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FISCAL IMPACT REPORT

ORIGINAL DATE 1/23/15
LAST UPDATED 3/04/15 **HB** _____

SPONSOR Cisneros/Trujillo

SHORT TITLE Hydrogen Fuel Production Tax Credit **SB** 7/aSFC

ANALYST van Moorsel

REVENUE (dollars in thousands)

Estimated Revenue						Recurring or Nonrecurring	Fund Affected
FY15	FY16	FY17	FY18	FY19	FY20		
\$0.0	\$0.0	(\$300.0)	(\$800.0)	(\$1,600.0)	(\$3,200.0)	Recurring	General Fund

(Parenthesis () indicate revenue decreases)

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY15	FY16	FY17	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
Total	\$25.0	\$50.0	\$50.0	125.0	Recurring	EMNRD Operating Fund

(Parenthesis () indicate expenditure decreases)

SOURCES OF INFORMATION

LFC Files

Responses Received From

Taxation and Revenue Department (TRD)
 Department of Finance and Administration (DFA)
 Energy, Minerals, and Natural Resources Department (EMNRD)
 Office of the State Auditor (OSA)

SUMMARY

Synopsis of SFC Amendment

The Senate Finance Committee amendment delays and phases in the implementation of the credit, allowing the credit to be claimed in the following amounts in the following taxable years:

2017 – \$500,000; 2018 – \$1 million; 2019 – \$2 million; 2020 and after – \$4 million.

The amendment also changes the effective date to January 1, 2017.

Synopsis of Original Bill

Senate Bill 7 creates a new section of the Corporate Income and Franchise Tax Act to create the hydrogen fuel production tax credit.

Specifically, the bill provides that, prior to January 1, 2021, a taxpayer that files a New Mexico corporate income tax return may claim the hydrogen fuel production corporate income tax credit if the taxpayer holds title to a qualified hydrogen fuel or hydrogen resource generator that produces and sells hydrogen. The purpose of the credit is to stimulate the production and sale of hydrogen as a renewable fuel and energy source.

The bill defines a "qualified hydrogen fuel or hydrogen resource generator" as a hydrogen fuel generator or hydrogen resource generator that uses renewably powered thermolysis or electrolysis that is: (1) solar-light-derived; (2) solar-heat-derived; (3) plasma-derived; (4) wind-derived; (5) hydroelectric-derived; or (6) geothermal-derived."

The bill provides that the credit equal the cost of generating the hydrogen, not to exceed one dollar per kilogram of the first 4 million kilograms of hydrogen fuel produced and sold in a year. The tax credit is capped at \$4 million per year. Applications for the tax credit must be considered in the order received by TRD. The tax credit may not be claimed in addition to the renewable energy production tax credit. Any portion of the credit exceeding the taxpayer's tax liability may be carried forward for up to five consecutive taxable years.

Taxpayers must claim the credit within five years of beginning hydrogen production. Taxpayers must apply to TRD for the credit, which must consider the applications in the order received. Applications must include a certification of eligibility from EMNRD that the applicant is a qualified hydrogen fuel or hydrogen resource generator.

The bill provides for reporting requirements. Taxpayers must report the amount of the credit to TRD, which must compile an annual report. Beginning 2017 and every three years, TRD must present these annual reports to Revenue Stabilization and Tax Policy Committee (RSTP) and the LFC. By October 30 of each year, TRD must compile a report concerning the credit for the RSTP that includes:

- the number of people applying for the credit;
- the number and amount of credits allowed;
- the number of new jobs created by the qualifying hydrogen fuel or resource systems in New Mexico in the year;
- the level of hydrogen fuel production by generators claiming the credit and the total production level in the state;
- the number of people employed in the generation of hydrogen for fuel or by hydrogen resource generators and the average and median wages of those employed;
- other data or information deemed necessary by TRD to determine the impact of the credit.

The provisions of SB7 apply to taxable years beginning on or after January 1, 2015.

The bill includes a sunset provision; the credit sunsets at the end of 2020.

