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

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|---|---|---|---|---|---|
| **SPONSOR** | Strickler/Alcon/ H Garcia | **ORIGINAL DATE** **LAST UPDATED** | 2/5/18 2/9/18 | **HB** | 220 |
| **SHORT TITLE** | Reduce Various Coal Taxes | | | **SB** | |
| | | | | **ANALYST** | Iglesias |

## REVENUE (dollars in thousands)

| Estimated Revenue | | | | | Recurring or Nonrecurring | Fund Affected |
|---|---|---|---|---|---|---|
| **FY18** | **FY19** | **FY20** | **FY21** | **FY22** | | |
| $0.0 | ($1,810.5) | ($3,626.1) | ($5,431.5) | ($5,431.5) | Recurring | General Fund |
| $0.0 | ($758.0) | ($1,516.0) | ($2,274.0) | ($2,274.0) | Recurring | Local Governments |
| $0.0 | ($12.6) | ($25.3) | ($37.8) | ($37.8) | Recurring | Reclamation Fund |
| $0.0 | ($1,242.4) | ($2,507.1) | ($3,760.7) | ($3,760.7) | Recurring | Severance Tax Bonding Fund |
| **$0.0** | **($3,823.4)** | **($7,674.5)** | **($11,504.0)** | **($11,504.0)** | **Recurring** | **TOTAL** |

Parenthesis ( ) indicate revenue decreases

## ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

| FY18 | FY19 | FY20 | 3 Year Total Cost | Recurring or Nonrecurring | Fund Affected |
|---|---|---|---|---|---|
| $115.0 | $115.0 | | $230.0 | Nonrecurring | TRD Operating (General Fund) |

Parenthesis ( ) indicate expenditure decreases

Relates to SB47 and HB80, which both provide a new financing mechanism for recovering costs of decommissioned coal-fired power facilities (energy redevelopment bonds) and specifies terms for replacement power resources.

**SOURCES OF INFORMATION**
LFC Files

Responses Received From
Taxation and Revenue Department (TRD)
Energy, Minerals and Natural Resource Department (EMNRD)

**SUMMARY**

House Bill 220 reduces various taxes on coal production and processing, phased in over a three-year period. In effect, the bill reduces gross receipts taxes (GRT), severance taxes, resources and processors taxes (a.k.a. resources excise tax), and conservation taxes on coal production and processing by 25 percent in FY19, 50 percent in FY20, and 75 percent from FY21 to FY31. After July 1, 2031, coal taxes will revert back to their current levels. The GRT deduction would be required to be separately reported and the Taxation and Revenue Department (TRD) would be required to compile a report and present it to the specified legislative committees yearly. The effective date of this bill is July 1, 2018.

## FISCAL IMPLICATIONS

The fiscal estimates use the Consensus Revenue Estimating Group (CREG) forecast from January 2018 as the starting point. LFC and TRD estimates for the bill's impacts use similar methodology and provide similar results. The CREG revenue forecast assumes an annual level of coal production for the state which includes a drop in coal production starting in FY18 as a result of the closing of two power units at the San Juan Generating Station. This level of coal production is assumed for all tax rate adjustment impacts in this bill and fiscal impacts beginning in FY19. The fiscal impact does not assume a significant change in coal production in response to the tax rate decreases.

The bill proposes a new GRT deduction for the sale or processing of coal. LFC and TRD used data from the RP-80 report to estimate the fiscal impact of the proposed GRT deduction. The estimate uses the total amount of the GRT paid by taxpayers filing under NAICS code 21211 (coal mining) for FY17 as a base and assumes all current applicable deductions remain in place. The estimated amount of GRT for FY18 through FY22 is based on the FY17 base year and assumed levels of annual coal production. The deduction percentage amounts by fiscal year are applied to the estimated amount of taxable GRT. This deduction results in a revenue loss to the general fund and to local governments. These amounts are included in the total impact from the bill and listed separately below.

**Gross Receipts Tax – New Deduction**

| Estimated Revenue (in thousands) | | | | | Recurring or Nonrecurring | Fund Affected |
|---|---|---|---|---|---|---|
| **FY18** | **FY19** | **FY20** | **FY21** | **FY22** | | |
| $0.0 | ($1,231.4) | ($2,462.8) | ($3,694.2) | ($3,694.2) | Recurring | General Fund |
| $0.0 | ($758.0) | ($1,516.0) | ($2,274.0) | ($2,274.0) | Recurring | Local Governments |
| **$0.0** | **($1,989.4)** | **($3,978.8)** | **($5,968.2)** | **($5,968.2)** | **Recurring** | **Subtotal** |

The new rates proposed in the resources excise tax, severance tax, and conservation tax were applied to the forecast. Revenue from the resources excise tax is distributed to the general fund, revenue from the severance tax is distributed to the severance tax bonding fund, and revenue from the conservation tax is distributed to the general fund and the oil and gas reclamation fund. The tables below indicate the revenue impacts from these three taxes.

