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

**SPONSOR** Smith **ORIGINAL DATE** 1/26/06
**LAST UPDATED** **HB**

**SHORT TITLE** Oil & Gas Property Taxation **SB** 332

**ANALYST** Francis

## REVENUE (dollars in thousands)

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

(Parenthesis ( ) Indicate Expenditure Decreases)

Duplicates HB375
Relates to HB 276

## ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

| | FY06 | FY07 | FY08 | 3 Year Total Cost | Recurring or Non-Rec | Fund Affected |
|---|---|---|---|---|---|---|
| **Total** | | 232.0 | 232.0 | 464.0 | Recurring | General Fund |

(Parenthesis ( ) Indicate Expenditure Decreases)

**SOURCES OF INFORMATION**
LFC Files
Taxation and Revenue Department (TRD)
Energy Minerals and Natural Resources Department (EMNRD)
New Mexico Oil and Gas Association (NMOGA)

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

**SUMMARY**

Synopsis of Bill

Senate Bill 332 modifies the valuation methodology for property used in the distribution and transmission of oil, natural gas, carbon dioxide, and liquid hydrocarbons. 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 takes effect July 1, 2006 and is applicable to property tax years 2006 forward.

## FISCAL IMPLICATIONS

There is no significant general fund impact though there may be significant impacts in energy basin counties in northwestern and southeastern New Mexico, where most of the oil and natural gas production takes place. 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. Table 1 shows how much oil/gas pipeline property valuation existed in tax year 2005.

