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FISCAL IMPACT REPORT

SPONSOR <u>Sariñana/Lujan</u>	LAST UPDATED <u>1/25/24</u>
	ORIGINAL DATE <u>1/22/2024</u>
SHORT TITLE <u>Energy Storage System Income Tax Credit</u>	BILL NUMBER <u>House Bill 73/aHENRC</u>
	ANALYST <u>Graeser</u>

REVENUE* (dollars in thousands)

Type	FY24	FY25	FY26	FY27	FY28	Recurring or Nonrecurring	Fund Affected
PIT		Up to (\$4,000.0)	Up to (\$4,000.0)	Up to (\$4,000.0)	Up to (\$4,000.0)	Recurring	General Fund

Parentheses () indicate revenue decreases.

*Amounts reflect most recent analysis of this legislation.

Note: HENRC amendment providing rollover might extend the fiscal impacts significantly beyond the January 1, 2029 sunset date for installations.

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT* (dollars in thousands)

Agency/Program	FY24	FY25	FY26	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
EMNRD	\$30.0	\$75.0	\$75.0	\$180.0	Recurring	General Fund
TRD	\$16.7	\$2.9	No fiscal impact	\$19.6	Nonrecurring	General Fund
Total	\$46.7	\$77.9	\$75.0	\$199.6		

Parentheses () indicate expenditure decreases.

*Amounts reflect most recent analysis of this legislation.

Sources of Information

LFC Files

Agency Analysis of House Bill 32 from 2023; House Bill 11 from 2022, and House Bill 262 from 2021

Agency Analysis Received From

Energy, Minerals and Natural Resources (EMNRD)

Taxation and Revenue Department (TRD)

SUMMARY

Synopsis of HENRC amendment to House Bill 73

The House Energy, Environment and Natural Resources Committee amendments to House Bill 73: (1) provide for rollover certification in case the \$4 million cap has been certified. The rollover would be to the next future tax year with remaining eligibility for that future year ; and (2) made a grammatical change for clarity in the definition of an eligible system.

Synopsis of Original House Bill 73

House Bill 73 proposes a personal income tax credit of 40 percent of the cost of equipment and installation for an energy storage system installed from March 2024 through December 31, 2028. The credit is for installation of an energy storage system on the claimant's residential, industrial, commercial, or agricultural property. The energy storage system must be installed for use with a new or existing solar photovoltaic system and has a minimum rating of three kilowatts and two hours of storage capacity. The system must stand alone. If installed in a grid-tied system, communication and control mechanisms must exist so the storage system can be used as a shared resource with a utility. The credit amount is 40 percent of the cost of equipment and installation, limited to a maximum credit of \$5,000 per system for residential systems and \$150 thousand for commercial, industrial, and agricultural systems.

EMNRD is required to certify installations and issue a certificate. Certifications must be submitted to EMNRD within 12 months after the end of the calendar year of installation. These applications will be processed by EMNRD on a first-come, first-served basis with a limit of \$4 million for all awards per year. EMNRD will post on its website the total amount of certificates approved. Pursuant to HENRC amendment, if a cap is reached in a particular year, EMNRD will issue a certificate for a future year for which there remains cap availability. Approved credits that exceed a taxpayer's tax liability will be refunded.

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. The provisions of the act are applicable to tax years beginning on or after January 1, 2024, for installations completed on or after March 1, 2024. Installations must be completed prior to January 1, 2029. However, HENRC amendment provides for rollover which may extend the fiscal impacts for several years after 2029.

FISCAL IMPLICATIONS

This bill creates a tax expenditure with a cost that is difficult to determine, although capped at \$4 million a year for the 2024 through 2029 tax years. 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 legislature has considered this proposal beginning with the 2021 session.

The fiscal impact of the provisions of this bill simply reflects the \$4 million cap along with refundability of the tax credit. With a maximum credit of \$150 thousand for agricultural and commercial installations and \$5,000 for residential installations, 20 commercial systems and 200 residential systems would consume the credit. It is unknown whether these are appropriate targets.

Industrial scale battery energy storage systems (BESS) currently cost about \$200 per kilowatt hour (KwH). However, Tesla Powerwall 2 stores 13.5 KwH at a cost of between \$9,200 and \$14,200 installed when purchased directly from Tesla. This is a cost (before federal and state tax credits) of \$680 to \$1,050 per KwH, with larger storage capacity cheaper. With 30 percent federal credits and this 40 percent state credit, net costs are \$200 to \$315 per KwH.

While acknowledging the \$4 million cap, TRD expects the credit to be less than the cap in the first two years.

New Mexico has seen a growing interest in battery storage projects in recent years. While the market is still considered underdeveloped, notable projects have emerged. One significant project is the Buena Vista Energy Center, developed by NextEra Energy Resources. This facility, completed in early 2023 with a capacity of 50 megawatts (MW), is one of the largest battery storage projects in the United States. The U.S. Energy Information Administration (EIA) provides data and reports on battery storage in the United States, including New Mexico. Their reports, such as the "Battery Storage in the United States: An Update on Market Trends¹," highlighted New Mexico as a developing market.

