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

SPONSOR Wirth, P. **ORIGINAL DATE** 02/6/15 **LAST UPDATED** **HB**

SHORT TITLE Water Harvesting Income Tax Credit **SB** 280

ANALYST Graeser

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund(s) Affected
FY15	FY16	FY17	FY18	FY19		
$0.0	($950.0)	($1,700.0)	($2,000.0)	($2,000.0)	Recurring	General Fund

(Parenthesis ( ) Indicate Revenue Decreases)

Note: the certificates are marketable and transferable. While it may take a short period of time to establish an orderly market for these certificates, it is certain that by the second year, the full amount of the credits will be allocated and claimed. Once granted, the credits could be applied to a previous tax year's amended tax return.

OSE and TRD in the 2014 review of SB 16 report minimal impact on each agency. RLD/CID reports that the agency does not inspect water catchment systems because these systems do not require a construction permit and the agency cannot implement the inspections required in this bill.

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY15	FY16	FY17	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
Total		34	25	59	R	TRD Operating

Parenthesis ( ) indicate expenditure decreases

SOURCES OF INFORMATION

LFC Files

Responses Received From
Regulation and Licensing Department, Construction Industries Division (RLD/CID) 2014 SB 16
Office of the State Engineer (OSE) 2014 SB 16
Taxation and Revenue Department (TRD)

SUMMARY

Synopsis of Bill

Senate Bill 280 proposes a new water harvesting tax credit of 20 percent of the cost of purchasing and installing a residential or commercial water harvesting system. The maximum credit for

any single installation would be capped at $5 thousand, while the aggregate annual maximum would be capped at $2 million. Based on an affidavit of performance, TRD is charged with approving an application for credit. If the application is approved, TRD will issue a negotiable certificate that includes the amount of the credit granted. If the original applicant chooses to sell or transfer the certificate, both the buyer and the seller must notify TRD of the sale or transfer within 10 days. Regulation and Licensing, Construction Industries Division and
the Office of the State Engineer are required to develop and promulgate regulations regarding the equipment and procedures to claim the credit. TRD is required to compile and report annually and beginning in 2019 and every five-years thereafter, TRD is required to analyze and report to the appropriate legislative committees on the effectiveness of the credit. The $2 million cap would be implemented on a first-come, first-served basis. The credit is only for the personal income tax; no corporate income tax credit would be allowed.

FISCAL IMPLICATIONS

TRD reports the following in its analysis of 2014's SB 16:

> According to Santa Fe County and Santa Fe businesses involved in selling and installing of water harvesting systems[1], in 2013 there was an estimated 500 residential systems and 35 commercial systems installed in Santa Fe County. The cost of a residential system including installation is estimated to be between $7,000 and $40,000, whereas the cost of a commercial system, including installation, is estimated to be between $30,000 and $140,000. TRD assumes that 70% (350) of the residential systems cost $7,000 and 30% (150) cost $ 40,000. At the minimum cost, a residential system can yield a tax credit of $1,400 (20% of $7,000) and at a maximum cost, a residential system can yield a tax credit of $8,000 (20% of $40,000), but since no credit can exceed $5,000, the maximum credit a taxpayer can claim is $5,000. For a commercial system, 20% of $30,000 is $6,000 and 20% of $140,000 is $28,000 but due to the cap, no credit will exceed $5,000. The Santa Fe residential (minimum cost and maximum cost) and commercial totals were multiplied by an assumed factor of 1.5 to obtain the total for the state in each category. For the minimum cost category (residential with a credit of $1,400), tax liability is assumed to limit the claim in the first year to 60% (of $1,400) and carry-forward the rest (40%) to the next year. For the residential, maximum cost ($5,000) category, the yearly distribution is assumed on average to be 30%, 30%, 30%, 10%. For the commercial category, the yearly distribution is assumed to be 60% and 40%. The totals were multiplied by these percentages for each year and summed up for all years to estimate the fiscal impact. With the amendment to allow the sale, exchange or transfer of credits, there is a higher likelihood that the credits will reach the maximum cap of $2 million each year.

This personal income tax credit is non-refundable. Any amounts of credit that exceed a taxpayer's tax liability in the taxable year in which the tax credit is claimed may be carried forward for a maximum of ten consecutive taxable years.

The bill allows the credits to be transferred. Most of the applicants who were granted certificates, but who could not use them in the year the certificate was issued would be tempted to sell them to a broker at a discount. This would benefit the broker and the purchaser of the certificate, but

[1] Santa Fe County passed an ordinance relating to Water Harvesting and Conservation in 2003 - "An Ordinance Amending Ordinance 1996-10, the Santa Fe County Land Development Code, Article III, Section 4.4.1 and Article III, Section 2.4.1 to require rainwater catchment systems for all commercial and residential development"

would reduce the benefit to the homeowner or business owner who installed the system but could not immediately use the certificate. This feature might increase the number of certificates issued, since homeowners would have a market to sell the certificates and get the value of the certificate sooner than if they waited until their individual liabilities were sufficient to utilize the credits. It is likely that the company installing the systems would simultaneous broker the credits when the taxpayers liability would be insufficient to cover the liability. In analogy with other marketable credits, the discount could range up to 80 percent of the amount of credit granted.

