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FISCAL IMPACT REPORT

ORIGINAL DATE 1/27/07
 SPONSOR Taylor LAST UPDATED 2/19/07 HB 178
 SHORT TITLE Navajo Nation Electric Facility Tax Credits SB _____
 ANALYST Schardin

REVENUE (dollars in thousands)

| Estimated Revenue | | | Recurring or Non-Rec | Fund Affected |
|-------------------|-----------|-----------|-------------------------|-----------------------------------|
| FY07 | FY08 | FY09 | | |
| | (3,400.0) | (6,800.0) | Recurring | General Fund |
| | (425.0) | (850.0) | Recurring | Small Cities Assistance Fund |
| | (425.0) | (850.0) | Recurring | Small Counties Assistance Fund |

(Parenthesis () Indicate Revenue Decreases)

Duplicates SB 431
 Relates to SB 994

SOURCES OF INFORMATION

LFC Files
 Navajo Nation

Responses Received From

Economic Development Department (EDD)
 Environment Department (NMED)
 Energy, Minerals and Natural Resources Department (EMNRD)
 Indian Affairs Department (IAD)
 Taxation and Revenue Department (TRD)

SUMMARY

Synopsis of Bill

House Bill 178 creates the intergovernmental compensating tax credit, which may be claimed by a taxpayer with a compensating tax liability from ownership, construction, maintenance or operation of a coal-fired electric generating facility on Navajo Nation land, so long as construction of the facility commences after January 1, 2007 and before December 31, 2008.

The amount of the credit received by a taxpayer shall be determined annually and be equal to 85 percent of compensating tax liability from ownership, construction, maintenance or operation of the qualified coal facility. The total amount of the credit is capped at \$85 million, subject to the restriction that if on or after December 31, 2020 the Taxation and Revenue Department finds that credits claimed by all taxpayers exceed the cumulative amount of taxes paid by these taxpayers to the Navajo Nation paid with respect to the qualified coal facility, the difference must be remitted to the state without penalty or interest.

The effective date of these provisions is July 1, 2007.

FISCAL IMPLICATIONS

Navajo Nation's Diné Power Authority has selected Sithe Global Power to develop, finance, construct and operate two 750 megawatt coal-fired generating facilities called "Desert Rock" 30 miles southwest of Farmington. These 1,500 megawatts would be enough to power about 1.5 million homes. The total cost of this facility is estimated at \$3 billion, making it the most costly construction project in New Mexico history.

Sithe Global Power already negotiated an agreement with the Navajo Nation that reduces the company's Navajo Nation tax liability by about two-thirds. According to the most recent information available, Sithe will pay the Navajo Nation \$12.6 million over four years of construction (\$3.1 million per year in FY08-FY11), \$164.5 million over the first ten years of operation (\$16.5 million per year in FY12 to FY21), and \$354.3 million over the 11th to 26th years of operation (\$20.8 million per year in FY22 to FY37) in lieu of Navajo Nation taxes.

Expected fiscal impacts of this bill to the State of New Mexico are detailed in the table below. Sithe's compensating tax liability is estimated to be \$45 million over a 4.5 year construction period that will begin halfway through FY08 and ending at the end of FY11. Over the 25 year operational life of the facility Sithe expects to owe a total compensating tax liability of \$477 million, starting with \$13,965 thousand in FY13 and growing by 2.5 percent per year due to inflation. Eighty percent of the compensating tax revenue loss will accrue to the state general fund, while 10 percent will accrue to each the small cities and small counties assistance funds. The \$85 million cap on total credits that may be received for the Desert Rock facility is expected to be reached in FY16.

Estimated Fiscal Impact of 85 Percent Compensating Tax Credit for Desert Rock (\$ in thousands)

| | FY08 | FY09 | FY10 | FY11 | FY12 | FY13 | FY14 | FY15 | FY16 |
|-------------------------------|-------|--------|--------|--------|--------|--------|--------|--------|--------|
| Compensating Tax Liability | 5,000 | 10,000 | 10,000 | 10,000 | 10,000 | 13,965 | 14,314 | 14,672 | 15,039 |
| 85 Percent Credit | 4,250 | 8,500 | 8,500 | 8,500 | 8,500 | 11,870 | 12,167 | 12,471 | 10,242 |
| Cumulative Credit | 4,250 | 12,750 | 21,250 | 29,750 | 38,250 | 50,120 | 62,287 | 74,758 | 85,000 |
| 80% Credit from General Fund | 3,400 | 6,800 | 6,800 | 6,800 | 6,800 | 9,496 | 9,734 | 9,977 | 8,193 |
| 10% Small Cities Asst. Fund | 425 | 850 | 850 | 850 | 850 | 1,187 | 1,217 | 1,247 | 1,024 |
| 10% Small Counties Asst. Fund | 425 | 850 | 850 | 850 | 850 | 1,187 | 1,217 | 1,247 | 1,024 |

SIGNIFICANT ISSUES

Dual taxation: Businesses that locate on Navajo Nation land are subject to both Navajo Nation and New Mexico taxes, which results in increased costs. This bill, along with the tax reduction agreement reached with the Navajo Nation, reduces the dual-taxation burden Sithe will experience for the Desert Rock power plant. According to Sithe, this 85 percent compensating

tax credit will reduce Desert Rock's overall New Mexico tax liability by about 15 percent.

Economic Issues: Sithe states that the purposes of the Desert Rock project are to improve the existing southwestern states power system, deliver competitively priced and reliable power, generate electricity from Navajo Nation coal resources, reduce dependence on natural gas-fired facilities, and support Navajo Nation economic development.

