FISCAL IMPACT REPORT

SPONSOR Sariñana/Stewart **LAST UPDATED** 1/31/23
ORIGINAL DATE 1/20/23
SHORT TITLE Energy Storage System Income Tax Credit **BILL NUMBER** House Bill 32/aHENRC
ANALYST Graeser

REVENUE* (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY23	FY24	FY25	FY26	FY27		
	Up to ($4,000.0)	Up to ($4,000.0)	Up to ($4,000.0)	Up to (4,000.0)	Recurring	General Fund

Parenthesis ( ) indicate revenue decreases.
*Amounts reflect most recent analysis of this legislation.

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT*
(dollars in thousands)

	FY23	FY24	FY25	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
TRD Operating	16.7	12.0		28.7	Nonrecurring	General Fund
TRD Operating		80.0	80.0	160.0	Recurring	General Fund
EMNRD Operating		160.0	160.0	320.0	Recurring	General Fund

Parentheses ( ) indicate expenditure decreases.
*Amounts reflect most recent analysis of this legislation.

Sources of Information
LFC Files
Agency Analysis of House Bill 11 from 2022 and House Bill 262 from 2021

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

SUMMARY

Synopsis of HENRC Amendment to House Bill 32

The HENRC amendment to House Bill 32 adds the requirement the storage unit be stationary and slightly revises the other requirements. This edition of the FIR also includes substantive comments on the original.

Synopsis of the Original House Bill 32

House Bill 32 proposes a personal income tax credit of 40 percent of the cost of equipment and installation for an energy storage system installed for taxable years up to January 1, 2028. The credit is for installation of an energy storage system on the claimant's residential, agricultural, or commercial property. The energy storage system must be installed for use with a new or existing solar photovoltaic system and has a minimum rating of 4 kilowatts and two hours of storage capacity. The system must stand alone. If installed in a grid-tied system, communication and control mechanisms must exist so the storage system can be used as a shared resource with a utility. The credit amount is 40 percent of the cost of equipment and installation, limited to a maximum credit of $5,000 per system for residential systems and $150 thousand for agricultural and commercial systems. Only one credit is allowed for each property.

EMNRD is required to certify installations and issue a certificate. Certifications must be submitted to TRD within 12 months after the end of the calendar year of installation. These applications will be processed by TRD on a first-come, first-served basis with a limit of $4 million for all awards per year. If aggregate applications exceed this cap, TRD will notify the taxpayer that the taxpayer may file a claim the following year. Approved credits that exceed a taxpayer's tax liability can be carried forward for five years or refunded at the option of the taxpayer.

There is no effective date of this bill. It is assumed the effective date is 90 days after this session ends (June 16, 2023) if the bill is signed into law. The provisions of the act are applicable to tax years beginning on or after January 1, 2023, for installations completed on or after March 1, 2023.

FISCAL IMPLICATIONS

This bill creates or expands a tax expenditure with a cost that is difficult to determine but likely significant. LFC has serious concerns about the significant risk to state revenues from tax expenditures and the increase in revenue volatility from erosion of the revenue base. The committee recommends the bill adhere to the LFC tax expenditure policy principles for vetting, targeting, and reporting.

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.

The fiscal impact of the provisions of this bill simply reflect the $4 million cap along with refundability of the tax credit. With a maximum credit of $150 thousand for agricultural and commercial installations and $5,000 for residential installations, 20 commercial systems and 200 residential systems would consume the credit. It is unknown whether these are appropriate targets.

Industrial scale battery energy storage systems (BESS) currently cost about $200 per kilowatt hour (KwH). However, Tesla Powerwall 2 stores 13.5 KwH at a cost of $8,500 to $11 thousand

installed, for a cost of $600 to $800 per KwH, with larger storage capacity cheaper.

Administration of the act would trigger costs for TRD and EMNRD, with the certification process likely to necessitate significant work force at EMNRD.

EMNRD notes the following fiscal impact: "HB32 creates a fiscal impact of $160,000 in recurring funding for EMNRD. This represents one new FTE to manage the tax credit program in ECMD and funds for EMNRD's information technology office's design, development, implementation, and maintenance of the application portal."

