LEGISLATIVE EDUCATION STUDY COMMITTEE
BILL ANALYSIS

Bill Number: **SB 3a** **51st Legislature, 1st Session, 2013**

Tracking Number: **.190108.1**

Short Title: **Hydrogen Fuel Production Tax Credit**

Sponsor(s): **Senator Carlos R. Cisneros**

Analyst: **Ian Kleats** **Date:** **March 5, 2013**

AS AMENDED

The Senate Finance Committee amendment introduces a maximum annual aggregate cap for the tax credit of $4.0 million (see Fiscal Impact, Amendments and Technical Issues, Amendments for further analysis of the amendment).

Fiscal Impact, Amendments:

Estimated Revenue Impact*				R or NR**	Fund(s) Affected
FY 14	FY 15	FY 16	FY 17		
0	(140)	(4,000)	(4,000)	R	General Fund

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

The Legislative Education Study Committee (LESC) analysis has been updated to account for the maximum annual aggregate cap introduced by the Senate Finance Committee amendment. This estimate still assumes no production would occur before the first half of FY 15 as qualifying hydrogen production facilities are constructed, but that eligible hydrogen fuel producers could reach the cap thereafter.

Based on *General Appropriation Act* appropriations for the last five years, the Legislature has appropriated approximately 43.5 percent of General Fund revenue for public education. The reduction of revenue from the General Fund as proposed in this bill, as amended, could result in decreased annual appropriations of $1.74 million for public education.

Technical Issues, Amendments:

The Senate Finance Committee amendment to SB 3 imposes a maximum annual aggregate cap on the tax credit of $4.0 million. However, it does not provide a mechanism with which the Taxation and Revenue Department (TRD) may allocate that cap between multiple qualifying taxpayers. Other tax credits, such as the *Film Production Tax Credit*, provide examples of how a maximum annual aggregate cap may be equitably administered. The sponsor may wish to consider further amendments that address such concerns arising from the previous amendment.

<u>Original Bill Summary</u>:

SB 3 introduces new material to the *Corporate Income and Franchise Tax Act* providing a tax credit for the production and sale of hydrogen fuel, applicable to taxable years beginning on or after January 1, 2013. Among its provisions, the bill would:

- create a non-refundable tax credit equal to the cost of generating hydrogen fuel, not to exceed $1.00 per kilogram, on the first four million kilograms of fuel produced and sold;
- allow taxpayers to claim the credit for five consecutive years beginning on the first date of qualified hydrogen production;
- limit the credit to taxpayers holding title to a qualified hydrogen generation facility that first produced and sold hydrogen on or before January 1, 2019; and
- require TRD to report certain data about the tax credit annually to the interim Revenue Stabilization and Tax Policy Committee.

Among its other provisions, SB 3:

- prohibits the hydrogen fuel production corporate income tax credit from being claimed as an addition to the renewable energy production tax credit; and
- requires TRD, using information provided by the Energy, Minerals and Natural Resources Department, to certify that the generator is powered by certain renewable energy sources.

<u>Fiscal Impact</u>:

SB 3 does not contain an appropriation. The estimated revenue impact is illustrated in the table below.

Estimated Revenue Impact*				R or NR**	Fund(s) Affected
FY 14	FY 15	FY 16	FY 17		
0	(140)	(4,140)	(8,000)	R	General Fund

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

The LESC analysis assumes no production would occur before the first half of FY 15 as qualifying hydrogen production facilities are constructed. This projection illustrates growth in the industry by introducing a second qualified hydrogen producer into the state in FY 16. The analysis also assumes that both producers could produce at least four million kilograms of hydrogen each. Assuming the cost of qualified hydrogen production to be $5.00 to $6.00 per kilogram (so the $1.00 per kilogram credit would apply, not the cost of producing the hydrogen), the taxpayers would claim the maximum $4.0 million credit each. The fiscal impact is phased in from FY 15 to reflect how companies generally account for their tax liabilities within their first year of operation.

Any estimate of fiscal impact might overstate the exposure to the General Fund from this incentive because the credit requires the sale of any hydrogen produced when qualifying for this tax credit. Gross receipts tax (GRT) from the sale of this hydrogen may offset some of the money spent on the credit. However, certain GRT deductions would apply to sales of hydrogen sold to an oil refinery for use as a reagent. Thus, there would be no GRT collected from these sales to offset the credit. Sales of hydrogen for other purposes would be gross receipts taxable.

Fiscal Issues:

The estimated fiscal impact of SB 3 could reduce General Fund revenue by approximately $8.0 million, if not more, from FY 17 until its effective sunset in FY 23.

Based on *General Appropriation Act* appropriations for the last five years, the Legislature has appropriated approximately 43.5 percent of General Fund revenue for public education. The reduction of revenue from the General Fund as proposed in this bill could result in decreased annual appropriations of $3.48 million for public education.

Substantive Issues:

The Department of Finance and Administration bill analysis notes that there is at least one potential producer of hydrogen in New Mexico. Depending on the production capacity of that producer, the total fiscal impact could potentially reach $4.0 million, the maximum credit allowed per taxpayer.

Hydrogen is required for many oil refining processes and products. Currently, oil refineries create their own hydrogen using processes with high capital costs and emitting large amounts of greenhouse gases. Hydrogen produced by qualified hydrogen resource generators could provide cost savings to the oil industry.

According to the TRD analysis, this tax credit may serve as an incubator for the renewably powered hydrogen fuel industry, and growth in that sector could have positive repercussions for the oil refinement and energy industries in the state.

Economic multiplier effects of any tax expenditure should be judged relative to multiplier effects from the likely use of the foregone government revenue. General Fund appropriations comprise many diverse uses, with the largest proportion going to fund public education. Without strong evidence to the contrary, an assertion that this deduction has an economic multiplier higher than economic base jobs and expenditures associated with public education or any other governmental program might be considered speculative.

Moreover, New Mexico's State Equalization Guarantee education funding formula implies that over 40 percent of government revenue would be spread equitably across the state, affecting small rural communities in a proportionate level to larger urban communities. It is unclear whether this deduction could ensure the same equitable economic impact to all communities that public school funding would provide, even absent any discussion of the relative economic multiplier effects of the tax policy.

Original Technical Issues:

Because SB 3 would create this credit under only the *Corporate Income and Franchise Tax Act*, pass-through entities such as limited liability corporations and S-corporations will be unable to claim it. This condition limits exposure to the General Fund but also reduces the incentive among those business structures to participate in this industry.

In addition, the TRD analysis raises the following technical issues:

- on Page 2, Subsection D is unclear what expenses would be considered in determining the cost of generating the hydrogen;

- on Page 2, Subsection E does not state whether the credit shall be applied to the tax liability of the taxpayer which raises the question of what “unused” means;

    - also, if the corporation has other credits to apply against taxes, there is no hierarchy of the application of the credits to the liabilities;

- on Page 3, line 2, should state “the number of entities” instead of “the number of people” since the credit is limited to corporations; and
- on Page 3, lines 6-14, the bill provides no mechanism to capture the number of jobs created or the number of people employed.

<u>Committee Referrals</u>:

SCORC/SFC

<u>Related Bills</u>:

None as of March 5, 2013.