FISCAL IMPACT REPORT

SPONSOR Soules **LAST UPDATED** **ORIGINAL DATE** 1/24/2024

SHORT TITLE Geothermal Heat Pump Tax **BILL NUMBER** Senate Bill 40

ANALYST Gray

REVENUE*
(dollars in thousands)

Type	FY24	FY25	FY26	FY27	FY28	Recurring or Nonrecurring	Fund Affected
PIT		Up to ($16,000.0)	Up to ($16,000.0)	Up to ($16,000.0)	Up to ($16,000.0)	Recurring	General Fund
CIT		Up to ($16,000.0)	Up to ($16,000.0)	Up to ($16,000.0)	Up to ($16,000.0)	Recurring	General Fund

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

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT*
(dollars in thousands)

Agency/Program	FY24	FY25	FY26	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
TRD – IT		$11.1		$11.1	Nonrecurring	General Fund
EMNRD	$30.0	$75.0	$75.0	$180.0	Recurring	General Fund
Total	$30.0	$86.1	$75.0	$191.1		General Fund

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

Sources of Information

LFC Files

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

Agency Declined to Respond
New Mexico Environment Department (NMED)

SUMMARY

Synopsis of Senate Bill 40

The bill reinstates and expands the geothermal ground-coupled heat pump tax credits. The credit rate remains at 30 percent of costs, with a maximum of $9,000 tax credit per installation. The cap

for the credit in each of the acts is increased from $2 million to $16 million. The bill also removes the carry-forward for the credit and makes any credit more than PIT liability refundable with respect to the credit in the Income Tax Act only. SB40 authorizes the Energy, Minerals and Natural Resources Department (EMNRD) to develop rules and implement the tax credit.

The provisions of this bill apply to tax years beginning after January 1, 2024. This bill does not contain an effective date and, as a result, would go into effect 90 days after the Legislature adjourns, or May 15, 2024, if enacted.

FISCAL IMPLICATIONS

This bill reinstates and 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 or action be postponed until the implications can be more fully studied.

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. Once a tax expenditure has been approved, information constraints continue to create challenges in tracking the real costs (and benefits) of tax expenditures.

TRD has provided an estimate of the fiscal impact as follows:

Estimated Revenue Impact*					R or NR**	Fund(s) Affected
FY24	FY25	FY26	FY27	FY28		
--	($1,150.0)	($1,160.0)	($1,170.0)	($1,170.0)	R	General Fund

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

TRD provided the following description of the methodology for estimated revenue impact:

> To estimate the fiscal impact, TRD utilized internal data from applications for the existing Geothermal Income Tax Credit, which limits purchases and installation to December 31, 2020. TRD calculated the base amount by averaging the applications for the credit over a 5-year period, excluding Tax Years 2020 and 2021 due to the COVID-19 pandemic's effects.
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> Firstly, the fiscal impact calculation takes the base amount and applies a 1 percent year-over-year growth rate based on market analysis conducted by Grand View Research1. In their market analysis published in August 2020, the firm projected a 7.2 percent growth in the geothermal heat pump market between 2020 and 2027. For this estimate, the growth rate was annualized to approximately 1 percent year-over-year.
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> Additionally, TRD incorporated an 83 percent growth rate on the base amount to account for the newly introduced refundability of the credit. This growth rate was calculated based on the amount of credit claimed between fiscal years 2009 and 2010 from the Renewable Energy Production Tax Credit. This credit was made refundable for projects that commenced operations after 2008, and this data was used to estimate the initial change in the growth rate.

This analysis presents the maximum total costs to the state because of the uncertainty in estimating costs. This uncertainty is exacerbated because geothermal heat pumps are an emerging technology. Further, increasing the cap from $2 million to $16 million may incentivize more consumers to opt-in to the credit, increasing the cost.

As TRD notes in its analysis, the $16 million cap is referred to in both section 1 and section 2. This means the aggregate cap is $32 million, as presented in the revenue table on page 1.

