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

SPONSOR Hickey

ORIGINAL DATE 02/06/21
LAST UPDATED 03/05/21
HB

SHORT TITLE Remove Some Solar GRT deductions
SB 243

ANALYST Graeser

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY21	FY22	FY23	FY24	FY25		
	Could be significant in the ($8,000.0) to ($10,000.0) range if deduction applied to community solar and commercial scale solar arrays.				Recurring	General Fund
	Could be significant in the ($5,000.0) to ($8,000.0) range if deduction applied to community solar and commercial scale solar arrays.					Counties, Municipalities and some SWCD districts

Parenthesis ( ) indicate revenue decreases

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY21	FY22	FY23	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
Total	$5.2			$5.2	NR	General Fund

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

Relates to House Bill106.

SOURCES OF INFORMATION
LFC Files

Responses Received From
Energy, Minerals and Natural Resources (EMNRD)
Taxation and Revenue Department (TRD

SUMMARY

Synopsis of Bill

Senate Bill 243 amends the gross receipts tax deduction for Solar Energy Systems (7-9-112 NMSA 1978) to provide a sunset date of July 1, 2030, to require taxpayers claiming this GRT deduction to report to TRD, which is then charged with preparing a report for relevant legislative committees and deletes the requirement that the solar energy system must deliver space heat, hot water or electricity to the property in which it is installed. This may allow a deduction for utility scale solar arrays and community solar installations.

The effective date of this bill is July 1, 2021. The delayed repeal date of this bill is July 1, 2030.

FISCAL IMPLICATIONS

TRD anticipates immediate, initial costs that would be incurred in FY21. (See "Administrative Implications.")

This bill sunsets a popular solar energy systems gross receipts tax deduction and requires direct reporting of this deduction to TRD. This reporting will allow the Legislature and the executive to better judge whether the solar energy system deduction is achieving whatever goals the deduction serves. However, the repeal of the requirement that the solar equipment be installed on the property that uses the produced energy may allow large-scale commercial and community solar systems to qualify for the credits.

TRD discusses the methodology.

Estimated Revenue Impact*					**R or NR****	**Fund(s) Affected**
FY2021	**FY2022**	**FY2023**	**FY2024**	**FY2025**		
--	($2,800 to $8,200)	($3,100 to $9,000)	($3,400 to $9,900)	($3,800 to $10,000)	R	General Fund
	($1,900 to $5,500)	($2,100 to $6,000)	($2,300 to $6,600)	($2,600 to $7,300)	R	Local Governments

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

The solar energy systems deduction had an estimated cost of $2.7 million to the general fund and $1.5 million to local governments in FY20 per the *2020 New Mexico Tax Expenditure Report* (TER). The current deduction is not separately reported though, and the TER cost is an estimate using associated data. Once the deduction is separately reported, a more accurate cost will be calculated. The striking of the language that requires a solar system to be used at "the property in which it is installed" opens the deduction substantially to community and commercial solar projects. Data from the Solar Energy Industry Association on residential, nonresidential, and utility installations is used in the estimation of the cost of the deduction expansion. The estimates include a range as it is assumed that utility level solar systems may opt for other tax advantaged options, such as Industrial Revenue Bonds.

The sunset in this legislation would eliminate this tax expenditure for FY31 and going forward. It is estimated the savings from the sunset will be more significant in FY31 and going forward than the cost of the estimate in FY20 as the result of inflation and demand growth.

TRD's analysis indicates that removal of the requirement that the solar system deliver space heat, hot water or electricity to the property on which it is installed may be significant. Consider a community photovoltaic solar installation of typically 500 to 1,000 kilowatts, installed and owned by a solar developer. Individuals in the community subscribe to this project in exchange for a portion of the net metering feature offered by the public utility. The solar array does not provide electricity directly to the subscribers but transfers the generated power to the public utility net. Currently, this array would be subject to the compensating tax or the gross receipts tax, depending on whether the arrays and mounting materials were purchased in-state or out-of-state and depending on whether the owner and organizer of the project constructed the project in-house or used an installation contractor. With the provisions of this bill, the tangible property would become deductible, whether purchased in-state or out-of-state. In terms of an order of magnitude, a 1,000 kilowatt (1 megawatt) solar photovoltaic array would cost about $3 million. Average tax rates statewide might be 4.4 percent for the state, 1.1 percent for the counties and 3 percent for the municipalities. This one installation would contribute a total of ($255 thousand) in revenue losses.

The analysis is similar for large commercial arrays. Many of the utility scale projects are now IRB eligible (see the analysis of HB105 and SB72). One major advantage of the IRB sponsorship is that the project is considered owned by a government entity and there is no gross receipts tax on the equipment portion of the project since receipts from sale of tangible personal property to a government is deductible. This introduces a great deal of uncertainty in the overall analysis. The amounts shown in the table are order of magnitude.

