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FISCAL IMPACT REPORT

SPONSOR <u>Ferrary</u>	LAST UPDATED <u>2/2/24</u>
	ORIGINAL DATE <u>1/26/24</u>
SHORT TITLE <u>School Solar Tax Credit</u>	BILL NUMBER <u>House Bill 187/aHENRC</u>
	ANALYST <u>Graeser</u>

REVENUE* (dollars in thousands)

Type	FY24	FY25	FY26	FY27	FY28	Recurring or Nonrecurring	Fund Affected
TRD/PIT		(\$2,200)	(\$2,600)	(\$3,100)	(\$3,700)	Recurring	General Fund

With a maximum cap expressed as follows:

Type	FY24	FY25	FY26	FY27	FY28	Recurring or Nonrecurring	Fund Affected
TRD/PIT		(\$204,000.0) over 12 years**				Recurring	General Fund

Parentheses () indicate revenue decreases.

*Amounts reflect most recent analysis of this legislation.

**(\$204,000.0) over the entire 12-year existence of the credit, without any defined method of estimating the cost in any single fiscal year. This averages \$17 million per year.

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT* (dollars in thousands)

Agency/Program	FY24	FY25	FY26	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
EMNRD		Up to \$90.0	Up to \$90.0	Up to 180.0	Recurring	General Fund
TRD	\$15.1			\$15.10	Nonrecurring	General Fund

Parentheses () indicate expenditure decreases.

*Amounts reflect most recent analysis of this legislation.

Relates or conflicts with House Bills 108, 187 and 189 and Senate Bills 2 and 121.

Sources of Information

LFC Files

Agency Analysis Received From

Energy, Minerals & Natural Resources Department (EMNRD)

Taxation and Revenue Department (TRD)

Agency Analysis was Solicited but Not Received From

Public Education Department (PED)

SUMMARY

Synopsis of HENRC amendment to House Bill 187

The House Energy, Environment and Natural Resources Committee amendment to House Bill 187 removes the requirement a taxpayer purchase a photovoltaic system to qualify for the credit and instead requiring the taxpayer only installs the system on school property.

Synopsis of Original House Bill 187

House Bill 187 creates a new credit against personal income tax in the Income Tax Act for installing a photovoltaic system on school property for the purpose of providing electricity to a school building in New Mexico. A companion tax credit for corporate income tax is not provided.

The allowable tax credit would equal 40 percent of all costs necessary to install a photovoltaic system, including engineering, permitting, interconnection, subcontracting costs, and other costs necessary to install a photovoltaic system on school property, but excludes the costs of modules, batteries, racking, and inverters.

Taxpayers would apply to the Energy, Minerals and Natural Resources Department (EMNRD) for a certification of eligibility. The total aggregate credit allocated is \$204 million in total, over the lifetime of the credit. The application shall include proof of purchase and installation of a photovoltaic system on a school property, proof that the system meets technical specifications and requirements relating to safety, code and standards compliance, system applications appropriate to the school, and lists of eligible components and any additional information that EMNRD may require to determine eligibility for the credit. Credits can be sold, exchanged, or otherwise transferred. The taxpayer shall have up to 12 months following the time at which the relevant utility gives permission to operate to apply for a certificate. That portion of tax credit that exceeds a taxpayer's tax liability in the taxable year in which the credit is claimed shall be refunded to the taxpayer.

TRD is directed to file an annual report to the Legislature on the tax credit program, although this provision is not required since TRD would classify this tax credit as a tax expenditure and is required to report participation and recommendations to the legislature for all tax expenditures.

This bill does not contain an effective date and, as a result, would go into effect 90 days after the Legislature adjourns, or May 15, 2024, if enacted. Provisions of the bill are applicable to tax years beginning January 1, 2024, and sunseting for installations after January 1, 2036.

FISCAL IMPLICATIONS

This bill creates a tax expenditure with an annual cost that is difficult to determine but likely significant. LFC has serious concerns about the substantial risk to state revenues from tax expenditures and the increase in revenue volatility from erosion of the revenue base. The committee recommends the bill provide an annual cap with rollover provisions to limit the exposure of the state to unanticipated fiscal consequences.

