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

SPONSOR Trujillo, CA   **ORIGINAL DATE** 1/30/18   **LAST UPDATED** 2/08/18   **HB** 238/ec

SHORT TITLE Outdoor Water Conservation Gross Receipts   **SB**

ANALYST Graeser

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY18	**FY19**	**FY20**	**FY21**	**FY22**		
($650.0)	($650.0)	($650.0)	($650.0)	($650.0)	Recurring	General Fund
($650.0)	($530.0)	($530.0)	($530.0)	($530.0)	Recurring	Local Governments
($1,300.0)**	($1,180.0)	($1,180.0)	($1,180.0)	($1,180.0)		Total

**Estimated costs for FY18 are on the assumption that the bill would be effective on or before March 1, 2018.

Parenthesis ( ) indicate revenue decreases

SOURCES OF INFORMATION
LFC Files

Responses Received From
Energy, Minerals, Natural Resources Department (EMNRD)
Office of State Engineer (OSE)

SUMMARY

Synopsis of Bill

House Bill 238 creates a new Gross Receipts and Compensating Tax Act deduction for sales of water-saving tangible personal property. The deduction is restricted to the one-week period beginning at midnight on March 1 and ending at midnight on March 8.

The bill provides for reporting requirements with taxpayers reporting the amount of the deduction separately. Taxation and Revenue Department (TRD) must compile an annual report on the deduction including the number of taxpayers claiming the deduction, the aggregate amount of deductions claimed, and any other information necessary to evaluate the effectiveness of the deduction. Beginning in 2019, the TRD must compile and present the report to the Revenue Stabilization and Tax Policy Committee and the Legislative Finance Committee with a cost and benefit analysis.

The bill defines "water-saving tangible personal property"

(1) as products:

- Intended for use on private property and not intended for business use, trade or resale;
- whose use may result in (1) water conservation or ground water retention; (2) water table recharge; or (3) a decrease in ambient air temperature that limits water evaporation and

(2) includes:

- drought-tolerant live plants, turf and grass
- soaker or drip-irrigation hosing
- moisture controls for sprinkler or irrigation systems
- mulches and soils
- rain barrels and alternative rain and moisture collection systems
- permeable ground cover surfaces that allow water to reach underground basins, aquifers or water collection points
- plant and grass seed coated with water-saving surfactants and
- water-saving surfactants

The effective date of this bill is March 1, 2018 if the act takes effect on or before March 1, 2018, otherwise the effective date is July 1, 2018.

The bill contains an emergency clause.

The bill does not contain a sunset date. LFC recommends that all tax expenditures be reviewed periodically to determine if conditions still warrant the tax expenditure.

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.

The costs of this tax expenditure will be particularly difficult to determine, since the period of deductible sales is shorter than the typical reporting cycle of one-month. Even if TRD sets up a special reporting code, many retailers will not use the special code in favor of one unified deduction for deductions from all sources. Similarly, there will be virtually no means of monitoring water saved from rooftop water collection systems, drip irrigation or xeriscaping.

The fiscal impact reported on the previous page is that of TRD, using the following methodology.
Methodology for Estimated Revenue Impact: The Taxation and Revenue Department (TRD)

collected data on tax paid by the retail industry during the months of March in the last five fiscal years. The amounts were averaged and divided by four as this deduction is only applicable for one out of four weeks of the month. This amount was then multiplied by a ratio which was calculated by dividing total expenditures on outdoor gardening equipment by the total expenditures in retail1. It is difficult to estimate the revenue impact of this deduction as there is no data directly applicable to these types of sales. TRD must make assumptions on taxpayer behavior which could cause the score to be over- or under-estimated.

DFA found a data source (http://gardenresearch.com/) and pointed out that the definition is rather broad. Allocating U.S. total "gardening expenditures" of $36 billion times the NM population ratio and assuming 1/3rd of these gardening expenditures would qualify gives an annual estimate of $80 million in water conservation expenditures. If one-tenth of this annual spending were bunched into spring tax free week, that would result in $8 million in deductible sales, or about $325 thousand in general fund impact.