Construction of Desert Rock is expected to create an average of 1,000 jobs per year for four years. Once Desert Rock operations begin in FY13, the facility is expected to create 200 permanent power plant jobs and 200 permanent mining jobs. Although Sithe reports they intend to fill as many of these new jobs with Navajo Nation residents, the bill does not create any obligation for the company to hire Navajo Nation residents or New Mexicans.

Pollution Concerns: Water use and emissions from any coal facility must be considered, since the southwest faces severe water constraints and coal facilities emit mercury, nitrogen oxides (a component of ozone and smog), carbon-dioxide (CO₂), sulfur-dioxide (SO₂), and other toxins into the environment.

Water: According to Sithe, by using air cooling instead of water cooling, the Desert Rock facility will use about 25 percent as much water as a conventional coal facility. Sithe expects the facility to use about 4,500 acre feet of water per year. This water will be obtained from Navajo groundwater sources.

Emissions: Sithe reports that Desert Rock will have a "high-efficiency supercritical boiler" that will make it 10 times cleaner than older coal facilities in northwestern New Mexico. Sithe reports that this supercritical boiler will make Desert Rock emit about 20 percent as much as conventional coal facilities. However, according to NMED, this type of boiler is a proven technology that comes with fewer financial risks but does not reduce emissions as much as some more advanced technologies that are available. NMED reports that Desert Rock's emissions would significantly impact air quality in a region where air quality is already close to exceeding National Ambient Air Quality Standard for ground-level ozone, the most common cause of smog.

Desert Rock is expected to emit 10.5 million metric tons of the CO₂ (a greenhouse gas) per year, which means greater reductions will be necessary from other emissions sources to meet New Mexico's goals for reducing greenhouse gases statewide. The state's goal is to reduce greenhouse gas emissions to 2000 levels by 2012, to 10 percent below 2000 levels by 2020, and to 75 percent below 2000 levels by 2050.

Desert Rock is expected to increase existing SO₂ emissions in the region by nearly 10 percent: two older coal plants in the area emit a combined 40,000 tons of SO₂ per year, and Desert Rock will emit about 3,500 tons of SO₂ per year. Desert Rock's SO₂ emissions will be below the nationwide average for coal-fired generators and below the Clean Air Act limit that will take effect in 2015.

Desert Rock is expected to increase New Mexico mercury emissions by about 13 percent. Currently, all existing sources emit about 920 pounds of mercury per year and Desert Rock's permit, which will require 80 percent of mercury emissions to be removed, will allow 120 pounds of mercury to be emitted per year. Mercury is a neurotoxin that is particularly harmful

when ingested by pregnant women and children.

In an effort to mitigate global climate change, the California Public Utilities Commission voted on January 25, 2007 to prohibit California power companies from entering new long-term contracts with electricity providers that emit more than 1,100 pounds of carbon dioxide (CO₂) per megawatt hour of electricity produced. According to Sithe, this development will not affect marketability of Desert Rock's coal since Desert Rock's target market will be New Mexico, Arizona and Nevada.

Navajo Nation views: According to the Navajo Nation's Office of President and Vice President, Navajo Nation President Joe Shirley and Vice President Frank Dayish Jr. support construction of Desert Rock. In May 2006, the Navajo council approved a lease and sublease of land to Desert Rock by a vote of 66-7. However, not all chapters of the Navajo Nation support construction of the Desert Rock power plant.

At least two groups of Navajo Nation residents, Diné Citizens Against Ruining our Environment (Diné CARE) and Dooda Desert Rock, oppose the Desert Rock Project. Reasons cited for opposition include increased emissions in an already polluted environment, water scarcity, and distrust for the company's promise to provide jobs to Navajos. The opposition voiced by these groups has taken the form of a blockade, marches, and a petition of tribal leadership.

ADMINISTRATIVE IMPLICATIONS

TRD reports this bill will require revisions to tax instructions, publications and audit procedures. Manual processes will need to be employed to track the credit.

DUPLICATION, RELATIONSHIP

House Bill 178 duplicates Senate Bill 431.

House Bill 178 relates to Senate Bill 994, which creates the advanced energy tax credit. That bill provides a credit of up to \$60 million to a qualified coal facility against gross receipts tax, compensating tax, or withholding tax. Senate Bill 994 creates emissions standards that Desert Rock would not meet. According to NMED, Desert Rock would need to reduce CO₂ emissions by 60 percent and reduce SO₂ emissions by 33 percent to qualify for the credit created in Senate Bill 994.

TECHNICAL ISSUES

EMNRD notes that the bill does not define commencement of construction, which could be interpreted to include activities such as assessment studies or other planning. The bill should be amended to define commencement of construction as the building of a permanent structure of a power plant that has been planned, evaluated, designed, and permitted in accordance with all requirements of agencies having jurisdiction.

EDD suggests an amendment to require taxpayers claiming the tax credit created by this bill to comply with New Mexico's renewable energy and energy conservation goals, which are described in "Significant Issues."

Environmental and economic concerns could be addressed by requiring taxpayers claiming the credit created by this bill to meet certain emissions standards and to fill a certain percent of new jobs with citizens of the Navajo Nation.

ALTERNATIVES

Consider amending the bill to require Desert Rock to meet the emissions standards stated in Senate Bill 994 to qualify for the intergovernmental compensating tax credit.

POSSIBLE QUESTIONS

What share of the 1,000 jobs generated by construction of Desert Rock and the 400 permanent mine and facility jobs are expected to be filled with Navajo Nation or New Mexico residents?

How will the Desert Rock project affect visibility in the region surrounding the facility?

The Desert Rock project will use 4,500 acre feet of water per year from Navajo groundwater sources. How will other users of Navajo groundwater be impacted by Desert Rock's usage?

Will the planned Desert Rock project impact cultural sites on Navajo Nation land?

SS/mt