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

ORIGINAL DATE 2/15/19
SPONSOR Gonzales/Garcia, H. **LAST UPDATED** 2/21/19 **HB** 506

SHORT TITLE Wastewater Treatment System Tax Credit **SB**

ANALYST Iglesias

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY19	**FY20**	**FY21**	**FY22**	**FY23**		
$0.0	(Indeterminate, likely minimal)				Recurring	General Fund

Parenthesis ( ) indicate revenue decreases

SOURCES OF INFORMATION
LFC Files

Responses Received From
Taxation and Revenue Department
New Mexico Environment Department

SUMMARY

Synopsis of Bill

House Bill 506 creates a $2,500 income tax credit for the purchase and installation of a residential wastewater treatment system that removes a greater amount of contaminant than is accomplished through primary treatment. The credit applies to systems installed on property owned and occupied by the taxpayer, can be claimed against the taxpayer's liability, and may be carried forward for a maximum of three consecutive tax years. The taxpayer must submit a copy of a certificate received from the New Mexico Environment Department (NMED) and must apply and claim the credit as specified by the Taxation and Revenue Department (TRD). The bill tasks TRD with compiling an annual report of the credit and presenting it to the specified legislative committees.

There is no effective date of this bill. It is assumed that the effective date is 90 days after this session ends. The bill applies to taxable years beginning on or after January 1, 2019.

FISCAL IMPLICATIONS

TRD identifies technical issues with the bill that prevent determination of a fiscal impact, namely the inability to determine how much of the credit taxpayers may claim. The bill states taxpayers may claim “up to” $2,500, but does not prescribe how the credit awarded amount is determined. It is possible the bill intends for taxpayers installing a wastewater treatment system to claim the full amount of the credit or some portion of the credit based on unidentified criteria.

A 2006 report by NMED indicated about 29 percent of New Mexico’s residents use on-site sewage systems, including an estimated 215 thousand septic systems, 2,400 advanced wastewater treatment systems, and 24 thousand other systems. The report indicates more that 50 percent of households in Catron, Harding, Mora, Rio Arriba, Taos, Torrance, and Valencia use onsite systems. Generally, installation of residential wastewater treatment systems cost about $5,000 to $10,000, and the cost to replace an existing system is about $3,000 to $7,000. A concrete septic tank can last 40 years to nearly indefinitely, though poor quality concrete or acidic ground water may result in deterioration. Given the cost and lifetime of such systems, the minimal fiscal impact assumes relatively few installations or replacements to be claimed each year for the credit.

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

Current statute allow homeowners to install liquid waste systems. The policy question at issue is whether the state should incentivize installation of these systems through an income tax credit. TRD provides the following policy analysis on this issue:

> “Municipalities and other political subdivisions serve the public good by managing municipal wastewater systems that efficiently and safely manage sanitary waste streams for all citizens. Citizens collectively support these systems through taxes and fees. Rural areas often manage sanitary waste with septic systems. These complex sanitary waste management systems address sanitary and environmental risks and protecting surface water and ground water for all individuals. Tax policy that incentivizes individuals to operate independently from a greater public network can place pressure on compliance resources and the financial structures to support public works.”

The bill may incentivize installation of advanced water treatment systems over a conventional “septic system” (see discussion in *Technical Issues* section). However, NMED states advanced treatment systems are not always necessary per the current liquid waste and disposal regulations. These regulations identify when alterative treatment systems must be installed and are determined based on lot size and other site conditions. Therefore, NMED points out the credit may apply to people who choose to install such a system even when it is not required.

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

According to NMED, the bill's requirement to establish procedures for providing certification that the wastewater system was installed in accordance with current Liquid Waste Treatment and Disposal Regulations, can be done through the current permitting and approval process.

TRD recommends added language that requires electronic information sharing for certificates awarded. By receiving electronic files of awarded certificates, data is readily available for annual reporting and increases return processing efficiency and accuracy.

TECHNICAL ISSUES

For the purpose of claiming this credit, the bill defines wastewater treatment system as "an on-site liquid wastewater treatment system that uses a process of wastewater treatment that removes a greater amount of contaminant than is accomplished through primary treatment." NMED states this language enables taxpayers to claim a credit for installing an advanced treatment system over a conventional septic system, identified as primary treatment. However, TRD states the bill's definition is not sufficient for managing the credit and must be written to conform with NMED's definitions.

TRD is concerned the current bill language could create conflict and litigation as to how it is applied and how much credit a taxpayer can receive. Section 1(A) sets the maximum amount of the credit, up to $2,500, but the remaining sections do not further detail the measures of the credit such as what costs can be included.

TRD also notes Section 1(E) of the bill states that the credit can be allocated in proportion to a taxpayer's ownership in a business entity which has met all the requirements to be eligible for the credit, but this credit is only available under the income tax act for systems installed at the taxpayer's primary residence.

This bill does not contain a delayed repeal date. LFC recommends adding a delayed repeal date.

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	✘	Not heard in interim meetings of LFC or RSTP.
Targeted		
Clearly stated purpose	✘	None.
Long-term goals	✘	None.
Measurable targets	✘	None.
Transparent	✓	The bill requires annual reporting by TRD on the number of taxpayers claiming the credit and the aggregate amount of the credits.
Accountable		
Public analysis	?	Because there is no stated purpose for the credit, it is indeterminate whether reported information will allow for analysis of the effectiveness and efficiency of the credit.
Expiration date	✘	
Effective		
Fulfills stated purpose	?	No stated purpose.
Passes "but for" test	?	Indeterminate.
Efficient	?	Because there is no stated purpose, it is indeterminate whether the credit is the most cost-effective way to achieve the desired results.
Key: ✓ Met ✘ Not Met ? Unclear		

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