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

		ORIGINAL DATE	1/28/06		
SPONSOR	Silva	**LAST UPDATED**	2/1/06	**HB**	276
SHORT TITLE	Electrical Power Plant Property Valuation			**SB**	
				ANALYST	Francis

REVENUE (dollars in thousands)

Estimated Revenue			**Recurring or Non-Rec**	**Fund Affected**
FY06	**FY07**	**FY08**		
	NFI *see narrative			

(Parenthesis ( ) Indicate Expenditure Decreases)

Relates to HB 276, SB 332

SOURCES OF INFORMATION
LFC Files
Taxation and Revenue Department (TRD)
Energy Minerals and Natural Resources Department (EMNRD)

Response Received From
Taxation and Revenue Department (TRD)

SUMMARY

Synopsis of Bill

House Bill 276 modifies the valuation methodology for property used in the generation, distribution or transmission of electricity. The valuation can include deductions for “functional” and “economic” obsolescence.

- Economic obsolescence is defined as the loss of value caused by unfavorable economic influences or factors not including physical depreciations.
- Functional obsolescence is loss due to functional inadequacies or deficiencies caused by factors within the property not including physical depreciation.

The taxpayer choosing to include economic and/or functional obsolescence must submit a claim documenting the obsolescence. Such documentation may include industry comparisons, volume reductions, and other objective evidence of obsolescence. The Taxation and Revenue Department (TRD) will determine if the evidence is sufficient and notify the taxpayer if a claim is rejected with the reasons and what additional information is needed to establish obsolescence, giving a taxpayer enough time to comply.

A taxpayer is given a choice of valuation methods:

1. capitalization of income
2. market value of stock
3. cost less allowance for obsolescence and depreciation.

Whichever method chosen the taxpayer must use that method for subsequent years unless, after three years, the taxpayer can show sufficient cause to change methods.

This act is applicable to property tax years 2007 forward.

FISCAL IMPLICATIONS

There is no significant general fund impact though there may be significant impacts in counties where there are electrical generating plants. There is no precise way to determine the impact of this modification to the valuation methodology. Since there is a choice of methods, the likely result is that property valuation will be lower in the future.

For an analysis regarding obsolescence in valuing pipelines (HB375), TRD reports that because of the way the property tax rates are set, there is no impact but rather the rates will be adjusted for all taxpayers as the proportions of valuation changes. The millage rates for property taxes are set according to the need (for debt service, etc) so the rates adjust for all taxpayers to ensure that the same total amount of revenue is generated. This is the “yield control” provision of property tax rate setting. TRD has estimated the amount of property taxes that would shift to other taxpayers at $9 million.

In the pipeline analysis (HB375), TRD reasons that the cost approach remains the most valid method of appraisal in that the other methods require too much subjective analysis that exposes the department to litigation with valuation experts on both sides without adding substantial accuracy in valuation.

ADMINISTRATIVE ISSUES

TRD reported that to adequately value the oil and gas pipelines using the proposed method and to come up with regulations and standards for obsolescence they would require additional FTEs.

TRD: The proposal would substantially increase the Department's Property Tax Division (“Division”) costs of administering the property tax system. The Division currently performs approximately 14 unitary appraisals annually. Performing unitary valuations on transmission and distribution facilities would increase this figure substantially and require approximately two additional full-time employees to perform at a cost of approximately $116,000 including salaries, benefits, equipment, travel and similar expenditures. The Department would also probably incur substantial legal costs associated with litigation that would likely result from enactment of the proposed legislation. This issue is also discussed in the "Other Issues" section of this report.

OTHER ISSUES

TRD:

Potential Fiscal Impacts of The Proposed Legislation
As shown in the table below, taxable value among properties of the type that would be affected by the proposed statute currently totals approximately $1.1 billion. The $1.1 billion total represents roughly three percent of the $38.5 billion in net taxable value of all New Mexico properties. If it is assumed that unitary valuation would, on average, decrease net taxable value of electrical generating properties by 30 percent, the resulting loss in value would total approximately $342 million. Multiplying loss of value in all affected counties by the average nonresidential property tax rate in each of the counties and summing suggests a revenue loss on the order of $9 million – *assuming no change in rates.* Rates would increase, however, through a number of mechanisms, including the state's "yield control" statute (Section 7-37-7.1 NMSA 1978), discretionary rate increases imposed by governing bodies of property tax recipients, and essentially automatic adjustment in rates that service outstanding debt. Essentially all groups of property tax payers would be affected in some way, although the effects would, in most cases, be relatively minor. Property tax obligations in New Mexico currently total approximately $1 billion. Hence the approximate $9 million impact represents slightly under one percent of total statewide property tax obligations.