**Resources Excise Tax**

| Estimated Revenue (in thousands) | | | | | Recurring or Nonrecurring | Fund Affected |
|---|---|---|---|---|---|---|
| **FY18** | **FY19** | **FY20** | **FY21** | **FY22** | | |
| $0.0 | ($472.1) | ($948.4) | ($1,416.3) | ($1,416.3) | Recurring | General Fund |

**Severance Tax**

| Estimated Revenue (in thousands) | | | | | Recurring or Nonrecurring | Fund Affected |
|---|---|---|---|---|---|---|
| FY18 | FY19 | FY20 | FY21 | FY22 | | |
| $0.0 | ($1,242.4) | ($2,507.1) | ($3,760.7) | ($3,760.7) | Recurring | Severance Tax Bonding Fund |

**Conservation Tax**

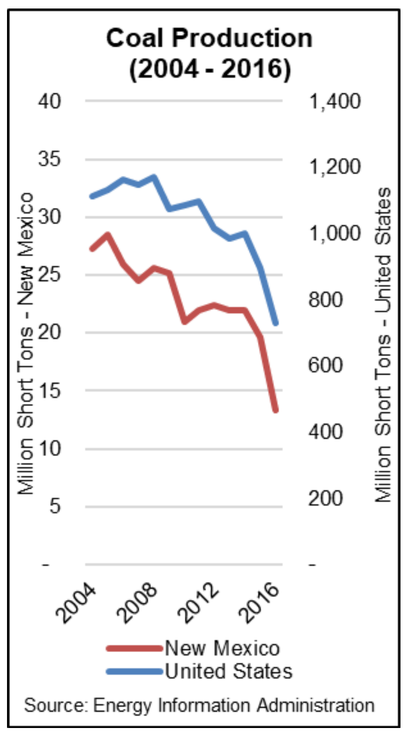
| Estimated Revenue (in thousands) | | | | | Recurring or Nonrecurring | Fund Affected |
|---|---|---|---|---|---|---|
| FY18 | FY19 | FY20 | FY21 | FY22 | | |
| $0.0 | ($107.0) | ($215.0) | ($321.0) | ($321.0) | Recurring | General Fund |
| $0.0 | ($12.6) | ($25.3) | ($37.8) | ($37.8) | Recurring | Reclamation Fund |
| **$0.0** | **($119.6)** | **($240.3)** | **($358.8)** | **($358.8)** | **Recurring** | **Subtotal** |

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. The statutory criteria for a tax expenditure may be ambiguous, further complicating the initial cost estimate of the expenditure's fiscal impact. Once a tax expenditure has been approved, information constraints continue to create challenges in tracking the real costs (and benefits) of tax expenditures.

This bill may be counter to the LFC tax policy principle of adequacy, as the increasing cost of tax expenditures, revenues may be insufficient to cover growing recurring appropriations. This bill may also be counter to the LFC tax policy principle of equity, as it treats different taxpayers differently (e.g. provides tax relief for the sale and processing of coal but not for other fuels used in electricity generation).

**SIGNIFICANT ISSUES**

The proposed rate changes and new GRT deduction would provide tax relief for those who are already selling and processing coal in the state. While the bill includes no purpose statement, it appears the intent for offering tax relief on coal production and processing could be to support New Mexico's coal mining industry, which has experienced decline both nationally and in New Mexico over the last decade.




Low natural gas prices have been a driving factor in the decline of coal production. Natural gas electricity generation has increased in New Mexico and the United States over the last 10 years, and in 2016 electricity generation in the U.S. from natural gas surpassed generation from coal-fired plants. Natural gas supplied an estimated 34 percent of total U.S. electricity generation in 2016 compared with 30 percent for coal. Additionally, solar costs fell 85 percent between 2008 and 2016, and wind costs fell 36 percent.[1] Based the difficulties coal has

[1] Columbia University Center on Global Energy Policy, April 2017, *Can Coal Make a Comeback?*

faced in remaining competitive given these changes, the Energy Information Administration (EIA) projects a continued downward trends in coal production in the U.S. through 2040.

In its 2017 integrated resource plan (IRP), the Public Service Company of New Mexico (PNM) is proposing a future energy resource portfolio that would eliminate the company's use of coal-fired generation by the end of 2031. As part of this plan, units 2 and 3 of the San Juan Generating Station (SJGS) closed at end of 2017. PNM also indicates the results of the report "point strongly toward" shutting down SJGS entirely after the current coal supply agreement runs out in 2022 and also exiting Four Corners Power Plant in 2031 when its coal supply agreement runs out.[2] The company states these actions will leave no coal in PNM's energy supply mix. The IRP is currently under protest and is still pending approval by the Public Regulation Commission. If PNM does shut down SJGS, the company indicates on its website that it plans to build more solar capacity and build new flexible natural gas generation.

However, it is noted the potential permanent retirement of SJGS and subsequent potential shutdown of San Juan Coal Company (if it could not find another market for its coal, which now goes directly to SJGS) would pose a variety of difficulties for the City of Farmington and San Juan County as well as the residents of these areas. Firstly, it would mean the loss of good-paying jobs that would not be easily replaced. It would also mean lost property tax and GRT revenue for San Juan County and the Central Consolidated School District.

