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## FISCAL IMPACT REPORT

ORIGINAL DATE 1/26/17

SPONSOR Ely LAST UPDATED \_\_\_\_\_ HB 193

SHORT TITLE Solar Market Tax Credit Permanent SB \_\_\_\_\_

ANALYST Graeser

### REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY17	FY18	FY19	FY20	FY21		
0*	(\$8,600.0)	(\$8,500.0)	(\$8,400.0)	(\$8,400.0)	Recurring	General Fund

Parenthesis ( ) indicate revenue decreases. R = recurring; NR = non-recurring

- The bill has no effective date, so the analysis assumes the bill's effective date would be June 16, 2017. Depending on procedures adopted at EMNRD, approvals could commence within FY 17. However, these are personal income tax and corporate income tax credits, and any fiscal consequences would be delayed until the spring of 2018, within FY 18.

Estimated Additional Operating Budget Impact*				Recurring or Nonrecurring	Fund(s) or Agency Affected
FY2018	FY2019	FY2020	FY 18-20		
\$23.7	\$3.7	\$3.7	\$31.2	Recurring	Taxation and Revenue Department
\$70.0	\$70.0	\$70.0	\$70.0	Recurring	EMNRD operating

Since this is a reinstatement and expansion of two newly repealed credits, both TRD and EMNRD have the programming and procedures in place to administer this extension at minimal cost. EMNRD expects the corporate income tax credit portion of this bill will generate the need for an additional FTE.

Conflicts: this bill is similar to HB 61, HB 82 and SB 41, but with the addition of an income-limited 15% bracket, the extension to pass-through entities and an extension to corporate taxpayers where the credit is limited to \$20 million and could generate up to 2,000 claims.

### SOURCES OF INFORMATION

LFC Files

#### Responses Received From

Energy, Minerals and Natural Resources Department (EMNRD)

Economic Development Department (EDD)

Taxation and Revenue Department (TRD)

## SUMMARY

### Synopsis of Bill

House Bill 193 reinstates the Solar Market Development Tax Credit and makes it permanent. The bill retains the 10 percent credit of the original 2006 credit and adds a 15 percent credit for taxpayers with taxable income for personal income tax purposes less than \$43,871. The maximum tax credit remains \$9,000 for each system. HB 193 also combines the current maximum annual aggregate tax credits of \$2 million for solar thermal systems and \$3 million for photovoltaic systems to create a cap of \$5 million for both solar thermal and photovoltaic systems. This conventional residential solar market development credit is extended to systems purchased by a pass-through entity in which the taxpayer has an ownership interest with the credit amount calculated in proportion to that ownership interest. (note the technical comment below which may identify an internal conflict in provisions of the bill). The bill provides that if any claimant is denied a credit in any year because of the cap, then their claim goes to the top of the list for the following year.

The second portion of the bill creates a Solar Market Development Corporate Income Tax Credit, similar to the residential credit of Section 1 of the bill. This can be considered a reinstatement of the Advanced Energy Credit at 7-2-18.25, 7-2A-25, and 7-9G-2 NMSA 1978, although with an increase from 6 percent of costs, with a limit of \$60 million per facility, to this bill's corporate income tax credit of 10 percent with a credit limit of \$50,000 per system. After proposed amendment removing an internal conflict between sections 2(F) and 2(K), the annual cap for the corporate credit will be \$20 million. The advanced energy credit was only sporadically utilized in comparison to other credits.

The provisions of the bill are applicable to tax years beginning on or after January 1, 2017. There is no delayed repeal date. The LFC recommends delayed repeal dates on all tax expenditure bills. There is no effective date of this bill. It is assumed that the effective date is 90 days after this session ends, or June 16, 2017.

## FISCAL IMPLICATIONS

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. Even with 10-years of revenue history, the behavioral response to the joint federal and state solar credit is uncertain. This provision of this bill extending the credit to pass-through entities and regular corporations makes the estimate even more uncertain. It should be noted that the federal credit is not available for business properties that are not also dwellings owned and used by the taxpayer.

LFC has built a model for the residential credit, using the data reported in a report prepared by EMNRD staffer Mark Gaiser entitled, "Economics of Residential Solar in New Mexico." County detail for the 2009 – 2014 period were also downloaded.

