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

SPONSOR Lujan, B. **ORIGINAL DATE** 02/04/11 **LAST UPDATED** 03/14/11 **HB** 198/aHBIC/aHTRC/aHFL#1

SHORT TITLE Tax Credits for Natural Gas as Vehicle Fuel **SB**

ANALYST Burrows/Golebiewski

REVENUE (dollars in thousands)

Estimated Revenue			Recurring or Non-Rec	Fund Affected
FY11	FY12	FY13		
	($200.0)	($1,000.0)	Recurring	General Fund

(Parenthesis ( ) Indicate Revenue Decreases)

Conflicts with HB 39.

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY11	FY12	FY13	3 Year Total Cost	Recurring or Non-Rec	Fund Affected
Total		$27.0	$27.0	$54.0	Recurring	TRD Operating Budget
Total		$22.0	$22.0	$44.0	Recurring	EMNRD Operating Budget

(Parenthesis ( ) Indicate Expenditure Decreases)

SOURCES OF INFORMATION
LFC Files

Responses Received From
Department of Taxation and Revenue (TRD)
New Mexico Environment Department (NMED)
Energy, Minerals and Natural Resources Dept (EMNRD)

SUMMARY

Synopsis of HFL Amendment

House Bill 198 was amended on the House Floor to correct an error in the HTRC amendment. The House Floor amendment changed the date on page 12, line 20 to allow fuel stations converted on or after January 1, 2011 to be eligible for the credit. This amendment is consistent with the other provisions of the bill, and does not reflect the period of time in which the credit can be claimed, which was pushed back to January 1, 2012 by HTRC.

AMENDMENT

On page 9, line 13, the second occurrence of "2012" refers to the period in which the natural gas conversion must occur to be eligible for the credit. This should be amended to read "2011" to be consistent with the other provisions of the bill.

On page 2, lines 12-13, it is not clear whether the dates refer to the period in which the credit can be claimed or the period in which the vehicle must be converted to natural gas to be eligible for the credit. Since the conversion period is already specified on page 2, line 1, these dates likely refer to the claim period. A possible amendment would clarify this section. Similar changes should be made to page 6, lines 9-10 and page 10, lines 1-2.

Section 4, subsection A on page 12 does not specify a sunset date for the tax credit.

On page 5, line 22 should be amended to include "on or after January 1, 2011 but before January 1, 2017" after "installs" and before "in New Mexico" to be consistent with other sections of the bill.

Synopsis of HTRC Amendment

House Bill 198 was amended by HTRC to push back the starting date for which the tax credit can be claimed from January 1, 2011 to January 1, 2012. This change also shortens the period for which the credit can be claimed from six years in the original bill (CY11-CY16) to five years (CY12-CY16). The fiscal impact assumes some taxpayers who convert to natural gas in calendar year 2011 will claim the credit in the second half of FY12.

Please note the amendment does not affect the period in which natural gas conversions must occur to be eligible for the credit (CY11-CY16).

Synopsis of HBIC Amendment

The HBIC amendment corrected typos noted in the original bill.

Synopsis of Original Bill

House Bill 198 provides personal and corporate income tax credits for a vehicle owner who converts a motor vehicle that only uses a petroleum-based fuel to use natural gas as a fuel. The tax credit would be for 70 percent of the conversion cost, after any available federal tax credit is applied. These credits may only be claimed for conversion on or after January 1, 2011, and before January 1, 2017. A maximum annual aggregate of $2,000,000 in tax credits may be claimed.

House Bill 198 also provides personal and corporate income tax credits to be claimed by a taxpayer who purchases and installs in New Mexico, at the taxpayer's gasoline or other fuel-dispensing retail station, pumps or other devices that dispense natural gas into storage tanks for use to fuel motor vehicles. The credit is for 50 percent of the purchase and installation cost, after any available federal tax credit is applied. These credits can only be claimed for purchases and installation of a natural gas dispensing system on or after January 1, 2011, and before January 1, 2017. A maximum annual aggregate of $2,000,000 in tax credits may be claimed.

Both credits are non-refundable, meaning a taxpayer cannot receive a credit greater than total tax liability. However, a portion of the credit that is unused in a taxable year may be carried forward for a maximum of three consecutive years.

The bill also amends the Motor Vehicle Excise Tax Act to provide a new one-time exemption for vehicles that use natural gas as a fuel. This exemption can only be taken at the time of the issuance of the original certificate of title for the vehicle. This exemption is only available from July 1, 2011, through June 30, 2016. As this section is drafted, it would also remove the GRT and compensating tax exemptions for sales of vehicles for re-sale or re-lease.

FISCAL IMPLICATIONS

TRD reports that due to significant uncertainty regarding the number of vehicle conversions, pump installations, and the associated costs, there is a high degree of uncertainty regarding the revenue impact. However, the aggregate credit limits ensure that the revenue impact will not exceed $4 million annually.

Although the proposed tax credit (in conjunction with currently available federal tax credits) will help create an incentive for installing fueling stations, a large demand for natural gas will be required for such installations to be profitable. According to the U.S. Department of Energy, New Mexico currently has eight natural gas fueling stations. A lack of natural gas fueling stations creates a disincentive for the conversion of vehicles to natural gas. EMNRD reports the number of natural gas-fueled vehicles in the state is currently less than 1,000, however there are several incentives for conversion. A federal tax credit of up to 80 percent of the conversion cost is currently available for converting vehicles to natural gas. In addition, the per-gallon cost of natural gas is currently approximately $0.50 lower than that of gasoline. The proposed credit would further increase the incentive for vehicle conversions.