Four Corners Economic Development (4CED) provided an analysis of the economic impact of the potential closure of SJGS and SJCC, stating it would result in the loss of 657 jobs with average annual salaries of $85 thousand plus benefits. The analysis indicates vendors in San Jan County would lose $31 million in purchases. Farmington, San Juan County, and the state would lose gross receipts tax (GRT) revenues due to lost wages from laid-off workers and loss of local purchases of goods and services by PNM and SJCC.

| | Farmington | County | State |
|---|---|---|---|
| From Vendor Purchases | $0 | $82,710 | $1,621,412 |
| Employee Spending (50%) | $224,625 | $303,904 | $1,083,486 |

There would also be an estimated loss of $9.6 million in property taxes paid by SJGS and SJCC. According to 4CED, this would require an automatic increase of 4 mills in debt service rate and 1.5 mills in operating rates requiring action of the San Juan County Commission and the San Juan College board. Additionally, the state, other state funds, and the Navajo Nation will lose severance tax revenue assuming that an alternative market for coal from the SJCC could not be developed. The following estimates of lost tax revenue are provided by 4CED.

| Other Lost Taxes ($ millions) | |
|---|---|
| Severance Tax (STBF) | $3.23 |
| Conservation Tax (Gen Fun and OSF) | $.33 |
| Resource Excise Tax (Gen Fund) | $1.41 |
| Gross Proceeds Tax (Navajo Nation) | $1.55 |
| Total | $6.52 |

[2] PNM 2016-2036 Integrated Resource Plan, https://www.pnm.com/irp

Additionally, the following policy analysis is offered by TRD:

> Due to the plans announced by PNM to shut-down the remaining two units at the San Juan Generating Station, the current market for New Mexico coal is expected to decrease significantly in the future, causing economic dislocation in the four corners region. Reducing taxes on coal will decrease the overall cost of severing coal and thus make coal more marketable. There are likely to be continuing challenges in the marketplace for New Mexico coal due to the cost of environmental regulations and to the low cost of alternative natural gas-fired power plants, so that a long-term rebound of the industry appears unlikely. In the meantime, the GRT deduction will mean a loss of the local tax base in San Juan and McKinley counties which have experienced declining revenue with the decrease in natural gas production in the San Juan basin. Finally, the rate reduction on coal will lower Severance Tax Bonding Fund revenue and thus lower the state's severance bond capacity and Permanent Fund distributions.

## PERFORMANCE IMPLICATIONS

The LFC tax policy of accountability is met with the bill's requirement to report annually to an interim legislative committee regarding the data compiled from the reports from taxpayers taking the GRT deduction and other information to determine whether the deduction is meeting its purpose.

## ADMINISTRATIVE IMPLICATIONS

According to TRD, the bill proposes a new temporary GRT deduction for the sale or processing of coal, which will require changes to forms and reprogramming to the GenTax system. Implementing this bill has a moderate impact on the Information Technology Division requiring $230 thousand in contract costs and 5 months to implement the new deduction and update all other rate changes in GenTax. TRD suggests the effective due date of July 1, 2018 may not be feasible; a more feasible effective date would be July 1, 2019 given the complexity and prerequisite legal and business process requirements.

## DUPLICATION, COMPANIONSHIP, RELATIONSHIP

SB47 (Energy Redevelopment Bonds) is a bill that has been advocated this session by PNM to facilitate the closure of the San Juan and Four Corners coal plants and to ensure 100 percent cost recovery for the company for the abandonment of these facilities. HB80 is a partial duplicate of this bill.

**Does the bill meet the Legislative Finance Committee tax policy principles?**

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

**Does the bill meet the Legislative Finance Committee tax expenditure policy principles?**

1. **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.
2. **Targeted**: The tax expenditure has a clearly stated purpose, long-term goals, and measurable annual targets designed to mark progress toward the goals.
3. **Transparent**: The tax expenditure requires at least annual reporting by the recipients, the Taxation and Revenue Department, and other relevant agencies.
4. **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.
5. **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.
6. **Efficient:** The tax expenditure is the most cost-effective way to achieve the desired results.

| LFC Tax Expenditure Policy Principle | Met? | Comments |
|---|---|---|
| **Vetted** | ✘ | Discussed with LFC staff prior to introduction; however, received no committee hearing. |
| **Targeted** | | |
| Clearly stated purpose | ✘ | None. |
| Long-term goals | ✘ | None. |
| Measurable targets | ✘ | None. |
| **Transparent** | ✔ | Requires annual reporting by TRD on the GRT deduction. |
| **Accountable** | | |
| Public analysis | ? | Requires annual reporting by TRD; however, without a clearly stated purpose, goals, or measurable targets, it is difficult to evaluate the effectiveness of the bill. |
| Expiration date | ✔ | Contains a delayed repeal date of July 1, 2031. |
| **Effective** | | |
| Fulfills stated purpose | ? | Difficult to determine, as there is no stated purpose. |
| Passes "but for" test | ? | |
| **Efficient** | ? | Desired results are unclear. |
| Key: ✔ Met ✘ Not Met ? Unclear | | |

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