TRD has provided the following:

> According to 2021 data from the U.S. Energy Information Administration (EIA), the market for energy storage systems in New Mexico remains underdeveloped. 2021 EIA's publication "Battery Storage in the United States: An Update on Market Trends" and its "Annual Electric Power Industry Report, Form EIA-861" detailed data files indicate zero-megawatt storage capacity in New Mexico.
>
> Being that this is a developing market, the fiscal impact will likely be under $4 million in the first couple of years, as consumers begin to take advantage of this credit. Starting in fiscal year 2026 and going forward, it is expected that the market will experience higher adoption by consumers who would then maximize the use of the aggregate credit cap.

SIGNIFICANT ISSUES

EMNRD has some concerns:

Omission of Corporate Tax Option. HB32 omits a corporate tax credit option. Other tax credits for equipment on residential and commercial property usually offer both an individual and corporate tax credit option. The current credit only differentiates between credit amounts based on installation locations. Additionally, it is unclear that an individual taxpayer would be able to claim credit for an installation they may own.

Credit and Credit Cap. The 40% of installation costs tax credit is larger than the 30% tax credit offered by the federal government, but the residential cap of $5,000 in HB 32 is less than the state's Solar Market Development Tax Credit cap of $6,000. Battery storage systems generally are more expensive than solar photovoltaic systems, and so the cap may be limiting. Similarly, the credit cap for commercial and agricultural installations may be appropriate given the larger size and higher costs of those systems; however, it may result in those facilities (which will be smaller in number) utilizing more of the cap in any given year.

Definitions. The Legislation does not include a definition of what qualifies as residential and what qualifies as agricultural and commercial.

System Requirements and Verification. The requirement that the storage system is installed for use with a new or existing photovoltaic system is limiting and may cause unintended problems. Firstly, there are many uses for energy storage without on-site solar

generation. Secondly, it is unclear how EMNRD would adequately verify the presence of an existing solar generation system on a taxpayer's property.

Additionally, the minimum power rating of the energy storage system required by HB 32 differs from the requirements in the federal tax credit for storage systems. EMNRD also notes that the bill sponsors should consider whether a different minimum power rating for commercial systems would be appropriate.

Finally, HB 32 requires that the storage system be installed as a stand-alone energy storage system; or, if the energy storage system is grid-tied, has the capability to provide grid services if control and communication infrastructure exists with the utility service provider. It is unclear how EMNRD would verify that these requirements have been met. Most New Mexico utilities are still defining how they themselves will verify the details of control and communication infrastructure and EMNRD cannot predict if the capabilities of the energy storage system will be able to provide these grid services in an unknown future grid.

The federal Department of Energy, Energy Information Agency published a study in July 2020[1] that contained some interesting statistics:

- In 2018, utilities reported 234 megawatts of existing small-scale storage power capacity in the United States. A little more than 50 percent of this capacity was installed in the commercial sector, 31 percent was installed in the residential sector, and 15 percent was installed in the industrial sector.
- In 2018, 86 percent of reported small-scaled storage power capacity in the United States was in California and, specifically, was owned by six utilities.
- Utah was in third place, outside California with about 0.6 megawatts of residential energy storage systems.
- In California, capacity and installations at the end-user level are not collected.
- Utah is in third place outside of California, with about 0.6 megawatts of capacity. Virtually all this capacity is for residential systems owned by the end-user. (Utah offers a 10 percent tax credit for renewable energy systems, including energy storage as long as the energy storage is installed at the same time as solar or wind systems.)

PERFORMANCE IMPLICATIONS

EMNRD notes the following:

Adding another tax credit program to EMNRD's certification responsibilities without adding additional FTE and IT resources will slow down processing for **all** tax credit certifications, particularly the New Solar Market Development Tax Credit and the Sustainable Buildings tax credit.

The LFC tax policy of accountability is met with the bill's requirement to report annually to an interim legislative committee regarding the data compiled from the reports from taxpayers taking the credit and other information to determine whether the credit is meeting its purpose.

[1] https://www.eia.gov/analysis/studies/electricity/batterystorage/pdf/battery_storage.pdf

ADMINISTRATIVE IMPLICATIONS

TRD will need to make information system changes and update forms, instructions, and publications. Staff training to administer the credit will need to take place. Changes to GenTax, the tax system of record, and Taxpayer Access Point, the taxpayer interface system, will incur approximately 300 hours, or about two months of staff workload cost of $16,661 for TRD's Information Technology Division (ITD). TRD assumes that electronic transfer of information will not occur without statutory requirement.

