit, which had similar provisions to the credit

described in SB173.

EMNRD will be required to create rules for administering this tax credit and for continuous monitoring of the electricity generated by these facilities. Ownership of these facilities change frequently, and a process will be required to certify energy production for new owners or new partial owners.

TRD expects SB173 to be a relatively difficult to implement:

TRD will need to make information system changes and update forms, instructions and publications. Implementation will have an impact on several divisions at TRD.

The Audit and Compliance Division (ACD) will need to train auditors on the new deduction from Section 4. This bill will have a high impact on TRD's Information Technology Division (ITD) of approximately 1,000 hours or about 6 months for an estimated \$210 thousand contractual cost. It is anticipated the proposal will have a moderate impact of approximately 140 hours on the Administrative Services Division (ASD) requiring staff workload hours from 3.0 existing full-time employee (FTE). The work includes testing of distributions, testing of multiple revenue reports, general ledger transactions and financial statements.

If several bills with similar effective dates become law there will be a greater impact to TRD and additional staff workload costs or contract resources may be needed to complete the changes specified by the effective date(s) of each bill. TRD recommends an effective date of January 1, 2024 or July 1, 2024 to ensure proper implementation of the legislation in TRD administration and system processes.

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

SB173 is related to SB8, "Geothermal Resources Development Act," which, among other provisions appropriates at total \$26,100.0 to develop the technology of producing electricity from deep hot rock geothermal areas.

SB173 relates to SB45, which proposes to reinstate the Geothermal Ground Source Heat Pump credits. This is a far different technology than that proposed in SB173 and SB8. However, SB45 proposes a \$16 million cap on tax credits for a developed technology.

TECHNICAL ISSUES

TRD notes a number of technical issues:

[Section 1]: On page 1, line 23: strike "sales and use" and replace with "gross receipts and compensating.

The language in Section 1 of the bill only details distributions for the gross receipts tax deduction from Section 4 being claimed. The section does not detail the associated distributions from the compensating tax deduction from Section 4 but the title of section 1 indicates it is for both.

Section 1 details what to do for distributions in the case of a Tax Increment Development District (TIDD) but does not cover other areas such as the Water and Sanitation Districts

or tribal locations.”

[Sections 2 & 3]: In Sections 2 and 3, paragraphs C, the certification is capped at \$5,000,000 and the bill clearly states that applications for certification received after the cap is met shall not be approved. There is no information on whether those applications that are received after the cap has been met can apply in another year or if they are automatically added to another year. In its current form, the bill does not have a timeframe between the time when the geothermal electricity is produced, when they can apply for the certification, and when they can apply for the credit. Adding this timeframe will help with a rolling cap issue where the cap is used in full in one year and the applicants apply for the following year. It is also not clear whether a taxpayer can apply for certification multiple times in a given tax year. Also, consider amending the language on page 4 line 24 through page 5 line 7, in regard to the eligibility and the issuance of the certificate to make clear that EMNRD shall only issue certificates to those that are eligible and whose applications were received before the cap was reached.

There is no timeframe set for the application process and when it opens for a calendar year. There should be a clear timeline when applications start to be filed for particular tax year so taxpayers know when they can begin to get an application prior to the cap being reached.

Additionally, there are no guidelines that EMNRD should be using to determine eligibility such as verification of a facility’s nameplate energy production capacity.

In Section 2, paragraph E on page 5, the language is a limit on the credits claimed that shall not exceed the cap set in Section C, but that double check on the cap is not necessary since the certifications for each tax year cannot exceed the cap, the claims also won’t be able to exceed the cap. This language is superfluous.

