F I S C A L I M P A C T R E P O R T

SPONSOR Lujan, B. **ORIGINAL DATE** 01/28/10 **LAST UPDATED** 01/29/10 **HB** 171

SHORT TITLE Transport of Dairy Waste for Gas Tax Credit **SB**

ANALYST Clifford

REVENUE (dollars in thousands)

Estimated Revenue			Recurring or Non-Rec	Fund Affected
FY10	**FY11**	**FY12**		
	(Indeterminate)	($720.0)	Recurring	General Fund

(Parenthesis ( ) Indicate Revenue Decreases)

SOURCES OF INFORMATION

LFC Files

Responses Received From
N.M. Environment Department (NMED)
Taxation and Revenue Department (TRD)

SUMMARY

Synopsis of Bill

House Bill 171 would create new credits against personal and corporate income tax equal to $5 per ton of agricultural biomass transported from the taxpayer's dairy or feedlot to a facility that uses the biomass to generate electricity or to create fuels for commercial use. The tax credits could be sold or transferred to another taxpayer. Partial owners of a qualified facility could be awarded a portion of the total tax credits earned by the facility. Total credits awarded would be limited to an annual amount of $5 million. The credit would sunset at the end of 2019.

FISCAL IMPLICATIONS

TRD reports that a biomass facility with an annual capacity of 360,000 wet tons is expected to come on line during the latter half of 2011. A second project with similar capacity is expected to come on line in the latter half of 2103. Thus, the total fiscal impact would be $2.5 million per year in FY14.

SIGNIFICANT ISSUES

From the website of the Energy, Minerals and Natural Resources Department:

> Rapid growth of the New Mexico dairy industry has greatly increased the production of manure in New Mexico. The State of New Mexico is working with the U.S. Department of Energy and Dairy Producers of New Mexico, a local dairy trade organization, to develop a project involving the use of a bioreactor to produce methane from this waste. The New Mexico dairy industry produces 1.15 million tons of manure annually - a potential source of methane gas for energy.

NMED notes:

> "Agricultural biomass" is defined as wet manure meeting specifications established by the Energy, Minerals and Natural Resources Department from either a dairy or feedlot commercial operation. Storage and disposal of dairy manure is currently regulated under authority of the New Mexico Water Quality Act to ensure that the manure does not cause contamination of water quality. For example, dairies must manage their wet manure using lined impoundments that prevent the liquid portion of the manure from seeping into the ground and contaminating aquifers beneath the facility. Currently, 65 percent of dairies in the state have contaminated groundwater beneath them due to dairy waste disposal practices that have not been protective of groundwater quality…It is important that dairy manure, which is known to be a significant source of groundwater contamination, is tracked, transported and stored in a manner that is protective of groundwater quality. HB 171 should also include a provision that allows a tax credit to be nullified if the transport practices result in contamination of ground or surface water quality.

PERFORMANCE IMPLICATIONS

NMED notes:

> HB 171 may have an impact on the NMED's Ground Water Quality Bureau performance measures, which require reporting on the percent of groundwater discharge permitted facilities receiving annual compliance evaluations and annual field inspections and the percent of permitted facilities where monitoring results demonstrate compliance with groundwater standards. A receiving facility that stores wet manure will be required to obtain a water quality protection permit. This will result in additional regulated facilities that require annual inspections and evaluation of monitoring results.

OTHER SUBSTANTIVE ISSUES

The proposal is an example of a "tax expenditure," i.e. the use of foregone tax revenue to subsidize private activities that are deemed to be worthwhile. New Mexico has added over $100 million per year of new tax expenditures in recent years. From an administrative standpoint, one concern with tax expenditures is that they are not subject to annual appropriation and oversight. Thus, the amount of revenue foregone is difficult to control during periods of financial distress. Another concern with the proposal is that the state already provides a variety of subsidies to biomass facilities including: the renewable energy production tax credit, the gross receipts tax (GRT) credit for biodiesel blending facilities, the compensating tax deduction for biomass equipment and materials and the alternative energy product manufacturer's tax credit. In addition, the biomass products that are the target of the new credit would qualify for the GRT

exemption for agricultural products. The variety of different subsidies makes it difficult to track how much in total subsidy is being provided to the industry and whether public money is being efficiently used.

ADMINISTRATIVE ISSUES

TRD notes that the division of duties between TRD and EMNRD is not clearly defined. It is not clear who will monitor eligibility for the credit and keep track of the aggregate amounts and the transfers of credits.

TECHNICAL ISSUES

House Bill 171 proposes that the tax credits be transferable – i.e. the credit could be sold by the taxpayer who conducts the eligible activity to another taxpayer to be claimed on the second taxpayer's return. Experience with transferable credits in other states indicates that the first taxpayer does not receive the full face value of the credit when transferring it to a second taxpayer. This may be due to a number of factors, including uncertainty on the part of the buying taxpayer about when they will have sufficient tax liability to claim the credits. If, for example, the selling taxpayer receives only 75 cents per dollar of tax credits sold, the remaining 25 cents is wasted public funds – i.e. tax revenue is foregone that does not benefit the targeted activity. For this reason, transferable credits are an inefficient way for the state to subsidize activity.

TRD notes:

> "Department" is not clearly defined. In addition, the bill allows the credit to be sold or exchanged but is silent on the type of documentation required as proof of the transaction. It is unclear whether the $5 million credit limit applies to credit certificates provided by EMNRD or credit claims processed by TRD.

TC/mew:svb

The Legislative Finance Committee has adopted the following principles to guide responsible and effective tax policy decisions:

1. ***Adequacy:*** *revenue should be adequate to fund government services.*
2. ***Efficiency:*** *tax base should be as broad as possible to minimize rates and the structure should minimize economic distortion and avoid excessive reliance on any single tax.*
3. ***Equity****: taxes should be fairly applied across similarly situated taxpayers and across taxpayers with different income levels.*
4. ***Simplicity****: taxes should be as simple as possible to encourage compliance and minimize administrative and audit costs.*
5. ***Accountability/Transparency:*** *Deductions, credits and exemptions should be easy to monitor and evaluate and be subject to periodic review.*

More information about the LFC tax policy principles will soon be available on the LFC website at www.nmlegis.gov/lcs/lfc