Since this market is still in its early stages, the fiscal impact is expected to be under \$4 million in the first two years. However, starting in fiscal year 2026 and onwards, it is anticipated that the market will experience higher adoption and the cap will be reached.

Administration of the act would trigger costs for TRD and EMNRD, with the certification process likely to necessitate significant work force at EMNRD.

EMNRD notes the following fiscal impact:

HB73 does not contain an appropriation for the staff and IT resources for EMNRD which will be necessary to administer the program. EMNRD estimates that \$75 thousand in recurring funding would be necessary to hire one (1) FTE to develop rules for the program, administer it, and evaluate certification applications – that is, to effectively provide system reviews, certify systems for tax credit eligibility, collect data, and maintain a database of certifications.

In addition, EMNRD would require \$30 thousand in one-time IT, legal, and administrative expenditures to develop an electronic submission process for the applications and shepherd the new rule through the rulemaking process.

HENRC amendment provides rollover in case the cap had been fully subscribed. This may extend the fiscal impacts for several years past the sunset date for installation of January 1, 2029. The \$4 million cap per year would still control the annual impact of rollovers.

SIGNIFICANT ISSUES

TRD points out several policy issues:

Tax incentives can support specific industries or promote desired social and economic actions, but the proliferation of more tax incentives has two primary effects. First, it creates special treatment and exceptions within the tax code, resulting in an expansion of tax expenditures and potentially narrowing the tax base. This, in turn, has a negative impact on the general fund, affecting overall revenue;

Second, it imposes a heavier compliance burden on both taxpayers and TRD. The proliferation of tax incentives and the subsequent complexity they introduce do not align with the principles of sound tax policy. While tax incentives can serve a purpose, it is crucial to strike a balance that ensures fairness, simplicity, and effectiveness in the tax system.

The credit has a defined sunset date. TRD supports sunset dates for policymakers to review the impact of tax expenditures before extending them.

TRD also notes difficulties associated with taxpayers applying for credits after a cap has been reached and provided two options to potentially address this issue: (1) “Given that TRD does not expect immediate full uptake of the credit, it may be possible to address this issue by rolling over the unused portion of the cap to subsequent tax years,” and (2) “Roll over applications that exceed the cap in one year to the subsequent tax year.” TRD indicates both of these solutions create additional administrative complexity for TRD and EMNRD. The HENRC amendment adopted the second of these two options.

EMNRD points out the following significant policy implications:

Energy storage systems installed on private property, whether residential, commercial, or agricultural, contribute to bolstering the resilience of the electric grid. As New Mexico faces increasingly aggressive weather events that can knock out electricity distribution – extreme cold, extreme heat, larger and more aggressive storm systems – it is critical that New Mexicans continue to have access to reliable electric power. Distributed energy storage systems, like those incentivized by the tax credit in HB73, can help, as they both absorb increased localized generation (from, for example, a rooftop solar system) on the distribution portion of the electric grid, thereby helping utilities balance electricity generation and demand at the local level, and also can be used as short-term backup power in an emergency. Distributed energy storage systems can also reduce the need to build more transmission lines, as energy can be generated, stored, and then used at the same location, eliminating the need to send electricity across distances.

A tax credit for distributed energy storage systems like the one proposed in HB73 might incentivize their adoption across New Mexico. However, it is worth pointing out that utilities will need to adopt further grid modernization strategies and technologies beyond the storage systems themselves to see, manage, and plan for these additional energy sources and sinks on the distribution grid.

The federal Department of Energy, Energy Information Agency published a study in July 2020¹ that contained some interesting statistics:

- In 2018, utilities reported 234 megawatts of existing small-scale storage power capacity in the United States. A little more than 50 percent of this capacity was installed in the commercial sector, 31 percent was installed in the residential sector, and 15 percent was installed in the industrial sector.
- In 2018, 86 percent of reported small-scaled storage power capacity in the United States was in California and, specifically, was owned by six utilities.
- Utah was in third place, outside California with about 0.6 megawatts of residential energy storage systems.
- In California, capacity and installations at the end-user level are not collected.
- Utah is in third place outside of California, with about 0.6 megawatts of capacity. Virtually all this capacity is for residential systems owned by the end-user. (Utah offers a 10 percent tax credit for renewable energy systems, including energy storage as long as the energy storage is installed at the same time as solar or wind systems.)

¹ https://www.eia.gov/analysis/studies/electricity/batterystorage/pdf/battery_storage.pdf

PERFORMANCE IMPLICATIONS

EMNRD notes the following:

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

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.

