FISCAL IMPACT REPORT

		LAST UPDATED	3/2/23
SPONSOR	Lara	**ORIGINAL DATE**	2/20/23
SHORT TITLE	Biodiesel Tax Credits	**BILL NUMBER**	House Bill 436/aHENRC
		ANALYST	Faubion/Torres, I

REVENUE*
(dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY23	**FY24**	**FY25**	**FY26**	**FY27**		
	(At least $15,700.0)	(At least $16,100.0)	(At least $16,400.0)	(At least $16,700.0)	Recurring	PIT/CIT Credit – General Fund
	($48,785.0-$87,400.0)	($48,785.0-$87,500.0)	($48,785.0 -$89,500.0)	($48,785.0 -$92,000.0)	Recurring	GRT Deduction - General Fund
	($32,525.0-$58,300.0)	($32,525.0-$58,400.0)	($32,525.0-$59,700.0)	($32,525.0-$61,300.0)	Recurring	GRT Deduction-Local Governments

Parenthesis ( ) indicate revenue decreases
*Amounts reflect most recent version of this legislation.

Relates to House Bill 354.

Sources of Information
LFC Files

Responses Received From
Energy, Minerals, and Natural Resources Department (EMNRD)
Department of Transportation (DOT)
Taxation and Revenue Department (TRD)

No Response Received
Municipal League
NM Counties

SUMMARY

Synopsis of HENRC Amendment to House Bill 436

The House Energy, Environment and Natural Resources Committee amendment to House Bill 436 adds blended renewable diesel to qualify for both the income tax credit and GRT deduction provisions in this bill.

Synopsis of Original Bill

House Bill 436 creates a personal and corporate income tax credit in the amount of $0.50 per gallon for each gallon of blended biodiesel purchased in New Mexico. This bill also allows the receipts from the sale of blended biodiesel to be deducted from the gross receipts tax.

The personal income tax and corporate income tax credits in this bill apply to tax years beginning on or after January 1, 2023 and prior to January 1, 2028. The effective date of the gross receipts and compensating tax deductions in this bill is July 1, 2023.

FISCAL IMPLICATIONS

The HENRC amendment adds blended renewable diesel to qualify for both the income tax credit and GRT deduction provisions in this bill. According to the U.S. Department of Energy, nearly all domestically produced and imported renewable diesel is used in California. They also report that there is not a single public or private renewable diesel fueling station in the state of New Mexico. Given the current lack of consumption of renewable diesel in New Mexico, the fiscal impact reflects only biodiesel consumption. If infrastructure to support renewable diesel consumption is built and sales begin in New Mexico, the fiscal impact of this bill would be higher.

GRT Deduction

HB436 deducts the sale of blended biodiesel from gross receipts tax, yet most B5 blended biodiesel is already exempt because it is subject to special fuels excise taxes. However, dyed B5 blended biodiesel is currently subject to the GRT and is not subject to special fuels excise taxes. It is unclear how much of total dyed diesel sales is from blended biodiesel, but blended biodiesel could become a new significant portion of dyed diesel if all the current dyed (off-road) diesel volume users would switch to dyed B5 blended biodiesel (to avoid GRT and receive the income tax credit). Thus, the range of cost for the GRT deduction could be anything above zero to the GRT on all dyed diesel sales.

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
AVG:	**$81,308,345**

Given the difficulty in estimating future diesel prices and purchases, for the purpose of this analysis, the reported lower bound of the range on page 1 is equivalent to the annual average GRT paid. 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.

PIT/CIT Credit

HB436 creates a personal and corporate income tax credit in the amount of $0.50 per gallon for each gallon of blended biodiesel purchased in New Mexico. The Taxation and Revenue Department (TRD) compiled data on the sales of various blend degrees of biodiesel. The blends include 100 percent, 99 percent, and 5 percent as reported to TRD in the return form RPD-41306 form. The costs were estimated by calculating a five-year average of blended biodiesel gallons. It was assumed that taxpayers would qualify for either the Income Tax Credit in Section 1 or the Corporate Income Tax Credit in Section 2, but not both. To estimate future biodiesel gallons, TRD used the diesel volume growth rates estimated by the New Mexico Department of Transportation in their January 2023 forecast. If more consumers switch to blended biodiesel as a result of this credit, the impact could be higher.

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

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

GRT Deduction

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.

In other related legislation, TRD submitted:

> If this legislation is enacted, receipts from the sale or use of the subset of fuels will not be subject to any excise tax. TRD understands that the purpose of the legislation is to encourage the use of special fuels. 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 fuels generally; (ii) adding complexity to the tax code for both taxpayers, increasing the burden of tax compliance, and for Tax & Rev, 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 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.

PIT/CIT Credit

Blended biodiesel is currently subject to the special fuels excise tax. The tax applies to the gallons of special fuel received in New Mexico. The tax is owed either by the rack operator, if sold to a non-registered customer, or by the registered New Mexico supplier buying the special fuel. There are some deductions that apply to this tax. The rate is $0.21 per gallon. The proposed tax credit would offset this excise tax and provide an additional $0.29 per gallon credit.

The Department of Transportation notes biodiesel is already subsidized under federal tax provisions, and that subsidy can be seen in the $0.20 price differential of blended biodiesel relative to regular diesel. Administration of this tax credit would probably be extremely difficult and subject to abuse. Taxpayers seeking to claim the tax credit may not be aware to document purchase receipts during the first year of the credit, and presumably purchase receipts would be the only means of documenting blended biodiesel purchases. Auditing of such a tax credit by the Taxation and Revenue Department would be time consuming, less cost effective than other compliance activity, and probably somewhat lacking in effectiveness.

