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

SPONSOR Sariñana **ORIGINAL DATE** 1/24/18 **LAST UPDATED** **HB** 77

SHORT TITLE Energy Storage System Tax Credit **SB**

ANALYST Graeser

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY18	FY19	FY20	FY21	FY22		
	($750.0)	($750.0)	($750.0)	($750.0)	Recurring	General Fund

Parenthesis ( ) indicate revenue decreases

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY18	FY19	FY20	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
Total		$27.0	$12.0	$39.0	Recurring	EMNRD Operating

Parenthesis ( ) indicate expenditure decreases

Duplicates, Relates to, Conflicts with, Companion to: HB36, HB87 and SB79

SOURCES OF INFORMATION
LFC Files

Responses Received From
Public Regulation Commission (PRC)
Energy, Minerals & Natural Resources Department (EMNRD)

SUMMARY

Synopsis of Bill

House Bill 77 adds new sections to both the Income Tax Act and the Corporate Income and Franchise Tax Act. The new sections are largely parallel and they establish a new tax credit for the purchase and installation of energy storage systems. With respect to taxpayers subject to the Income Tax Act, the bill establishes the energy storage system tax credit (ESTC). With respect to entities subject to the Corporate Income and Franchise Tax Act, the bill establishes the energy storage corporate income tax credit (ESCTC). The tax credits are available for systems that are purchased and installed between 2018 and 2023. The amount of the tax credit is not to exceed the

lesser of three amounts: (1) $5,000 for a system installed on residential property (applicable to the ESTC only), (2) $75,000 for a system installed at a taxpayer's non-residential property, or (3) 30 percent of the total cost of installation of the system. The tax credits are subject to an annual aggregate cap of $750,000. The tax credits are not refundable and cannot be carried forward to any other taxable year. The ESTC and ESCTC programs are both to be administered by the Energy, Minerals and Natural Resources Department (EMNRD). Each installed energy storage system is subject to certification by EMNRD in order to obtain the applicable tax credit.

The purpose of the energy storage system income tax credit is to encourage research, development and installation of electricity storage facilities.

There is no effective date of this bill. It is assumed that the effective date is 90 days after this session ends or May 16. The provisions of the bill are applicable to taxable years beginning on or after January 1, 2018. The tax credit is repealed effective January 1, 2025.

FISCAL IMPLICATIONS

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.

From the 2016 TRD Tax Expenditure Report, credit claims actually paid for the Solar Market Development Tax Credit averaged about 90 percent of the $3 million credit cap for solar photovoltaic systems and minimal for solar thermal systems. However, this energy storage credit cannot be refunded or rolled over if the credits exceed the application year tax liability. With a maximum credit amount of $75K for an energy system installed on the taxpayer's commercial property, there could be as few as ten systems that receive tax credits. Up to five credits – one per year – could be paid to Facebook, which is going to use 100 percent renewable energy in the massive plant in Las Lunas.[1]

When battery storage is included in the installation of a solar system, the federal solar credit applies. The former state solar credit also applied to the costs of the storage component of the system. This bill is less costly to the general fund than the bills seeking to reinstate the solar credit.

[1] "This filing represents over 200 MW of new wind and solar energy projects that, if approved, will be built in **New Mexico**," **Facebook** said in a statement. ... Two new wind farms and a solar facility may be built in **New Mexico** to supply another 266 megawatts of renewable energy to **Facebook's** massive data center in Los Lunas ..." https://www.facebook.com › Places › Los Lunas, New Mexico

1.
2.

PRC notes that there may be additional revenue costs associated with a shift from peak to non-peak pricing attributed to the energy storage system. The ancillary revenue losses have not been recognized in previous analyses of this tax credits.

