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FISCAL IMPACT REPORT

ORIGINAL DATE 02/04/14
 SPONSOR SCORC LAST UPDATED 02/14/14 HB _____
 SHORT TITLE Water Harvesting Income Tax Credit SB 16/SCORCS
 ANALYST Graeser

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund(s) Affected
FY14	FY15	FY16	FY17	FY18		
\$0.0	(\$1,600.0)	(\$2,000.0)	(\$2,000.0)	(\$2,000.0)	Recurring	General Fund

(Parenthesis () Indicate Revenue Decreases)

Note: the certificates are marketable. While it may take a short period of time to establish an orderly market for these certificates, it is certain that by the second year, the full amount of the credits will be allocated and claimed.

OSE and TRD report minimal impact on each agency. RLD/CID reports that the agency does not inspect water catchment systems because they are not permitted and cannot implement the inspections required in this bill.

SOURCES OF INFORMATION

LFC Files

Responses Received From

Regulation and Licensing Department, Construction Industries Division (RLD/CID)

Office of the State Engineer (OSE)

Taxation and Revenue Department (TRD)

SUMMARY

Synopsis of Bill

The Senate Corporations and Transportation Committee substitute for Senate Bill 16 proposes a new water harvesting tax credit of 20 percent of the cost of purchasing and installing a residential or commercial water harvesting system. The maximum credit for any single installation would be capped at \$5 thousand, while the aggregate annual maximum would be capped at \$2 million. Based on an affidavit or performance, TRD is charged with approving an application for credit. If the application is approved, TRD will issue a negotiable certificate that includes the amount of the credit granted. If the original applicant chooses to sell or transfer the certificate, both the buyer and the seller must notify TRD of the sale or transfer within 10 days. RLD/CID and the OSE are required to develop and promulgate regulations regarding the equipment and procedures

to claim the credit. TRD is required to compile and report annually and beginning in 2019 and every five-years thereafter, TRD is required to analyze and report to the appropriate legislative committees on the effectiveness of the credit. The \$2 million cap would be implemented on a first-come, first-served basis. The credit is only for the personal income tax; no corporate income tax credit would be allowed.

FISCAL IMPLICATIONS

TRD reports the following:

According to Santa Fe County and Santa Fe businesses involved in selling and installation of water harvesting systems, (Santa Fe County passed an ordinance relating to Water Harvesting and Conservation in 2003 - **“An Ordinance Amending Ordinance 1996-10, the Santa Fe County Land Development Code, Article III, Section 4.4.1 and Article III, Section 2.4.1 to require rainwater catchment systems for all commercial and residential development”**), in 2013 there was an estimated 500 residential systems and 35 commercial systems installed in Santa Fe County. The cost of a residential system including installation is estimated to be between \$7,000 and \$40,000, whereas the cost of a commercial system including installation is estimated to be between \$30,000 and \$140,000. TRD assumes that 70% (350) of the residential systems cost \$7,000 and 30% (150) cost \$ 40,000. At the minimum cost, a residential system can yield a tax credit of \$1,400 (20% of \$7,000) and at a maximum cost, a residential system can yield a tax credit of \$8,000 (20% of \$40,000), but since no credit can exceed \$5,000, the maximum credit a taxpayer can claim is \$5,000. For a commercial system, 20% of \$30,000 is \$6,000 and 20% of \$140,000 is \$28,000 but due to the cap, no credit will exceed \$5,000. The Santa Fe residential (minimum cost and maximum cost) and commercial totals were multiplied by an assumed factor of 1.5 to obtain the total for the state in each category. ~~For the minimum cost category (residential with a credit of \$1,400), tax liability is assumed to limit the claim in the first year to 60% (of \$1,400) and carry forward the rest (40%) to the next year. For the residential, maximum cost (\$5,000) category, the yearly distribution is assumed on average to be 30%, 30%, 30%, 10%. For the commercial category, the yearly distribution is assumed to be 60% and 40%. The totals were multiplied by these percentages for each year and summed up for all years to estimate the fiscal impact.~~