TRD suggests the language be changed to:

> Suggested language: "D. The department may allow a maximum annual aggregate of sixteen million dollars ($16,000,000) in geothermal ground-coupled heat pump tax credits approved under the Income Tax Act and Corporate Income and Franchise Tax Act."

Operating Budget Impacts

The Energy, Mineral and Natural Resources Department (EMNRD) estimates that it will need one FTE to manage the program and $30 thousand in one-time expenditures. The agency asserts that "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 reinstated New Solar Market Development tax credit, the reinstated Sustainable Buildings tax credit and other tax credits that are administered by EMNRD."

TRD asserts the agency will need to make IT changes that will impact its operating budget.

SIGNIFICANT ISSUES

EMNRD identified several key issues with SB40:

Standards

SB40 does not describe any nationally accepted standards that should be used to determine the energy efficiency requirements of eligible heat pumps. Instead, SB 40 merely requires the heat pump to be installed by a nationally accredited installer. Under the prior instance of the geothermal ground-coupled heat pump tax credit, nationally accredited installers installed equipment in New Mexico that was not tested by a third-party independent testing laboratory such as the Air-Conditioning, Heating and Refrigeration Institute (AHRI[1]). Some of these systems were self-certified and did not provide adequate (nor promised) benefits to the taxpayer who paid for the system's installation on their property. EMNRD strongly encourages the bill sponsor to require third-party certification for tax credit eligibility.

Furthermore, during the expired program, more than 95 percent of applications came from the service territory of El Paso Electric (EPE). EPE provides a rebate for ground source heat pump systems, but EPE does not recognize ground source heat pump systems as eligible for their rebates if the systems are not AHRI certified.[2]

[1] https://www.ahridirectory.org/NewSearch?programId=1&searchTypeId=3

[2] EPE's requirements can be found at Refrigerated Cooling - EPE (epesaver.com).

Duplication

Since the previous geothermal ground-coupled heat pump tax credit's expiry, New Mexicans have gained access to other tax incentives to install heat pumps. There is a provision for ground-coupled heat pumps in the 2021 Sustainable Building Tax Credit, as well as in federal energy tax credits. There are also rebates offered by several New Mexico utilities. EMNRD also expects to be able to offer rebates for heat pump systems through several upcoming programs authorized by the federal Inflation Reduction Act. See table below.

Program Duplication, Companionship, Relationship	**Incentive for Low-Income Residents**	**Incentive for Non Low-Income Residents**
New Mexico Tax Credits: A. Energy Star Certified equipment is eligible. B. Applicants with adjusted gross income of less than 200% of the federal poverty can receive a refund for the amount that exceeds their tax liability		
Sustainable Building Tax Credit-Ground Source Heat Pump	$2,000	$1,000
Sustainable Building Tax Credit-Air Source Heat Pump	$2,000	$1,000
Sustainable Building Tax Credit-Heat Pump Water Heater	$700	$ 350
Federal Tax Credits: Energy Star Certified equipment is eligible		
Geothermal heat pump – 30% up to $2,000	$2,000	$ 2,000
Heat pump water heaters	$300	$300
Heat Pump for space heating and cooling Heat Pump water heating	$8,000 $1,750	n/a n/a

TRD provided the following policy discussion:

While tax incentives can support specific industries or promote desired social and economic behaviors, the growing number of such incentives complicate the tax code. Introducing more tax incentives has two main consequences: (1) it creates special treatment and exceptions within the code, leading to increased tax expenditures and a narrower tax base, which negatively impacts the General Fund; and (2) it imposes a heavier compliance burden on both taxpayers and TRD. Increasing complexity and exceptions in the tax code is generally not in line with sound tax policy.

The extension of the credit still includes a sunset date and places a cap on the total amount of credit that can be claimed in a taxable year, although the cap is raised from $2 million to $16 million. TRD supports the inclusion of sunset dates, as they allow policymakers to assess the impact of a credit before deciding whether to extend it. The 2021 Tax Expenditure report2 shows that from tax year 2017 to tax year 2020, on average there were 205 taxpayers claiming the current credit for an aggregate annual amount of $450 thousand. During that time, the $2 million cap was never reached. Converting the credit to a refundable credit is assumed to increase the demand for heat pumps as detailed in the revenue impact.

