

BILL ANALYSIS AND FISCAL IMPACT REPORT
Taxation and Revenue Department

February 5, 2025

Bill: HB-137

Sponsor: Representative Susan K. Herrera and Senator George K. Muñoz

Short Title: Strategic Water Supply Act

Description: This bill creates the Strategic Water Supply Act and also adds language to the Produced Water Act, Section 70-13-6 NMSA 1978, which imposes a produced water fee of 5 cents per barrel of produced water from an oil or gas well, and which will be collected and administered by Tax & Rev in accordance with the Tax Administration Act (TAA). The bill also amends Section 7-1-2 NMSA 1978 to add this fee to the TAA. Section 7-1-8.8(S) NMSA 1978 is also amended to provide that Tax & Rev may share return information concerning the produced water fee with the Energy, Minerals and Natural Resources Department (EMNRD) to facilitate the identification of delinquent or noncompliant taxpayers.

Effective Date: Not specified; 90 days following adjournment (June 20, 2025).

Taxation and Revenue Department Analyst: Sara Grubbs and Lucinda Sydow

Appropriation*		R or NR**	Fund(s) Affected
FY2025	FY2026		
--	\$75,000	NR	Strategic Water Supply Program Fund
--	\$28,750	NR	New Mexico Institute of Mining and Technology
--	\$4,000	NR	New Mexico State University

* In thousands of dollars. Parentheses () indicate a revenue loss. ** Recurring (R) or Non-Recurring (NR).

Estimated Revenue Impact*					R or NR**	Fund(s) Affected
FY2025	FY2026	FY2027	FY2028	FY2029		
--	\$99,200	\$103,000	\$106,100	\$106,100	R	Section 10: Strategic Water Supply Program Fund
--	(\$0 - \$831)	(\$0 - \$905)	(\$0 - \$916)	(\$0 - \$949)	R	Section 10: Severance Tax Bonding Fund
--	(\$0 - \$3,319)	(\$0 - \$3,431)	(\$0 - \$3,301)	(\$0 - \$3,251)	R	Section 10: Early Childhood Trust Fund
--	(\$0 - \$119)	(\$0 - \$285)	(\$0 - \$466)	(\$0 - \$649)	R	Section 10: Severance Tax Permanent Fund
--	(\$0 - \$43)	(\$0 - \$47)	(\$0 - \$47)	(\$0 - \$49)	R	Section 10: General Fund
--	(\$0 - \$4)	(\$0 - \$5)	(\$0 - \$5)	(\$0 - \$5)	R	Section 10: Reclamation Fund
--	(\$0 - \$2,816)	(\$0 - \$3,035)	(\$0 - \$3,079)	(\$0 - \$3,187)	R	Section 10: Land Grant Permanent Fund
--	(Slightly negative)	(Slightly negative)	(Slightly negative)	(Slightly negative)	R	Section 10: Counties and School Districts (Ad Valorem Taxes)

* In thousands of dollars. Parentheses () indicate a revenue loss. ** Recurring (R) or Non-Recurring (NR).

Methodology for Estimated Revenue Impact: In 2023, New Mexico produced over 2.3 million barrels of water from oil and natural gas wells. 27% of this water production was either reinjected for enhanced oil recovery (EOR) or used in completions¹, leaving 73% of produced water that was not reused². The Taxation and Revenue Department (Tax & Rev) assumes this percentage is constant for future oil and natural gas extraction.

Tax & Rev used the December 2024 Consensus Revenue Estimating Group (CREG) forecast for oil production and estimated the total produced water volumes using a water-oil ratio (WOR) of 3.5³. In 2023, 98.8% of produced water was produced from wells in the Permian Basin and 75% of this was produced from oil wells. Most Permian natural gas production is produced in tandem with oil⁴. Tax & Rev then applied the percentage of produced water that is not reused (73%) per Section 10(A)(1) and (2) on page 21 of this bill. Finally, Tax & Rev multiplied this volume by the \$0.05/barrel produced water fee.

Tax & Rev then estimated the potential loss of production associated with the fee. This fee is more likely to affect marginal natural gas producers that also produce higher levels of produced water. Natural gas prices are more volatile than oil prices and can be associated with high volumes of produced water. Breakeven prices can vary significantly depending on the basin, and whether the natural gas is dry or wet. Tax & Rev assumes a potential 0.19% drop in natural gas production based on the percentage of marginal producers to all producers as reviewed from EMNRD data. The estimated drop in production is then applied to the CREG's December 2024 forecast for natural gas. The distribution change to the various funds is based on the CREG's December 2024 forecast for oil and natural gas revenue and statutory distributions and includes impacts to taxes and to state and federal royalties. Due to the uncertainty of an impact to production, Tax & Rev assumes the potential 0.19% drop represents the top of the range of potential revenue impact to state and local funds.

Policy Issues: Produced water is a byproduct of oil and gas production. Produced water contains flowback water (water used for oil and gas operations), formation water (naturally occurring ancient sea water), oil residue, salts, metals, solvents, surfactants, acids, and other additives. The accidental discharge of produced water can have significant environmental and financial impacts. The cost of disposal of produced water can range from \$2-\$4 per barrel⁵.

