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## FISCAL IMPACT REPORT

ORIGINAL DATE 2/18/19

SPONSOR Cisneros LAST UPDATED \_\_\_\_\_ HB \_\_\_\_\_

SHORT TITLE Deduction for Water Conservation Products SB 464

ANALYST Graeser

### REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY19	FY20	FY21	FY22	FY23		
	(\$650.0)	(\$650.0)	(\$650.0)	(\$650.0)	Recurring	General Fund (GRT)
	(\$530.0)	(\$530.0)	(\$530.0)	(\$530.0)	Recurring	Local Governments (GRT)

Parenthesis ( ) indicate revenue decreases

SB464 duplicates the substantive features of HB-513, with longer period of effect.

### SOURCES OF INFORMATION

LFC Files  
 FIR on HB152 (2016)  
 FIR on HB238 (2018)

#### Responses Received From

Office of State Engineer (OSE)  
 Energy, Minerals, Natural Resources Department (EMNRD)  
 Taxation and Revenue Department (TRD) on previous year's bills.

### SUMMARY

#### Synopsis of Bill

Senate Bill 464 enacts a new section of the Gross Receipts and Compensating Tax Act to provide a deduction from gross receipts from the sale of "water saving tangible personal property". SB464 provides the deduction for one year between midnight on March 1, 2020 and midnight on March 8, 2020.

SB464 limits the deduction for use by private and communal property; it is not for business use and trade or resale. "Water saving tangible personal property" is defined as products whose outdoor use or planting results in water conservation, ground water retention, water table recharge, or a decrease in ambient temperature that limits evaporation. SB464 lists a number of items including drought-tolerant live plants and rain barrels that would qualify.

The bill defines “water-saving tangible personal property”

(1) as products:

- Intended for use on private property and not intended for business use, trade or resale;
- whose use may result in (1) water conservation or ground water retention; (2) water table recharge; or (3) a decrease in ambient air temperature that limits water evaporation and

(2) includes:

- drought-tolerant live plants, turf and grass
- soaker or drip-irrigation hosing
- moisture controls for sprinkler or irrigation systems
- mulches and soils
- rain barrels and alternative rain and moisture collection systems
- permeable ground cover surfaces that allow water to reach underground basins, aquifers or water collection points
- plant and grass seed coated with water-saving surfactants and
- water-saving surfactants

SB464 requires a taxpayer to report the use of the deduction to the Taxation and Revenue Department in the form required by the TRD. It further directs TRD to report “annually” to the Revenue and Stabilization Committee on the cost and benefit of this deduction. This will result in one report.

SB464 has no effective date, assume 90 days after the end of the session (June 14, 2019). The first deduction period would be March 1, 2020 through March 8, 2020. The short-term deduction would expire with a delayed repeal of July 1, 2024.

## **FISCAL IMPLICATIONS**

This bill may be counter to the LFC tax policy principle of adequacy, efficiency, and equity. Due to the increasing cost of tax expenditures, revenues may be insufficient to cover growing recurring appropriations.

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.

The costs of this tax expenditure will be particularly difficult to determine, since the period of deductible sales is shorter than the typical reporting cycle of one-month. Even if TRD sets up a special reporting code, many retailers will not use the special code in favor of one unified deduction for deductions from all sources. Similarly, there will be virtually no means of monitoring water saved from rooftop water collection systems, drip irrigation or xeriscaping.

The fiscal impact reported on the previous page is that of TRD for 2018’s HB-238, using the

following methodology.

The Taxation and Revenue Department (TRD) collected data on tax paid by the retail industry during the months of March in the last five fiscal years. The amounts were averaged and divided by four as this deduction is only applicable for one out of four weeks of the month. This amount was then multiplied by a ratio which was calculated by dividing total expenditures on outdoor gardening equipment by the total expenditures in retail. It is difficult to estimate the revenue impact of this deduction as there is no data directly applicable to these types of sales. TRD must make assumptions on taxpayer behavior which could cause the score to be over- or under-estimated.

DFA found a data source (<http://gardenresearch.com/>) and pointed out that the definition is rather broad. Allocating U.S. total “gardening expenditures” of \$36 billion times the NM population ratio and assuming 1/3<sup>rd</sup> of these gardening expenditures would qualify gives an annual estimate of \$80 million in water conservation expenditures. If one-tenth of this annual spending were bunched into spring tax free week, that would result in \$8 million in deductible sales, or about \$325 thousand in general fund impact.<sup>1</sup>

LFC estimated a lower impact in the original FIR. LFC acknowledged that the tax expenditure was both difficult to estimate and equally difficult to track costs and benefits.

