FISCAL IMPACT REPORT

SPONSOR Muñoz

ORIGINAL DATE 02/27/13
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HB

SHORT TITLE Energy Education & Marketing Tax Act

SB 535

ANALYST Walker-Moran

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY13	**FY14**	**FY15**	**FY16**	**FY17**		
$0.0	$5,831.0	$5,922.0	$6,016.0	$5,980.0	Recurring	Lottery Fund (50%)
$0.0	$2,915.0	$2,961.0	$3,008.0	$2,990.0	Recurring	Energy Education and Marketing Fund (25%)
$0.0	$2,915.0	$2,961.0	$3,008.0	$2,990.0	Recurring	Clean Energy Grants Fund (25%)
$0.0	**($11,661.0)**	**($11,843.0)**	**($12,033.0)**	**($11,960.0)**	**Recurring**	**TOTAL**

(Parenthesis ( ) Indicate Revenue Decreases)

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY13	FY14	FY15	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
Total	$0.0	$80.0	$80.0	$160.0	Recurring	Clean Energy Grants

(Parenthesis ( ) Indicate Expenditure Decreases)

SOURCES OF INFORMATION

LFC Files

Responses Received From
Environment, Minerals and Natural Resources Department (EMNRD)
Department of Finance and Administration (DFA)
Taxation and Revenue Department (TRD)

SUMMARY

Synopsis of Bill

Senate Bill 535 (SB 535) creates the Energy Education and Marketing Tax Act. This act defines interest owner, operator, person, product, production unit, purchaser, severance, tax and value.

This bill also imposes a new severance tax. The "energy education and marketing tax" is imposed on all products severed and sold in the state. The tax rate is 0.1 percent of the taxable value on products severed or removed at or near the wellhead. The method of determining the taxable value is defined.

The proceeds from the Energy Education and Marketing Tax would be distributed to three funds:

- Lottery Tuition Fund (50%).
- Energy Education and Marketing Fund (25%);
- Clean Energy Grants Fund (25%);

The Clean Energy Grants and Lottery Tuition currently exist in statute.

This bill creates the Energy Education and Marketing Board to provide for management of proceeds to the funds. The board consists of 9 members that serve 4 year terms. This bill also creates the Energy Education and Marketing Fund in the state treasury.

The effective and applicability date of this bill is July 1, 2013. There is no sunset date. The Legislative Finance Committee (LFC) recommends adding a sunset date.

FISCAL IMPLICATIONS

The LFC used the February 2013 consensus revenue estimates of oil and gas prices and production to determine the taxable value. The 0.1 percent energy education and marketing tax costs the general fund about $12 million. Distributions are made from this tax to the Lottery Tuition Fund (50 percent), Energy Education and Marketing Fund (25 percent), and the Clean Energy Grants Fund (25 percent).

This bill creates a new fund and provides for continuing appropriations. The LFC has concerns with including continuing appropriation language in the statutory provisions for newly created funds, as earmarking reduces the ability of the legislature to establish spending priorities.

The Clean Energy Grant Program (NMSA 1978, Section 71-7-6) allows the Energy, Minerals and Natural Resources Department (EMNRD) to use up to $100,000 of the Clean Energy Grants Fund for administrative purposes. The administrative funds would be used to support an EMNRD Energy Conservation and Management Division (ECMD) project manager assigned to manage the program.

SIGNIFICANT ISSUES

According to the Taxation and Revenue Department (TRD), the additional tax burdens imposed by this legislation will have the effect of making New Mexico oil and natural gas production less competitive and impose a disadvantage on the marketing of production. This bill represents a significant implementation burden to the TRD to resolve operating, software, and tax form issues. Implementation would have a substantial impact on the distribution process.

As reported by the Department of Finance and Administration (DFA):

The proposal constitutes an earmarked allocation for a specific project, program, or organization, which may reduce resources available to other areas. Earmarks may ensure consistent funding for programs of particular interest. The state has experienced a long term heavy reliance on volatile oil and gas revenues. This proposal continues, rather than mitigates, that tradition.

The Energy Education and Marketing Fund is administered by the Energy Education and Marketing Board for the purpose of promoting the importance of the oil and natural gas exploration and production industries in the state, encouraging the efficient use of energy in the state and promoting environmentally sound production methods and technologies in the production of oil and natural gas.

The Clean Energy Grants Fund is administered by the EMNRD to fund clean energy grants programs to provide clean energy grants to municipalities and county governments, state agencies, state universities, public schools, post-secondary educational institutions and Indian nations, tribes and pueblos for physical projects utilizing clean energy technologies and clean energy education, technical assistance and training programs.

The Lottery Tuition Fund is administered by the Higher Education Department to fund New Mexico's public post-secondary educational institutions to provide tuition assistance for New Mexico resident undergraduates.

As reported by the EMNRD:

SB 535 imposes an additional severance tax on oil and gas to pay for lottery tuition scholarships, clean energy grants and efforts to promote oil and gas, energy efficiency and environmentally sound technologies. This is in addition to current taxes on the extraction of oil and gas, which include the Severance Tax (Section 7-29-4: 3.75%), the Oil and Gas Conservation Tax (Section 7-30-4: 0.19%), and the Oil and Gas Emergency School Tax (Section 7-31-4: 3.15% – 4%). Oil and gas production also triggers a number of other significant tax and payment obligations including gross receipts taxes and royalties to state and federal landowners.