The substitute bill allows the credits to be transferred. Most of the applicants who were granted certificates, but who could not use them in the year the certificate was issued would be tempted to sell them to a broker at a discount. This would benefit the broker and the purchaser of the certificate, but would not benefit the homeowner or business owner who installed the system, but could not use the certificate. This feature might increase the number of certificates issued, since homeowners would have a market to sell the certificates and get the value of the certificate sooner than if they waited until their individual liabilities were sufficient to utilize the credits.

In addition to the constituency of urban/suburban residents with access to municipal or county water and a desire to become more environmentally responsible, there is a second group of rural homeowners for whom a well is not financially feasible or who have a well with ultimately limited capacity for which water harvesting and storage is a useful strategy. The urban/suburban residential environmentally responsible group will likely have a payback period in excess of 25-years. Thus, the takeup reported in TRD’s analysis may be overstated, unless costs and payback

periods can be dramatically reduced. On the other hand, TRD's analysis does not include any rural residences and businesses without access to well water for which payback periods can be less than 10-years. TRD also assumed that urban/suburban water harvesting will occur only incidentally in other communities beside Santa Fe. These comments would affect the time until the \$2 million cap were reached.

This bill may be counter to the LFC tax policy principle of adequacy, efficiency and equity. Due to the increasing cost of tax expenditures revenues may be insufficient to cover growing recurring appropriations.

Estimating the cost of tax expenditures is difficult. Confidentiality requirements surrounding certain taxpayer information create uncertainty, and analysts must frequently interpret third-party data sources. The statutory criteria for a tax expenditure may be ambiguous, further complicating the initial cost estimate of the expenditure's fiscal impact. Once a tax expenditure has been approved, information constraints continue to create challenges in tracking the real costs (and benefits) of tax expenditures.

EFFECTIVE DATE: not stated, May 21, 2014; applicable for taxable years beginning on or after 1/1/2014.

SIGNIFICANT ISSUES

TRD describes the significant issues:

This bill encourages the installation and use of water harvesting systems in New Mexico. Rainwater harvesting provides an independent water supply during regional water restrictions and in developed countries is often used to supplement the main supply. It provides water when there is a drought, prevents flooding of low-lying areas, replenishes the ground water level, and enables dug wells and bore wells to yield in a sustained manner. It also provides an additional source of clean water by reducing the salinity and the presence of iron salts. It makes use of a natural resource and reduces flooding, storm water, erosion, and contamination of surface water with pesticides, sediment, metals, and fertilizers. It is an excellent source of water for landscape irrigation, with no chemicals such as fluoride and chlorine, and any dissolved salts and minerals from the soil. It often promotes both water and energy conservation.

Businesses conducted as pass-through entities, such as Sub-S corporations, LLCs, LLPs or MLPs, would be eligible for the credit. As noted, there would be no corporate income tax credit allowed.

The "first-come, first-served" provision is generally not good policy because taxpayers cannot be certain in their planning whether the credit will apply or not. LFC suggests having a roll-over provision similar to that provided for the film production credit, where aggregate claims cannot exceed \$50 million. However, if the cap is reached, valid claims in one year are rolled over to the next year and have priority in the roll-over year. If the fiscal analysis is correct, the \$2 million annual cap is likely to be breached in the relatively near future. The marketability of the certificates would mean that a taxpayer, once granted the certificate would be assured of getting some value from the certificate. There would always be a willing buyer to buy the certificates because the certificates, once granted, could be applied immediately on an amended income tax return.