The most unusual feature of this bill is the total cap amount available over the 12 tax years of applicability of \$204 million. This is an average general fund cost of \$17 million per year, with no guarantee that the annual cost could not be the entire amount.

The amendment opens an interesting possibility for school districts. If the school district purchases the modules, batteries, racking and inverters, and subcontracts the installation, the school district would become eligible for a 30 percent renewable energy investment credit as enacted in the Inflation Reduction Act (IRA). Pursuant to the provisions of the IRA, nonprofits and government entities are now eligible for the renewable energy production tax credit or the somewhat more generous renewable energy production credit calculated based on the sum of the equipment and installation costs. The provisions of this bill would allow a state tax credit and a federal tax credit for the private installation contractors. It is uncertain whether the changes would allow stacking of credits by the installer and the school district. More research will be necessary.

This proposal also creates an unusual interaction with other taxes:

1. Sales of solar systems are deductible from gross receipts and compensating taxes if the system is used to provide space heat, hot water, or electricity to the property in which it is installed; this proposal requires installation on or adjacent to a school building and would qualify the expenditures for the gross receipts deduction. This would be true even for a solar installation on a private or parochial school, although the definitions require the installation on a school building owned or leased by a public school district.
2. Without this tax credit, the donation of a solar system (tangible personal property) to a governmental entity, such as a school district would be gross receipts tax deductible pursuant to Section 7-9-54 NMSA 1978 for sale of tangible personal property to government. Sales of tangible personal property to a private or parochial school would not be eligible for this deduction.
3. Any donation to a 501(c)(3) non-profit entity or to a government entity is deductible for income tax purposes and, with some restrictions, to business entities as eligible business deductions. These deductions would reduce income tax obligations for federal purposes if the taxpayer itemizes deductions and would reduce state income tax liabilities whether the individual itemizes or takes the standard deduction (Section 7-2-xx NMSA 1978). Any tax credit such as this would reduce the amount of deduction allowed. The proposed credit is 40 percent of the costs of the donated system, hence the amount of deduction allowed would be 60 percent. Depending on the level of taxable income net of any allowable deductions¹, a deduction is worth up to 43 percent of the amount donated or as little as 0 percent. With the amendment, an installer could deduct the donated services.
4. The donation would be property tax exempt for a 501(c)(3) non-profit entity or to a government entity but would be taxable for a for-profit private school. For a private, for-profit entity, the property tax assessment would be based on the entity's depreciation schedule. On the books of the private entity, the system would be valued at cost, but would be allowed an accelerated depreciation schedule with 15 percent salvage value and full depreciation in 6 years of 85 percent of the costs.

¹ There are seven federal income tax rates and brackets in 2023 and 2024: 10%, 12%, 22%, 24%, 32%, 35% and 37%. Your taxable income and filing status determine which rates apply to you. <https://www.nerdwallet.com/article/taxes/federal-income-tax-brackets#:~:text=There%20are%20seven%20federal%20income%20tax%20rates%20and%20brackets%20in,which%20rates%20apply%20to%20you.>

With all these variables involved and the unusual feature of using the total cap over a 12-year period. LFC strongly recommends that this proposal be further studied in the interim.

TRD has studied the effects of the amendment and reduced the estimate of the fiscal impact.

Estimated Revenue Impact*					R or NR**	Fund(s) Affected
FY24	FY25	FY26	FY27	FY28		
--	(\$2,200)	(\$2,600)	(\$3,100)	(\$3,700)	R	General Fund

TRD cannot anticipate how many taxpayers will purchase and install a PV system on school property and, therefore, potentially claim a credit against their income tax liability or if the process to claim a credit and the amount of the final credit will incentivize taxpayers. Therefore, this analysis is based on the number of potential installations. Also, because the credit is refundable the number of taxpayers that claim this credit will likely increase.

