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

SPONSOR Maestas Barnes **ORIGINAL DATE** 2/5/15 **LAST UPDATED** 3/13/15 **HB** 296/a HFl#1

SHORT TITLE Tax Credit for Lease of Solar Energy Installation **SB**

ANALYST Graeser

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY15	**FY16**	**FY17**	**FY18**	**FY19**		
	NFI	**	**	(3,000)**	Recurring	General Fund

(Parenthesis ( ) indicate revenue decreases

Note: see “FISCAL IMPLICATIONS” below. The provisions of this bill will have little or no impact through the installation sunset of December 31, 2016, but may extend the fiscal impact of the Solar Market Development Credit Act for as long as twenty-five years in the future – perhaps at the level of the photovoltaics cap of $3 million annually.

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY15	FY16	FY17	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
Total	$50.0	$50.0	$0.0	$100.0	Recurring	EMNRD Operating (General Fund)

(Parenthesis ( ) Indicate Expenditure Decreases)

SOURCES OF INFORMATION
LFC Files

Responses Received From
Energy, Minerals and Natural Resources Department (EMNRD)
Taxation and Revenue Department (TRD)

SUMMARY

Synopsis of Amendment

House Floor Amendment #1 to House Bill 296 requires any creditable solar equipment to be new and unused by a prior owner or lessee.

Synopsis of Bill

House Bill 296 extends the solar market development tax credit for residential and small business solar thermal and photovoltaic systems by allowing leased systems access to the credit. This conforms the state solar credit to the federal credit which allows the federal credit for leased systems.

There may be an unintended consequence of this bill. The provisions of 7-2-18.14 NMSA 1978 allow a 10% Solar Market Development Tax Credit for any qualified system installed prior to December 31, 2016. If this bill passes, a New Mexico resident who signs a lease and has the system installed prior to December 31, 2016 may be able to claim 10% SMDT credits annually for the duration of the lease. The $5 million annual cap does not expire on December 31, 2016.

The effective date of the act is not stated – assume 90 days after adjournment or June 19, 2015. The provisions of the bill are applicable to taxable years beginning on or after January 1, 2015. Solar market development tax credits are sunset for installations that are completed after December 31, 2016.

FISCAL IMPLICATIONS

This bill will have no impacts through December 2016, when the provisions of the bill expire, but may serve to extend the credit into the future – even until 2041. The Solar Market Development Tax Credit for residential and small businesses is capped at $2 million for solar thermal systems and $3 million for photovoltaic systems. Including leased systems in the credit will not increase these caps. However, the caps are not sunset, only the installations. It is expected that the photovoltaic systems credit will be fully subscribed each year until the installation sunset. There may be some unused cap for solar thermal systems, but most of the anticipated leases will be for photovoltaic systems, not solar thermal systems. The solar market tax credits appear to be “first come, first served.” That is, EMNRD approves credits until the $2 million or $3 million caps are fully subscribed. Any additional applications will be denied. On the other hand, EMNRD may roll applications that have been denied because of the cap forward to the next fiscal year. This might become important for a leased system installed by December 31, 2016. Generally, leases would be written in terms of, “xx dollars due at the time of lease signing and yy dollars due each month for 300 months.” Prima facie, it seems as if there is no provision in law to allow the full financed value of the system to generate the credit in the year of installation based on the total cost of the project. The initial payment plus any monthly payments made in the year of installation would be creditable in the year of installation. Thereafter, the sum of the monthly payments may be creditable. The total approvals will be capped whether leased systems are added to the mix or not. However, since Solar City has announced a long-term leased solar system business model,[1] this bill has the potential to extend the fiscal impact of the Solar Market Development Tax Credit Act until 25 years after the installation sunset.

TRD notes that in FY2013 the credit claims reached $2.8 million and with the historical rate of growth it is assumed that by FY15 the credit will reach the maximum cap of $3 million.

[1] http://www.abqjournal.com/216118/biz/solar-leasing-arrives-in-new-mexico-2.html

EMNRD points out that this bill may have been introduced as a technical measure. If TRD or EMNRD denied a tax credit for a leased system in the past, the change proposed in this bill would allow a system installed at any time from 2006 when the credit was first approved through 2014 would become eligible for approval.

Specifically, EMNRD notes:

> “The additional applications for the Solar Market Development Tax Credit provided for by HB 296 could also include leased solar systems installed in previous years, depending on Taxation and Revenue Department requirements for retroactive personal income tax claims, due to the unchanged effective dates in HB 296.”

EMNRD also notes, “Because the 10 percent Solar Market Development Tax Credit applies to purchase and installation costs, it is not immediately clear what leasing expenses this expanded version of the credit would cover. Taxpayers that lease solar systems would not actually own the system and could put as little as $0 down, paying off the cost of the system over time, with interest. Additional clarification would be needed in a rulemaking process to determine eligible expenditures for the tax credit.”

This tax credit only applies to solar systems installed before December 31, 2016, so the installation window will be short term. On the other hand, the best guess is that it is the lease payments, not the system cost that will be creditable. Further, the leased systems may be competing with the purchased systems for the limited credits.

EMNRD provides some data on uptake of the credit:

> “In general, a significant investment in solar systems is occurring throughout much of New Mexico. During the 2014 calendar year, $27 million was invested by homeowners and EMNRD approved $2.6 million in Solar Market Development Tax Credits for these homeowners. Installation of all of these solar systems paid $5.5 million in labor costs. There were 1,023 household scale solar systems installed statewide that added 6 megawatts of solar capacity to the electric grid. For additional data on this program see www.CleanEnergyNM.org. (Source: data from certified Solar Market Development Tax Credit applications.)”