**Illustration: Potential Fiscal Impacts of HB-375**

| *County* | *Net Taxable Value, Pipelines** | *% of Total* | *Total Assessed Value* | *Pipelines % of Total Assessed* | *Estimated Loss in Assessed Value*** | *% of Total Assessed* | *Estimated Loss/Shift in Obligations**** |
|---|---|---|---|---|---|---|---|
| Bernalillo | 33,843,024 | 3.21 | 11,002,745,292 | 0.31 | 3,384,302 | 0.03 | 134,626 |
| Catron | - | - | 79,816,454 | 0.00 | 0 | - | - |
| Chaves | 52,155,187 | 4.94 | 789,734,022 | 6.60 | 5,215,519 | 0.66 | 141,730 |
| Cibola | 14,407,061 | 1.37 | 226,421,527 | 6.36 | 1,440,706 | 0.64 | 45,481 |
| Colfax | 9,936,936 | 0.94 | 484,149,148 | 2.05 | 993,694 | 0.21 | 21,969 |
| Curry | 8,142,208 | 0.77 | 447,626,964 | 1.82 | 814,221 | 0.18 | 18,790 |
| De Baca | 2,163,181 | 0.20 | 37,354,701 | 5.79 | 216,318 | 0.58 | 5,781 |
| Dona Ana | 15,046,059 | 1.43 | 2,532,509,902 | 0.59 | 1,504,606 | 0.06 | 46,842 |
| Eddy | 145,059,831 | 13.74 | 2,142,990,148 | 6.77 | 14,505,983 | 0.68 | 284,366 |
| Grant | 7,233,189 | 0.69 | 506,896,825 | 1.43 | 723,319 | 0.14 | 16,781 |
| Guadalupe | 5,723,833 | 0.54 | 92,320,166 | 6.20 | 572,383 | 0.62 | 18,260 |
| Harding | 2,722,580 | 0.26 | 28,424,729 | 9.58 | 272,258 | 0.96 | 6,138 |
| Hidalgo | 13,269,308 | 1.26 | 117,164,432 | 11.33 | 1,326,931 | 1.13 | 28,754 |
| Lea | 119,359,625 | 11.31 | 2,056,750,177 | 5.80 | 11,935,963 | 0.58 | 323,568 |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| Lincoln | 20,586,799 | 1.95 | 686,219,982 | 3.00 | 2,058,680 | 0.30 | 50,541 |
| Los Alamos | 230,369 | 0.02 | 651,053,050 | 0.04 | 23,037 | 0.00 | 464 |
| Luna | 21,199,596 | 2.01 | 321,253,366 | 6.60 | 2,119,960 | 0.66 | 46,113 |
| McKinley | 57,852,375 | 5.48 | 605,214,520 | 9.56 | 5,785,238 | 0.96 | 208,618 |
| Mora | - | - | 71,229,738 | 0.00 | 0 | - | - |
| Otero | 4,383,727 | 0.42 | 678,279,824 | 0.65 | 438,373 | 0.06 | 12,607 |
| Quay | 6,684,470 | 0.63 | 116,307,543 | 5.75 | 668,447 | 0.57 | 17,806 |
| Rio Arriba | 78,456,690 | 7.43 | 1,548,239,274 | 5.07 | 7,845,669 | 0.51 | 174,464 |
| Roosevelt | 7,704,877 | 0.73 | 228,795,110 | 3.37 | 770,488 | 0.34 | 16,797 |
| San Juan | 349,153,941 | 33.08 | 3,653,126,771 | 9.56 | 34,915,394 | 0.96 | 839,536 |
| San Miguel | - | - | 394,907,217 | 0.00 | 0 | - | - |
| Sandoval | 26,554,497 | 2.52 | 1,791,689,224 | 1.48 | 2,655,450 | 0.15 | 76,700 |
| Santa Fe | 11,798,050 | 1.12 | 4,887,341,480 | 0.24 | 1,179,805 | 0.02 | 29,861 |
| Sierra | 1,262,198 | 0.12 | 201,271,893 | 0.63 | 126,220 | 0.06 | 3,070 |
| Socorro | 3,107,939 | 0.29 | 178,138,033 | 1.74 | 310,794 | 0.17 | 9,568 |
| Taos | 1,646,545 | 0.16 | 833,527,532 | 0.20 | 164,655 | 0.02 | 3,075 |
| Torrance | 19,197,434 | 1.82 | 236,306,231 | 8.12 | 1,919,743 | 0.81 | 45,821 |
| Union | 3,734,640 | 0.35 | 101,033,556 | 3.70 | 373,464 | 0.37 | 8,192 |
| Valencia | 12,762,637 | 1.21 | 820,258,796 | 1.56 | 1,276,264 | 0.16 | 39,568 |
| Totals | 1,055,378,806 | 100.00 | 38,549,097,626 | | 105,537,881 | 0.27 | 2,675,887 |

*Includes other properties subject to alternative valuation under House Bill 375, 2005 Tax Year

** 10 per cent of pipeline values listed in column 2.

*** Estimated loss in value multiplied by average nonresidential tax rate in associated county.

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 reports that approximately $2.7 million will be shifted to other taxpayers (see table). Their estimate is based on pipelines which is the majority of the property that would be affected.

**SIGNIFICANT ISSUES**

The New Mexico Oil and Gas Association have indicated that this legislation clarifies the intent of the current statute. According to NMOGA, the intent embodied in the phrase “any other justifiable factor” includes economic and functional obsolescence. NMOGA feels that this obsolescence was generally accepted from 1973 till 2003 when the Property Tax Division of the Taxation and Revenue Department began rejecting claims of obsolescence without adequate explanation to the taxpayers.

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 IMPACT**

TRD:

The proposal would substantially increase the Department's Property Tax Division’s costs of administering the property tax system. The Division currently performs approximately 14 unitary appraisals annually. Performing unitary valuations on pipelines and similar properties would increase this figure substantially, and require approximately four full-time employees to perform at a cost of approximately $232,000 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. A detailed discussion of the administrative burdens associated with the proposal is included at the end of this review.

## CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

SB 332 duplicates HB 375. SB 332 relates to HB276 as far as proposing to use functional and economic obsolescence as a factor for valuation. HB 276 refers to electrical generation facilities.

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