There are 941 schools within the New Mexico Public Education Department² (PED). TRD assumes 896 of these schools qualify under this bill per Section 1 (J) (2) and (3). This excludes home schools, off- site programs, and private schools. Additionally, there are 35 tribal-controlled or Bureau of Indian Education-operated schools on tribal land in New Mexico³. TRD assumes there are a total of 931 schools eligible for the school solar income tax credit.

According to the National Renewable Energy Laboratory (NREL), the Q1 2022 percentage of stand - alone labor cost for the national benchmark commercial PV system is 9 percent. When including engineering, permitting, interconnection, support structure, racking, batteries, subcontracting costs and other costs necessary to install a PV system on school property, this percentage increases to 40 percent. TRD then assumes the average total cost of installing and purchasing a PV system at a New Mexico school is \$450 thousand⁴ excluding federal solar tax credits and other rebates⁵. Of this cost, 40 percent is eligible for the school solar tax credit and the installation cost is inflated annually by the average growth of national labor cost from 2019 to 2022 of 4.1 percent⁶. TRD also assumes an initial frequency of 40 projects per year (see footnote 3) grown by 13percent per annum, the growth rate in the number of U.S. schools that installed a PV system from 2014 to 2021⁷.

If the bill passes, EMNRD has some concerns about administrative costs:

² [New Mexico Public Education Department \(state.nm.us\)](http://state.nm.us)

³ [Bureau of Indian Education \(www.bie.edu\)](http://www.bie.edu)

⁴ U.S. Solar Photovoltaic System and Energy Storage Cost Benchmarks, With Minimum Sustainable Price Analysis: Q1 2022 (www.nrel.gov)

⁵ [Federal Solar Tax Credits for Businesses \(www.energy.gov\)](http://www.energy.gov)

⁶ [U.S. Bureau of Labor Statistics \(bls.gov\)](http://bls.gov); Labor Cost Index

⁷ [Brighter-Future -A-Study-on-Solar-in-U.S.-Schools-2020 \(generation180.org\)](http://generation180.org)

HB187 effectively creates a new solar tax credit program for individual taxpayers, requiring EMNRD to promulgate a new rule and administer this credit separately from the existing Solar Market Development Tax credit. Given the burden on ECMD's tax team, an additional FTE may be required, though it is difficult to estimate the workload that would be associated with HB187, and whether it could be absorbed with existing staff.

SIGNIFICANT ISSUES

TRD notes a significant feature of the HENRC amendment:

The HENRC committee amendment removes the requirement for the taxpayer claiming the credit to purchase the solar system being installed on the school property. As amended, although the taxpayer will only get the credit for the installation of the solar system, the credit will still offset a percentage of the cost to get schools utilizing solar as an electricity source.

For many credits, a personal income tax credit is mirrored by a corporate income tax credit. This bill restricts the credit to individuals and entities reporting as individuals or pass-through entities. Pass-through entities include Subchapter-S corporations, sole proprietorships, limited liability corporations (LLCs), partnerships, limited liability partnerships (LLPs), master limited liability partnerships. The lack of a CIT mirror is increasingly less important.

EMNRD points out an interesting feature of the provisions of this bill:

HB187 creates an incentive for individuals to donate a solar system to a public school. Public schools are well-positioned to take advantage of on-site solar and could see tremendous energy bill savings from a right-sized installation.

TRD provides extensive policy analysis:

An alternative solution to the issue raised in this bill would be to allow solar installations in public schools to be funded through the Public School Capital Outlay program. The PSCOC program was established over 20 years ago to fund facility needs in public schools statewide. It is funded by supplemental severance tax bonds issued by the State Board of Finance. According to the December 2023 bonding capacity forecast issued by the SBOF, about \$750 million per year is available through this bonding program for public school facilities, with a total capacity of \$3.7 billion in the next five years. Because solar installations are not required to meet adequacy standards, they are not currently funded through the PSCOC program. That could be accomplished by amending the Severance Tax Bonding Act.