Illustration: Potential Fiscal Impacts of HB-276

	Net Taxable Value:					
County	*Electric Utilities*	*Electric Generating*	*Electric Transmission*	*Electric Co-Ops*	*Total Electric*	*% of Total Electric*
Bernalillo	109,188,123	11,141,107	0	879,858	121,209,088	10.6
Catron	4,944,533	5,722,218	0	3,601,956	14,268,707	1.2
Chaves	16,736,415	8,527	0	7,058,446	23,803,388	2.1
Cibola	987,651	1,870,259	0	4,675,863	7,533,773	0.7
Colfax	0	2,477,675	0	3,736,824	6,214,499	0.5
Curry	9,966,972	913,333	0	6,693,724	17,574,029	1.5
DeBaca	2,546,179	0	0	2,187,423	4,733,602	0.4
Dona Anna	94,755,307	577,253	0	0	95,332,560	8.3
Eddy	30,453,725	0	0	11,715,530	42,169,255	3.7
Grant	8,918,128	700,653	0	400,168	10,018,949	0.9
Guadalupe	2,594,237	0	0	2,865,279	5,459,516	0.5
Harding	0	49,919	0	742,968	792,887	0.1
Hidalgo	4,338,114	33,788,600	0	1,871,010	39,997,724	3.5
Lea	44,910,596	0	0	6,992,116	51,902,712	4.5
Lincoln	3,640,878	25,667	0	5,811,989	9,478,534	0.8
Los Alamos	81,474	0	0	0	81,474	0.0
Luna	7,875,615	7,970,695	0	2,803,537	18,649,847	1.6
McKinley	2,803,743	69,286,771	0	3,471,625	75,562,139	6.6
Mora	0	190,033	0	2,349,565	2,539,598	0.2
Otero	11,086,559	2,099,912	0	6,323,726	19,510,197	1.7
Quay	2,502,068	0	60	4,449,533	6,951,601	0.6
Rio Arriba	2,224,403	7,510,387	0	13,123,371	22,858,161	2.0
Roosevelt	13,888,058	0	0	6,622,257	20,510,315	1.8
San Juan	136,779,349	249,429,944	376,510	1,557,169	388,142,972	34.0

San Miguel	4,199,388	315,652	0	3,321,133	7,836,173	0.7
Sandoval	24,957,271	4,497,422	0	5,678,326	35,133,019	3.1
Santa Fe	27,032,383	40,709	0	4,225,897	31,298,989	2.7
Sierra	3,495,996	1,689,168	0	2,747,361	7,932,525	0.7
Socorro	692,828	2,313,313	0	5,052,743	8,058,884	0.7
Taos	0	2,559,758	0	13,130,593	15,690,351	1.4
Torrance	314,008	1,352,886	0	9,287,147	10,954,041	1.0
Union	942,050	1,309,414	0	3,415,799	5,667,263	0.5
Valencia	14,070,445	113,892	0	404,853	14,589,190	1.3
Totals	586,926,496	407,955,167	376,510	147,197,789	1,142,455,962	100.0

Illustration: Potential Fiscal Impacts of HB-276 (continued)

County	*Total Net Taxable Value*	*Electric % of Total Assessed*	*Estimated Loss In Taxable Value**	*% of Total Assessed*	*Estimated Loss/Shift In Obligations***
Bernalillo	11,002,745,292	1.1	36,362,726	0.3	1,446,489
Catron	79,816,454	17.9	4,280,612	5.4	53,973
Chaves	789,734,022	3.0	7,141,016	0.9	194,055
Cibola	226,421,527	3.3	2,260,132	1.0	71,349
Colfax	484,149,148	1.3	1,864,350	0.4	41,217
Curry	447,626,964	3.9	5,272,209	1.2	121,668
DeBaca	37,354,701	12.7	1,420,081	3.8	37,951
Dona Anna	2,532,509,902	3.8	28,599,768	1.1	890,382
Eddy	2,142,990,148	2.0	12,650,777	0.6	247,998
Grant	506,896,825	2.0	3,005,685	0.6	69,733
Guadalupe	92,320,166	5.9	1,637,855	1.8	52,250
Harding	28,424,729	2.8	237,866	0.8	5,363
Hidalgo	117,164,432	34.1	11,999,317	10.2	260,023
Lea	2,056,750,177	2.5	15,570,814	0.8	422,104
Lincoln	686,219,982	1.4	2,843,560	0.4	69,810
Los Alamos	651,053,050	0.0	24,442	0.0	493
Luna	321,253,366	5.8	5,594,954	1.7	121,701
McKinley	605,214,520	12.5	22,668,642	3.7	817,441
Mora	71,229,738	3.6	761,879	1.1	21,399
Otero	678,279,824	2.9	5,853,059	0.9	168,329
Quay	116,307,543	6.0	2,085,480	1.8	55,553
Rio Arriba	1,548,239,274	1.5	6,857,448	0.4	152,489
Roosevelt	228,795,110	9.0	6,153,095	2.7	134,138
San Juan	3,653,126,771	10.6	116,442,892	3.2	2,799,852
San Miguel	394,907,217	2.0	2,350,852	0.6	72,245
Sandoval	1,791,689,224	2.0	10,539,906	0.6	304,434
Santa Fe	4,887,341,480	0.6	9,389,697	0.2	237,652
Sierra	201,271,893	3.9	2,379,758	1.2	57,881
Socorro	178,138,033	4.5	2,417,665	1.4	74,428
Taos	833,527,532	1.9	4,707,105	0.6	87,901
Torrance	236,306,231	4.6	3,286,212	1.4	78,437
Union	101,033,556	5.6	1,700,179	1.7	37,296
Valencia	820,258,796	1.8	4,376,757	0.5	135,692
Totals	38,549,097,626	3.0	342,736,789		9,341,725

*30% of Total Electric ** Estimated loss in assessed value multiplied by weighted average nonresidential property tax rates.

