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## FISCAL IMPACT REPORT

**ORIGINAL DATE** 01/26/22

**SPONSOR** Soules **LAST UPDATED** \_\_\_\_\_ **HB** \_\_\_\_\_

New Solar Market Development Income Tax Credit

**SHORT TITLE** Extension **SB** 44

**ANALYST** Graeser

### REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY22	FY23	FY24	FY25	FY26		
	(\$0.0) to (\$3,900.0)	(\$0.0) to (\$3,600.0)	(\$1,000) to (\$3,700.0)	(\$3,000.0) to (\$3,800.0)	Recurring	General Fund

Parenthesis ( ) indicate revenue decreases

The bill increases the cap to \$16 million from the current \$8 million. While LFC, EMNRD, and TRD agree the current law cap of \$8 million will not likely be exceeded within the forecast period, only EMNRD believes the credits paid, even with refund ability, will reach the proposed \$16 million cap by 2031. There is more uncertainty than usual in this estimate because the New Solar Market Development Tax Credit has operated for only a brief period of time.

### ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

FY22	FY23	FY24	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
\$30.0	\$70.0	\$70.0	\$170.0	Recurring	EMNRD Operating
\$30.4	\$60.9	\$60.9	\$152.1	Recurring	RPD – one FTE
--	\$5.2	--	\$5.2	Non-recurring	ITD

Parenthesis ( ) indicate expenditure decreases

Duplicates HB34

### SOURCES OF INFORMATION

LFC Files: FIR for 2020 SB29 and TRD's 2021 Tax Expenditure Report

#### Responses Received From

Energy, Minerals and Natural Resources (EMNRD)  
Taxation and Revenue Department (TRD)

### SUMMARY

#### Synopsis of Bill

Senate Bill 44 extends the sunset on the new solar market development income tax credit by four years from December 31, 2027 to December 31, 2031. The cap on the credit is increased from \$8 million to \$16 million. The credit is made refundable rather than eligible for carry forward for five years.

The effective date of the bill is not stated; assume 90 days after the close of the legislative session. The credit is applicable for tax years beginning January 1, 2022. There is an implicit delayed repeal (sunset) of the provisions of this bill, since systems must be installed prior to the end of 2031.

**FISCAL IMPLICATIONS**

This bill expands a tax expenditure with a cost that is difficult to determine but likely significant. LFC has serious concerns about the significant risk to state revenues from tax expenditures and the increase in revenue volatility from erosion of the revenue base. The Committee recommends the bill adhere to the LFC tax expenditure policy principles for vetting, targeting, and reporting or be held for future consideration.

EMNRD expects the provisions of this bill will stimulate an expansion of the market and a collateral expansion in the number of approved claims for refund. The potential fiscal revenue impact to the general fund could be an additional \$8 million, if the solar installations continue to increase. Because the New Solar Market Development Tax Credit is quite new, there is only limited data available from EMNRD and TRD.

<b>Summary of New Solar Market Development Credit Use Data from EMNRD and TRD</b>		
<b>EMNRD</b>	<b>TY20</b>	<b>TY21</b>
Installations	2,364	1,680
Expenditures	\$6,682,831	\$5,166,768
Average Credit Claim	\$2,827	\$3,075
Average Installation	\$28,269	\$30,755
Average size of installation in watts	6,800	6,800
Implying an installed price(\$ per watt)	\$4.16	\$4.52
<b>TRD</b>		
Claims	1,475	
Expenditures	\$3,477	
Average Credit Claim	\$2,357	
Average Installation	\$23,573	
Percentage of approvals paid by TRD	52%	
<small>Note that the claimed installed price of over \$4.00 per watt is substantially higher than implied in the literature. Also note the significant discrepancy between EMNRD approvals and TRD paid claims. Only 52% of TY20 approved expenditure were claimed on 2020 returns. Finally, note that EMNRD expects claims to increase substantially, exceeding the current \$8 million annual cap by TY21 and, perhaps, exceeding the proposed cap of \$16 million by TY 2025.</small>		

EMNRD estimates that because these changes will likely increase the number of applications, there will be an increased fiscal impact on the agency for staff support to expand the tax credit program to handles this increase. According to EMNRD there would be an estimated cost of \$70 thousand, for a new staff position to support application processing and review and an additional approximately \$30 thousand for program redesign, administrative, legal, and information technology staff to update the current application process.

TRD estimates the fiscal impact of the increased cap amounts and refund ability as follows: “The New Solar Market Development Tax Credit was enacted beginning Tax Year 2020, while a prior solar market development credit program was available from tax years 2006 through 2016. Based on data received from EMNRD, an average of 1,000 photovoltaic systems received the previous solar market development credit and approximately 350 solar thermal systems received it. Given the \$3 million maximum aggregate cap amount on the credit for photovoltaic systems and a weighted average total system cost of \$28,640, photovoltaic system credits were hitting the cap by the third year of the previous credit.”