Personal income tax (PIT) represents a consistent source of revenue for many states. For New Mexico, PIT is approximately 25 percent of the state's recurring general fund revenue. While this revenue source is susceptible to economic downturns, it is also positively responsive to economic expansions. New Mexico is one of 41 states, along with the District of Columbia, that impose a broad-based PIT (New Hampshire and Washington do not tax wage and salary income). Like several states, New Mexico computes its income tax based on the federal definition of taxable income and ties to other statutes in the federal tax code. This is referred to as "conformity" to the federal tax code. The PIT is an important tax policy tool that has the potential to further both horizontal equity, by ensuring the same statutes apply to all taxpayers, and vertical equity, by ensuring the tax burden is based on taxpayers' ability to pay.

Nationally, public K-12 districts spend approximately \$8 billion a year on energy bills. This is the second largest expense after teacher salaries⁸. Albuquerque Public Schools (APS) has an electric utility bill of over \$50,000 per day. The installation of PV systems can significantly reduce electricity costs. Atrisco Heritage Academy High School in Albuquerque spends about \$354 thousand per year in utility expenses. The school completed the district's largest solar and battery storage project in 2022 with a total cost of \$3.2 million. It is expected to save the school district over \$3.5 million over the next 25 years. However, most PV systems installed at a school do not include battery storage and have lower levels of electricity consumption.

The typical lifespan of solar projects is around 30 years, providing school districts with decades of low- cost solar power. About 90 percent of schools enter into a power purchasing agreement (PPA) with a third party which allows the school to purchase power at a discounted rate over several decades.

The installation of PV systems also provides schools the opportunity to use solar technology to teach science and engineering skills to students at any school and further professional development of older students. The New York City Department of Education trains students on solar PV installation and offers internships for students to become solar PV installers⁹.

The broader question of subsidizing solar energy implicates many economic factors, including job creation, impacts to established markets and environmental concerns. A credit is a tax expenditure that gives preferential tax treatment to certain taxpayers and while any taxpayer may apply for this credit most of the financial benefit is realized by high wealth individuals. Some economists would argue that energy costs should reflect the associated cost impacts or benefits to the environment. Thus, solar energy which can be expensive to start-up, should be given tax incentives due to its low environmental impact and health and social benefits for the current and future populations. The long-term environmental, health and social benefits outweigh the short-term revenue cost. New job opportunities are associated with solar energy generation, such as solar photovoltaic installers, engineers and managers.

The bill does not require the taxpayer receiving the credit to have any connection with the school. Public schools are publicly owned, and charter schools may be in public or private leased facilities. It is unclear whether the bill envisions making solar energy available in leased space, where the taxpayer claiming the credit would own the building. TRD suggests that there should be a requirement for an agreement between a school and a taxpayer to purchase and install the system.

There is no parallel corporate income tax credit, limiting the scope of those who may take advantage of the credit. The credit will be more effective if corporations, especially those involved in the solar industry, are also granted eligibility for the credit.

It is unclear whether the credit is available for private schools or home schools. The bill

⁸ www.whitehouse.gov

⁹ [Brighter-Future_-A-Study-on-Solar-in-U.S.-Schools-2020 \(generation180.org\)](http://Brighter-Future_-A-Study-on-Solar-in-U.S.-Schools-2020_(generation180.org))

does not explicitly state that it applies only to public schools. The definition of “school” in Section 1(J)(2) of the bill mirrors the definition of “*public* school” in the Public School Code, Section 22-1-2(L) NMSA 1978, but the bill uses only the term “school” in its text, and therefore appears to be attempting to include private schools and possibly home schools.

PERFORMANCE IMPLICATIONS

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

EMNRD has concerns:

Adding another tax credit program to EMNRD’s certification responsibilities without adding additional FTE and IT resources could slow down processing for all tax credit certifications, particularly the New Solar Market Development Tax Credit and the Sustainable Buildings tax credit.

