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## FISCAL IMPACT REPORT

**ORIGINAL DATE** 2/6/15

**SPONSOR** James **LAST UPDATED** \_\_\_\_\_ **HB** 210

**SHORT TITLE** Exempting Pollution-Control Equipment from Gross Receipts **SB** \_\_\_\_\_

**ANALYST** Graeser \_\_\_\_\_

### REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY15	FY16	FY17	FY18	FY19		
	(1,280.0)*	(1,280.0)*	(1,280.0)*	(1,280.0)*	Recurring	General Fund, Compensating Tax and GRT

(Parenthesis ( ) indicate revenue decreases

[\*] Note: there is a high likelihood of unintended consequences with this bill as drafted.

### SOURCES OF INFORMATION

LFC Files

### SUMMARY

#### Synopsis of Bill

House Bill 210 would exempt from gross receipts tax the receipts from the sale of pollution-control equipment. "Pollution-control equipment" is defined to mean equipment required to meet national or state standards to prevent, monitor, control or reduce air, water or land pollution.

The effective date of the act is July 1, 2015. There is no sunset date. The LFC recommends adding a sunset date. LFC staff also recommends the exemption be converted into a deduction with separate reporting and accountability provisions.

### FISCAL IMPLICATIONS

This bill may be counter to the LFC tax policy principles of adequacy, efficiency, accountability and equity. Due to the increasing cost of tax expenditures revenues may be insufficient to cover growing recurring appropriations.

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. In the case of this bill, LFC strongly recommend converting the exemption into a fractional deduction and requiring separate reporting of both the gross receipts

tax and the compensating tax impacts of the provisions of the bill.

While there may be general activity as individuals and businesses attempt to meet federal Environmental Protection Agency (EPA), State Department of Environment, or Albuquerque Environmental Health Department standards, the proximate issue is PNM's plan to close two generating units at the San Juan Power Station, install advanced pollution control equipment on the remaining two units at San Juan and build additional natural gas fueled generating capacity as well as some utility-scale solar photovoltaics. The plan would reduce pollution at the San Juan plant by 50 percent according to the company's calculations.

In early 2013, PNM estimated its proposal would cost the company between \$400 million and \$430 million. Judging from rough estimates made at the time, the plan would cost PNM customers a little more than \$30 more per year for each household.<sup>1</sup> A copyrighted story by the Albuquerque Journal, dated July 21, 2014 provides additional information.<sup>2</sup>

To make up for lost generation and meet growing electric demand in coming years, PNM wants to acquire another 134 MW of electricity from the Palo Verde Nuclear Generating Station in Arizona, add a new 177 MW natural gas-fired plant near Farmington, and build 40 MW more of utility-scale solar generation.

The addition of 134 MW from Palo Verde would not add to the capital cost estimate of \$400 to \$430 million. Both the 177 MW natural gas plant and the 40MW of utility scale solar generation would require about \$300 million to \$350 million, based on average cost data from Wikipedia<sup>3</sup> and DOE/EIA.<sup>4</sup> For the purpose of estimating, we use \$1 per watt for natural gas peak load capacity and \$3 per watt for utility-scale solar. However, the current cost of advanced pollution control technology for coal ranges up to \$5 per watt, so that the cost of retrofitting the two units of San Juan to acceptable standards could be as much as \$1,000 per KW. Thus, the retrofit cost for the remaining 863 MW capacity would be on the order of \$100 million of the total \$400 to \$430 million estimated total cost. If half of this cost is equipment and half installation, then the gross receipts tax or, more likely, compensating tax impact, on the equipment, would be 5.125 percent times \$50 million or approximately \$2.6 million general fund.

Although this is the revenue impact under the rules, in the real world, this exemption would be offset by gross receipts tax on the installation costs of \$3.19 million just from the installation of pollution control equipment at the San Juan Generating Station – (San Juan County imposes 1.25 percent in local option GRT, while the state rate is 5.125 percent). The reason this impact is not included in the revenue table is that the December revenue estimate includes an estimate of future gross receipts tax collections based on the FOR-UNM employment model. This project has been included in the employment forecast, and therefore has already been included in the revenue estimate as a positive amount of gross receipts tax expected.