FISCAL IMPLICATIONS

As amended, the fiscal impact of the bill does not begin until FY17. Using a 40%/60% split to fiscalize the general fund impact of the credit from calendar years. The first impact is seen in FY17, growing to \$3.2 million by FY20.

EMNRD reports no qualifying commercial activities currently occurring in New Mexico. However, the tax credit may attract one or more facilities to start production in New Mexico by the end of FY15, at the earliest. Due to the technology becoming cost-effective, one qualifying hydrogen production facility could claim as much as \$4 million or the entire cap. Currently, since no facilities are planned to operate in New Mexico, the fiscal impacts cannot be estimated with any reasonable confidence. Assuming hydrogen production facilities are constructed and produce at the maximum capacity allowed under the bill, the fiscal impact is estimated to reach the \$4 million cap.

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.

Estimating the cost of tax expenditures is difficult. Confidentiality requirements surrounding certain taxpayer information create uncertainty, and analysts must frequently interpret third-party data sources. The statutory criteria for a tax expenditure may be ambiguous, further complicating the initial cost estimate of the expenditure's fiscal impact. Once a tax expenditure has been approved, information constraints continue to create challenges in tracking the real costs (and benefits) of tax expenditures.

SIGNIFICANT ISSUES

SB 7 has been endorsed by the interim Science, Technology and Telecommunications Committee.

DFA notes in its analysis that the petroleum and chemical industries use hydrogen in significant quantities. In a petrochemical plant, it can be used for hydrodesulfurization, which removes sulfur from other natural gas, and hydrocracking, a process by which complex chemicals are broken down into simpler components. Hydrogen is required for many oil refining processes and products. Hydrogen produced by qualified hydrogen resource generators could provide cost savings to the oil industry. Food companies often use it to hydrogenate oils or fats, which permits the production of margarine from liquid vegetable oil. Chemists also use it to produce methanol and hydrochloric acid, both of which can be used commercially or as part of consumer products.

DFA notes that, according to the National Renewable Energy Laboratory, most of the hydrogen in the United States is produced by steam reforming of natural gas, including in New Mexico. For the near term, this production method is expected to continue to dominate. This production method does not qualify for the credit. According to EMNRD, the only hydrogen production that might be taking place in New Mexico would be on-site production at oil and gas refineries as they use hydrogen to remove sulfur. Shifting to a renewable energy source would help the oil and gas industry reduce CO2 emissions inherent in the steam methane reformation process.

EMNRD notes SB 7 could stimulate market investment in renewable hydrogen production, which would also advance potential hydrogen energy storage technologies. EMNRD is aware of

some businesses that are currently considering establishing renewable hydrogen production in New Mexico.

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.

ADMINISTRATIVE IMPLICATIONS

TRD estimates a minimal administrative impact in that the bill would 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.

EMNRD reports it will incur a fiscal impact to administer the credit as it is required to develop regulations and review eligibility for each potential hydrogen fuel or hydrogen resource generator. EMNRD estimates an additional \$50,000 in the operating budget would be required for a technical staff member (0.5 FTE per year). For FY 15, EMNRD estimates needing only a 0.25 FTE needed.

TECHNICAL ISSUES

TRD Notes subsection C of the bill clarifies that a taxpayer cannot claim both the hydrogen and the renewable energy production credit. TRD adds that an examination of other credits that might also be claimed for the same activity may be warranted to determine whether to add other prohibitions or specific allowances. For example, the production of hydrogen fuel from water (as opposed to fossil fuels) may constitute "manufacturing" to which the Investment Tax Credit might apply. Supposing the credit is not to be claimed with other credits added prohibitions may be necessary.

TRD adds subsection H requires TRD to provide annual reports to RSTP. The bill should require the applicants to provide the requested information to TRD as a condition of application. As drafted, the bill does not require this information as part of the credit application or as part of the requirements to even get the credit. TRD adds subsection K appears duplicative of Subsection H as it seems to require the same reporting.

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