Unitary Assessment – Administrative issues

The existing special method of valuation, Section 7-36-29, requires property used in the generation, transmission or distribution of electrical power to be valued on a cost basis. Section 7-36-29 as it is now codified presents few administrative problems for either the taxpayer or the Department. The property's cost and depreciation figures for reporting for NM property tax purposes come directly from the records that the taxpayer is required to maintain for either the state or federal regulators. The Department can easily verify these figures.

HB 276 allows the taxpayer an election of valuation methods: a unitary basis, employing the cost method, capitalization of income method or market value of stock and debt approach or any combination of methods. While unitary valuations and the income and stock and debt methods of valuation are all well-accepted appraisal techniques, their complexity may outweigh their benefit in terms of yearly valuations for property tax assessments. These proposed valuation approaches open the door to numerous judgment calls and the frequent exercise of discretion. This results in challenges to the valuations. Historically, each year, taxpayers protest roughly all of the unitary valuations. In contrast, less than 10% of all other valuations are protested. Case law illustrates how almost every factor used in the unitary method is subject to dispute and controversy. The unitary method raises subjective judgment issues when forecasting future income, the duration of the income, the capitalization rate and the method of capitalization. Unitary valuations rely on the efficiency of the financial market and the ability to forecast the financial future. Judgment calls must be made concerning trading volumes and bid/ask spreads for the stock sales. In addition, to accurately develop a unitary value, the company being valued must be engaged in only the primary business for which the property is used. This rarely occurs in the energy industry.

The reasons that the original drafters chose the cost approach for the special method of valuation for the electrical industry remain as valid today as they were in the past. The cost method provides a relatively easy, accurate picture of the property annually. The sponsors of HB 276 have not presented any evidence that the cost method is not generating fair values for tax purposes. The proposed amendment will not aid the Department. HB 276 provides the taxpayer with more valuation options and vests in the taxpayer the choice of what valuation method it wants to use. Taxpayers will naturally choose the method that minimizes the property tax burden.

The use of "shall" throughout the proposed subsection labeled "C(1)(2)(3) [pages 3-5] creates a presumption in favor of a taxpayer electing to switch valuation methods. The taxpayer may exercise this choice if it has experienced a "substantial adverse effect" as a result of the implementation of law and regulation. "Substantial adverse effect" is not defined in the proposed amendment, but it is obvious that it means a property value that is higher than the taxpayer thinks it can achieve under a different valuation method. The proposal conflicts with appraisal principles in that it allows the owner, rather than a supportable appraisal, to establish the property's value. (This 'valuation election option' is not new to the Property Tax Code. The language found in HB 276 at C(1)(2)(3) corresponds to the provision in Section 7-36-30(C), the special method of valuation for communication systems. The 'valuation election option' has not yet been tested in a New Mexico property tax protest proceeding or district court refund claim.)

Both the Department's and the counties' administrative burdens will increase if the proposed amendments become law. Not only will the Department need to hire more appraisers to perform complex unitary valuations, but also, each valuation of electric generation and transmission property has the potential of becoming a battle of the experts. The Department will provide the initial unitary appraisal and the front line defense to the challenges to the valuation, while the counties will suffer from delays in tax revenue while protests wind their way through the courts. Revenue forecasting will have to adjust to the potential that taxpayers will switch valuation methods every few years in order to achieve lower values.

Finally HB 276, subsections I and J, attempt to shift from the taxpayer to the Department the responsibility that the taxpayer has traditionally had to prove its entitlement to a deduction from value. The proposed language requires the Department to respond in writing to taxpayer's obsolescence claims in the valuation rendition. The bill assigns to the Department the task of defining for the taxpayer how the taxpayer is to establish a deduction for obsolescence. The Department becomes responsible for analyzing the taxpayer's obsolescence claim and detailing how it is to be proven.

It is therefore the Department's view that the proposed changes to the special method of valuation now found at Section 7-36-29:(1) are not supported by administrative need or sound tax policy; (2) would create serious administrative burdens for both the Department and counties; and (3) would reduce revenue and/or shift property tax burdens from the beneficiaries of the proposal to other taxpayers.

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

HB 276 relates to HB375 and SB332 as far as proposing to use functional and economic obsolescence as a factor for valuation. HB 276 refers to electrical transmission property where the other two bill refer to oil and gas transmission property..

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