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

SPONSOR HTRC **ORIGINAL DATE** 03/08/11 **LAST UPDATED** **HB** 440/HTRCS

SHORT TITLE Advanced Energy Deduction for Certain Leases **SB**

ANALYST Graeser

REVENUE (dollars in thousands)

Estimated Revenue			Recurring or Non-Rec	Fund Affected
FY11	**FY12**	**FY13**		
	$0.0*	$0.0*	Recurring	General Fund

(Parenthesis ( ) Indicate Revenue Decreases)

(*) TRD notes a fiscal impact, but scores this the same as does LFC. See Fiscal Implications sections for discussion.

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY11	FY12	FY13	3 Year Total Cost	Recurring or Non-Rec	Fund Affected
	$4.0	$0.0 - $44.0	$0.0 - $44.0	$4.0 - $92.0	Recurring	TRD Operating (General Fund)
					Recurring	EDD &NMED operating (General Fund)

(Parenthesis ( ) Indicate Expenditure Decreases)

SOURCES OF INFORMATION
LFC Files

SUMMARY

Synopsis of Bill

House Taxation and Revenue Committee Substitute for House Bill 440 amends last year's advanced electrical energy generation gross receipts tax deduction to add "lease" of tangible property (equipment) to the "sale" of tangible property included last year. Subject to a $60 million limit per facility for all tax benefits claimed from this deduction, the sunset for claims is increased from 10 years in statute to 25 years pursuant to this bill for leases only. The sunset for sales remains at 10 years.

The substitute bill conforms the proposal to the requirements in Section 9-15-56 for an "economic development tax incentive." The economic development tax incentive guidelines require that the enabling statute for an economic development tax incentive shall include: (1) a statement of purpose; and (2) a requirement that the economic development department track job creation. These provisions are included in the substitute bill.

FISCAL IMPLICATIONS

Last year's SB 201 & 202/SFCS/aSFl (Chapter 77) and the duplicate House Bill (HB 261 – Chapter 78) created the Advanced Energy Gross Receipts Tax Deduction for the sale of equipment for an advanced electrical generation facility. The maximum tax benefit allowed for all generation plant costs were limited to $60 million per facility. The revenue impact table last year was as follows:

Estimated Revenue			**Recurring or Non-Rec**	**Fund Affected**
FY10	**FY11**	**FY12**		
NFI	($3,375.0) to ($1,1385.0)	($3,375.0) to ($11,385.0)	Recurring	General Fund
NFI	($657.0) to ($2216.0)	($657.0) to ($2,216.0)	Recurring	County Governments

However, this bill, by including "leases" as well as sales/purchases of eligible equipment will not increase this range. The portion of the bill should be viewed as a technical change more than a substantive change.

TRD notes the following:

> The Department has received information on one proposed new facility in the state that might benefit from the proposed changes to the statute. Other facilities might also benefit from the financing arrangements that are enabled by the proposal. Thus, the proposal could increase gross receipts tax (GRT) deductions and reduce state and local GRT revenue. However, the current consensus general fund revenue forecast has already included reduced GRT revenue to reflect new developments under the present law deduction. It now appears that those new developments will not occur as soon as previously anticipated. Thus, the proposal may not reduce general fund revenue below the current forecast. The renewable energy sector has been particularly hard hit by the recession so many projects have been delayed. However, the availability of federal incentives could revive interest in these developments if energy prices rise in the future. Under that scenario, the proposed deduction expansion has the potential to reduce general fund revenue in years to come.

SIGNIFICANT ISSUES

This bill amends 2010's Chapter 77 Electric Facility Gross Receipts Tax Deduction and Chapter 78 to add "leases" of tangible personal property. This was probably inadvertently left out of last year's bill.

The bill increases the 10-year sunset date on this bill to 25-years for leased property so that energy companies can benefit from the full $60 million available tax benefit. The timeline from proposal to operation of a plant can easily exceed 10 years, even if financing is available. Permitting any large-scale electrical generation facility is a lengthy process.

Any tax expenditure reduces revenue. The box explains the LFC's guidelines for good tax policy. Because this bill is really just a technical change to last year's enactment, the caution about good tax policy may be less appropriate than when considering other tax expenditures from scratch.

However, TRD notes:

> The maximum tax benefit allowed is capped at **$60 million** per facility for the combined total of (1) deductions claimed pursuant to the advanced energy deduction in Section 7-9-114 (which this bill expands), (2) the advanced energy income tax credit in Section 7-2-18.25, (3) the advanced energy corporate income tax credit in Section 7-2A-25 and (4) the advanced energy combined reporting tax credit in Section 7-9G-2.
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> This bill will reduce the gross receipts tax base in order to achieve other public policy goals. There may be a potential for double dipping with this deduction and other state or federal incentives.
>
> The proposed deduction expansion will be added to a number of other state and federal policies designed to subsidize the development of renewable energy. These provisions raise the question of what public benefits are associated with these facilities that justify the reduction of state revenues, often termed a "tax expenditure." Proponents of renewable energy point to environmental concerns such as reducing the potential for global warming. Much of these benefits would not accrue to the residents of New Mexico. Although these benefits are not unimportant to public policy, they may be more appropriately targeted by national rather than state-level policies.
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> Meanwhile, to the extent that renewable energy generating facilities become a substitute for traditional power sources, the state's tax base is eroded by tax exclusions like the ones in this bill. Proponents of renewable energy argue that these benefits are only temporary and that the industry will eventually be able to compete without the subsidies. Nevertheless, the combination of all renewable energy incentives may have significant negative implications for the state's budget in the coming years. A sunset date may be prudent.

CONFLICTS, DUPLICATES AND COMPANIONS

HB 440 and SB 409 are duplicates. However, CS/HB 440 is more comprehensive and is now in conflict with SB 409.

SB 234 SOLAR ENERGY SYSTEM GROSS RECEIPTS is related.

TECHNICAL ISSUES

LFC's tax policy guidelines imply that economic development tax incentives intended to develop a sustainable energy industry should carry sunset dates to encourage the industry to prosper because of beneficial economics and meeting a basic demand rather than encouraging non-economic activities to the detriment of the general fund.

ADMINISTRATIVE IMPACT

TRD reports that this bill further complicates the advanced energy deduction and its relation to the advanced energy tax credits under Sections 7-2-18.25, 7-2A-25 and 7-9G-2. The change also makes taking the deduction in place of the credit more attractive – when taking the deduction is more difficult and labor intensive to track for the Department. Tracking the deduction is difficult because the Taxation and Revenue Department must track the amount that is taken by the buyer, when the seller actually reports the deduction. The deduction as currently structured has a high potential for abuse and/or fraud.

WHAT WILL BE THE CONSEQUENCES OF NOT ENACTING THIS BILL

Advanced energy companies might lose out on the tax benefits enacted last year because of the method of financing tangible generation and pollution reduction equipment. Also, without increasing the period over which all advanced energy producing plants could receive the deduction, there might be some portion of the total $60 million tax benefit left on the table.

LG/bym: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