> The decrease in Gross Receipts Tax (GRT), Franchise Tax (FT), and Inspection and Supervision (I&S) revenues that will result is dependent on the number of energy storage system installations that will receive the credit and the extent of any resulting shift in electricity consumption from peak to non-peak periods. Because no estimate is available to the PRC of the impact of any shift in consumption pattern resulting from the energy storage systems installed under the ESTC and ESCTC programs, the PRC is unable to estimate the total reduction in GRT, FT, and I&S that may result. The amount of tax revenue loss, though, is estimated below for each $1,000 of utility bill reduction that results from any shift in consumption pattern:
>
> - GRT (5.500 percent to 9.250 percent, depending on location): $55.00 to $92.50 decrease per $1000 of utility revenue decrease
> - FT (+/- 3 percent, depending on municipality): $30.00 per $1000 of utility revenue decrease in the franchise area
> - I&S (0.056 percent): $0.56 per $1000 of utility revenue decrease

If the energy storage system is installed separate from an underlying solar system, then the gross receipts tax or compensating tax would be due. If all of the energy storage systems were taxable, the state would receive about $100,000 in gross receipts taxes and local governments about $85,000.

SIGNIFICANT ISSUES

This tax credit is not allowed to be carried over to future tax years; any amount remaining after a taxpayer claims the tax credit is forfeited. If the annual aggregate energy storage tax credit amount of $750,000 is met, EMNRD will notify taxpayers. Only one tax credit is allowed per taxpayer per year, and a taxpayer may claim the tax credit in the taxable year the energy storage system was installed. Married individuals filing separate tax returns may each claim only one-half of the tax credit. Business entities are allowed, under the Income Tax Act only, to claim the tax credit in proportion to the taxpayer's ownership interest in the business provided all members of the business partnership of limited liability company does not exceed the total tax credit amount. HB 77 requires the taxpayer to obtain a certification of the energy storage system from the Energy, Minerals and Natural Resources Department (EMNRD). EMNRD must adopt rules establishing for the certification. HB 77 requires the Taxation and Revenue Department (TRD) to compile an annual report evaluating the effectiveness of the credit, and present the report to interim committees.

Per Data from DOE/EIA, total small scale commercial and residential solar installations increased by 19 percent from CY 2014 to CY 2015, 20 percent from CY 2015 to 2016 and is expected to increase by almost 30 percent from CY 2016 to CY 2017. There was no solar market development credit for the whole of 2017, but the industry grew substantially. Part of the increase represented competition from new entrants in the market, and part represented substantial decrease in the cost of the modules.

	Estimated Small Scale Generation (Thousand megawatt hours)		
	YTD	Prior YTD	% Chg
December 2017 YTD	222	171	29.8%
December 2016 YTD	171	142	20.4%
December 2015 YTD	138	116	19.0%

There is no data on the portion of installations that currently involve battery storage or other technologies for electrical energy storage.

Representatives of the industry point out that the Trump administration is imposing a 30 percent tariff on solar modules manufactured principally by Chinese companies in third countries. This manufacturing location strategy was apparently adopted to avoid the tariff imposed on China for dumping modules on the worldwide market at lower than cost. Because of the economics of the industry, a 30 percent tariff on the bulk of the imported modules will likely cause a rise of 10 percent in the installed cost per kilowatt. The solar industry in the state may be able to weather this increase in cost with moderate disruption, but it will be difficult for new energy storage technologies to gain a foothold, when the underlying solar system costs are increasing. In comparison with the traditional 10 percent state solar credit, this energy storage credit is 30 percent of the installed cost.

PRC notes, "While unlikely to impact overall energy consumption, energy storage systems installed at the point of consumption allow customers to shift their consumption of electricity generally within a given day but not across a number of days. Many public utilities have Commission approved rates for residential customers which are based on time of use. Rates for larger commercial and industrial customers generally include a demand element which is based on the customer's peak demand during a billing period as well as a time of use element. Such rates may result in reduced electric bills and utility revenues from customers with energy storage systems. Consumers can redirect their savings to other purposes. GRT, FT, and I&S revenues are also reduced because of the bill reduction, thereby decreasing local and state and NMPRC revenues."