ADMINISTRATIVE IMPLICATIONS

TRD will update forms, instructions, and publications and make information system changes. Implementing the new income tax credit will be included in the annual tax year changes along with staff training to administer the credit. TRD’s Administrative Services Division will be required to test the system changes and revise revenue reports. It is anticipated this work will take approximately 40 hours, split between two existing full-time employees. This bill will have a low impact on TRD’s Information Technology Division (ITD) of approximately 220 hours, or just over one month and \$12,210 of staff workload costs.

Estimated Additional Operating Budget Impact*				R or NR**	Fund(s) or Agency Affected
FY24	FY25	FY26	3 Year Total Cost		
--	\$2.9	--	\$2.9	NR	TRD – ASD staff workload
--	\$12.2	--	\$12.2	NR	TRD – ITD staff workload

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

EMNRD has concerns:

HB187 creates an individual taxpayer credit for the purchase of a solar installation with different parameters than the existing Solar Market Development Tax credit for individual taxpayers. The eligible costs, tax credit amount and aggregate tax credit allocated by the state are different, creating the need for EMNRD to stand up an entirely new program. It is not clear if the resources required to stand up this program would justify the mere handful of individual taxpayers who would likely take advantage of this tax credit.

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

HB187 relates to or conflicts with a HB108, Local Solar Access Fund; HB187, School Solar Tax Credit; HB189, Low Income Solar Act; SB 2, Low Income Solar Act; and SB121, Solar Market Development Tax Credit Changes.

TECHNICAL ISSUES

On the original bill, LFC recommended the bill make clear that title to the system must pass to the school district. This is an unconditional donation and not a sale or lease. With the HENRC amendment, this issue has been resolved.

LFC also recommended the bill make clear that the school must be either owned and operated by one of the 89 public school districts in the state or be a state-chartered charter school. Private or parochial schools should be excluded pursuant to an interpretation of the constitutional requirement that restricts support of private entities. TRD points out that BIA schools would also be eligible for this credit, as well as the 30 percent renewable energy investment credit pursuant to the IRA.

TRD notes seven areas where amendments should be considered:

In Subsection A, with 931 schools eligible, many with multiple buildings, it is unclear if this credit is applicable to one school building per year, if the PV system must provide electricity to the entire school building in a single installation, or if a taxpayer may apply this credit multiple times per year. The bill also does not specify if tribal schools not associated with New Mexico's public school system are eligible. The ownership of the PV system nor the generation of electricity once installed is not specified.

In Subsection C, for clarity, TRD recommends stating that the aggregate amount of credits of \$204 million is in total, not annually.

In Subsection D, lines 14 through 15, the time that the taxpayer may claim the credit with TRD is based on the date the system gets approval from the utility. This may be better based on the time they get certified by EMNRD since they must be certified to claim the credit. In addition, the requirement in Section H is duplicative of the requirement in Section D.

The taxpayer is entitled to the credit in the year the solar system is installed, page 3, lines 10-11. On page 3, lines 14-15, the taxpayer has up to "twelve months following the time at which the relevant utility gives permission to operate to apply." This language raises the question of how and when the credit can be claimed by the taxpayer on the original return or will an amended return be required. This is because on page 2, lines 18-25, the application requires cost certification, but then the twelve-month utility requirement makes it unclear as to what taxable year the credit can be claimed. Section 7-2-18.14 NMSA 1978 has a similar credit, and it may be possible to have the same criteria. However, the fixes to avoid confusion as to when the credit could be claimed are suggested below:

Page 2, line 22, insert after "components" insert "the date the relevant utility gives permission to apply" Page 3, line 13, remove "and shall have"

Page 3, remove line 14

Page 3, line 15 "utility give permission to operate to apply."

Section 1(J)(2) defines "school"; but the definition is different from the definition of "school" in the Public School Code, Section 22-1-2(M) NMSA 1978 ("school" means a supervised program of instruction designed to educate a student in a particular place,

manner, and subject area.”) TRD recommends avoiding inconsistent definitions in statute, as that can lead to confusion and inconsistency in the law; that is especially the case when, as here, the subsequent definition of “school property” refers specifically to the Public School Code. Alternatively, the bill should use the term “public school,” which definition is in the Public School Code, 22-1-2(L) NMSA 1978, and which mirrors the language in Section 1(J)(2).

