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

SPONSOR	Strickler/Alcon /Garcia/Allison/Bandy	**ORIGINAL DATE** / **LAST UPDATED**	2/04/19 / 2/07/19	**HB**	347
SHORT TITLE	Coal Sales & Processing Gross Receipts			**SB**	
				ANALYST	Iglesias

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY19	**FY20**	**FY21**	**FY22**	**FY23**		
$0.0	($1,940.0)	($3,990.0)	($5,670.0)	($5,510.0)	Recurring	General Fund
$0.0	($960.0)	($1,900.0)	($2,900.0)	($3,000.0)	Recurring	Local Governments
$0.0	($10.0)	($20.0)	($30.0)	($20.0)	Recurring	Reclamation Fund
$0.0	($1,120.0)	($2,260.0)	($2,860.0)	($2,320.0)	Recurring	Severance Tax Bonding Fund
$0.0	**($4,030.0)**	**($8,170.0)**	**($11,460.0)**	**($10,850.0)**	**Recurring**	**TOTAL**

Parenthesis ( ) indicate revenue decreases

SOURCES OF INFORMATION
LFC Files

Responses Received From
State Land Office (SLO)
Energy, Minerals, and Natural Resources Department (EMNRD)
Taxation and Revenue Department (TRD)
Department of Finance and Administration (DFA)

SUMMARY

Synopsis of Bill

House Bill 347 reduces various taxes on coal production and processing, phased in over a three-year period. In effect, the bill reduces gross receipts taxes (GRT), severance taxes, resources and processors taxes (a.k.a. resources excise tax), and conservation taxes on coal production and processing by 25 percent in FY20, 50 percent in FY21, and 75 percent from FY22 to FY31. After July 1, 2032, coal taxes will revert back to their current levels. The GRT deduction would be required to be separately reported and the Taxation and Revenue Department (TRD) would be required to compile a report and present it to the specified legislative committees yearly. The effective date of this bill is July 1, 2019.

FISCAL IMPLICATIONS

This bill narrows the gross receipts tax (GRT) base. See *Significant Issues* for more information.

The fiscal estimates from TRD use the Consensus Revenue Estimating Group (CREG) forecast from December 2018 as the starting point. The CREG revenue forecast assumes a drop in coal production in FY19 as a result of the closing of two power units at the San Juan Generating Station. The revenue forecast also assumes an annual level of coal production for the state that includes a drop in coal production starting in FY22 as a result of the closing of the remaining power units at the San Juan Generating Station. This level of coal production is assumed for all tax rate adjustment impacts in this bill and fiscal impacts begin FY20. The fiscal impact does not assume a significant change in coal production in response to the tax rate decreases.

The bill proposes a new GRT deduction for the sale or processing of coal. TRD used data from the RP-80 report with an applied inflation factor to estimate the fiscal impact of the proposed GRT deduction. This deduction results in a revenue loss to the general fund and to local governments. These amounts are included in the total impact from the bill and listed separately below.

Gross Receipts Tax – New Deduction

Estimated Revenue (in thousands)					Recurring or Nonrecurring	Fund Affected
FY19	FY20	FY21	FY22	FY23		
$0.0	($1,400.0)	($2,900.0)	($4,300.0)	($4,400.0)	Recurring	General Fund
$0.0	($960.0)	($1,900.0)	($2,900.0)	($3,000.0)	Recurring	Local Governments
$0.0	**($2,360.0)**	**($4,800.0)**	**($7,200.0)**	**($7,400.0)**	**Recurring**	**Subtotal**

The new rates proposed in the resources excise tax, severance tax, and conservation tax were applied to the forecast. Revenue from the resources excise tax is distributed to the general fund, revenue from the severance tax is distributed to the severance tax bonding fund, and revenue from the conservation tax is distributed to the general fund and the oil and gas reclamation fund. The tables below indicate the revenue impacts from these three taxes.

Resources Excise Tax

Estimated Revenue (in thousands)					Recurring or Nonrecurring	Fund Affected
FY19	FY20	FY21	FY22	FY23		
$0.0	($440.0)	($880.0)	($1,110.0)	($900.0)	Recurring	General Fund

Conservation Tax

Estimated Revenue (in thousands)					Recurring or Nonrecurring	Fund Affected
FY19	FY20	FY21	FY22	FY23		
$0.0	($100.0)	($210.0)	($260.0)	($210.0)	Recurring	General Fund
$0.0	($10.0)	($20.0)	($30.0)	($20.0)	Recurring	Reclamation Fund
$0.0	**($110.0)**	**($230.0)**	**($290.0)**	**($230.0)**	**Recurring**	**Subtotal**