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY18	FY19	FY20	FY21	FY22		
	(\$210.0)	(\$210.0)	(\$210.0)	(\$210.0)	Recurring	General Fund
	(\$165.0)	(\$165.0)	(\$165.0)	(\$165.0)	Recurring	Local Governments

LFC’s methodology follows:

Several sources estimate the cost of large water tanks suitable for rooftop water collection and storage at \$2 to \$3 per gallon. Pumps and piping would add about \$1 per gallon. Drip irrigation systems for large gardens or small farms are estimated to cost \$500 to \$1.2 thousand per acre.

Other technologies are similar in cost.

[http://www.plastic-mart.com/product/13258/contain-water-systems-601s-780-gallon-metalcorrugated-steel-rainwater-tank?gclid=EAIaIQobChMI8Y-zhOSA2QIVCKvsCh3LmQCHEAQYASABEgLTUPD\\_BwE](http://www.plastic-mart.com/product/13258/contain-water-systems-601s-780-gallon-metalcorrugated-steel-rainwater-tank?gclid=EAIaIQobChMI8Y-zhOSA2QIVCKvsCh3LmQCHEAQYASABEgLTUPD_BwE)  
<http://edis.ifas.ufl.edu/hs388>

Assume that one thousand full systems costing \$5 thousand per system (allowing 1 gallon of storage per square foot of roof area) would be sold during the one-week deduction period. The state tax rate is about 4.14 percent and the total city and county/Municipal rate about 3.3 percent.

<sup>1</sup> U.S. Bureau of the Census, Advance Retail Sales: Building Materials, Garden Equipment and Supplies Dealers [RSBMGESD], retrieved from FRED, Federal Reserve Bank of St. Louis; <https://fred.stlouisfed.org/series/RSBMGESD>, February 6, 2018.

Since the TRD estimate is the highest, it is reported here. Because of taxpayer behavior and the difficulties inherent in fairly and accurately administering the provisions of this bill, even this estimate may be low.

### **SIGNIFICANT ISSUES**

The provisions will be very hard to administer and the benefits will be equally difficult to monitor. The deduction is claimed by the seller, not the buyer of the water saving equipment or plantings. The seller, if a retailer and not responsible for the installation, would have no accurate means of determining if the buyer intended the equipment for installation on business premises. The seller will similarly have no means of determining how much water is being conserved. Thus, the required TRD report to the legislature will have no means of determining the interesting information – which is the amount of water saved or conserved per \$1,000 of state and local revenue cost.

The OSE points out that on page 3, line 22 et seq. “water-saving” tangible personal property” is defined to “include” a list of six categories of products. This could lead to uncertainty and disputes over whether other categories of water saving products would also qualify for the deduction from gross receipts allowed by the bill.

In general, TRD has the statutory authority to regulate tax issues and issue letter rulings. This regulatory and interpretive ability will serve to expand the list of water conservation products included in the deduction. However, since this is a one-year deduction, it is unlikely that TRD could propose or promulgate regulations. TRD would probably publish a letter of advice, which would not have the force of law.

There is no requirement, as in the case of the expired solar credits, that the equipment be installed at all, and no requirement that the installation be monitored and supervised.

### **PERFORMANCE IMPLICATIONS**

The LFC tax policy of accountability is nominally 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 deduction and other information to determine whether the deduction is meeting its purpose. However, TRD would have no means of accurately determining the cost of the deductions since there is no penalty for failure to report correctly. Similarly, TRD would have no means of determining the benefits accruing to the deduction in terms of water conserved or saved.

### **ADMINISTRATIVE IMPLICATIONS**

TRD will have moderate difficulty establishing and maintaining the deduction. Separate reporting without penalty is the same as no separate reporting. Since this is a one-year deduction, TRD’s ability to administer the provisions of this bill is problematic.

### **CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP**

SB464 is a near duplicate of HB513. While SB464 sunsets in 2024, HB513 sunsets in 2020.

### **OTHER SUBSTANTIVE ISSUES**

In the 2016 TRD Tax Expenditure Report, TRD notes that separate reporting is not effective, because there is no penalty for failure to separately report.

**ALTERNATIVES**

This would be more administrable and transparent if it were administered as an income tax credit, particularly if the system would have to be reported to and approved by OSE.

Note that this bill fails all five of the core LFC tax policy principles and five of the six core LFC tax expenditure policy principles (Vetted, Targeted, Transparent, Accountable, Effective and Efficient).

LG/al/sb

**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