Section 1(J)(3) defines “school property” as a “school district pursuant to the Public School Code.” Section 22-1-2(R) NMSA 1978 defines “school district” as “an area of land established as a political subdivision of the state for the administration of public schools and segregated geographically for taxation and bonding purposes.” A school district is therefore a political unit of taxation that can often be coextensive with the boundaries of a county or municipality. The entire school district is not school property, as the term “property” is commonly understood. TRD suggests revising Section 1(A) of the bill to substitute “purchases and installs a photovoltaic system on or adjacent to a school building for the purpose of providing electricity to school buildings...” on page 1, lines 20-22. “School building” though used in the bill is not defined; it is however defined in the Public School Code, Section 22-1-2(P) NMSA 1978, and TRD suggests incorporating that definition in this bill, whether or not the proposed change above is adopted.

The bill should be amended to clarify that a taxpayer cannot claim both this credit as well as the New Solar Market Development tax credit. That credit, created in Section 7-2-18.31 NMSA 1978, allows a credit of up to \$6,000 for installation of a PV system in residence, business or agricultural enterprise in New Mexico.

OTHER SUBSTANTIVE ISSUES

TRD notes another substantive issue:

Since the requirements of this school solar credit are similar to the preexisting new solar market development income tax credit, it may be a better to add to the eligibility for an individual who purchases and installs a solar system on school property to the existing credit. This would simplify the application process and reduce costs of administering two separate credits. EMNRD could still follow the proposed aggregate amount of credits allowed for solar systems installed on school property but without necessarily creating a different credit. As proposed, this new credit would need to be applied on a new separate application, and then claimed on the income tax return on a separate line, when the requirements of each credit are essentially the same.

In assessing all tax legislation, LFC staff considers whether the proposal is aligned with committee-adopted tax policy principles. Those five principles:

- **Adequacy:** Revenue should be adequate to fund needed government services.
- **Efficiency:** Tax base should be as broad as possible and avoid excess reliance on one tax.
- **Equity:** Different taxpayers should be treated fairly.
- **Simplicity:** Collection should be simple and easily understood.
- **Accountability:** Preferences should be easy to monitor and evaluate.

In addition, staff reviews whether the bill meets principles specific to tax expenditures. Those policies and how this bill addresses those issues:

Tax Expenditure Policy Principle	Met?	Comments
Vetted: The proposed new or expanded tax expenditure was vetted through interim legislative committees, such as LFC and the Revenue Stabilization and Tax Policy Committee, to review fiscal, legal, and general policy parameters.	✘	Not vetted; because of unusual features of this bill, LFC recommends studying this proposal in the interim.
Targeted: The tax expenditure has a clearly stated purpose, long-term goals, and measurable annual targets designed to mark progress toward the goals. Clearly stated purpose Long-term goals Measurable targets	✘ ✘ ✘	No purpose stated; implicit is support of the state’s renewable energy goals.
Transparent: The tax expenditure requires at least annual reporting by the recipients, the Taxation and Revenue Department, and other relevant agencies	✔	
Accountable: The required reporting allows for analysis by members of the public to determine progress toward annual targets and determination of effectiveness and efficiency. The tax expenditure is set to expire unless legislative action is taken to review the tax expenditure and extend the expiration date. Public analysis Expiration date	✔ ✔	
Effective: The tax expenditure fulfills the stated purpose. If the tax expenditure is designed to alter behavior – for example, economic development incentives intended to increase economic growth – there are indicators the recipients would not have performed the desired actions “but for” the existence of the tax expenditure. Fulfills stated purpose Passes “but for” test	✘ ✘	
Efficient: The tax expenditure is the most cost-effective way to achieve the desired results.	?	
Key: ✔ Met ✘ Not Met ? Unclear		

LG/al/ne/hg/ne