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## FISCAL IMPACT REPORT

|  |   |
|--|---|
| <b>SPONSOR</b> <u>Armstrong/Lara/Zamora/Woods/Townsend</u> | <b>LAST UPDATED</b> <u>2/24/23</u><br><b>ORIGINAL DATE</b> <u>2/13/23</u> |
| <b>SHORT TITLE</b> <u>Dyed Diesel Fuel Gross Receipts</u>  | <b>BILL NUMBER</b> <u>House Bill 354</u>                                  |
| <b>ANALYST</b> <u>Torres</u>                               |   |

### REVENUE\* (dollars in thousands)

| Estimated Revenue |             |             |             |             | Recurring or Nonrecurring | Fund Affected     |
|-------------------|-------------|-------------|-------------|-------------|---------------------------|-------------------|
| FY23              | FY24        | FY25        | FY26        | FY27        |                           |                   |
|                   | (\$4,878.5) | (\$4,878.5) | (\$4,878.5) | (\$4,878.5) | Recurring                 | General Fund      |
|                   | (\$3,252.5) | (\$3,252.5) | (\$3,252.5) | (\$3,252.5) | Recurring                 | Local Governments |

Parenthesis ( ) indicate revenue decreases

\*Amounts reflect most recent version of this legislation.

Note: the estimated cost is difficult to predict and could greatly exceed costs shown above based on taxpayer behavior, diesel prices, and consumption shifting.

Duplicates SB360

### Sources of Information

LFC Files

### Responses Received From

Taxation and Revenue Department (TRD)

Department of Transportation (NMDOT)

## SUMMARY

### Synopsis of House Bill 354

House bill 354 (HB354) exempts the sale and use of dyed special fuels from the gross receipts and compensating tax when used for agricultural purposes. Qualifying dyed special fuels are those dyed in accordance with federal regulation for use in agricultural purposes. The bill also removes the obsolete reference to Section 7-16-3, which was repealed in 1992.

The effective date of this bill is July 1, 2023.

## FISCAL IMPLICATIONS

The Department of Transportation reports volumes of dyed diesel as follows:

|         |                         |  |
|---------|-------------------------|--|
| FY2017: | 330,448,986 gallons ... | 65% as large as taxable special fuel (excluding IFTA). |
| FY2018: | 448,406,653 gallons ... | 84% as large as taxable special fuel (excluding IFTA). |
| FY2019: | 524,998,010 gallons ... | 92% as large as taxable special fuel (excluding IFTA). |
| FY2020: | 427,272,899 gallons ... | 72% as large as taxable special fuel (excluding IFTA). |
| FY2021: | 325,031,794 gallons ... | 52% as large as taxable special fuel (excluding IFTA). |
| FY2022: | 331,135,193 gallons ... | 50% as large as taxable special fuel (excluding IFTA). |

Along with the reported volumes, LFC used the Energy Information Administration (EIA) data on dyed diesel prices over the same period. Finally, LFC used the current weighted average gross receipts tax rate for the state of 7.13 percent and determined the following amounts of GRT had been paid on dyed diesel for each year:

|             | Estimated GRT Paid  |
|-------------|---------------------|
| FY17        | \$64,341,199        |
| FY18        | \$93,966,592        |
| FY19        | \$104,292,788       |
| FY20        | \$74,171,043        |
| FY21        | \$58,234,327        |
| FY22        | \$92,844,119        |
| <b>AVG:</b> | <b>\$81,308,345</b> |

According to a survey conducted by the NM Petroleum Marketers, dyed diesel wholesalers expect selling around 10 percent of products to agricultural users. Given the difficulty in estimating future diesel prices and purchases, for the purpose of this analysis, the cost on page 1 is equivalent to the annual average GRT paid times the 10 percent expectation for agricultural use. Furthermore, LFC assumed GRT paid followed the general split of other purchases in the state where 60 percent of the impact is to the general fund with the remaining 40 percent of impact experienced by local governments.

Because it is unclear how the tax department would determine which purchases are for agricultural use, the entire cost of the exemption could be up to \$48.8 million to the general fund and \$32.5 million to local governments should all sales of dyed fuel qualify (by misreporting or inability to administer the agricultural use provision). The bill should be clarified to ensure agricultural use is verifiable and reported by those claiming the exemption.