There will be an impact on TRD information technology systems because one more deduction will be added to the CRS tax return. This modification will be accomplished within currently budgeted resources. (See "Administrative Implications.")

SIGNIFICANT ISSUES

TRD reports an estimate of the general fund cost of the deduction in the annual TRD Tax Expenditure Report. A portion of this report is included below:

Reliability Factor: 3 - The solar market development credit, authorized in Section 7-2-18.14 NMSA 1978, is used as a proxy to estimate the size of this deduction. However, that incentive expired in 2016. Data from the Solar Energy Industries Association on residential and non-residential installations which excludes utilities is used to estimate the growth and cost of the deduction in the estimate. The deduction amount is multiplied by the statewide average GRT rate for each year to estimate the cost.

Fiscal Impact:

	Fiscal Year	2016	2017	2018	2019	2020
Solar Energy Systems Deduction	**State General Fund Expenditure (thousands)**	$1,530	$1,560	$1,960	$2,360	$2,660
	Local Government Expenditure (thousands)	$980	$1050	$1,240	$1,440	$1,540

Note the discussion of reliability of the estimate. Because there is no direct reporting to TRD of the utilization of the deduction, TRD economists are forced to approximate what the revenue reductions are. One difficulty with the estimate is that solar market development credits are limited to $5 million a year (10 percent of costs of PVs or solar thermal systems). If that limit has been reached, then the proxy factor may not be a good data source for the deduction attributed to sale and installation of more broadly defined solar energy systems. This disconnect may be one reason this bill proposes direct reporting.

This disconnect may also help explain the second amendment proposed in this bill – removing the qualification that the solar energy system must provide energy to the property in which it is installed. Vendors of solar equipment would have no means of knowing whether the installation of the equipment would provide space heat, hot water or electricity to the property in which it is installed. Of course, solar equipment installers would have that information.

TRD notes the following policy issues:

The original intent of the solar systems deduction may have been to incentivize the growth of the solar and renewable energy industry by improving its cost effectiveness compared with traditional hydrocarbon sources. The desired policy outcome of this is to reduce greenhouse emissions, and to improve resource and environmental sustainability.

In recent years, the cost of solar systems has declined dramatically due to improved technological efficiencies and lower production costs and is increasingly competitive with traditional utility energy costs. The solar systems deduction may be less likely to achieve a desirable return on investment as technological efficiencies continue to improve and costs decline. The proposed sunset will allow policymakers to review the impact of this deduction before extending it.

In administrating gross receipts tax (GRT), TRD works to maintain a balance between minimizing taxpayer burden, GenTax system programming requirements, and obtaining more precise return data for economic analysis. Requiring separate reporting of this deduction will slightly increase taxpayer burden and accountability. On the other hand, a separately reported deduction means TRD, and therefore policymakers, will obtain precise data to calculate the impact to the general fund and the effectiveness of the deduction.

PERFORMANCE IMPLICATIONS

The LFC tax policy of accountability is met with the bill's requirement that TRD report annually to an interim legislative committee regarding the data compiled from the reports from taxpayers taking the deduction and other information to determine whether the deduction is meeting its purpose.

ADMINISTRATIVE IMPLICATIONS

TRD will incur relatively modest IT costs to add this required direct reporting to the list of other deductions requiring direct reporting. Because there is no penalty for failing to direct report, compliance with the new requirement may be spotty.

TRD expands on this impact:

A deduction code is required to be stated separately effective July 1, 2021. The Information and Technology Division (ITD) of TRD estimates implementation of the legislation will cost approximately $5.2 thousand in staff workload costs. The Tax Information and Policy Office of TRD will need to update return forms and instructions and review regulations and rulings related to the deduction.

TRD expects to be able to absorb the impact of these changes as outlined in this standalone bill within the annual tax year implementation. This July 1, 2021, TRD implements the conversion for the Combined Reporting System (CRS) redesign project, which received a non-recurring appropriation. On July 1, 2021, TRD also implements the local option compensating tax, local option GRT on internet sales, a new version 12 of Gentax, and moves to destination-based sourcing of the GRT. Due to the effective date of July 1, 2021 for this bill and other proposed bills, any changes to rates, deductions and distributions adds to the complexity and risk TRD faces on July 1 to ensure complete readiness and testing of all processes. If several bills with similar effective dates become law, there will be a greater impact to TRD and additional staff workload costs or contract resources may be needed to complete the changes specified by the effective date(s) of each bill. TRD recommends an effective date of date of January 1, 2022 or July 1, 2022 to ensure proper implementation of the legislation in TRD administration and system processes.

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