An expired Blended Biodiesel Fuel Excise Tax Credit against personal and corporate income tax was in effect from 2007 to 2012. Blended biodiesel fuel for this credit was defined as a 3 percent mixture of biodiesel as opposed to a 5 percent mixture as proposed in HB436. The credit amount was phased down from 3 cents per gallon to 1 cent per gallon over the life of the incentive.

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 credit or deduction and other information to determine whether the credit and deduction is meeting their purpose.

ADMINISTRATIVE IMPLICATIONS

The tax changes proposed in this bill will likely result in moderate operational budget impact to TRD, including costs related to updating GenTax, training staff, and updating forms, instructions, and publications.

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

This bill relates to HB 354 which exempts the sale and use of dyed special fuels from the gross receipts and compensating tax.

TECHNICAL ISSUES

EMNRD notes the following definitional issue:

> HB436 defines blended biodiesel as "a diesel engine fuel that is at least five percent biodiesel". HB436 further defines biodiesel as "a renewable, biodegradable, mono alkyl ester combustible liquid fuel that derives from agricultural plan oils or animal fats that meets biodiesel fuel industry fuel standards for B100 or B99 blend stock for distillate fuels".
>
> The definition of biodiesel tracks with the definition in the Special Fuels Supplier Tax Act (NMSA 1978 7-16A-2), the extant (but expired) Blended Biodiesel Fuel Excise Tax Credit (NMSA 1978 7-2-18.21), and the extant Biodiesel Blending Facility Tax Credit (NMSA 1978 7-9-79.2), but the definition of "blended biodiesel" does not – in all of the above statutes, blended biodiesel is defined as "a diesel engine fuel that is at least two percent biodiesel".
>
> HB436 does not repeal or amend the extant statutes, creating a definitional conflict within the NMSA.

OTHER SUBSTANTIVE ISSUES

The Energy, Minerals, and Natural Resources Department (EMNRD) notes the following:

> Providing an income tax credit and corporate tax credit for purchase of blended biodiesel, as well as providing a GRT and compensating tax deduction for the sale and use of blended biodiesel may help promote the use of biodiesel in New Mexico by bringing down the cost of using blended biodiesel. Biodiesel has a lower carbon intensity than fossil-based diesel, meaning that one unit of biodiesel takes less greenhouse gases to produce than one unit of fossil-based diesel. Reducing the amount of greenhouse gases produced will help New Mexico attain our climate change goals.
>
> Biodiesel is currently being produced at one refinery in New Mexico, located in Artesia and operated by HF Sinclair. The refinery produces 9,000 gallons of biodiesel daily. Ideally, higher demand for biodiesel would spur the development of a biodiesel refining and blending industry in New Mexico.

In 2007, the New Mexico legislature created a biodiesel blending mandate for New Mexico, requiring a five percent biodiesel blend in all diesel sold in the state by July 1, 2012. However, the biodiesel mandate has never gone into effect. Instead, the mandate has been waived by the Secretary of the Department of Agriculture in consultation with the Secretary of EMNRD, as per NMSA 1978 57-19-28(C): "If in consultation with the secretary of energy, minerals and natural resources and pursuant to regular, periodic monitoring, the director determines that sufficient amounts of biodiesel are not available to meet the requirements of Section 57-19-29 NMSA 1978 or that the price of the biodiesel blend significantly exceeds the price of diesel fuel for at least two months, the director shall suspend those requirements for a period of up to six months."

New Mexico has never approached levels of biodiesel sales or blending to fulfil the mandate. In the period between January and August 2022, data from the Taxation and Revenue Department shows that sales only satisfied 28 percent of the mandate.

It is possible that biodiesel tax credits and GRT deductions contemplated by HB436 may incentivize biodiesel blending to levels which would allow the mandate to actually go into effect. However, it must be noted that prior tax incentives have not successfully spurred the development of a biodiesel industry in New Mexico and may be illustrative of what happens with the credits created by HB436.

New Mexico has attempted to incentivize the production and use of biodiesel through tax policy before:

- The Special Fuel Supplier Excise Tax has an exemption for special fuels which are biodiesel (NMSA 1978 7-16A-9.4);
- The Blended Biodiesel Fuel Excise Tax Credit (for both personal and corporate income tax), which expired in 2012 with a five-year carry-forward that ended in 2017 (NMSA 1978 7-2-18.21)
- The Biodiesel Blending Facility Tax Credit, (NMSA 7-9.79.2), which is a tax credit for up to 30 percent of the cost of both purchasing and installing equipment used to produce biodiesel blends containing at least 2 percent biodiesel (B2). The tax credit is limited to $50,000 per facility and is claimed against gross receipts tax or compensating tax.
    - The credit has not been claimed since FY2020, in which there were only three claimants.
    - In FY2017-FY2019, there were zero claimants.

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	✗	This bill was not vetted through an interim legislative committee.
Targeted		
Clearly stated purpose	✗	No stated purpose.
Long-term goals	✗	No stated long-term goals.
Measurable targets	✗	No measurable targets.
Transparent	✓	This bill does require annual reporting to interim legislative committees. Both the credit and deduction will also be included in TRD's tax expenditure report.
Accountable		
Public analysis	?	As there are no stated annual targets or goals, there is nothing from which to determine progress, effectiveness, or efficiency.
Expiration date	?	The income tax credits expire after tax year 2027. The GRT deduction has no expiration date.
Effective		
Fulfills stated purpose	?	As there are no stated annual targets or goals, there is nothing from which to determine effectiveness or passing of the "but for" test.
Passes "but for" test	?	
Efficient	?	No stated desired results.
Key: ✓ Met ✗ Not Met ? Unclear		

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