ADMINISTRATIVE IMPLICATIONS

TRD will need to update forms, instructions, and publications and make information system changes. TRD’s Administrative Services Division (ASD) will be required to test the system changes. It is anticipated this work will take approximately 40 hours, split between two existing full-time employees.

TRD’s Information Technology Division (ITD) estimates that implementing the bill will require approximately 300 hours or about two months and an estimated staff workload cost of \$16,650. The implementation will be included in the annual tax year changes.

Estimated Additional Operating Budget Impact*				R or NR**	Fund(s) or Agency Affected
FY2024	FY2025	FY2026	3 Year Total Cost		
–	\$2.9	–	\$2.9	NR	TRD - ASD - Operating
\$16.7	--	–	\$16.7	NR	TRD - ITD - Staff workload

EMNRD’s Energy Conservation and Management Division will be required to develop and adopt rules, establish the program certification and administrative certification processes. In addition, EMNRD, possibly through the division’s IT, would need to design an online application portal.

EMNRD is required to develop a list of eligible components for the tax credit.

EMNRD is also required to provide the Taxation and Revenue Department certification information for all taxpayers in a secure and regular manner.

TECHNICAL ISSUES

TRD points out some suggested drafting changes:

Page 2, lines 11 and 12: “Costs related to equipment or installation costs for energy generation shall not be eligible.” “Costs related to” is vague. Replace with: “Indirect

costs related to the purchase of the equipment or installation costs for energy generation shall not be eligible.”

The bill provides that the credit must be claimed within 12 months of installation. The system can be installed, but not operational. Suggested language change: “The credit must be claimed within 12 months after the system becomes operational.”

TRD notes that the terms “residential” and “commercial, industrial or agricultural” are not defined. This may lead to confusion, as for example may arise if a system is installed on a multi-family apartment building. A multi-family housing property would appear to be “residential” but might be deemed to be “commercial” from the point of view of the owners of the property or the county assessor, as the ownership and management of the building represents a commercial enterprise from the owners’ point of view. The bill also does not define “photovoltaic system,” and TRD recommends defining this term.

Page 5, line 7: rather than “stationary”, TRD suggests using the word “fixed”, which is a well-defined term in real property law. On the same line, TRD suggests defining “commercially available” – this term is ambiguous, as it is not clear whether this would include custom-designed systems, for example. Page 5, line 9, it is not clear what distinction is intended between “retaining” and “storing” and suggest striking the word “retaining”.

TRD is now required by Section 7-1-84 NMSA 1978 to compile and present a tax expenditure budget, which includes the number of taxpayers that claim and the amount of claims for a tax expenditure. Credits are seen as a tax expenditure and will be included in this report. For that reason, TRD recommends that on page 4, lines 21 through 25 and page 5, lines 1 through 4 are stricken in full.

OTHER SUBSTANTIVE ISSUES

EMNRD notes several key issues:

Omission of Corporate Tax Option. HB73 omits a corporate tax credit option. Other tax credits for equipment on both residential and commercial property usually offer both an individual and corporate tax credit option.

Credit and Credit Cap. The proposed tax credit of 40 percent of installation costs is larger than the 30 percent tax credit offered by the federal government, but the residential cap of \$5,000 in HB73 is less than the state’s Solar Market Development Tax Credit cap of \$6,000. Since battery storage systems generally are more expensive than solar photovoltaic systems, this cap may be limiting. However, the credit cap for commercial and agricultural installations may be appropriate given the larger size and higher costs of those systems; but, such a high cap may result in a small number of commercial and/or agricultural properties using up the majority of the \$4 million cap in any given year, leaving no available funding for residential taxpayers.

Definitions. HB73 does not include a definition of what qualifies as residential and what qualifies as agricultural and commercial.

System Requirements and Verification. The requirement that the storage system is installed for use with a new or existing photovoltaic system is limiting and may cause unintended problems.

Firstly, there are many uses for energy storage without on-site solar generation. Secondly, it is unclear how EMNRD, rather than an electric utility, would adequately verify the presence of an existing solar generation system on a taxpayer’s property.

Additionally, the minimum power rating of the energy storage system required by HB73 differs from the requirements in the federal tax credit for storage systems. EMNRD also would note that the bill sponsor should consider whether a different minimum power rating for commercial systems would be more appropriate.

Finally, HB73 allows that the energy storage system can be installed as a stand-alone energy storage system; or, if the energy storage system is grid-tied, has the capability to provide grid services if control and communication infrastructure exists with the utility service provider. Most New Mexico utilities are still defining how they themselves will verify the details of control and communication infrastructure.

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.	✓	Previously introduced as HB-32 (2023 Session)
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	? ? ?	Implicit purpose is to support 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	* *	No stated purpose. May not be necessary to have this level of support for a mature technology
Efficient: The tax expenditure is the most cost-effective way to achieve the desired results.	?	
Key: ✓ Met * Not Met ? Unclear		

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