The fiscal impact of Section 1 of the bill may be quite different depending on whether EMNRD strictly enforces the restriction of Section 1 E (2). This disallows a credit for "a commercial or

industrial photovoltaic system other than an agricultural photovoltaic system on a farm or ranch that is not connected to an electric utility transmission or distribution system.” EMNRD expects the consolidation of the separate annual limits to increase the utilization from 1,150 systems in 2015 to 1,800 in FY 18. LFC believes that these numbers are too high and has used 1,400 for the increase in the cap from \$3 million to \$5 million. However, LFC staff do believe that if EMNRD allows credits for systems installed in business properties and the pass-through entity owning the business is allowed to fraction the allowed credit to the fractional owners of the business that at least 100 more systems would be installed annually. Note that systems installed on a business that is not also a dwelling are not eligible for the federal credit of up to 30%. LFC staff believe that without amendment repealing Section 1 E(2), the expansion to pass-through entities will have virtually no impact. If EMNRD takes the opposite tack and allows credits for pass-through entities, then the full amount of the \$5 million cap will be utilized.

Estimated Revenue					R or NR **	Fund Affected
FY17	FY18	FY19	FY20	FY21		
0*	(\$3,600)	(\$3,500.0)	(\$3,400.0)	(\$3,400.0)	R	General Fund (expansion of cap)
	(\$1,400)	(\$1,500)	(\$1,600)	(\$1,600)	R	General Fund (expansion to pass-through entities)

The details of this model have been discussed in the FIR of HB 61. Here, we conclude that:

“Using a plausible multiplier of \$125,000 per job, enacting this phased-down will result in an FY 18 general fund cost of \$3,600,000, 300 to 350 more installations annually and about 70 more permanent jobs. This is a FY 18 cost of about \$49,000 per job. Because both the federal credit and the state credit decline over time, the differential impacts in jobs, projects and general fund cost decline over time.”

The fiscal impact of section 2 of the bill is confusing. The advanced energy credit which was repealed effective December 31, 2015 was only sporadically used (\$5.4 million claimed in FY 13 and similar amounts in other years, although the credit was claimed by fewer than 3 taxpayers.) The cap on the corporate income tax credit is to be \$20 million. EMNRD expects at least 400 systems a year to be installed at the maximum cost of \$500,000 per system and a \$50,000 in credit per year. Such systems might be eligible for renewable energy credits from PNM or other larger investor-owned utilities, but would not be eligible for federal energy credits. The underlying economics, however, with total installation costs below \$5.00 per watt recover the costs from energy savings in under 15 years. This may be a return on investment (ROI) that is less attractive than using investment funds to expand the underlying business. However, doctors, lawyers, accountants and other professional services providers might well consider investing in solar photovoltaic systems. Smaller businesses, however, would probably install systems in the 10 to 20 KW range costing \$50,000 to \$100,000. These systems would generate state tax credits of \$7,500 to \$10,000. It would take at least 2,000 of these sub-maximum systems to consume the full amount of the \$20 million cap. Because of the uncertainty, the corporate income tax portion of this credit has been scored at \$5 million annually, but could increase to the \$20 million cap amount.

Last year, EMNRD reported the following:

“...The tax credits for photovoltaic systems have reached the \$3 million ceiling in each of the last five years, while in 2015, EMNRD certified 18 solar thermal systems for tax credits issued of approximately \$68 thousand. Therefore, \$1.932 million in available credits were unused for solar thermal systems. By creating an annual aggregate tax credit cap of \$5 million for both systems, some homeowners and businesses who would have been denied a credit because of the current cap on photovoltaic systems could now receive the tax credit.”

“An average of \$38 million has been spent on photovoltaic system installation and labor over the last five taxable years, according to LFC analysis of EMNRD data, as indicated in the chart on the left side below. If this trend continues, and 100 percent of tax credits awarded are fully claimed, then HB 26 could generate roughly \$3.8 million in negative general fund revenue from FY18 through FY20, assuming all solar expenses qualify for the 10 percent credit, as indicated in the chart below on the right side.”

TRD, in the 2015 Tax Expenditure report details the following for the now-repealed residential solar market development tax credit.