PERFORMANCE IMPLICATIONS

With all tax expenditures, LFC recommends some reporting and/or accountability provisions be included in the bill. Section 1, subsection L requires TRD to report annually to an interim legislative committee regarding the data compiled from the reports from taxpayers taking the deduction. It is also required to analyze the data and make a recommendation of effectiveness and cost of the credit. Although it is somewhat unusual to assign to TRD the approval of applications in an area in which it has no expertise, this will at least put the financial (cost) data and the benefits (square feet or roof area, capacity of the storage, gallons of water harvested, stored and used for enumerated purposes) in TRD's databases. If TRD has data on the collection area and storage capacity, it can calculate each year the gallons of water harvested from knowledge of regional rainfall.

ADMINISTRATIVE IMPLICATIONS

RLD/Construction Industries Division notes the following: "The Regulation and Licensing Department, Construction Industries Division jurisdictionally does not regulate water storage tanks, cisterns, reservoirs or other water saving home usage collectors or containers. The Construction Industries Division is restricted to only construction platforms or foundations used to install or build a water storage unit, or a "water harvesting system," but the Division does not license, permit or inspect water storage units." However, RLD/CID does have extensive knowledge of construction quality and can consult with the Office of the State Engineer regarding safety, code and standard compliance, minimum and maximum system sizes and eligible components."

Although TRD reported minimal administrative and compliance impact for the original bill, the substitute bill imposes a substantially greater burden on the agency.

CONFLICT, COMPANIONSHIP

Companion to SB 91 (Water Harvesting Financing Districts), SB 77 (Inter-Basin Water Rights Transfers) and may conflict with HB 124 (Home Energy & Water Efficiency Tax Credit).

TECHNICAL ISSUES

Page 2, Subsection D, allows for a \$2 million annual maximum but does not specify if it is calendar year or a state fiscal year cap.

Not providing for a rollover of credits if the cap is exceeded in any particular year may be a defect that will affect a taxpayer's or business's decision to invest in a water harvesting system, since whether the installed system will receive a credit becomes speculative. This is an issue even though the substitute bill allows the certificates to be sold or transferred. The certificates are subject to the \$2 million cap.

OSE suggests that Section 1, Subsection J (page 3, line 25 through page 4, line 10) should incorporate additional considerations, including the need for assessment of the site to determine what level of storage and use can occur within the pre-development state of the rooftop area harvesting the precipitation. OSE is also concerned that if the report required in Section 1, Subsection I includes gallons harvested and other technical data as a measure of effectiveness of the credit, neither TRD, nor OSE will be in a position to gather or report on such data.

OTHER SUBSTANTIVE ISSUES

OSE has an interesting perspective:

This bill raises issues relating to the capture and use of water generated from precipitation runoff from rooftops. In general, any capture and use of surface water requires an application to the State Engineer. However, as a common sense policy, the State Engineer has a policy statement dated November 24, 2004 as follows.

“The New Mexico Office of the State Engineer supports the wise and efficient use of the state's water resources; and, therefore, encourages the harvesting, collection and use of rainwater from residential and commercial roof surfaces for on-site landscape irrigation and other on-site domestic uses.

The collection of water harvested in this manner should not reduce the amount of runoff that would have occurred from the site in its natural, pre-development state. Harvested rainwater may not be appropriated for any other uses.”

Strict adherence to the surface water rules requires a permit from the State Engineer for any impoundment and use of water. Further, all surface waters of the state have been determined to be fully appropriated. Therefore, it is conceivable that truly successful harvesting throughout the state could result in new depletions to surface water whereby the State Engineer may require a water harvesting district to acquire water rights to offset the increased depletion.

As the above policy states, so long as the use of the harvested water does not exceed the pre-development state, theoretically, there should not be an impact to the stream system. However, if the State Engineer determines there is impairment, then he could invoke his supervisory powers, and may seek an appropriate corrective action.

In addition to these general concerns, the Gila watershed is governed by a United States Supreme Court Decree that prohibits any outdoor uses of water without a water right. Therefore, this tax credit would not be available to that watershed without a permit from the State Engineer.

LG/svb:jl