The Taxation and Revenue Department (TRD) provided an alternative estimate using data on dyed special fuel reported during Fiscal Year 2023 and applied the most recent state road fund forecast produced by the Department of Transportation (DOT) to estimate future volumes. To estimate the prices, TRD collected diesel prices reported by the U.S. Energy Information Administration (EIA) and produced a projection of prices based on the Chained Price Index for consumer fuel produced by the firm IHS Markit. TRD estimated 100 percent of sales claim the exemption. The TRD estimates are reflected below:

| Estimated Revenue Impact* |                    |                    |                    |                    | R or NR** | Fund(s) Affected |
|---------------------------|--------------------|--------------------|--------------------|--------------------|-----------|------------------|
| FY2023                    | FY2024             | FY2025             | FY2026             | FY2027             |           |                  |
| --                        | (\$87,400)         | (\$87,500)         | (\$89,500)         | (\$92,000)         | R         | General Fund     |
| --                        | (\$58,300)         | (\$58,400)         | (\$59,700)         | (\$61,300)         | R         | Local Government |
| --                        | <b>(\$145,700)</b> | <b>(\$145,900)</b> | <b>(\$149,200)</b> | <b>(\$153,300)</b> |           | <b>Total</b>     |

This bill creates 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 action be postponed until the implications can be more fully studied.

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.

## SIGNIFICANT ISSUES

Dyed diesel and dyed gasoline are exempt from both federal and state motor fuel excise taxes. Motor fuel excise taxes are considered road user fees and dyed fuels are supposed to be used for purposes other than road vehicles (construction equipment, mining, agriculture, generators, etcetera).

The federal government applies excise tax to all clear fuels. New Mexico applies excise taxes to almost all clear fuels. So, if it is clear fuel, it is subject to gasoline or special fuels tax. If it is dyed fuel, it is exempt from gasoline or special fuels tax and therefore GRT is applied. By exempting dyed diesel from GRT, it would receive special tax status where no tax is applied, contrary to the LFC adopted tax policy principle of equity.

TRD adds:

If this legislation is enacted, receipts from the sale or use of the subset of dyed special fuels used for agricultural purposes will not be subject to any excise tax. TRD understands that the purpose of the legislation is to encourage the use of dyed special fuels in agriculture. However, the creation of special exemption for the sale or use of a particular category of fuels goes against sound tax policy by: (i) distorting the market for agricultural fuels generally; (ii) adding complexity to the tax code for both taxpayers, increasing the burden of tax compliance, and for TRD, increasing administrative costs; and, (iii) violates principles of horizontal equity by favoring consumption of certain fuels that are otherwise similar in application and use to other fuels.

This bill narrows the gross receipts tax (GRT) base. Many 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 Municipal League notes:

The Municipal League is concerned about the significant revenue loss to municipalities that would result from passage of this bill, as identified in the LFC FIR.

Without more information on where sales of dyed fuel occur, we cannot identify the particular cities that would experience the revenue loss, but we are concerned that some cities might be disproportionately affected.

Maintaining an adequate and stable revenue base for municipalities is critical, and HB354 could jeopardize municipal revenue stability by shrinking the tax base.

Sales of dyed fuel are one of many business inputs that are taxed under the gross receipts tax act. Studies have determined that up to 60 percent of New Mexico gross receipts

revenues are derived from taxes on business inputs. Removing all of these from the tax base would have a huge impact on State and local revenues.

## TECHNICAL ISSUES

It is unclear how the determination will be made that the purchase of the fuel will be used for agricultural purchases. It may render the exemption ripe for abuse.

Regulation 3.16.102.9 would need to be repealed if this bill is enacted: “3.16.102.9 - EXCLUSION WHEN RECEIPT OR USE IS SUBJECT TO GROSS RECEIPTS TAX, A. Receipts from the sale of special fuel for non-highway use is subject to gross receipts tax and not the special fuel excise tax.”

### **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 |
|--|------------------|----------|
| <b>Vetted</b>  | ✘                |          |
| <b>Targeted</b><br>Clearly stated purpose<br>Long-term goals<br>Measurable targets | ✘<br>✘<br>✘<br>✘ |          |
| <b>Transparent</b>   | ✘                |          |
| <b>Accountable</b><br>Public analysis<br>Expiration date                           | ✘<br>✘           |          |
| <b>Effective</b><br>Fulfills stated purpose<br>Passes “but for” test               | ✘<br>✘           |          |
| <b>Efficient</b>   | ✘                |          |
| Key:    ✓ Met    ✘ Not Met    ? Unclear  |                  |          |

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