Some produced water is reinjected for disposal, used for pressure maintenance, or in secondary or EOR operations. In New Mexico, approximately 73% of produced water was not reused and in 2023; this accounted for just under 1.7 million barrels of produced water that was not reused. This, combined with limited water resources, has resulted in a growing interest in the reuse of produced water, either within the oil industry or for other purposes.

In the oil and gas industry, large amounts of water are required to drill, complete, and hydraulically fracture a well. Fracking a single well can use more than 40 million gallons of water⁶. In the Permian Basin,

¹ Well completion is the process in which a well is prepared in its final stages for production of oil or natural gas, https://glossary.slb.com/en/terms/c/complete_a_well

² New Mexico Energy, Minerals, and Natural Resources Department (EMNRD), Oil Conservation Division (OCD), personal correspondence, 1-30-2025

³ Estimated using Rystad ShaleWell Cube of oil and water production; extracted 1-27-2025.

⁴ New Mexico Strategic Water Supply Feasibility Study, New Mexico Environmental Department; September 16, 2024

⁵ New Mexico Energy, Minerals, and Natural Resources Department (EMNRD), Oil Conservation Division (OCD), personal correspondence, 1-30-2025

⁶ <https://www.nytimes.com/interactive/2023/09/25/climate/fracking-oil-gas-wells-water.html>

estimates of water use per well for hydraulic fracturing were 29 times higher in 2019 than in 2010⁷. Often, the primary source of water is groundwater, which may be locally scarce. New Mexico's water supply has been a long-term concern and it is projected that New Mexico will have approximately 25% less water available in rivers and aquifers over the next 50 years at current use⁸. The increasing demand for water in oil and gas production puts further strain on New Mexico's water resources. This bill may incentivize oil and gas operators to increase the reuse of produced water or potentially invest in further research on options for produced water alternatives.

Except for some non-potable aquifers, all groundwater in New Mexico is part of a declared basin, meaning the aquifer is subject to regulation by the State Engineer per Section 72-12-25 NMSA 1978⁹. Groundwater appropriations from a declared non-potable deep aquifer for oil and natural gas wells, prospecting, mining, road construction, agriculture, electricity generation, use in industrial processes, and geothermal use are exempt from most regulations (Section 72-12-25(B)(1) NMSA 1978), but other uses are subject to the same regulations as fresh water (Section 72-12-25(B)(2) NMSA 1978). Some heavy water-use industries may be more attracted to using groundwater as they would be subject to fewer regulations.

In 2023, the Water Security Planning Act, designed to invest in regional water, was signed into law. Building off this act, the 50-Year Water Action Plan was developed. The 50-Year Water Action Plan encompasses the following¹⁰:

- Water Conservation
 - A1: Develop a public education campaign
 - A2: Incentivize agricultural water conservation
 - A3: Reduce leaks in drinking water infrastructure and increase municipal conservation
 - A4: Improve water storage and delivery systems
- New Water Supplies
 - B1: Establish a \$500 million strategic water supply to spur investments in desalination and wastewater treatment
 - B2: Adopt policies to expand potable and non-potable water reuse
 - B3: Improve groundwater mapping and monitoring
- Water and Watershed Protection
 - C1: Cleanup contaminated groundwater sites
 - C2: Protect surface water by controlling pollution through a discharge permitting program
 - C3: Modernize wastewater treatment plants and stormwater infrastructure
 - C4: Protect and restore watersheds

This bill addresses several goals within the 50-Year Water Action Plan, including goals related to New Water Supplies. The \$75 million appropriation to the Strategic Water Supply Program Fund will be augmented by the produced water fee, which can be used to incentivize investments in desalination and wastewater treatment infrastructure. The \$28.75 million appropriation to the New Mexico Institute of Mining and Technology for aquifer monitoring and improved ground water characterization and the \$4 million appropriation to New Mexico State University for innovation, research, monitoring, support, and development of technology will both encourage optimization of water resource management in New Mexico.

⁷ Estimates of Water Use Associated with Continuous Oil and Gas Development in the Permian Basin, Texas and New Mexico, 2010–19, with Comparisons to the Williston Basin, North Dakota and Montana; United States Department of the Interior, United States Geological Survey (USGS), October 2021

⁸ <https://www.nm.gov/wp-content/uploads/2024/01/New-Mexico-50-Year-WaterAction-Plan.pdf>

⁹ EDPC 071422 Item 5 OSE water law.pdf

¹⁰ <https://www.nm.gov/wp-content/uploads/2024/01/New-Mexico-50-Year-WaterAction-Plan.pdf>

Technical Issues: [Section 10]: In subsection A, on page 21, line 7 change “working interest owners” to “operators.” This will align the current taxpayers under the various oil and natural gas severance tax programs with the new fee. On line 9, after “well,” delete all narrative through “department,” on line 11.