TRD also highlights: “During the prior credit, the average cost per watt for an installed residential photovoltaic system dropped from \$9.01 per watt in 2009 to \$4.50 per watt in 2016. Estimated national median installed prices in 2020 for residential installations were at \$3.80 per watt<sup>1</sup>. The average residential installation price in New Mexico would be around \$24,700, assuming national average per watt costs, a 14 percent decrease in system installation cost from the previous credit program. Further cost reductions are being sought by the U.S. Department of Energy’s Solar Energy Technologies Office to maintain cost incentives over the lifetime of solar photovoltaic systems.” The federal government continues a residential energy credit through tax year 2023 and a commercial credit beyond tax year 2022. The state solar energy systems gross receipts tax deduction, Section 7-9-112 NMSA 1978, also provides a deduction from the sale and installation of solar energy systems if used to generate power for on-site consumption.”

“Lower installation prices and current solar market tax deductions and credits contribute to incentivizing continued growth in residential photovoltaic installations. U.S. Energy Information Administration data for solar photovoltaic net generation by sector indicates that between October 2015 and October 2021, New Mexico residential solar photovoltaic generation increased at an annual average rate of 31 percent and small-scale systems in the commercial sector increased at a rate of 9 percent<sup>2</sup>. In FY21, a total of 1,529 taxpayers claimed the New Solar Market Development Tax Credit from TRD. TRD assumes applications for this credit will continue to grow at an average annual rate of 20 percent to support the growth trend in solar photovoltaic generation seen between 2015 and 2021. However, with these assumptions while the state may reach the current cap of \$8 million for aggregate credit in FY25, the state would not reach the proposed cap of \$16 million in the forecasted timeframe.”

LFC staff notes TRD analysis may not have included that the tax credit becomes refundable with 2022 tax returns filed in late FY22, because the applicability date of the changes affect the 2022 tax year. The current law carryover would be reduced for 2020 and 2021, but would not be repealed (See TECHNICAL ISSUES for discussion). Even with no expansion in installations and claims, the refundable tax credits will more closely approach the approvals. If there is an expansion in the number of claims, then this expansion will also increase the estimate. LFC staff found the current law is expected to lead to approximately \$10.6 million in total credit approvals by TY26, while the proposed law would lead to \$11.6 million in credit approvals and a decrease to the general fund of \$4.1 million by TY26.

Both LFC staff and TRD estimates are shown in the table on page 1, assuming no significant difference between tax year and fiscal year values. In OTHER SUBSTANTIVE ISSUES, TRD explains some portion of the discrepancy between EMNRD approvals and TRD payment of claims may be administrative. This discrepancy does not affect the estimate of EMNRD approvals but may profoundly affect the estimate of TRD payment of claims.

## **SIGNIFICANT ISSUES**

According to EMNRD, the agency “has seen a measurable increase in applications submitted for tax credit certificates under the New Solar Market Development Income Tax Credit. This has

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<sup>1</sup> Galen Barbose, Naïm Darghouth Eric O’Shaughnessy, and Sydney Forrester, Lawrence Berkeley National Laboratory, “Tracking the Sun – Pricing and Design Trends for Distributed Photovoltaic Systems in the United States”, 2021 Edition, September 2021.

<sup>2</sup> U.S. Energy Information Administration, “Electric Power Monthly” available at: <https://www.eia.gov/electricity/monthly/>

resulted in an increased workload at EMNRD. The amendments to double the annual cap and make the credit refundable will likely increase volumes and may encourage low- or middle-income homeowners and fixed income applicants to install solar systems, which would represent an expansion of the applicant pool.”

“EMNRD’s data indicates that the Solar Tax Credit became effective on March 1, 2020, and for that nine-month period over 2,364 solar installations were certified for a tax credit. The total amount of tax credit certificates for 2020 was \$6,682,831. To date, the 2021 tax credit certificates are at 1,680 with a tax credit amount certified of \$5,166,768. Applications for 2021 can be submitted until December 31, 2022. Based on the rate of applications received to date, it is likely that the current annual cap will be reached for 2022 applications.”

TRD provides the following: “The bill extends the end date for the credit from 2028 to 2032. TRD supports sunset dates for legislators to review the impact of a credit before extending them, if a sufficient timeframe is allotted for tax incentives to be measured.”