Section G apparently prevents the homeowner or business granted the credit from filing an amended return to claim the credit immediately after it was granted. The credit in excess of liability in the year in which the credit is claimed may be carried forward for 10 years. However, there doesn't seem to be anything in the bill that would prevent the purchaser of the credit from immediately applying the credit to a previous year's amended return.

In addition to the constituency of urban/suburban residents with access to municipal or county water and a desire to become more environmentally responsible, there is a second group of rural homeowners for whom a well is not financially feasible or who have a well with ultimately limited capacity for which water harvesting and storage is a useful strategy. The urban/suburban residential environmentally responsible group will likely have a payback period in excess of 25-years. Thus, the takeup reported in TRD's analysis may be overstated, unless costs and payback periods can be dramatically reduced. On the other hand, TRD's analysis does not include any rural residences and businesses without access to well water for which payback periods can be less than 10-years. TRD also assumed that urban/suburban water harvesting will occur only incidentally in other communities beside Santa Fe. These comments would affect the time until the $2 million cap were reached.

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. Although this bill provides for periodic reporting to the legislature, TRD does not have the data or expertise to determine benefits, in value of harvested water, that it is supposed to report to the legislature. Analysis is particularly easy in Santa Fe County outside of the city of Santa Fe. The County sells water to residential customers at $1.00 per 100 gallons and to commercial customers at $2.00 per 100 gallons. However, TRD will have to develop pro-forma procedures for linking water harvested to annual rainfall by county or sub-county regions.

At maximum (capped) utilization, there could be 400 systems annually installed that would be eligible for the credit ($2 million/$5,000 = 400). More likely, if the average system trends to TRD's minimum cost of $1,700, in excess of 5,000 per year could take advantage of this credit.

EFFECTIVE DATE

Not stated – assume 90 days after adjournment, or June 19, 2015. The provisions of the bill are applicable for taxable years beginning on or after 1/1/2015. The initial fiscal impact would be realized around April 2016.

SIGNIFICANT ISSUES

TRD, in its analysis of 2014's SB 16 describes the significant issues:

> This bill encourages the installation and use of water harvesting systems in New Mexico. Rainwater harvesting provides an independent water supply during regional water restrictions and in developed countries is often used to supplement the main supply. It provides water when there is a drought, prevents flooding of low-lying areas, replenishes the ground water level, and enables dug wells and bore wells to yield in a sustained manner. It also provides an additional source of clean water by reducing the salinity and the presence of iron salts. It makes use of a natural resource and reduces flooding, storm water, erosion, and contamination of surface water with pesticides, sediment, metals, and fertilizers. It is an excellent source of water for landscape irrigation, with no chemicals such as fluoride and chlorine, and any dissolved salts and minerals from the soil. It often promotes both water and energy conservation.

Businesses conducted as pass-through entities, such as Sub-S corporations, LLCs, LLPs or MLPs, would be eligible for the credit. As noted, there would be no corporate income tax credit allowed.

The "first-come, first-served" provision is generally not good policy because homeowners or businesses cannot be certain in their planning whether the credit will apply or not. LFC staff suggest having a roll-over provision similar to that provided for the film production credit, where aggregate claims cannot exceed $50 million. However, if the cap is reached, valid claims in one year are rolled over to the next year and have priority in the roll-over year. If the fiscal analysis is correct, the $2 million annual cap is likely to be breached in the relatively near future. The marketability of the certificates would mean that a taxpayer, once granted the certificate, would be assured of getting some value from the certificate. There would always be a willing buyer to buy the certificates because the certificates, once granted, could be applied immediately on an amended income tax return.

PERFORMANCE IMPLICATIONS

With all tax expenditures, LFC recommends some reporting and/or accountability provisions be included in the all tax expenditure bills. Section 1, subsection L requires TRD to report annually to an interim legislative committee regarding the data compiled from the reports from taxpayers taking the deduction. It is also required to analyze the data and make a recommendation of effectiveness and cost of the credit. Although it is somewhat unusual to assign to TRD the approval of applications in an area in which it has no expertise, this will at least put the financial (cost) data and the benefits (square feet or roof area, capacity of the storage, gallons of water harvested, stored and used for enumerated purposes) in TRD's databases. If TRD has data on the collection area and storage capacity, it can calculate each year the gallons of water harvested from knowledge of regional rainfall.