Severance Tax

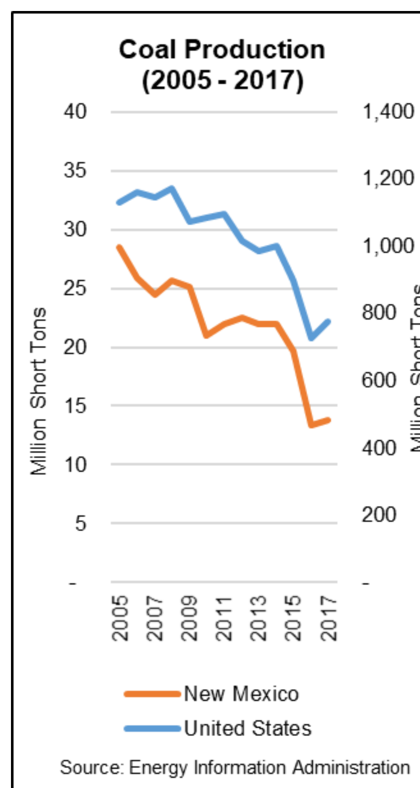
Estimated Revenue (in thousands)					Recurring or Nonrecurring	Fund Affected
FY19	FY20	FY21	FY22	FY23		
$0.0	($1,120.0)	($2,260.0)	($2,860.0)	($2,320.0)	Recurring	Severance Tax Bonding Fund

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

This bill narrows the gross receipts tax (GRT) base. Many of the efforts over the last few years to reform New Mexico's taxes focused on broadening the GRT base and lowering the rates. Narrowing the base leads to continually rising GRT rates, increasing volatility in the state's largest general fund revenue source. Higher rates compound tax pyramiding issues and force consumers and businesses to pay higher taxes on all other purchases without an exemption, deduction, or credit.



The proposed rate changes and new GRT deduction would provide tax relief for those who are already selling and processing coal in the state. While the bill includes no purpose statement, it appears the intent for offering tax relief on coal production and processing could be to support New Mexico's coal mining industry, which has experienced a general decline both nationally and in New Mexico over the last decade.

Low natural gas prices have been a driving factor in the decline of coal production. Natural gas electricity generation has increased in New Mexico and the United States over the last 10 years, and in 2016 electricity generation in the U.S. from natural gas surpassed generation from coal-fired plants. Natural gas supplied an estimated 34 percent of total U.S. electricity generation in 2016 compared with 30 percent for coal. Additionally, solar costs fell 85 percent between 2008 and 2016, and wind costs fell 36 percent.[1] Based the difficulties coal has faced in remaining competitive given these changes, the Energy Information Administration (EIA) projects a continued downward trends in coal production in the U.S. through 2040.

[1] Columbia University Center on Global Energy Policy, April 2017, *Can Coal Make a Comeback?*

In its 2017 integrated resource plan (IRP), the Public Service Company of New Mexico's (PNM) is proposing a future energy resource portfolio that would eliminate the company's use of coal-fired generation by the end of 2031. Included in this plan are the closure of units 2 and 3 of the San Juan Generating Station (SJGS), which occurred at end of 2017. PNM also indicates the results of the report "point strongly toward" shutting down SJGS entirely after the current coal supply agreement runs out in 2022 and also exiting Four Corners Power Plant in 2031 when its coal supply agreement runs out.[2] The company states these actions will leave no coal in PNM's energy supply mix. The IRP is currently under protest and is still pending approval by the Public Regulation Commission. If PNM does shut down SJGS, the company indicates on its website that it plans to build more solar capacity and build new flexible natural gas generation.

However, the potential permanent retirement of SJGS and subsequent potential shutdown of San Juan Coal Company (if it could not find another market for its coal, which now goes directly to SJGS) would pose a variety of difficulties for the City of Farmington and San Juan County as well as the residents of these areas. Firstly, it would mean the loss of good-paying jobs that would not be easily replaced. It would also mean lost property tax and GRT revenue for San Juan County and the Central Consolidated School District.

Four Corners Economic Development (4CED) provided an analysis of the economic impact of the potential closure of SJGS and SJCC, stating it would result in the loss of 657 jobs with average annual salaries of $85 thousand plus benefits. The analysis indicates vendors in San Juan County would lose $31 million in purchases. Farmington, San Juan County, and the state would lose gross receipts tax (GRT) revenues due to lost wages from laid-off workers and loss of local purchases of goods and services by PNM and SJCC.

	Farmington	County	State
From Vendor Purchases	$0	$82,710	$1,621,412
Employee Spending (50%)	$224,625	$303,904	$1,083,486

There would also be an estimated loss of $9.6 million in property taxes paid by SJGS and SJCC. According to 4CED, this would require an automatic increase of 4 mills in debt service rate and 1.5 mills in operating rates requiring action of the San Juan County Commission and the San Juan College board. Additionally, the state, other state funds, and the Navajo Nation will lose severance tax revenue assuming that an alternative market for coal from the SJCC could not be developed. The following estimates of lost tax revenue are provided by 4CED.

