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

SPONSOR	Munoz & Gentry	**ORIGINAL DATE** **LAST UPDATED**	02/03/12	**HB**	
SHORT TITLE	Natural Gas Sale Gross Receipts			**SB**	241
				ANALYST	Walker-Moran

REVENUE (dollars in thousands)

Estimated Revenue Impact*					R or NR**	Fund(s) Affected
FY12	**FY13**	**FY14**	**FY15**	**FY16**		
--	($11,784.0)	($11,784.0)	($11,784.0)	($11,784.0)	Recurring	General Fund
--	($6,735.0)	($6,735.0)	($6,735.0)	($6,735.0)	Recurring	Local Governments (GRT)
--	($662.0)	($662.0)	($662.0)	($662.0)	Recurring	Municipal Equivalent Distribution
--	($346.0)	($346.0)	($346.0)	($346.0)	Recurring	Small County Assistance Fund
--	($346.0)	($346.0)	($346.0)	($346.0)	Recurring	Small City Assistance Fund

(Parenthesis ( ) Indicate Revenue Decreases)

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY12	FY13	FY14	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
Total	$0.0	$10.0	$10.0	$20.0	Recurring	General Fund

(Parenthesis ( ) Indicate Expenditure Decreases)

Related to SM 40

SOURCES OF INFORMATION
LFC Files

Responses Received From
Taxation and Revenues Department (TRD)
joint analysis with Department of Finance and Administration (DFA)
Economic Development Department (EDD)
Public Regulation Department (PRC)
Energy, Minerals and Natural Resources Department (EMNRD)

SUMMARY

Synopsis of Bill

Senate Bill 241 adds new sections to both the Gross Receipts and Compensating Tax Act and the Corporate Income and Franchise Tax Act.

Section 1 of the bill pertains to gross receipts and provides a deduction for the sale of natural gas to an owner or operator of a power plant or other electric generating facility that uses natural gas as fuel to generate electric power for resale.

Section 2 of the bill pertains to corporate income tax and creates a new credit for the owner or operator of a power plant or electric generation facility that uses natural gas as fuel to generate electric power for resale. The credit is equal to the taxpayer's investment in constructing a new power plant or electric generating facility of this type, or retrofitting an existing power plant or electric generation facility to use natural gas as fuel to generate electric power for resale. Any portion of this credit in excess of the taxpayer's corporate income tax liability may not be refunded or transferred, but it may be carried forward for up to five years.

The purpose of the deduction and tax credit is to reduce the impact of fluctuating natural gas price on these taxpayers, reduce the cost of operating a natural gas-fired power plant or electric generation facility that uses natural gas, and to stimulate electric generation facilities to use more natural gas and develop more electric generation facilities in areas of New Mexico that produce natural gas.

The effective date of the deduction in section 1 in this bill is July 1, 2012. The provisions of the tax credit in section 2 apply to taxable year beginning on or after January 1, 2012.

FISCAL IMPLICATIONS

This bill may be counter to the LFC tax policy principle of adequacy. According to the LFC staff General Fund Recurring Appropriation Outlook for FY14 and FY15, December 2011 forecasted revenues will be insufficient to cover growing recurring appropriations.

Per to TRD:
This estimate combines the impacts of both the gross receipts deduction and the corporate income tax credit. Data from the Energy Information Administration (EIA) were used regarding fuel use for natural gas-fired power plants in NM to calculate an estimated revenue impact for the gross receipts deduction.

The majority of the revenue impact from this bill comes from the gross receipts deduction; $19.1 million of the total $19.8 million. Although this is in part because the bottlenecking of the income tax credit reduces its impact in any given year, it is mostly due to a large value of natural gas used as fuel for power plants.

The EIA estimates that natural gas-fired power plants used over 71 million Mcf of natural gas in NM in 2010. This analysis assumed 80 percent of that gas came from NM and was subject to the gross receipts tax while the other 20 percent came from out of state and was subject to the compensating tax. A price of $4.75 per Mcf was assumed based on data from the EIA as well.

At an effective gross receipts tax rate of 5.8 percent and a compensating tax rate of 5.125 percent, the estimated revenue impact for the gross receipts deduction would be approximately $19.1 million based on these data and assumptions.

The capacities of current natural gas-fired facilities in NM range from as little as 7.3 MW to as much as 618 MW. (Based on information from the Environment Department's Air Quality Bureau's list of power generation projects). For reference, the San Juan coal-fired plant has a capacity of almost 1800 MW. To calculate the impact of the tax credit, this analysis assumed an average cost of construction equal to $1 million per megawatt of capacity. At this cost, a new gas-fired facility with even 500 MW of capacity would reach the $500 million cap; a new facility with capacity equivalent to the San Juan or Four Corners plants would far exceed the cap.