In subsection C, starting on page 21, line 25, delete the words “owner or” to align with proposed subsection A changes.

In subsection C, continuing on the top of page 3, line 1, and subsection D, the taxpayer will have 45 days to report to EMNRD’s Oil Conservation Division (OCD), then OCD will have up to 60 days to get Tax & Rev the reporting information, and then the taxpayer will have 60 days to pay the fee. This will amount to up to 165 days passing from the end of the period rather than a more traditional route which has the taxpayer self-reporting 25 days from the end of the month in which the taxable transaction occurred. Tax & Rev proposes that the fee be self-assessed and reported by the taxpayer on a return to Tax & Rev directly. Tax & Rev proposes language similar to that in Section 7-29-7 NMSA 1978: “Each operator shall, in the form and manner required by the department, make a return to the department showing the total volume of produced water produced from each production unit for each calendar month. All taxes due from the operator shall accompany this return. The return shall be filed on or before the 25th day of the [second] month after the calendar month for which the return is required.”

In subsection E, on page 22, lines 19-22, Tax & Rev recommends the language be amended to match other distribution statutes under the Tax Administration Act for identification of the distribution. Tax & Rev suggested language to replace the current subsection E: “A distribution pursuant to 7-1-6.1 NMSA 1978 shall be made to the strategic water supply program fund to the net receipts attributable to the produced water fee authorized under the produced water act.”

This bill does not define an effective and applicability date for the new produced water fee under section 10. Tax & Rev suggests an effective date of January 1, 2026 for Section 10. This effective date will provide time for EMNRD and Tax & Rev to establish an electronic filing system, regulations, and data sharing.

Other Issues: Tax & Rev notes that this new tax program is administered under Chapter 70, which is not associated with Chapter 7 where other Oil and Gas severance taxes and fee programs are typically identified.

Administrative & Compliance Impact: As detailed below, this bill is expected to impose a roughly \$2.6 million implementation cost on Tax & Rev. No funding source is currently identified to pay for those costs. Tax & Rev requested a non-recurring special appropriation for bill implementation that was included in the Executive budget recommendation, but was not included in the LFC recommendation.

This bill proposes the implementation of a new fee. Tax & Rev will create and publish new forms and publications, make changes to information systems, and create new regulations. Tax & Rev will test system changes and train employees on the administration of the proposed fee. A system for the electronic exchange of data between EMNRD-OCD and Tax & Rev will be needed for the information to be sent to Tax and Rev for the collection of the fee.

Tax & Rev’s Administrative Services Division (ASD) anticipates this bill will take approximately 145 hours from the work of two staff one at a pay-band 70 and the other at a pay-band 80. The estimated cost in staff workload is \$8,900. The staff will be testing, creating new reports and establishing new revenue distributions. Pay-band 70 is estimated at time and ½ due to extra hours worked.

The implementation of this bill will result in a significant impact on Tax & Rev’s Information Technology Division (ITD), requiring approximately 9-12 months and incurring contractual and staff workload costs of approximately \$3,487,535. This cost breakdown includes \$3,210,313 for contractual resources and an additional \$277,111 for staff workload costs. Considering the nature and complexity of the effort needed to implement the proposed changes, a contract with the GenTax vendor, FAST Enterprises, LLC, is necessary. In addition to the contract with FAST, there will be a need for a full-time contract project manager and Independent Verification and Validation (IV&V) contract services would also be necessary. The staff workload costs require one state development resource and one state business analyst for the project's duration. After implementation is complete, one application developer, one business analyst and one database/system administrator FTE will be needed for ongoing operations and support.

Tax & Rev’s Audit and Compliance Division (ACD) estimates that it will need 1 FTE employee at a pay band 70 to process and test the new fee program, perform collection and audit functions on a reoccurring basis.

The addition of a new tax program necessitates collaboration between the Revenue Processing Division (RPD), ACD, ITD, ASD and the Taxpayer Information and Policy Office (TIPO). This collaboration is required for the creation of forms and instructions, as well as the implementation of the new fee program. RPD estimates that implementing this bill will cost \$31,000 in staff workload.

Estimated Additional Operating Budget Impact*				R or NR**	Fund(s) or Agency Affected
FY2025	FY2026	FY2027	3 Year Total Cost		
--	\$8.9	--	\$8.9	NR	Tax & Rev – ASD - Operating
\$802.6	\$2,407.7	--	\$3,210.3	NR	Tax & Rev – ITD – Contractual
\$69.3	207.9	--	\$277.2	NR	Tax & Rev – ITD – Staff workload
--	--	\$277.2	\$277.2	R	Tax & Rev – ITD – FTE
--	\$48.5	\$96.9	\$145.4	R	Tax & Rev – ACD – FTE
--	\$31.0	--	\$31.0	NR	Tax & Rev – RPD – Staff workload & Operating

* In thousands of dollars. Parentheses () indicate a cost saving. ** Recurring (R) or Non-Recurring (NR).

Related Bills: Similar to SB-178 (2025 Regular Session)