	FY2010	FY2011	FY2012	FY2013	FY2014
Expenditures	\$1,262.6	\$2,244.4	\$2,651.5	\$2,823.8	\$2,667.1
Claims	581	1,014	1,358	1,358	1,364

TRD notes the following:

“...the solar market development tax credit implicates the tax policy principle of efficiency and is designed to incentivize consumer behavior. According to the most recent data available, the average credit claim is approximately \$1,875 per taxpayer, and the average number of claims is 1,400. During tax years 2013 – 2015 the expenditure amount has averaged \$2.6 million per year, well below the statutory cap. Between tax years 2012 and 2013 there was a significant increase in claims, but the average number of claims has plateaued at 1,400 per year. “

“EMNRD reported in December 2016 that the solar thermal credit is not being used. The credit is primarily being used for photovoltaic systems. The federal government also offers a tax credit of 30% for solar systems available until 2022. Both solar thermal and photovoltaic systems are significant investments. This expense limits the use of this credit to taxpayers in a narrow socio-economic strata. If the costs to install these systems comes down, then a broader base of taxpayers should gain access to this investment incentive.”

“It is unknown whether the reduction in credit rates, coupled with consumer’s purchasing power and the costs of eligible systems, will continue to incentivize purchases of these systems in the later years in which the credit is available. The phased down credit rate reduction will continually narrow the band of taxpayers who can afford this type of investment, absent decreases in system costs. Historically, the average taxable income of taxpayers applying for this credit is over \$170,000 per year.”

## SIGNIFICANT ISSUES

The corporate solar market development income tax credit duplicates the effect of the advanced energy tax credit and the wind and solar energy equipment credits 7-9-54.3 NMSA 1978

A significant investment in solar photovoltaic systems is occurring throughout much of New Mexico. New Mexico was home to 1,600 solar jobs in 2014. During 2015, approximately \$31 million was invested by homeowners in solar systems. Installation of these solar systems resulted in \$6.7 million in labor costs. There were 1,143 household scale solar systems installed statewide, including rural and off-grid farms that added 6 megawatts of solar generation capacity as part of New Mexico's electric system.

There is a significant amount of residential solar generation capacity installed in most counties. In 2015 EMNRD certified 638 solar photovoltaic systems in the PNM and 167 systems in the El Paso Electric service territories, along with dozens of others in areas served by Cooperatives and municipal systems. Through certification of solar systems in 2015, EMNRD recognizes 60 firms installing solar photovoltaic systems and eight firms installing solar thermal systems.

TRD notes that the plateau in utilization raises issue as to whether the credit is still necessary. However, there has not been a drop in either the number of claims or amounts claimed, which does not indicate decreased utilization and more fulsome market saturation. It is unknown whether the reduction in credit rates, coupled with consumer's purchasing power and the costs of eligible systems, will continue to incentivize purchases of these systems in the later years in which the credit is available.

The federal solar tax credit of 30 percent for residential solar thermal and photovoltaic systems, which was set to expire on December 31, 2016, was extended in December 2015 until December 31, 2019 with a phase-down of the credit from 30 percent to 22 percent through December 31, 2022. Therefore, there is no change expected in market demand due to the impact of the federal tax credit until beyond FY20.

On August 3, 2015, the federal government unveiled the final version of the Clean Power Plan to reduce carbon emissions by 32 percent nationwide by 2030. The Environmental Protection Agency assigned each state a unique carbon emission reduction, requiring New Mexico to reduce emissions by 36 percent of 2012 levels by 2030. Currently, 8 percent of electricity generation in New Mexico comes from renewable sources.

Distributed solar generation installations allow customers to reduce their consumption of electricity from their electricity providers, thereby reducing their electric bills and utility revenues. Gross receipts tax, franchise tax, and inspection and supervision revenue are also reduced, thereby potentially decreasing local, state and PRC revenues, though consumers may redirect their savings to other purposes.

## **PERFORMANCE IMPLICATIONS**

The LFC tax policy of accountability is not met since TRD is not required in the bill to report annually to an interim legislative committee regarding the data compiled from the reports from taxpayers taking the deduction and other information to determine whether the deduction is meeting its purpose.

Based on the LFC model (which might overstate the utilization), the cost per job for FY 18 is \$83,000. This amount declines because the federal and state credit percentages decline. This amount argues that the expenditure is not effective.

