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FISCAL IMPACT REPORT

ORIGINAL DATE 1/24/18
 LAST UPDATED 2/13/18 HB _____

SPONSOR Stewart

SHORT TITLE Solar Market Development Tax Credit SB 79/SFI#1

ANALYST Graeser/Iglesias

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY18	FY19	FY20	FY21	FY22		
	(\$5,000.0)	(\$5,000.0)	(\$5,000.0)	(\$5,000.0)	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	\$19.0	\$38.0	\$35.0	\$101.0	Recurring	EMNRD Operating

Parenthesis () indicate expenditure decreases

Because of the May 16 effective date for the provisions of this bill, there will be claims filed with EMNRD in the last month and a half of FY 2018. EMNRD may have to plan and hire for this surge of claims, many of which may have been for systems installed in 2015 or 2016.

Duplicates, Relates to, Conflicts with, Companion to: HB36, HB77 and HB87

SOURCES OF INFORMATION

LFC Files

Responses Received From

Taxation and Revenue Department (TRD)

Energy, Minerals & Natural Resources Department (EMNRD)

SUMMARY

Synopsis of Senate Floor Amendment #1

Senate Floor Amendment #1 extends the 10 percent Solar Market Development Credit for systems installed prior to January 1, 2023, provides an 8 percent credit for systems installed from January 1, 2023 until December 31, 2027 and provides no credit for systems installed after January 1, 2023.

Synopsis of Original Bill

Senate Bill 79 repeals and reenacts the Solar Market Development Tax Credit and allows credits for systems installed before January 1, 2033. The reinstatement provisions would begin for systems installed after January 1, 2018. The tax credit would be issued for up to 10 percent of the purchase and installation price for photovoltaic or solar thermal systems up to a limit of \$9,000 for a residence, business or agricultural enterprise.

For systems installed from January 1, 2018 (and for legacy systems) to December 31, 2020, the credit is 10 percent of the installed cost;

For systems installed from January 1, 2021 to December 31, 2023, the credit is 9 percent of the installed cost;

For systems installed from January 1, 2024 to December 31, 2026, the credit is 8 percent of the installed cost;

For systems installed from January 1, 2027 to December 31, 2029, the credit is 7 percent of the installed cost; and

For systems installed from January 1, 2030 to December 31, 2032, the credit is 6 percent of the installed cost.

The tax credit would have a total annual cap of \$5 million with no stated split between systems installed in business and agricultural enterprises and systems installed in residences. The issued tax credit would carry forward for up to five years.

Application for the tax credit would be through the Taxation and Revenue Department (TRD) forms with a certification conforming to application process rules and standards established by EMNRD. SB79 adds a requirement for the tracking of the tax credits and compilation of reports by TRD. TRD must report annually to interim committees on the cost effectiveness of the tax credit.

The bill also contains a temporary provision such that systems installed prior to 2018 but declared ineligible due to lack of prior program tax credits could apply for this tax credit.

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. With this effective date and the extension of eligibility to systems installed prior to 2018, but declared ineligible due to lack of prior program tax credits, there will be claims filed and allowed in FY 2018. However, since this is an income tax or corporate income tax credit, there will be no fiscal impact until 2019.

FISCAL IMPLICATIONS

From the 2016 TRD Tax Expenditure Report, credit claims actually paid average about 90 percent of the \$3 million credit cap for solar photovoltaic systems. It is possible this will be more of a commercial/agricultural credit than a residential credit. The fiscal estimates assume the full \$5 million capped impact each year.

There is some concern in the industry that natural growth of the industry may slow and there may be some of the \$5 million cap “left on the table.” The combined residential and commercial,

small scale solar generation production has been growing in excess of 20 percent per year. The recently announced 30 percent solar module tariff may slow this growth for a few years, but the competitive energy prices will continue to make the investment in solar attractive. LFC staff concurs with TRD that the full amount of the cap will be paid each year.

In addition to the installation year installation credit, there is a reduction in gross receipts tax in every jurisdiction in the state. The average size of a solar installation is 5.0 kilowatts, with approximately 2,000 per year of sun, with the total production estimated at 222 thousand megawatt hours for 2017. With an average 7.4 percent GRT rate and \$.1137 per kwhr electricity charge, the total small scale solar capacity costs the state about \$1 million in foregone annual revenues and the local governments about \$800 thousand. Over time, this denied revenue is an order of magnitude greater than the 10 percent tax credits.

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

Notably, while the stated purpose of this bill is to incentivize installation of solar systems, the bill allows tax credits for systems already purchased as of January 1, 2018, as well as systems purchased *prior* to January 1, 2018 that had met eligibility requirements for the prior solar development tax credit program. Given that the prior tax credit program met the tax credit cap in June of 2016, estimated applications for 2016 and 2017 that could be submitted could be as high as 2,000 applications. These provisions, in effect, reward consumers for purchases already made rather than providing an incentive for new installations.

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%

These data may indicate that the industry might ***NOT*** need the extra 10 percent tax credit support to remain viable. However, 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-world 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. This cost is currently estimated at \$3.59 per watt in the Albuquerque area and this may rise to \$3.95 per watt. With the federal 30 percent credit, the cost will rise from \$2.51 per watt to \$2.77 a watt, installed. If this bill were to pass, the additional state 10 percent would reduce the installed \$2.77 per watt cost to \$2.37 or about 5.6 percent less than with current law, even with the additional 30 percent tariff.

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 this deduction would probably 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 amend the rules for the solar market development tax credit, which is estimated at \$38,000 in program and legal staff time (800 hours at \$37 average hourly rate plus fringe benefits). Additional annual staff resources for management of the technical portion of this tax credit program are estimated at \$35,000 per year (960 hours at \$28 average hourly rate plus fringe benefits) to manage, provide technical reviews of solar systems, and certify systems for tax credit eligibility.

Under Section 2.A (Temporary Provision), systems installed prior to 2018 but declared ineligible due to lack of prior program tax credits could apply for this tax credit. Given that the prior tax credit program met the tax credit cap in June of 2016, estimated applications for 2016 and 2017 that could be submitted could be as high as 2,000 applications.

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 enacts an annual \$750.0 cap for the installation of an “energy storage system.” This is a relatively generous 30 percent credit limited 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 (this bill) 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.

LFC Tax Expenditure Policy Principle	Met?	Comments
Vetted	?	
Targeted		“...to encourage the installation of solar thermal and photovoltaic systems in residences, businesses and agricultural enterprises.”
Clearly stated purpose	✓	
Long-term goals	✗	
Measurable targets	✗	
Transparent	✓	TRD is required to report annually to interim committees
Accountable		Unclear if the required reporting information will be sufficient to evaluate the effectiveness and efficiency of this credit
Public analysis	?	
Expiration date	✓	January 1, 2033
Effective		Arguably provides a reward for some purchases already made
Fulfills stated purpose	?	
Passes “but for” test	?	
Efficient	?	Unclear if the credit is the most cost-effective way to encourage solar system installation, and the industry may not need this assistance to remain viable.
Key: ✓ Met ✗ Not Met ? Unclear		