The majority of the full \$400 to \$430 million in project costs will be subject to gross receipts tax or compensating tax. Advocates for this bill may testify to this fact that the “true” cost of this proposal is not negative, as shown, but positive because most of the remaining construction costs

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<sup>1</sup> Capitol Reports, **Too early to tell how new EPA regulations will affect NM customers**, June 2nd, 2014, By Rob Nikolewski, New Mexico Watchdog

<sup>2</sup> <http://www.abqjournal.com/432516/news/san-juan-battle-lines-drawn.html>,

<sup>3</sup> [http://en.wikipedia.org/wiki/Price\\_per\\_watt](http://en.wikipedia.org/wiki/Price_per_watt)

<sup>4</sup> <http://www.eia.gov/forecasts/capitalcost/>

will be taxable. However, that testimony would be correct only if the project were not included in the December revenue estimate and if there were substantial reasons to believe that the project would not be built except for the exemption. Since this plan is virtually guaranteed because of federal rule, the “but-for” argument is not valid. Under current law, all equipment costs would be subject to either the gross receipts tax or the compensating tax for equipment imported into the state from elsewhere.

In addition to the estimable impacts of this proposal attributable to the San Juan Generating Plant, there will probably be significant impacts from other projects and remediation. For example, replacing an underground fuel tank on a farm with a double-wall tank could be within the definition of this bill. Similarly, the extra equipment required in the oil patch to meet the pit rules would be within the definition of this bill. Even the entire materials cost of installing a septic system might be considered to be meeting state standards. The possibilities are endless.

For the purpose of this analysis, the PNM impact has been doubled in the table. The true cost could be orders of magnitude greater.

A 10 percent fractional deduction for pollution control equipment would change the revenue estimate to the following:

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY15	FY16	FY17	FY18	FY19		
	(128)	(128)	(128)	(128)	Nonrecurring	General Fund, Compensating Tax

Note that this would assume that the inclusion of water and land pollution remediation equipment are removed from the bill.

### SIGNIFICANT ISSUES

This bill poses an interesting policy issue: whether society in general should bear at least a portion of the financial burden of cleaning up our air, water or land or whether utility companies, utility company shareholders or ratepayers should bear 100 percent of the financial burden.

This bill is posed as an exemption for receipts that would normally be expressed as deductions. Exempt sales are not reported to TRD, so this bill would exacerbate the problem of determining the future costs and benefits of this exemption. LFC staff strongly recommends amending the provisions of this bill to convert this exemption into a deduction and to require separate reporting of both the gross receipts tax and compensating tax impacts to TRD and subsequently to the legislature.

Section 7-7-90 NMSA 1978 requires separate reporting to TRD. The section allows a deduction for sales of uranium hexafluoride and enrichment of uranium and could be used as a drafting base for reports required of persons and businesses that would take advantage of this exemption. As pointed out in the analysis of this year’s HB-18, separate reporting is only feasible for deductions, not exemptions.

When changed into a deduction, the pollution control equipment deduction could be either

phased in or could be expressed as a permanent fraction. For example, (the drafting base here is the percentage deduction for aviation jet fuel at 7-9-83 NMSA 1978 (55 percent) for gross receipts and 7-9-84 NMSA 1978 (55 percent) for compensating tax), a 10 percent or 20 percent fractional deduction might be appropriate to answer the policy question of what portion of the total cost of cleaning up our air should be borne by society in general or by the ratepayers and users of the energy whose production is causing the problem.

The possibility of unintended consequences mentioned in the Fiscal Implications section are quite concerning. The discussion above mentioned three examples:

- replacing an underground fuel tank on a farm with a double-wall tank
- extra equipment required in the oil patch to meet the pit rules
- installing a septic system – particularly a sand filter system

LFC staff recommends restricting the scope of this bill only to air pollution remediation equipment. There may be some unintended inclusions even if the scope is limited, but the fiscal consequences will be substantially less than if water and land pollution are included.

### **PERFORMANCE IMPLICATIONS**

The LFC tax policy of accountability is not met since TRD is not required in the bill to report annually to an interim legislative committee regarding the data compiled from the reports from taxpayers taking the exemption and other information to determine whether the deduction is meeting its purpose. In the analysis for HB 18 of this session, LFC staff note that separate reporting cannot be required of gross receipts tax exempt receipts. In order to ensure accountability, this proposed exemption should be converted into a gross receipts tax deduction.

### **ADMINISTRATIVE IMPLICATIONS**

None

### **TECHNICAL ISSUES**

This bill does not contain a sunset date. The LFC recommends adding a sunset date.

LFC staff recommends that this gross receipts tax exemption be converted into a fractional gross receipts tax deduction with separate reporting requirements.

LFC staff strongly recommends that this exemption pertaining to air, water and land pollution remediation equipment be scaled down to apply only to air pollution remediation equipment. The chances of unintended consequences and fiscal impacts with the provisions as stated in the bill are large.

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