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

1. **Vetted:** The proposed new or expanded tax expenditure was vetted through interim legislative committees, such as LFC and the Revenue Stabilization and Tax Policy Committee, to review fiscal, legal, and general policy parameters.
2. **Targeted:** The tax expenditure has a clearly stated purpose, long-term goals, and measurable annual targets designed to mark progress toward the goals.
3. **Transparent:** The tax expenditure requires at least annual reporting by the recipients, the Taxation and Revenue Department, and other relevant agencies.
4. **Accountable:** The required reporting allows for analysis by members of the public to determine progress toward annual targets and determination of effectiveness and efficiency. The tax expenditure is set to expire unless legislative action is taken to review the tax expenditure and extend the expiration date.
5. **Effective:** The tax expenditure fulfills the stated purpose. If the tax expenditure is designed to alter behavior – for example, economic development incentives intended to increase economic growth – there are indicators the recipients would not have performed the desired actions “but for” the existence of the tax expenditure.
6. **Efficient:** The tax expenditure is the most cost-effective way to achieve the desired results.

LFC Tax Expenditure Policy Principle	Met?	Comments
<b>Vetted</b>	✘	
<b>Targeted</b> Clearly stated purpose Long-term goals Measurable targets	✘ ✘ ✘	
<b>Transparent</b>	✘	
<b>Accountable</b> Public analysis Expiration date	✔ ✔	
<b>Effective</b> Fulfills stated purpose Passes “but for” test	✘ ✘	No clear purpose is stated. FY 18 cost is \$83,000 per job.
<b>Efficient</b>	✘	The industry will survive because the cost of modules has brought the overall costs into the range where payoff period is about 10 years or less. Much depends on how much of PNM’s rate case is approved.
Key:    ✔ Met    ✘ Not Met    ? Unclear		

**ADMINISTRATIVE IMPLICATIONS**

Since the tax credit is currently in place, EMNRD has an existing program to review applications and provide certifications. EMRND would update existing rules (NMAC 3.3.28) to comply with changes to the solar market development tax credit in HB 26.

TRD claims a minimal impact as shown in the table on page 1: GenTax must be programmed to allow for different credit percentages by year; the maximum annual aggregate will need to be updated to the new consolidated cap. Programming issues with Business Credit Manager will

need to be addressed. Forms must be updated to include an installation date so that the correct tax credit percentage can be used for total credit calculation. Taxpayer instructions will need to be updated pursuant to the changes. The consolidation of the system credit caps will require clarifying language specifying if changes apply to applications submitted but not approved as of the effective date. Cross-

Division Memorandums of Understanding should be updated prior to the start of the new applicability period. Regulations will need revision to accommodate the proposed changes.

EMNRD expects that the expansion to corporate income tax, with an increase of at least 400 claims a year will require an FTE.

## **TECHNICAL ISSUES**

Section A of the bill designates an eligible system as one installed in a residence, business or agricultural enterprise. Section E prohibits EMNRD from approving “a commercial or industrial photovoltaic system other than an agricultural photovoltaic system on a farm or ranch that is not connected to an electric utility transmission or distribution system.” Section I allows a proportional credit for a pass-through entity. These provisions seem to be somewhat in conflict. If the intent is to allow non-residential systems owned by business owners – whether sole proprietors or pass-through entities, then perhaps Section E (2) should be eliminated.

The conflict between the \$20 million cap (section 2, F) and the \$5 million cap (section 2, K) should be resolved.

TRD notes several technical issues that exist with the current law. While not precipitated by the proposed bill, these issues should be considered when analyzing the proposed legislation. First, there is an absence of claim procedures, specifically with regard to timing. The law should require the credit to be claimed for the taxable year in which the installation occurred or, alternatively the taxable year in which EMNRD issues certification. Clear claim timing will keep credits flowing smoothly and tie them more closely to the annual caps. Second, there is an inherent tension between the prohibition on systems being used for commercial or industrial purposes and the applicability of the credit to systems installed on business premises. Clarification that the systems cannot be used for commercial or industrial applications within a structure would be helpful. Finally, TRD recommends that language be added in 7-2-18.14 (A) that limits eligibility to systems producing energy that is “predominantly” used at that specific location. This language will further reduce tension pertaining to commercial or industrial use and credit eligibility.

## **WHAT WILL BE THE CONSEQUENCES OF NOT ENACTING THIS BILL**

The delayed repeal date for New Mexico’s Solar Market Development Tax Credit will remain at December 31, 2016.

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