TRD's Revenue Processing Division (RPD) will need one additional full-time employee (FTE) to process credit claims.

TRD's Administrative Services Division (ASD) will be required to test credit sourcing and perform other systems testing. It is anticipated this work will take approximately 40 hours split between 2 FTE of a pay band 70 and a pay band 80.

TRD expects to be able to absorb the impact of these changes, as outlined in this standalone bill, with 1 additional FTE. However, if several bills with similar effective dates become law there will be a greater impact to TRD and additional FTE or contract resources may be needed to complete the changes specified by the effective date(s) of each bill.

Estimated Additional Operating Budget Impact*				R or NR**	Fund(s) or Agency Affected
FY2023	FY2024	FY2025	3 Year Total Cost		
$16.7	--	--	$16.7	NR	Tax & Rev – ITD staff workload
--	$79	$79	$158	R	Tax & Rev - RPD FTE
--	$1	$1	$2	R	Tax & Rev - RPD phone and license
--	$10	--	$10	NR	Tax & Rev - RPD FTE equipment and materials
	$1.9	--	$1.9	NR	Tax & Rev – ASD staff workload

* In thousands of dollars. Parentheses ( ) indicate a cost saving. ** Recurring (R) or Non-Recurring (NR).

EMNRD's Energy Conservation and Management Division will be required to establish the program certification requirements and administrative processes, design an online application with the assistance of EMNRD IT, and develop rules through the public rulemaking process.

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

HB32 is similar to HB201 from the 2020 regular session, HB262 from the 2021 regular session, and HB11 from the 2023 regular session. The provisions of this bill adopt amendments and suggestions from the previous bills.

TECHNICAL ISSUES

The requirement that the energy storage system have a minimum rating of 4 kilowatts and two hours capacity may be overly restrictive. Capacity is conventionally measured in kilowatt-hours. Multiplying the power rating and the two hours capacity results in a requirement of 8 KwH. This is within the range of larger residential solar systems but greater than the average residential system. This is proposed as a personal income tax credit only, so the primary utilization of this credit will be agricultural and commercial entities that report as partnerships, single member

limited liability corporations, Subchapter-S corporations or other pass-through entities.

TRD has a number of concerns with provisions of the bill:

In section D, TRD is charged with maintaining and monitoring the $4 million cap, with the responsibility to notify the taxpayers that their credit may be claimed in the following taxable year. This implies that the Energy, Minerals and Natural Resources Department (EMNRD) would certify credits in excess of the allotted $4,000,000 per calendar year. It would be more efficient if EMRND certified the systems while maintaining the cap, ensuring that EMNRD does not certify above the $4 million cap. When the cap is reached, EMNRD can then stop certifying systems at the front end before taxpayers request a credit from TRD. This was a demonstrated problem with the Renewal Energy Production Tax Credit when taxpayers became confused after receiving certification from EMNRD and were then told by TRD that there was no available space in the cap.

In section E, the taxpayer has the option to either have the balance refunded or carried forward for five consecutive years. Tracking carry-forwards for current credits is administratively more complex. This option adds even more complexity for tracking the remaining liability. TRD recommends simplifying the credit and making it only refundable. If a credit is refundable, it is difficult to imagine why any taxpayer would choose to carry it forward, but if the statute allows carryforward, TRD will need to program that functionality into the credit in GenTax.

TRD recommends adding language to require an electronic file sharing agreement with EMNRD to receive the list of taxpayers certified for the credit. This will allow faster processing and verification of credits awarded and a more accurate evaluation of the credits' effectiveness.

TRD notes that the terms "residential" and "commercial or agricultural" are not defined. This may lead to confusion, as for example may arise if a system is installed on a multi-family apartment building. A multi-family housing property would appear to be "residential", but might be deemed to be "commercial" from the point of view of the owners of the property, as the ownership and management of the building represents a commercial enterprise from the owners' point of view. The bill also does not define "photovoltaic system", and TRD recommends defining this term.

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

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
Vetted	✓	
Targeted		
Clearly stated purpose	✗	No purpose stated
Long-term goals	✗	
Measurable targets	✗	
Transparent	✓	
Accountable		
Public analysis	✓	
Expiration date	✓	
Effective		
Fulfills stated purpose	✗	
Passes "but for" test	✗	
Efficient	✗	
Key: ✓ Met ✗ Not Met ? Unclear		

LG/mg/hg/al/ne