The language for the cap of this credit is placed on EMNRD. This will be the amount of credit that they can certify in a year. However, the language on page 5 under line 17 and 18 is basing the amount on tax credits claimed in a taxable year with TRD. TRD would suggest choosing one method or the other. As both will cause confusion for the public and the two departments tasked with administration. If EMNRD is to manage this cap as they are awarding the credit amounts the lines on page 5 should be deleted. If TRD is managing this credit on claims, then the carry forward period needs to be amended and the language needs to be clarified in the case of denials because too much credit has been claimed. In the past, for credits like this EMNRD has managed the cap of the credit and limits the number of credits issued in a year once the cap has been met. For example, the sustainable building credit.

[Section 4]: The report in subsection D on page 13, includes EMNRD but this section is about the gross receipts tax (GRT) deductions, which EMNRD does not administer. EMNRD should be removed from this reporting on page 13 lines 5-6.

OTHER SUBSTANTIVE ISSUES

TRD notes other substantive issues:

[Section 1]: This section provides for a distribution from state general fund GRT and compensating tax (CMP) to local governments to offset a proposed deduction defined in

Section 4. Governmental Accounting Standards Board (GASB) 84 requires state governments to distinguish between their own and fiduciary monies. Local option GRT and compensating taxes are local sourced revenue and are fiduciary funds of the local government. A distribution from state sourced GRT or CMP to local governments to provide a reimbursement for a deduction would mean state-sourced revenues, which are not fiduciary, would be co-mingled with locally sourced revenues. Ideally, fiduciary and state revenues would be maintained separately. Even though legacy tax programs have prevented a complete separation, TRD does not recommend going back and co-mingling the revenues.

Adding a new deduction with an effective date for July 1, 2023, does not allow enough time to update changes to forms, instructions, GenTax, the tax system of record, and Taxpayer Access Point (TAP), the taxpayer interface system. It is recommended to add an effective date of January 1, 2024, to properly implement this deduction.

Since the income tax credits are not refundable, there is an issue with the aggregate caps, separate from the certification cap administered by EMNRD. In a given tax year when the certified projects by EMNRD total \$5 million but the taxpayers don't have sufficient tax liability, TRD would only approve credit claims less than \$5 million. However, the taxpayers that carry forward credits and accrue sufficient tax liability in a subsequent year where EMNRD certified another \$5 million, TRD could approve an excess of \$5 million in credits, being \$5 million from the current year, plus carryforwards from previous years. If this is not the intent of the legislation, it is recommended that the credit be made refundable or that the cap only be at the certification level by EMNRD as discussed in Technical Issues above.

[Sections 2 & 3]: Recommend striking sub-section D, on page 5, lines 8 through 12, and page 9, lines 11 through 15. An application for approval of the tax credit is redundant and causes unnecessary administrative workloads. The certification by EMNRD reviews and approves the specifications required by statute. TRD does not have access to the certification application or details, further, the TRD does not receive certification details from EMNRD.

TRD recommends adding a section that requires EMNRD to share data with TRD in place of sub-section D. The recommended addition is as follows:

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 Energy, Minerals, and Natural Resources Department.

The carryforward on credits should be limited or closer to the limitations for claiming a refund, which is three years plus the current year. This would allow for TRD to provide more accurate numbers on the amount of carryforward on a credit that has not been claimed to date that still sits on the state's books. This would also allow for the legislative body to know more about the effectiveness of a credit after 5 years. For example, with the bill as written, the last year that a taxpayer could qualify for the credit based on the sunset date would be taxable year 2030, the carryforward would be able to be claimed all the way until taxable year 2037.”

SUGGESTED AMENDMENTS

TRD suggests a number of amendments are needed. These are in the “Technical Issues” and the “Other Substantive Issues” sections above.

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		
Clearly stated purpose	✓	Purpose not stated but is apparently to assist in developing a new industry. Cap limited to a relatively small fraction of potential.
Long-term goals	✗	
Measurable targets	✗	
Transparent	✓	
Accountable		
Public analysis	✗	
Expiration date	✓	
Effective		
Fulfills stated purpose	✓	
Passes “but for” test	?	
Efficient	✗	
Key: ✓ Met ✗ Not Met ? Unclear		

LG/mg/hg/al