ADMINISTRATIVE IMPLICATIONS

RLD/Construction Industries Division in the analysis of 2014's SB-16 notes the following: "The Regulation and Licensing Department, Construction Industries Division jurisdictionally does not regulate water storage tanks, cisterns, reservoirs or other water saving home usage collectors or containers. The Construction Industries Division is restricted to only construction platforms or

foundations used to install or build a water storage unit, or a "water harvesting system," but the Division does not license, permit or inspect water storage units." However, RLD/CID does have extensive knowledge of construction quality and can consult with the Office of the State Engineer regarding safety, code and standard compliance, minimum and maximum system sizes and eligible components."

Although TRD reported minimal administrative and compliance impact for the 2014's SB-16, this bill imposes a substantially greater burden on the agency.

CONFLICT, COMPANIONSHIP

This bill conflicts with:
HB 64 -- Home Energy & Water Efficiency Tax Credit (Carl Trujillo & Peter Wirth)
HB 113 -- Energy-Efficient Homes Tax Credit (Brian Egolf)
SB 279 -- Sustainable Building Tax Credits (Peter Wirth & Carl Trujillo)

TECHNICAL ISSUES

Page 2, Subsection D, allows for a $2 million annual maximum but does not specify if it is calendar year, tax year or a state fiscal year cap.

Not providing for a rollover of credits if the cap is exceeded in any particular year may be a defect that will affect a taxpayer's or business's decision to invest in a water harvesting system, since whether the installed system will receive a credit becomes speculative. This is an issue even though the substitute bill allows the certificates to be sold or transferred. The certificates are subject to the $2 million annual cap.

OSE in its analysis of 2014's SB 16 suggests that Section 1, Subsection J (page 3, line 25 through page 4, line 10) should incorporate additional considerations, including the need for assessment of the site to determine what level of storage and use can occur within the predevelopment state of the rooftop area harvesting the precipitation. OSE is also concerned that if the report required in Section 1, Subsection l includes gallons harvested and other technical data as a measure of effectiveness of the credit, neither TRD, nor OSE will be in a position to gather or report on such data.

Apparently, earned and approved credits that are sold to another taxpayer are not subject to the same roll-over provisions as those that limit the ability of the homeowner to take immediate advantage of the credit by filing an amended return for a previous tax year. The bill is not at all clear whether this same prohibition of look-back applies when the credits are sold.

OSE explains in the following note that some areas of the state may not be able to install water harvesting equipment unless the State Engineer issues a permit. Also, harvested water may not be appropriated off the site of collection. It may be necessary to include these provisions in Section 1.

OTHER SUBSTANTIVE ISSUES

OSE has an interesting perspective related in its analysis of 2014's SB-16:

This bill raises issues relating to the capture and use of water generated from precipitation runoff from rooftops. In general, any capture and use of surface water requires an application to the State Engineer. However, as a common sense policy, the State Engineer has a policy statement dated November 24, 2004 as follows.

"*The New Mexico Office of the State Engineer supports the wise and efficient use of the state's water resources; and, therefore, encourages the harvesting, collection and use of rainwater from residential and commercial roof surfaces for on-site landscape irrigation and other on-site domestic uses.*

The collection of water harvested in this manner should not reduce the amount of runoff that would have occurred from the site in its natural, pre-development state. Harvested rainwater may not be appropriated for any other uses."

Strict adherence to the surface water rules requires a permit from the State Engineer for any impoundment and use of water. Further, all surface waters of the state have been determined to be fully appropriated. Therefore, it is conceivable that truly successful harvesting throughout the state could result in new depletions to surface water whereby the State Engineer may require a water harvesting district to acquire water rights to offset the increased depletion.

As the above policy states, so long as the use of the harvested water does not exceed the pre-development state, theoretically, there should not be an impact to the stream system. However, if the State Engineer determines there is impairment, then he could invoke his supervisory powers, and may seek an appropriate corrective action.

In addition to these general concerns, the Gila watershed is governed by a United States Supreme Court Decree that prohibits any outdoor uses of water without a water right. Therefore, this tax credit would not be available to that watershed without a permit from the State Engineer.

ADMINISTRATIVE IMPACT

TRD reports a moderate impact. Three new forms would need to be developed at a cost of $9,000. Coordination between RLD and TRD would be necessary to establish rules and procedures. Modifications to forms and instructions related to the personal income tax would be performed at minimal cost as part of the new tax year process. Tracking, monitoring and approval of the credits will require an additional half of an FTE at a cost of $25,000.

Moderate IT impact (400 hours) – Requires changes to the Gentax and Taxpayer Access Point documents, and configuration changes to the business credit module tables. Additional reports need to be developed to summarize the annual credit details. This can be completed as part of regular year end changes.

In its analysis of last year's SB-16, RLD indicated that it would be unable to administer the provisions of this bill assigned to it. RLD/CID neither permits nor inspects water systems as proposed in this bill.

LG/bb/je