“The broader question of subsidizing solar energy has many economic factors to consider including job creation, impacts to established markets, and environmental concerns. A credit is a tax expenditure which gives preferential tax treatment to certain taxpayers. Some economists would argue that energy costs should include indirect impacts of energy use such as environmental impacts. Thus solar energy, which is often expensive to start-up, should be given tax incentives due to its low environmental impact and health and social benefits for the current and future populations. The long-term environmental, health and social benefits outweigh the short-term revenue cost. New job opportunities are associated with solar energy generation, such as solar photovoltaic installers, engineers, and managers. But job displacement also occurs with the shifting incentives for energy production away from traditional fossil fuels. Employees of both the San Juan Generating Station and associated coal mines face losing jobs with the closing of the station and care must be taken to ensure economic stability for those workers.”

Given the uncertainty of the federal tax credit for residential solar continuing beyond tax year 2023, this state solar credit would provide a replacement for the federal credit. The proposed credit would support continued consumer demand and stability for the solar energy market. The credit aligns with Executive Order 2019-003, which aims to address climate change and energy waste prevention.

In previous personal income tax credits, including the former solar market development credit, the Legislature chose to implement a collateral corporate income tax credit. The current law does not allow a solar credit to be claimed on regular corporate income tax returns. However, the advent of virtually universal acceptance and use of pass-through entities (PTEs), including Sub-S corporations, Limited Liability Companies (LLCs), partnerships, limited liability partnerships, and others is critical. This credit can be claimed on personal income tax returns reporting income and liability from PTEs.

## **PERFORMANCE IMPLICATIONS**

The LFC tax policy of accountability is met with the bill’s requirement to report annually to an interim legislative committee regarding data compiled from reports from taxpayers taking the deduction and other information to determine whether the deduction is meeting its purpose. The actual report from TRD to the Legislature is likely to be in the form of the annual update of the

TRD Tax Expenditure Report. However, note refund ability makes this tax credit different from the 2020 enactment. TRD might be able to separately detail the amount of carryover.

TRD recommends all tax incentive legislation include specific standardizations to facilitate operational efficiency. This includes: (1) Tax credits programs should be limited to five year periods. This term facilitates a market-facing analysis, whereby market changes can be acted upon by legislators; (2) Credits should not be refundable, but they should incorporate a standardized carryforward period of three years. This limits the evaluation period of any tax credit incentive to a total of eight years, and limits the fiscal obligation to a period of three years after expiration; and (3) Legislation should require tax filers to apply for any credit within 12 months of the calendar year the filer qualified for the credit. This incentivizes the filer to use the credit program timely, or risk losing eligibility due solely to their nonfeasance.

### **ADMINISTRATIVE IMPLICATIONS**

EMNRD states ongoing staff resources are required to manage, redesign electronic application processes, provide system reviews, certify systems for tax credit eligibility, collect data, and maintain a database. Based on feedback from past applicants, many struggled with electronic submissions. In anticipation of increased volumes, EMNRD will need to revise the electronic platform to ensure continued struggles do not increase paper applications which further slowdown processing and significantly increase administrative workloads.

Similarly, TRD states they will need to make information system changes, and update forms and publications. These changes will be incorporated into annual tax year implementation. Currently, all certifications must be entered manually, so if increasing the cap and making the credit refundable leads to an increase in claims received, the administrative workload for TRD will increase. Also, the Information Technology Division (ITD) will need to update GenTax and the Taxpayer Access Point to implement provisions of this bill. ITD will work approximately 100 hours or approximately 1 month for an estimated \$5,164 of staff workload costs. Furthermore, its Revenue Processing Division (RPD) assumes electronic transfer of credit information will not occur before the effective date of the bill and an additional FTE will be required to process additional credit claims, the recurring budget estimate is based on a Tax Examiner-A.

### **CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP**

Duplicates HB34.

### **TECHNICAL ISSUES**

TRD is somewhat concerned about the effect of eliminating carryover provisions in favor of refundability. The concern is with the substantial carryover for systems installed in TY20 and TY21. It is unclear whether the carryover provisions have been repealed and collaterally whether any amount of carryover is automatically converted into a claim for refund in excess of tax liability.

TRD suggests the carry forward information is not removed but that the refundable portion of the credit is clarified as follows on page 4 starting on line 1. “That portion of a new solar market development income tax credit that exceeds a taxpayer’s liability in the taxable year in which the credit is claimed may be carried forward for a maximum of five consecutive taxable years. Starting for those credits issued with the first claimable tax year starting January 1, 2022, any credit that

exceeds a taxpayer’s liability in the taxable year in which the credit is claimed shall be refunded to the taxpayer.” This will prevent confusion as to which time period’s credits are refundable and individuals who have carry forward credit available to them prior to this bill’s changes will not be able to get the amount refunded based on current law. This will also make this change easier to administer and easier to estimate the amount of credit that will need to be refunded from this credit. Without this change, it is possible that individuals who have received this credit in the past will file amended returns for prior years and request refunds of any unused credit.

