Fiscal impact reports (FIRs) are prepared by the Legislative Finance Committee (LFC) for standing finance committees of the NM Legislature. The LFC does not assume responsibility for the accuracy of these reports if they are used for other purposes.

Current FIRs (in HTML & Adobe PDF formats) are available on the NM Legislative Website (legis.state.nm.us). Adobe PDF versions include all attachments, whereas HTML versions may not. Previously issued FIRs and attachments may be obtained from the LFC in Suite 101 of the State Capitol Building North.

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

ORIGINAL DATE 01/31/12
SPONSOR Chavez, E. **LAST UPDATED** **HB** 174

SHORT TITLE Oil, Gas & Mineral Tax Changes **SB**

ANALYST Walker-Moran

REVENUE (dollars in thousands)

Estimated Revenue Impact					Recurring or Nonrecurring	Fund Affected
FY12	FY13	FY14	FY15	FY16		
$0.0	$26,420.0	$26,580.0	$26,790.0	$27,050.0	Recurring	General Fund
$0.0	$5,100.0	$5,190.0	$5,110.0	$5,040.0	Recurring	Severance Tax Bond Fund
$0.0	$30.0	$30.0	$30.0	$30.0	Recurring	Oil Reclamation Fund
$0.0	$1,470.0	$1,450.0	$1,430.0	$1,410.0	Recurring	County Treasurers, including State GO bond levies

Relates to HB 142

SOURCES OF INFORMATION
LFC Files

Responses Received From
Taxation and Revenue Department (TRD)
Department of Finance and Administration (DFA)
Economic Development Department (EDD)
Energy, Minerals and Natural Resources Department (EMNRD)
State Land Office (SLO)

SUMMARY

Synopsis of Bill

House Bill 174 reduces by ten percent certain deductions of certain oil, natural gas and mineral taxes. The bill amends Sections 7-25-3, 7-26-4, 7-29-4.1, 7-30-5, 7-31-5, 7-32-5 and 7-33-4 NMSA 1978, to reduce the deductions used in determining taxable value to ninety percent. It also amends Section 7-29C-1 NMSA 1978 to reduce the intergovernmental production equipment tax credit from seventy-five percent to sixty-seven and five-tenths percent. Section 7-31-4 NMSA 1978 is also amended to change the percentage used on oil and other liquid hydrocarbons removed from natural gas from three and fifteen hundredths percent to three and forty-six hundredths percent.

The effective date of this bill is July 1, 2012. There is no sunset date. The LFC recommends adding a sunset date.

FISCAL IMPLICATIONS

This bill may be counter to the LFC tax policy principle of efficiency by narrowing the base and relying heavily on one tax.

Per the TRD: The Ad Valorem Production Tax impact is on the actual revenue collections. This is consistent with an increase of approximately $118 million in net taxable value for determination of the State general obligation bond capacity. There would also be a lagged increase in Ad Valorem Production Equipment Tax of roughly 20% of the amount of Ad Valorem Production Tax.

The State Land Office is concerned that if this bill were adopted, remitters to the SLO from oil operations on state trust lands may attempt to pass through the tax increase on to land owners. This could result in a decrease of State Land Office Royalty Revenue by absorbing a severance tax rate of approximately 9% on 10% of their royalty revenue. Currently the state's 1/8th royalty is fully deductible, since 10% of that 1/8th royalty interest would now be subject to taxation, the new taxes would then be deducted from the gross, from which royalty rates are carved, thus reducing royalty payments to the permanent fund and the Trust beneficiaries.

SIGNIFICANT ISSUES

The TRD has identified some legal policy issues: One part of this bill reduces the federal, state or Indian royalty deduction currently allowed. The current law allows a deduction of 100% of the royalties paid or due. This bill limits the deduction to 90% of the royalties paid or due. In 2005 the TRD legal staff looked into this same comparable question from a constitutionality application and wrote the following: "Unless authorized by federal law, an attempt to repeal the deduction from taxable value of severed products provided under New Mexico statutes for governmental royalty interests probably would be challenged as unconstitutional". The current interpretation is that all the taxes are imposed on the severer and not the government, so that the reduction in royalty deduction would not be constitutionally permitted. Further advice on this point should be sought.

The TRD has identified a tax policy issue: Another part of the bill also proposes to reduce the intergovernmental tax credit from 75% to 67.5%. The current credit application is associated to production from Indian lands and is applicable to severance tax, emergency school tax, conservation tax, ad valorem production tax and the ad valorem equipment tax. However, this bill appears to reduce the credit percentage only against the ad valorem equipment tax program and not the 4 monthly tax programs. It is amending Subsection E of Section 7-29C-1 and leaves in place the current rate within Subsection D of Section 7-29C-1. There appears to be no basis for the inconsistency across tax programs.

PERFORMANCE IMPLICATIONS

Per the Economic and Development Department, the mining industry currently employs about 18,000 New Mexicans and is the second fastest growing major industry sector, at 8.4%. By comparison, statewide employment growth in the same period was less than 1%. The industry also pays high wages when compared with other sectors. In the 2nd quarter of 2011 the average weekly wage in oil and gas extraction was $1,699, second only to the financial investment sector. (Source: New Mexico Department of Workforce Solutions) While other industry sectors struggle

to recover, oil and gas is making a significant contribution with both employment growth and revenues to the state.

Reducing incentives for this industry could negatively impact employment and revenues contributed by the sector. In counties where oil and gas represent a significant portion of total employment, reductions in the industry could be significant.

ADMINISTRATIVE IMPLICATIONS

According to the TRD, the change to Emergency School Tax rate within Section 7-31-4 from 3.15% to 3.46% would require oil and gas systems updates and testing. All other changes do not affect criteria within the systems so no impact to either GenTax or the Oil and Gas system. This bill has low impact on the TRD's distribution process. All of these changes would be accomplished within existing resources.

TECHNICAL ISSUES

One technical issue related to the effective date. It is unclear from the bill if it is the intent to apply the effective date against the production month of the product or the due date of the taxes. Clarification and transparency would be helpful.

OTHER SUBSTANTIVE ISSUES

Per the TRD, with these changes, the effective tax rate for all taxes on oil and gas (excluding Ad Valorem Production Equipment Tax would be (based on FY 2011 production pursuant to the provisions of this bill:

	Production Value	Effective Tax Rate
Gas – current law	6,759,804,754	7.479%
Gas – this bill		7.640%
Oil – current law	5,840,481,108	7.170%
Oil – this bill		7.577%

Note that natural gas processing and transportation deductions average 14 percent of production value for FY 2011 and throughout the forecast period, while crude oil processing and transportation deductions are essentially zero percent. These significant differences in the deductions for the two commodities mean that oil experiences only a slightly lower effective tax rate on production, even though the stated (statutory) emergency school tax rate is 3.15 percent for oil and 4 percent for natural gas. With this proposed increase in the statutory emergency school tax rate for oil, oil would almost achieve parity with natural gas on an effective tax rate basis.

Does the bill meet the Legislative Finance Committee tax policy principles?

1. **Adequacy**: Revenue should be adequate to fund needed government services.
2. **Efficiency**: Tax base should be as broad as possible and avoid excess reliance on one tax.
3. **Equity**: Different taxpayers should be treated fairly.
4. **Simplicity**: Collection should be simple and easily understood.
5. **Accountability**: Preferences should be easy to monitor and evaluate

EWM/svb