TECHNICAL ISSUES

EMNRD notes:

It is unclear from the text of SB40 how many tax credits an individual taxpayer may claim for systems installed on the same property (i.e., can a taxpayer claim a credit for both a heat pump water heater and a heat pump heating and cooling system at the same address?) and also how many tax credits an individual taxpayer may claim in any one tax year (i.e. a tax credit for installing a heat pump water heater at multiple addresses).

EMNRD recommends that SB40 allow only systems that are certified under EPA's Energy Star program to be eligible for the tax credit. The requirement would make this tax credit consistent with the New Mexico 2021 Sustainable Building Tax Credit, all federal tax credits and the programs created by the Inflation Reduction Act.

TRD made the following recommendation:

As the current credit already sunset as of December 31, 2020, TRD recommends that instead of amending this credit, that a "new" credit be created as was done recently with the Solar Market and Sustainable Building credits. This will allow smoother administration by TRD. The current credit permits taxpayers to carryforward their credit amounts up to 10 years. A new credit adds complexity in needing to separately track credits that are refundable and nonrefundable. Taxpayers who have carryforwards under the existing law would not be permitted to claim a refund. There are approximately $2 million in pending carryforwards for the recently expired credit in the GenTax system. However, the language of the carryforward provision on page 2 lines 17 through 20 is repealed under this proposal. The repeal could create legal issues for TRD should taxpayers who installed a system between 2010 and 2020 submit a credit claim and expect to carry it forward to future tax years. These claims may be invalid with the proposed repeal. It would also be preferable to have two separate credits for purposes of TRD's annual Tax Expenditure Report.

There is no language in Section 2 (the CIT credit) to make the credit refundable on par with Section 1 (the PIT credit). TRD recommends consistent language for personal income tax and corporate income tax filers to avoid confusion. The corporate income tax credit is left as a carry-forward credit, further creating inconsistency between that credit and the personal income tax credit, and increasing complexity, and the possibility of return errors, for taxpayers, as well as complicating the administration of the credit.

TRD recommends the cap be on credit certification rather than on credit claims as tracking that on the return creates more uncertainty for taxpayers as to whether their credit will fit under the cap. During filing season, TRD receives thousands of returns each day and cannot ensure credits are processed on a first come first serve basis.

On page 4, lines 2 through 8 and page 6, line 25 through page 7 line 6, the proposed language indicates that a claim for the geothermal credit will not be allowed if a claim for 2021 sustainable tax credit is made. TRD suggests that this language be placed under the certification criteria for EMNRD as they also certify projects for the 2021 sustainable tax credit. EMNRD will have detailed information to confirm the bill language that the "geothermal ground-coupled heat pump is not a component of the qualification for the

2021 sustainable tax credit and thus deny or approve the geothermal credit. This will also ensure that a taxpayer is thoroughly certified for all conditions of the credit.

OTHER SUBSTANTIVE ISSUES

In assessing all tax legislation, LFC staff considers whether the proposal is aligned with committee-adopted tax policy principles. Those five principles:

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

In addition, staff reviews whether the bill meets principles specific to tax expenditures. Those policies and how this bill addresses those issues:

Tax Expenditure Policy/Principle	Met?	Comments
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.	✓	Reinstates expired credit
Targeted: The tax expenditure has a clearly stated purpose, long-term goals, and measurable annual targets designed to mark progress toward the goals.		
Clearly stated purpose	✗	
Long-term goals	✗	
Measurable targets	✗	
Transparent: The tax expenditure requires at least annual reporting by the recipients, the Taxation and Revenue Department, and other relevant agencies	✓	
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.		
Public analysis	✗	
Expiration date	✓	
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.		
Fulfills stated purpose	✗	No purpose or goals stated
Passes "but for" test	✗	
Efficient: The tax expenditure is the most cost-effective way to achieve the desired results.	✗	
Key: ✓ Met ✗ Not Met ? Unclear		

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