This analysis assumes that the amount of any credit would far exceed the corporate income tax liability of any taxpayer even cumulative across the five year carry forward. The analysis also assumes that only one project could qualify for the credit in any five-year period simply because the outstanding liability to the aggregate cap would be too large to allow any additional claims on the credit. As such, this analysis estimates that the credit would negate roughly $750,000 of corporate income tax liability in any given year. The estimate distributes gross receipts tax, compensating tax and corporate income tax revenues according to their statutory requirements.

SIGNIFICANT ISSUES

Per TRD:
The merits of the gross receipts deduction are fairly clear. Good tax policy suggests that the gross receipts tax should be applied at the end of the chain of commerce when the final good is sold to its end user. By applying gross receipts tax on both the sales of the input (natural gas) and the output (electricity), this principle is violated. By allowing this deduction, the state would reduce tax pyramiding in electricity generation.

The corporate income tax credit creates an incentive for the construction of new natural gas-fired power plants and the retrofitting of other power plants for the use of natural gas. Although the credit is sizable, up to the amount invested in construction or retrofitting, the way it would be administered significantly reduces the incentive it could provide.

This bill would establish a preference for a particular form of electricity generation. According to the PRC, this runs contrary to traditional regulation which requires utilities to acquire a portfolio of resources depending upon cost, dispatch ability and other factors.

PERFORMANCE IMPLICATIONS

The LFC tax policy of accountability is met with the bill's requirement to report annually to the interim Revenue Stabilization and Tax Policy committee (RSTP) regarding the data compiled from the reports from taxpayers taking the deduction and other information to determine whether the deduction is meeting its purpose. TRD notes that because this is a very specific deduction, very few taxpayers will be able to take advantage of it which could pose a confidentiality issue when reporting to RSTP.

ADMINISTRATIVE IMPLICATIONS

Per TRD, new types of NTTCs would need to be developed along with a new special code to identify the deduction on the CRS-1 Form. The Department would need additional resources to determine taxpayer eligibility, and to track the carry forward of the credit and the aggregate cap.

Regulatory proceedings would be much more complex if this bill is enacted, according to the PRC, as traditional principles of cost allocation would have to be reevaluated.

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

SM 40 requests a study of gas-powered power plants. SJM 20 requests the state make the energy industry a central component of the state's economic development strategy.

According to the PRC, this bill could have an impact upon implementation of the Renewable Use of Energy Act, as the cost threshold for renewables would be affected by this lowering of the cost of electricity generated by natural gas.

TECHNICAL ISSUES

Per TRD:
The tax credit provided for in Section 2 of this bill has a serious flaw in the administration of its aggregate cap considering the carry forward of five years. Construction of a single large natural gas-fired power plant could easily account for the entire $500 million aggregate cap, but it is unlikely any taxpayer could exhaust their entire credit within a five year period. This presents a severe bottleneck in the process; until the five-year carry forward period ended, no new credits could be claimed. This could easily be addressed by reducing the credit to an amount equal some percent of the taxpayer's investment. Taxpayers would likely be able to realize the same amount of tax savings, but the credit would provide an incentive for concurrent projects.

Concerning Section 1, subsection B(1), the deduction proposed within the bill cannot reduce the impact of fluctuating natural gas prices. By allowing the deduction, natural gas would become less expensive for owners and operators of gas fired power plants, but the underlying price volatility of the commodity would still persist. A more accurate description for the purpose of the gross receipts deduction would be to reduce tax pyramiding in the chain of commerce. A similar argument can be made for Section 2, subsection B(1) which also references the same purpose for the proposed tax credit; effectively reducing the cost of construction will have no bearing on the volatility of natural gas prices.

The bill offers no guidance on what expenditures a taxpayer may include in the "investment in constructing a new natural gas-fired plant" or "retrofitting an existing power plant or other electric generation facility." The TRD would need to promulgate regulations regarding this.

OTHER SUBSTANTIVE ISSUES

According to EDD, New Mexico natural gas production accounts for close to one-tenth of the U.S. total. The San Juan Basin contains the nation's largest field of proven natural gas reserves (Source: Energy Information Administration). The oil and gas industry employs approximately 18,000 New Mexicans at an average weekly wage (second quarter of 2011) of $1,699, exceeded

only by the financial investment sector. (Source: New Mexico Department of Workforce Solutions).

According to the "World Energy Outlook of 2011," from the International Energy Agency (IEA), natural gas demand in the U.S. will be around 18 percent higher by 2035. This increase is primarily due to an increased demand for power generation in the U.S. The higher demand for natural gas for power generation will cause coal demand to drop by around nine percent, according to IEA.

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

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