The underlying credit may be counter to the LFC tax policy principles of adequacy, efficiency, accountability and equity. Due to the increasing cost of tax expenditures revenues may be insufficient to cover growing recurring appropriations.

Estimating the cost of tax expenditures can be difficult. However, the solar market development tax expenditure is a tax credit applicable to personal income tax. The EMNRD approves the credit, while TRD administers the non-refundable credit applications. Both aggregate numbers are important, but readily obtainable. What is missing in this case is a requirement that EMNRD and TRD report to the legislature periodically the approvals and applications, as well as estimated energy savings for the aggregate approvals. LFC staff recommends adding accountability provisions to this bill.

SIGNIFICANT ISSUES

Adding leases to eligibility for this tax credit can be viewed as technical, rather than substantive. Both solar photovoltaic and solar thermal systems are quite capital intensive, with payback periods extending, typically, ten or eleven years. Thus, the obstacle to widespread adoption of these technologies is generally financing. Adding leases to the credit eligibility adds some financing options that may increase adoption. However, an increase in adoption by homeowners of this financing option will not increase the fiscal impacts on the general fund which are capped as noted above.

However, the timing of this bill raises some questions. In an Albuquerque Journal story published July 1, 2013, A Texas-based company "Sunnova Energy Corp announced it had established a partnership with Albuquerque's Affordable Solar to sell and install leased solar systems. In another Albuquerque Journal story published March 4, 2015, Tesla Motors CEO, Elon Musk, announced the Solar City [2] with a similar business model that leases and installs residential scale solar system with lease terms typical extending 25 years into the future.

On the other hand, TRD notes that allowing creditable leases may not increase adoption of the technology since only the lease payments made in the year of installation may be creditable.

> "The amendment to this Section of law potentially enlarges a taxpayer's ability to claim this credit over multiple years. Current law allows a deduction for the purchase and installation costs. This is a one-time expense. Depending on the length and cost of a lease, a taxpayer may be able to claim this credit in multiple tax years. If this tax credit is to remain as a one-time credit, language will need to be added to the bill to assure the credit is only allowable in the year the lease is initiated. The $9,000 credit cap per taxpayer would presumably still apply to those taxpayers who leased a solar thermal system or photovoltaic system."

The answers to the question of whether it is the system value, including installation, but excluding financing costs that is creditable in the year of installation, or the ongoing lease payments (implicitly including financing costs) that are creditable each year for the term of the lease will only be known after EMNRD and TRD decide the correct answer and embedded that answer in regulation. This lack of clarity and specificity may be problematic.

PERFORMANCE IMPLICATIONS

The LFC tax policy of accountability is <u>not</u> met since TRD and EMNRD are <u>not</u> required in the bill to report annually or periodically 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. This lack of accountability is noted for both purchased, as well as the leased systems proposed in this bill.

ADMINISTRATIVE IMPLICATIONS

TRD reports a moderate impact (400 hours). The bill's provisions will require changes to the Gentax and Taxpayer Access Point documents, and configuration changes to the business credit module tables. This can be done as part of year end changes. Modification to forms, instructions and publications related to the solar market development tax credit can be completed at no additional cost. TRD may expect to see additional certificates, increasing the number of applicants. Data entry of the certificates will increase.

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[2] http://www.abqjournal.com/549309/news/solarcity-coming-to-albuquerque.html

EMNRD reports moderate administrative impacts from this bill:

> "Because the tax credit is currently in place, EMNRD has an existing program to review applications and provide certifications. However, extending eligibility to leased solar systems will require rule changes to define the eligible leasing costs for the credit and require the creation of a new program to handle solar leasing applications."

> "A significant rulemaking process will be needed for amendment of 3.3.28 NMAC to address issues such as: 1) acceptable lease agreement provisions; 2) additional application information needed; 3) ownership of tax credits; and 4) compliance with federal IRS regulations. HB 296 does not provide any specifics about what qualifies, what the requirements would be, and what costs are eligible."

CONFLICT, DUPLICATION

HB 296 conflicts with HB 70 and its duplicate SB 391, which seek to extend the sunset date for the Solar Market Development Tax Credit by four years, from December 31, 2016 to December 31, 2020. The current expiration of the date of the Solar Market Development Tax Credit, of December 31, 2016, remains unchanged in HB 296.

OTHER SUBSTANTIVE ISSUES

There is a December 31, 2016 sunset date for the solar market development tax credit being amended by this bill. The LFC recommends adding sunset dates to all tax expenditure bills, as well as accountability provisions. This is a particularly good tax expenditure for reporting purposes, since EMNRD processes applications for the credit and can relatively easily determine aggregate energy savings and TRD can relatively easily determine aggregate annual applications of the credit to determine delayed costs because taxpayers may not be able to utilized the approved credits if the credits exceed liabilities.

LFC staff suggest that allowing credits to be taken for 25 years after the installation sunset is not in keeping with the nature of a viable and effective sunset provision. TRD, in the same vein, suggests that the interests promoted by residential solar leasing can be addressed by front-loading the tax credit as a refundable or partially refundable credit, allowing cash-flow challenged taxpayers more efficient access to the technology.

It may be up to EMNRD, in the regulatory process, to develop a procedure for determining the net present value of the lease payments for 25 years and use that net present value as the basis for the value to be used to calculate the credit for these leased systems.

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