Other Lost Taxes ($ millions)	
Severance Tax (STBF)	$3.23
Conservation Tax (Gen Fun and OSF)	$.33
Resource Excise Tax (Gen Fund)	$1.41
Gross Proceeds Tax (Navajo Nation)	$1.55
Total	$6.52

Additionally, TRD provides the following discussion regarding this bill:

> "Due to the plans announced by PNM to shut-down the remaining two units at the San Juan Generating Station, the current market for New Mexico coal is expected to decrease

[2] PNM 2016-2036 Integrated Resource Plan, https://www.pnm.com/irp

> significantly in the future, causing economic dislocation in the four corners region. Reducing taxes on coal will decrease the overall cost of severing coal and thus make coal more marketable. There are likely to be continuing challenges in the marketplace for New Mexico coal due to the cost of environmental regulations and to the low cost of alternative natural gas-fired power plants, so that a long-term rebound of the industry appears unlikely. In the meantime, the GRT deduction will mean a loss of the local tax base in San Juan and McKinley counties which have experienced declining revenue with the decrease in natural gas production in the San Juan basin. Finally, the rate reduction on coal will lower Severance Tax bonding fund revenue and thus lower the state's severance bond capacity and permanent fund distributions."

The Department of Finance and Administration (DFA) also points out this bill would reduce revenues to the severance tax bonding fund, lowering the state's severance bond capacity and permanent fund distributions. Severance tax revenues on coal have declined significantly in the last ten years, declining around 47 percent between FY 14 and FY 18. The reduction in revenues to the fund resulting from this bill would roughly drop receipts an additional 70 percent, effectively eliminating coal as a material contributor to severance tax bonding receipts.

DFA states that, while the coal-related receipts forgone by the bill are relatively minor in terms of their effect on the state's outstanding severance tax bonds, there is concern that reducing pledged revenues could raise a red flag to the investment market. Such an action as proposed in the bill would establish a legal precedent that could negatively impact bondholder interests in the future. Bondholders may be concerned that the State is not exacting the same diligence in oversight of sufficient bond reserves, and that taxes on resources that contribute much more to the severance tax bonding fund (i.e., oil and gas) may also be reduced.

DFA also notes that it appears the bill proposes reducing tax rates on coal producers to provide relief to an already struggling coal industry. If that is the case, DFA states "the proposed tax reduction would likely not contribute significantly to alleviating the industry's problems, which come primarily from reduced demand and low coal prices."

The State Land Office provides the following analysis on this bill:

> Due to environmental regulations related to the burning of coal, the dramatic rise in supply and drop in cost of natural gas, and the near parity of cost with zero-emission renewable resources (wind and solar), the long-term production and use of coal will very likely continue its rapid decline. Tax breaks on the resource might help operators in the short-term, but will most likely not preserve an industry with so many forces aligned to supplant it.

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

The bill proposes a new temporary GRT deduction for the sale or processing of coal. This deduction will require changes to forms and reprogramming to the GenTax system to implement

a special code in order to track the number of taxpayers who claimed the deduction from gross receipts each year. TRD will need to also update forms, instructions, and publications to reflect the tax rate changes for the Resources Excise Tax, Severance Tax, and Conservation Tax.

TECHNICAL ISSUES

The GRT deduction in this bill requires that the coal be subject to the Severance Tax, but coal is also subject to the Resource Excise Tax. TRD suggests there be a comprehensive requirement that all required taxes be paid and proof of actual payment be submitted before the deduction applies.

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

House Bill 353 could also reduce revenues to the severance tax bonding fund by increasing the price threshold at which oil and gas stripper wells receive a reduced severance tax rate.

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	✖	Discussed with LFC staff prior to introduction; however, received no committee hearing.
Targeted Clearly stated purpose Long-term goals Measurable targets	 ✖ ✖ ✖	No purpose statement, but it appears the intent is to support New Mexico's coal mining industry. None. None.
Transparent	✓	Requires annual reporting by TRD on the GRT deduction.
Accountable Public analysis Expiration date	 ? ✓	Requires annual reporting by TRD; however, without a clearly stated purpose, goals, or measurable targets, it is difficult to evaluate the effectiveness of the bill. Contains a delayed repeal date of July 1, 2032.
Effective Fulfills stated purpose Passes "but for" test	 ? ?	Difficult to determine; however, the trend of declining coal production in NM and nationally are unlikely to be reversed through state-specific tax deductions, as the declines are primarily due to a shift to cheaper natural gas and toward renewable energy.
Efficient	?	Desired results are unclear.
Key: ✓ Met ✖ Not Met ? Unclear		

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