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

SPONSOR Papen **DATE TYPED** 03/18/05 **HB**

SHORT TITLE Agricultural Water Expenses Tax Credit **SB** 309/a SCONC

ANALYST Padilla-Jackson

REVENUE

Estimated Revenue		Subsequent Years Impact	Recurring or Non-Rec	Fund Affected
FY06	FY07			
($1,100.0)	($1,100.0)	($3,400.0)	Recurring*	General Fund

(Parenthesis ( ) Indicate Revenue Decreases)

*Impact is recurring until 2015, when the bill expires.

Duplicates House Bill 91 prior to amendment

SOURCES OF INFORMATION
LFC Files

Responses Received From
Taxation and Revenue Department (TRD)
Office of the State Engineer (OSE)
New Mexico Environment Department (NMED)
New Mexico Department of Agriculture (DOA)

SUMMARY

Synopsis of SCONC Amended Bill

Senate Bill 309 has been amended by the Senate Conservation Committee (SCONC). The amended Senate Bill 309 would expand eligibility for the income tax credit to land owned or leased by the taxpayer, which is used to manage golf course facilities. The amendment removes the restriction that would prohibit the water conserved from being put to consumptive beneficial use and instead allows the water rights holder to sell or lease the conserved water if there is no net depletion.

Synopsis of Original Bill

Senate Bill 309 provides a personal and corporate income tax credit for agricultural water conservation expenses. The bill provides a tax credit against income tax liability equal to 75 percent of expenses for eligible improvements in irrigation systems or water management methods, not to exceed an annual credit of $10,000. A credit may be claimed for the taxable year in which expenses are incurred if the taxpayer, in that year, owned or leased a water right appurtenant to the land on which an eligible improvement was made.

The bill defines "eligible improvement in irrigation systems or water management methods" as an improvement that is:

- made after January 1, 2006;
- complies with a water conservation plan approved by the local soil and water conservation district in which the improvement is located; and
- primarily designed to conserve water on land in New Mexico that is owned or leased by the taxpayer and used by the taxpayer or the taxpayer's lessee to produce agricultural products, harvest or grow trees, or sustain livestock.

The Soil and Water Conservation Commission would be required to promulgate rules and guidelines to implement provisions of the bill. When tax liability is insufficient to allow taxpayers to claim the credits, the credits may be rolled over for no more than five consecutive years. Section 3 of this bill provides for a delayed repeal effective January 1, 2011 for the tax credit, although credit not used could be carried forward until January 1, 2015.

This bill is being proposed on behalf of the Water and Natural Resources Committee

This act applies to taxable years beginning on or after January 1, 2006 and ending on or before December 31, 2010.

Significant Issues

According to the OSE, there is little incentive at the present time for irrigators to make improvements to their irrigation system to conserve water. The tax credit established by this bill provides a financial incentive for making improvements in irrigation efficiency. This bill provides this financial incentive while also ensuring that the overall level of depletions on fully appropriated river systems does not increase by specifying that any water conserved shall not be put to consumptive beneficial use.

According to the DOA, New Mexico agriculture has been severely impacted by the drought. While this problem has been alleviated by recent rains, reservoirs are not at full capacity so water allotments to farms will be short. Agricultural producers may not qualify for the credit due to insufficient farm income within the five-year time frame to utilize the credit.

FISCAL IMPLICATIONS

The total fiscal impact of the original bill provided by TRD is -$1 million in FY06 and -$3 million in FY07 to the general fund. TRD notes that because of the importance of irrigation and water conservation to farm operations in New Mexico, it is likely that many farms will have some expenditures that qualify for the proposed credit. However, the net tax liability of most farms is relatively low, limiting the dollar amount of tax credits they could claim. TRD impact analysis made the following assumptions:

- A total of 14,000 operating farms in New Mexico (Economic Census of 1997)
- About one-fifth of all farms have eligible expenses averaging $2,500 in a given year

One fifth of 14,000 farms is 2,800 farms, multiplied by the average eligible expense of $2,500 generates a total eligible expense of $5.25 million. Seventy five percent of this amount would be a little over $5 million. According to TRD, limited tax liability reduces the fiscal impacts to an estimated $3 million per year. Note, TRD's FY06 estimate reflects payments for the first six months of tax year 2006, or 50 percent of the full-year effect.

The amendments to the bill would increase the fiscal impact as the use of golf course facilities now are eligible and due to the change allowing the credit for conserved water sold or leased. According to TRD, the addition of golf courses should have a modest impact due to the small number of facilities in the state (less than 50) and the credit limit of $10,000 per taxpayer. Thus, TRD estimates that these facilities should add less than $500 thousand per year to the fiscal impact. This is a conservative measures since data was not readily available for the impact of the second provision related to the sale or lease of the conserved water. The new total fiscal impact to the general fund, with the amendments, is $1.1 million in FY06 and $3.4 million in subsequent years.

ADMINISTRATIVE IMPLICATIONS

According to TRD, Senate Bill 309 requires the development of mechanisms to verify that the tax basis of the equipment is decreased by the amount of the credit. Modifications will be required in forms and instructions for both personal income tax and corporate income tax, systems and training for department personnel.

TECHNICAL ISSUES

TRD provided the following technical issues:

Section 1(A)(4) of the bill (p. 2, line 9) provides that the deduction is available if the taxpayer "…does not take a tax credit for the same expense on any corporate return filed by the taxpayer." To avoid any potential argument that the individual must personally file the corporate return in order to fail this requirement, it might be preferable to have language providing:
"…does not take a tax credit for the same expense on any New Mexico corporate return for a corporation in which the taxpayer owns ___% of the stock."

The measure would probably not allow owners of S-corporations to share the credit. Owners of S-corporations are co-owners of the corporation not co-owners of the land. If the intent is for owners of S-corporation to share the credit, the term "pass-through entity" should be employed in statute. An example of this type of language would be similar to: "If a pass-through entity (S-corporation partnership or limited liability company) owns the land on which an eligible improvement in irrigation systems or water management method is made, the owners of the entity may claim a pro rata share of the credit allowed….".

OTHER SUBSTANTIVE ISSUES

TRD also notes that Senate Bill 309 would, in many cases, reward taxpayers for making water conservation expenditures that they would undertake in the absence of the proposed credits. Additionally, TRD feels that the proposed 75 percent credit rate is a very high rate of subsidy for the targeted expenditures, especially because these expenditures are already deductible for federal and state income tax purposes.

OPJ/yr