This bill contains an implicit delayed repeal date for installation, but may allow rollovers to continue for some time. The bill does not require taxpayers to file the claim for refund in the year of the installation. In addition, in the case of the previous Solar Credit that was limited by the cap, EMNRD apparently rolled over applications for certification in excess of the cap – in effect allowing these applications in excess of the cap to be first in the queue for the following year. If the total amount of approved credits should exceed the \$16 million cap, there may well be rollover. LFC usually recommends adding a delayed repeal date. In this case, however, the credit should not be repealed until the expiration of the rollover period.

**OTHER SUBSTANTIVE ISSUES**

TRD notes implementation of the New Solar Market Tax Credit has been somewhat difficult. At least some of the discrepancy noted between EMNRD approvals and TRD’s payment of tax credit claims can be explained by this difficulty. Tax year 2020 is the first year TRD received tax credit claims for the New Solar Market Credit. Many returns were not able to be processed at time of receipt due to incomplete information. Some issues were attributed to backlogs at EMNRD. This added to TRD’s Revenue Processing Division inventories of returns suspended and this suspension caused taxpayer frustration. To better serve the taxpayers and to create department efficiencies, the smooth flow of certification data to TRD is necessary. TRD recommends adding language requiring electronic information sharing for EMNRD certificates awarded. Receiving electronic files of awarded certificate data improves return processing efficiency and accuracy and supports annual reporting by allowing for process automation and avoiding time delays associated with manual processing.

On January 22, 2018, the President’s administration announced import tariffs on a portion of the total quantity of imported solar panels and modules.

<b>Safe Guard Tariffs on Imported Solar Cells and Modules</b>			
<b>Year 1 (2018)</b>	<b>Year 2 (2019)</b>	<b>Year 3 (2020)</b>	<b>Year 4 (2021) and beyond</b>
30%	25%	20%	15%

\* First 2.5 gigawatt of imported cells are excluded from the additional tariff.

**OTHER SUBSTANTIVE ISSUES**

1. Any tax expenditure reduces revenue. In this case, a personal income tax credit only reduces general fund revenue, whereas gross receipts tax expenditures tend to reduce both state level taxes and local taxes.
2. Economic efficiency is also suspect, since this tax expenditure serves to subsidize a particular form of economic activity.

3. Overall, the purchase of a 5 or 6 Kilowatt solar array for around \$28 thousand puts this option out of the price range of about 80 percent of New Mexicans. It is, perhaps, still a luxury good, which may raise equity issues.
4. Because of the desirable feature of this tax expenditure that minimizes abuse but requires at least three state agencies to be involved (Construction Industries Division of RLD, TRD and EMNRD) and an Investor-Owned Utility (in case of grid-tied systems and the potential of REC), soft costs and approval delays add between \$3,200 and \$4,700 to the costs of a typical 5 Kw system.
5. Accountability is preserved with this credit because of the required TRD reporting to the legislature.

<b>Does the bill meet the Legislative Finance Committee tax expenditure policy principles?</b>	
1.	<b>Vetted:</b> 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.	<b>Targeted:</b> The tax expenditure has a clearly stated purpose, long-term goals, and measurable annual targets designed to mark progress toward the goals.
3.	<b>Transparent:</b> The tax expenditure requires at least annual reporting by the recipients, the Taxation and Revenue Department, and other relevant agencies.
4.	<b>Accountable:</b> 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.	<b>Effective:</b> 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.	<b>Efficient:</b> The tax expenditure is the most cost-effective way to achieve the desired results.

<b>LFC Tax Expenditure Policy Principle</b>	<b>Met?</b>	<b>Comments</b>
<b>Vetted</b>	✓	This is an expansion of an existing credit.
<b>Targeted</b>		
Clearly stated purpose	✓	The solar industry in New Mexico can hardly be considered new. Zomeworks began business in New Mexico in 1969 and is still in business. The purpose is clearly to incentivize the expansion of the industry
Long-term goals	✗	None stated.
Measurable targets	✗	None stated
<b>Transparent</b>	✓	
<b>Accountable</b>		
Public analysis	✓	
Expiration date	✓	
<b>Effective</b>		
Fulfills stated purpose	✗	No purpose stated
Passes “but for” test	✗	The industry has been continuously growing, but may be in a saturation phase.
<b>Efficient</b>	✗	Credit serves to subsidize a particular but socially beneficial industry. This may be a way of internalizing positive externalities because of the non-polluting nature of solar-generated electricity.
Key: ✓ Met ✗ Not Met ? Unclear		