SB 535 may violate the State Constitution. Section 3 is entitled "SEVERANCE TAX IMPOSED". Article VIII, Section 10, provides that revenue derived from excise taxes which have been "designated severance taxes" shall be deposited in the severance tax permanent fund. Section 12 of SB 535 provides that this tax is distributed to funds other than the severance tax permanent fund. At minimum, SB 535 should avoid any mention of the term "severance taxes". An example is the Oil and Gas Emergency School Tax, which is a tax on oil and gas production, but is designated a "privilege tax". Section 7-31-4 NMSA 1978.

Fifty percent of the revenue collected by the new tax is distributed to the lottery tuition fund. A number of other bills this session deal with various aspects of the lottery scholarship program including finding for the lottery tuition fund. See, e.g., HB 27, HB 28, HB 586, and SB 392.

Twenty five percent of the revenue is distributed to the existing Clean Energy Grants Fund which is established in the Advanced Energy Technologies Economic Development Act, Section 71-7-5 NMSA 1978. The Clean Energy Grants Fund is administered by the EMNRD and can be used to provide grants to public entities (schools, governments) to fund clean energy education, technical assistance and training and to fund projects using clean energy technologies. The Fund is currently empty and has not received any appropriations for several years.

Twenty five percent of the revenue is distributed to the new Energy Education and Marketing Fund. This Fund would be administered by the new Energy Education and Marketing Board which consists of the EMNRD Secretary and 8 public members with experience in the oil and gas industry. The Fund is appropriated to the Board for the purpose of carrying out the Board's duties. The Board is directed to promote the importance of the oil and gas industry, encourage the efficient use of energy and promote environmentally sound methods in oil and gas production. The Board appears to be limited to spending the Fund through contracts or perhaps through cooperative agreements with other public and private organizations (although the Anti-Donation Clause would limit grants to private entities).

The Energy Education and Marketing Board is given the responsibility to administer the Fund but is not given the authority to spend money on administration or to hire employees. The Board is also not administratively attached to any agency.

PERFORMANCE IMPLICATIONS

SB 535 provides funding for a program, Clean Energy Grants, that the Legislature directed the EMNRD to administer but has not funded for a number of years. The EMNRD/ECMD has the financial and programmatic tools in place to manage clean energy projects as a result of distributions to the Clean Energy Grants Fund.

ADMINISTRATIVE IMPLICATIONS

The ECMD will make the necessary adjustments to staff resources to implement a new cycle of clean energy projects. The Clean Energy Grant Program (NMSA 1978, 71-7-6) allows the EMNRD/ECMD to use up to $100,000 of the Clean Energy Grants Fund for administrative purposes.

As a new tax, this bill would have an extremely high administrative impact on the TRD and would result in the addition of new reporting requirements relating to existing Oil and Gas extraction programs. The effect of this legislation involves all reports, management reports, instructions, electronic reporting methodologies, training taxpayers, staff and working closely with IT staff at the ONGARD Service Center. Assumption is the new tax would be designed, tested and implemented into the existing Oil and Gas System because it is an extraction tax. A full requirements definition must be completed to ensure proper integration with the existing system. Meeting the July 1, 2013, effective date for the ONGARD system is not possible without stopping existing ONGARD certified project work already underway. Testing the completed product would require full regression testing due to the extensive impact of the changes. Testing of the top 40 tests and use cases would require significant input and support from Oil & Gas bureau and is estimated to run 6 weeks in duration. Please note that all estimates could change when business requirements are completed due to the many uncertainties in the bill.

The new tax will require setting up a completely new tax algorithm in the ONGARD system, both for collection and required distribution reports. The changes would be extensive in the ONGARD system and would encompass both mainframe and server (reports and return collection) processing. Based on the assumption that the required severance tax is new and not an extension of existing severance tax programs, the estimated effort for ONGARD changes to the system is from 1-3 person years ($300k-$900k, if using contract labor).

TECHNICAL IMPLICATIONS

This bill creates the Energy Education and Marketing Tax Act, imposing a severance tax without clearly defining the taxable event and indicating what would be subject to taxation. The bill should indicate which Suspense Fund is used for deposits and distributions.

Although much of the language in the bill mirrors that of NMSA 7-29 (Oil & Gas Severance Tax Act), it isn't clear whether this is an additional tax on hard minerals, coal, or simply on oil and natural gas. The reporting due date follows the 55-day pattern, but there is no advance payment requirement. Therefore it's not clear which software would be appropriate.

Page 3, line 10 Section 3: "SEVERANCE TAX IMPOSED" Draft legislation states it is a new tax; therefore, not a part of Section 7-29 yet we are calling it a severance tax on oil and gas extraction. There are specific credits found in 7-29C that could impact this new tax if it is statutorily a part of 7-29 SEVERANCE tax.

The tax rate is low, so it appears that this bill is intended to put law on the books now and assess tax later. If the intent was to raise additional revenue, standing tax rates could be raised and the new beneficiaries and funds declared. The bill also lays out initial plans and operating instructions for a new board to manage the new tax, and whose operations would be funded by 25 percent of the new tax receipts.

If the taxable event is from severing resources, then the initial receipts in September won't accrue back to FY13.

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

EWM/svb