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FISCAL IMPACT REPORT

SPONSOR: Beffort DATE TYPED: 2/18/03 HB _____

SHORT TITLE: Income Tax Credit for Drip Irrigation SB 127/a SCONC

ANALYST: Smith

REVENUE

Estimated Revenue		Subsequent Years Impact	Recurring or Non-Rec	Fund Affected
FY03	FY04			
	(2,000.0)	(10,000.0)	Recurring	General Fund

(Parenthesis () Indicate Revenue Decreases)

SOURCES OF INFORMATION

Responses Received From
TRD

SUMMARY

Synopsis of SCONC Amendment

The Senate Conservation Committee Amendment clarifies that the proposal does not affect a taxpayer's water rights.

Synopsis of Original Bill

Senate Bill 127 allows tax credits of up to 75 percent of expenses incurred in purchasing and installing drip irrigation systems after January 1, 2004. The credits apparently may not total more than \$1,000 for any irrigation system project. To qualify for the credits, taxpayers must own or lease water rights appurtenant to the land on which an eligible improvement is made, and not be dependents of other individuals. The measure does not specify that the systems must be used for agricultural purposes, hence essentially any taxpayer could claim the credits, including residential homeowners, renters, owners of apartments, golf courses and similar real property.

The Soil and Water Conservation Commission is assigned responsibility for developing rules and guidelines designed to help the Taxation and Revenue Department determine whether the improve

ments qualify for the credits. Unused credits are not refundable, but may be carried forward for five years. They may be taken against personal or corporate income tax obligations.

FISCAL IMPLICATIONS

TRD assumed that that 1 percent of New Mexico's approximately 830,000 personal income tax return filers and 1 percent of New Mexico's 30,000 corporate income taxpayers claim the credit. Hence approximately 10,000 taxpayers claim the credit annually. There is no precise way to estimate the number of likely claimants, hence the \$10 million figure should be viewed as a *very* rough approximation. The FY 2004 estimate reflects adjustments to tax payments for the first six months of tax year 2004.

TECHNICAL ISSUES

TRD notes the technical issues:

- The bill's language is not clear regarding what the \$1,000 limitation applies to. Apparent intent is to limit the credit to \$1,000 per project. As written, it would probably be interpreted as \$1,000 per year. Hence a taxpayer could expend \$6,666.67 on a drip irrigation system and deduct three-quarters of the \$6,666.67 or \$5,000 in \$1,000 increments over a five-year period. By continuously installing drip irrigation systems, businesses could probably receive the credits for an indefinite period. Hence the proposal needs to be more specific on these issues than it currently is.
- Intent of language in the proposal requiring that taxpayers must own or lease water rights appurtenant to land on which an irrigation system is installed is unclear, and seems to suggest that the credits are intended for agricultural users. TRD legal counsel, however, states that residential owners would, in fact, typically possess these rights by virtue of prior beneficial use of water, and hence would qualify for the credits. If the proposal's intent is to limit the credits to agricultural users, it should be modified accordingly.
- The measure would probably not allow owners of S-corporations to share the credit. Owners of S-corporations are co-owners of the corporation not co-owners of the land. If the intent is for owners of S-corporations to share the credit, the term "pass-through entity" should be employed in statute. An example of this type of language would be similar to: "If a pass-through entity (S-corporation partnership or limited liability company) owns the land on which an eligible improvement in irrigation systems or water management method is made, the owners of the entity may claim a pro rata share of the credit allowed....".

OTHER SUBSTANTIVE ISSUES

TRD makes the following observations:

- Without a provision actually guaranteeing reduced water use--and perhaps a resulting sale to municipalities or environmental credits for leaving water in rivers--the proposed credits may not achieve their apparent purpose of water use reduction.

- The proposed measure would effectively subsidize taxpayers for making water conservation expenditures that they would make in absence of the bill's provisions.
- Although drip irrigation systems represent effective mechanisms for conserving water, they are not the only effective procedure available to taxpayers for doing so, and some limitations apply to their use. For example, drip irrigation systems often deteriorate in five to ten years.¹ Hence subsidies provided by legislation similar to those in the proposed measure may actually produce inefficient use of water by encouraging use of systems that would not be as cost effective for this purpose as systems that would be selected in absence of tax subsidies.

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¹ <http://ag.arizona.edu/AZWATER/awr/sept98/feature1.html>