PERFORMANCE IMPLICATIONS

The LFC tax policy of accountability may be met since TRD is required in the bill 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. However, in the 2016 edition of the TRD Tax Expenditure Report, the Department reports that there is no penalty in statute for not separately reporting deductions, such as the Back-to-School deduction. Thus, the information provided to the Department is underreported and the costs reported in the Tax Expenditure Report are considered at the lowest level of reliability. This deduction would possibly face the same reporting unreliability problem. However, if the credit must be approved by EMNRD, then the reporting will be accurate and costs and benefits may be accurately assessed.

ADMINISTRATIVE IMPLICATIONS

EMNRD would incur a fiscal impact for staff resources needed to write the rules for the energy storage tax credit. It is expected that fewer than 50 claims for credit will be received each year. The fiscal impact for EMNRD includes staff resources to create rules for the energy storage tax credit, which is estimated at $27,000 in program and legal staff time. Additional staff resources over the six-year life of this new tax credit program are estimated at $12,000 per year (240 hours at $37 hourly rate plus fringe benefits) to manage, provide technical reviews of energy storage systems, and certify systems for tax credit eligibility.

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

HB 36 reinstates the solar market development 10 percent credit and allows it to operate until 2028. Maximum credits per system would be $9,000 for business and agricultural systems and $4,000 for residential systems.

HB 77 (this bill) enacts an annual $750.0 cap for the installation of an "energy storage system." This is a relatively generous credit of 30 percent of system cost, up to $75,000 per system if installed on commercial property or $5,000 if installed on residential property. It is first-come, first-served with no rollover of unused credits. There is no restriction on doubling up a solar credit with an energy storage system credit.

HB 87 repeals the existing solar market development credit and replaces it with a credit effective for installations from January 1, 2018 through January 1, 2023. The maximum credit available for residences, businesses or agricultural enterprises is $9,000 per system and represents 10 percent of the cost of the installed system. There is no companion corporate income tax credit.

SB 79 repeals the existing solar market development credit and replaces it with a credit effective at various percentages from 10 percent to 6 percent from January 2018 through January 1, 2033. The maximum credit available for residences, businesses or agricultural enterprises is $9,000 per system. Total credits are capped at $5,000,000 per year. There is no companion corporate income tax credit.

TECHNICAL ISSUES

It is not clear if the total cap for all systems is to be applied on a calendar year, or fiscal year basis. Since it is an income tax credit, it would be logical to assume that the cap is to be applied on a calendar year basis. It might be wise, however, to clarify this point.

OTHER SUBSTANTIVE ISSUES

The federal ITC was originally established by the Energy Policy Act of 2005 and was set to expire at the end of 2007. A series of extensions pushed the expiration date back to the end of 2016, but experts believed that an additional five-year extension would bring the solar industry to its full maturity. Thanks to the spending bill that Congress passed in late December 2015, the tax credit is now available to homeowners in some form through 2021. Here are the specifics:

- 2016 – 2019: The tax credit remains at 30 percent of the cost of the system. This means that in 2017, you can still get a major discounted price for your solar panel system.

- 2020: Owners of new residential and commercial solar can deduct 26 percent of the cost of the system from their taxes.
- 2021: Owners of new residential and commercial solar can deduct 22 percent of the cost of the system from their taxes.
- 2022 onwards: Owners of new commercial solar energy systems can deduct 10 percent of the cost of the system from their taxes. There is no federal credit for residential solar energy systems.

Additionally, in previous years, owners of new solar energy systems could not claim the tax credit unless their system was operational. Now, the legislation allows them to claim it as soon as the construction of the system begins, as long as it is operational by December 31, 2023.

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.

This tax expenditure is contrary to most of the LFC tax policy and tax expenditure guidelines because there are no targets, no goals and has a weak testable purpose.

LG/sb