LFC estimated a lower impact in the original FIR. LFC acknowledged that the tax expenditure was both difficult to estimate and equally difficult to track costs and benefits.

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY18	FY19	FY20	FY21	FY22		
	($210.0)	($210.0)	($210.0)	($210.0)	Recurring	General Fund
	($165.0)	($165.0)	($165.0)	($165.0)	Recurring	Local Governments

LFC's methodology follows:
Several sources estimate the cost of large water tanks suitable for rooftop water collection and storage at $2 to $3 per gallon. Pumps and piping would add about $1 per gallon. Drip irrigation systems for large gardens or small farms are estimated to cost $500 to $1.2 thousand per acre. Other technologies are similar in cost.

http://www.plastic-mart.com/product/13258/contain-water-systems-601s-780-gallon-metal-corrugated-steel-rainwater-tank?gclid=EAIaIQobChMI8Y-zhOSA2QIVCKvsCh3LmQCHEAQYASABEgLTUPD_BwE

http://edis.ifas.ufl.edu/hs388

Assume that one thousand full systems costing $5 thousand per system (allowing 1 gallon of storage per square foot of roof area) would be sold during the one-week deduction period. The state tax rate is about 4.14 percent and the total city and county rate about 3.3 percent.

Since the TRD estimate is the highest, it is reported here. Because of taxpayer behavior, even this estimate may be low.

SIGNIFICANT ISSUES

---

[1] U.S. Bureau of the Census, Advance Retail Sales: Building Materials, Garden Equipment and Supplies Dealers [RSBMGESD], retrieved from FRED, Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/series/RSBMGESD, February 6, 2018.

The provisions will be very hard to administer and the benefits will be equally difficult to monitor. The deduction is claimed by the seller, not the buyer of the water saving equipment or plantings. The seller, if a retailer and not responsible for the installation, would have no accurate means of determining if the buyer intended the equipment for installation on business premises. The seller will similarly have no means of determining how much water is being conserved. Thus, the required TRD report to the legislature will have no means of determining the interesting information – which is the amount of water saved or conserved per $1,000 of state and local revenue cost.

The OSE points out that on page 3, line 2, "water-saving" tangible personal property" is defined to "include" a list of eight categories of products. This could lead to uncertainty and disputes over whether other categories of water saving products would also qualify for the deduction from gross receipts allowed by the bill. It is not clear if the OSE is willing to take on the responsibility of regulating appropriate types of equipment.

There is no requirement, as in the case of the expired solar credits, that the equipment be installed at all, and no requirement that the installation be monitored and supervised.

PERFORMANCE IMPLICATIONS

The LFC tax policy of accountability is nominally 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. However, TRD would have no means of accurately determining the cost of the deductions since there is no penalty for failure to report correctly. Similarly, TRD would have no means of determining the benefits accruing to the deduction in terms of water conserved or saved.

ADMINISTRATIVE IMPLICATIONS

TRD will have moderate difficulty establishing and maintaining the deduction. Separate reporting without penalty is the same as no separate reporting.

TECHNICAL ISSUES

This bill does not contain a delayed repeal date. LFC recommends adding a delayed repeal date. The purpose of the deduction is to assist New Mexico during times of drought. Perhaps a conditional effective date or repeal date could be tied to a drought severity index on a county-by-county basis. There are agricultural extension agents in each county that could be relied upon to design and supervise the installation of a water conservation system.

OTHER SUBSTANTIVE ISSUES

In the 2016 TRD Tax Expenditure Report, TRD notes that failure to report separately is not effective, because there is no penalty for this failure.

ALTERNATIVES

This would be more administrable and transparent if it were administered as an income tax credit, particularly if the system would have to be reported to and approved by OSE.

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

Note that this bill fails all five of the core LFC tax policy principles.

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.

The bill fails five of the six core LFC tax expenditure policy principles. The bill provides for accountability, but TRD experience with this type of tax expenditure reporting has been disappointing.

LG/jle/sb