According to EMNRD, the conversion cost varies with vehicle size. Based on EMNRD's estimates, it is assumed that the average cost of conversion is $11,000. After deducting a $4,000 federal tax credit, the 70 percent credit associated with the $11,000 average conversion cost is therefore $4,900. Assuming conversion of 100 vehicles per year, total credits would be on the order of $490,000 annually. Some taxpayers would not have enough tax liability to utilize the full amount of the credit, lowering the fiscal impact somewhat. The figure below illustrates the estimated cost of vehicle conversion by size.

Estimated Cost of Natural Gas Conversion	
Small passenger vehicles	$8,000
Mid-sized passenger vehicles	$10,000 to $12,000
Pickup trucks	$15,000 to $17,000
Buses and large trucks	$40,000 to $50,000

Source: EMNRD

According to TRD, the cost of installing a fueling station can vary from $10,000 to several million. Assuming one conversion per year, at an average cost of $2 million, the 50 percent credit will result in $1 million in annual credit claims for fueling station purchase and installation costs. Since the credit is not refundable or transferable, tax liability will limit the fiscal impact to something less than the maximum. An annual total of $500,000 in tax credits is estimated.

Assuming another 100 new natural gas vehicles are sold in the state each year, the motor vehicle excise tax exemption would reduce revenue by about $100,000 per year.

Note: estimated fiscal impacts assume the bill is amended to reinstate the motor vehicle excise tax exemption for the sale of vehicles for re-sale or re-lease. Without that change, the bill would have a positive fiscal impact as a result of the double-taxation of vehicles for re-sale or re-lease (see Technical Issues).

SIGNIFICANT ISSUES

According to TRD, the state currently spends over $20 million annually on subsidies for renewable energy. The potential benefits of these technologies are hard to quantify, so that the state cannot conduct a cost-effectiveness analysis on the investment. Given the state's difficult financial position, it is not clear that there are sufficient financial resources to undertake a potentially expensive subsidy of a technology that may eventually fail the test of the marketplace. The new technology represents such a small part of the market for natural gas that it would not have a measurable impact on the state's revenues from natural gas production for the foreseeable future.

ADMINISTRATIVE IMPLICATIONS

The bill requires EMNRD to adopt rules establishing procedures and guidelines for obtaining approval of the above credits prior to July 1, 2011. EMNRD reports an additional 0.25 FTE will be needed at a cost of $22,000 annually to certify dispensing systems and conversion systems for tax credits in addition to staff time necessary to establish certification procedures.

The Taxation and Revenue Department (TRD) is also required to compile an annual report that includes the number of taxpayers approved by TRD to receive these credits. According to TRD, current tax processing systems will require programming of additional tax credits. TRD will also need to collaborate with EMNRD on how to verify required qualifying certification. TRD estimates an additional 1/3 FTE at a cost of $27,000 will be needed to manually review and track the tax credit, and create reports.

CONFLICT

House Bill 39 provides a tax credit for plug-in electric vehicles. This bill also amends Section 7-9-22, which pertains to motor vehicle excise tax exemptions.

TECHNICAL ISSUES

On page 16, line 1, the exemption that currently refers to subsection 7-14-6(F) of the motor vehicle tax is changed to refer to Section 7-14-6(H). Section 7-14-6(F) refers to vehicles sold for subsequent re-sale or re-lease by the purchaser. This provision is important for tax policy reasons because it prevents double-taxation. To avoid eliminating this exemption, the language should be modified to retain the exemption for Section 7-14-6(F).

According to TRD, language requiring annual reports from TRD (page 4, line 18 through page 5, line 5; page 8, lines 10-23; page 11, lines 16 through page 12, line 3; and page 14, line 21 through page 15, lines 10) creates a conflict with Section 7-1-8, the confidentiality provisions of the Tax Administration Act. Since there are severe penalties for Department personnel who violate the confidentiality statute, the proposal should incorporate the reporting requirements as an explicit exception to Section 7-1-8.

TRD also notes that the bill does not specify which federal credits must be applied prior to the taxpayer claiming this new credit, which could create disagreements between TRD and taxpayers. The bill is silent on the deadline the taxpayer has to apply for the credit. Also, the bill does not provide guidance on how TRD should handle applications that come in after the $2 million has been expended. One option is to treat those applications as eligible for the next year's allocation of credits. This would be consistent with considering the applications "in the order received…" For clarity, the bill could state that the taxpayer will apply for the credit on a form prescribed by the department.

On page 2, lines 7-8, "owned by the taxpayer" should be defined. If a vehicle has been financed, then the taxpayer technically does not own it until they receive the title.

Page 5, line 13, describes vehicles that operate on both natural gas AND petroleum-based fuel, which means a vehicle could qualify for credit because it would have the <u>potential</u> to run on natural gas, but it could still be operated on petroleum products. This would seem to fail to meet the goals of the legislation.

Page 3, line 16 contains a typo: "…natural gas conversion <u>income</u> system…"

OTHER SUBSTANTIVE ISSUES

According to NMED, natural gas vehicles have fewer air emissions than vehicles using petroleum based fuels. NMED's Air Quality Bureau has a legislative performance measure to reduce annual statewide greenhouse gas emissions to a target level. House Bill 198 will assist with achieving this performance measure. This could result in fewer requirements for other sources of these emissions in potential nonattainment areas.

EMNRD reports that House Bill 198 would aid in its mission to promote the development of fuel-efficiency and alternative fuels, particularly New Mexico-produced fuels, such as natural gas.

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