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

ORIGINAL DATE 3/5/19
SPONSOR Sharer **LAST UPDATED** **HB**

SHORT TITLE Climate Change Compliance Tax Credits **SB** 499

ANALYST

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY19	**FY20**	**FY21**	**FY22**	**FY23**		
	Unknown but could be highly significant – with capital costs on the order of $2 billion.				Non-Recurring	General Fund (PIT & CIT)
	Unknown, but additional royalties and severance taxes on newly captured natural gas could be significant on the order of $20 million.				Recurring	General Fund, Severance Tax Bond Fund, Land Grant Permanent Fund, Local property taxes

Parenthesis ( ) indicate revenue decreases

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY19	FY20	FY21	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
Total		$70.0	$70.0	$140.0	Recurring	TRD Operating

Parenthesis ( ) indicate expenditure decreases

SOURCES OF INFORMATION
LFC Files

Responses Received From
Taxation and Revenue Department (TRD)

SUMMARY

Synopsis of Bill

Senate Bill 499 creates two new credits called the “Climate Change Compliance Income Tax Credit” and the “Climate Change Compliance Corporate Income Tax Credit.” To be eligible for the credit, the taxpayer must be subject to the Severance Tax Act, Oil and Gas Severance Tax Act, Oil and Gas Conservation Tax Act, Oil and Gas Emergency School Tax Act, Natural Gas Processors Tax Act or Oil and Gas Ad Valorem Production Tax Act. The credit shall be in an amount equal to the costs to a taxpayer of complying with Executive Order 2019-003. The credit shall be claimed in the year the expenses were incurred and any amount that exceeds the taxpayer's liability may be carried forward for ten consecutive years. The Taxation and Revenue Department (TRD) and the Energy, Minerals and Natural Resources (EMNRD) are tasked to adopt rules that establish a procedure and certification process for this credit.

There is no effective date of this bill. It is assumed that the effective date is 90 days after this session ends (June 14, 2019); Applicable to taxable years begging on or after January 1, 2019. The bill does not contain a delayed repeal. LFC recommends the bill include delayed repeal to allow the legislature to review the costs and benefits of the provisions of this bill.

FISCAL IMPLICATIONS

This bill may be counter to the LFC tax policy principle of adequacy, efficiency, and equity. The provisions of the bill create a tax expenditure with a cost that is difficult to determine but likely significant. LFC has serious concerns about the significant risk to state revenues from tax expenditures and the increase in revenue volatility from erosion of the revenue base. The committee recommends the bill adhere to the LFC tax expenditure policy principles for vetting, targeting, and reporting or be held for future consideration.

TRD notes that Executive Order 2019-003 summarizes goals to address climate change and energy waste prevention. It is not yet possible to begin estimating potential costs for taxpayers. Most of the directives would require legislation or other actions in order to come into effect. However, directive number 6, which aims to reduce methane omissions and to prevent waste from the oil and gas sector, appears to be tied directly with the taxpayers proposed to receive the credit in this bill. It appears this directive could come into effect as soon as EMNRD and NMED agree on the regulatory framework. However, until directive 6 has quantifiable reduction standards and it is possible to estimate how those apply to taxpayers, an estimate of the revenue impact from this bill is not feasible.

It should be noted that the environmental impact statement associated with the federal venting and flaring rules for OGAS production on federal and Indian lands was substantially revenue positive for the state and federal governments. Capturing the gas that was previously leaked, flared or vented would generate additional royalty revenue for the federal government, shared 49 percent to the state (federal mineral leasing) and additional tax revenue for the state. In New Mexico about 53 percent of crude oil and 65 percent of natural gas is produced on federal or Indian lands. Imposing venting and flaring rules on private and state lands in the state would probably be revenue positive, since the state collects royalties on production on state lands and severance tax, emergency school tax, conservation tax, ad valorem production tax, ad valorem production equipment tax and natural gas processors tax. Some of this additional revenue collected would cover a portion of the tax credits claimed pursuant to the provisions of this bill.

Previous testimony from industry indicated that the capital cost of monitoring equipment could run as high as $150,000 per well. There are currently about 50,000 wells that produced at least one day in 2017. The total capital cost of installing monitoring equipment on 80 percent to 90 percent of the wells – some already have monitoring equipment, some do not produce any natural gas and some stripper wells would be shut in – would be on the order of $6 billion. FY 18 total natural gas production value was around $4.5 billion.

The total value of this tax credit could be in the range of many billions of dollars, non-recurring.

SIGNIFICANT ISSUES

The text of directive 6 follows:

6. EMNRD and NMED shall jointly develop a statewide, enforceable regulatory framework to secure reductions in oil and gas sector methane emissions and to prevent waste from new and existing sources and enact such rules as soon as practicable.

One possible approach to this regulatory framework would be to extend the federal bureau of land management's (BLM) venting and flaring rules for OGAS production on federal and Indian lands to all production.

A memorandum on the status of the federal bureau of land management's (BLM) venting and flaring rules for OGAS production on federal and Indian lands are included in the "OTHER SUBSTANTIVE ISSUES" section of this review.

TRD notes that this tax credit represents an additional tax expenditure for the state. The bill does not contain a purpose statement for the tax credit, which TRD recommends for new credits to facilitate evaluating them. TRD also recommends sunset provisions in order for legislators to review the impact of credits before extending them. This bill does not contain a sunset date. There is no limit to the amount of credit a taxpayer may receive, nor is there a cap on the amount of credit costs the state will incur annually. This poses a risk to state revenue.

PERFORMANCE IMPLICATIONS

The LFC tax policy of accountability is approximately met with the bill's requirement for TRD to report annually to RSTPC and LFC regarding the costs of the tax credit and associated increase in taxed natural gas produced. The bill does not establish goals, purpose or milestones, so that TRD would not be able to report on whether the tax credit met an unstated purpose.

ADMINISTRATIVE IMPLICATIONS

Based on TRD's experience with the Renewable Energy Tax Credit, the 10-year carryforward has been administratively burdensome. A new position at TRD will be required. These costs are shown in the Operating Budget Table on page 1.

TECHNICAL ISSUES

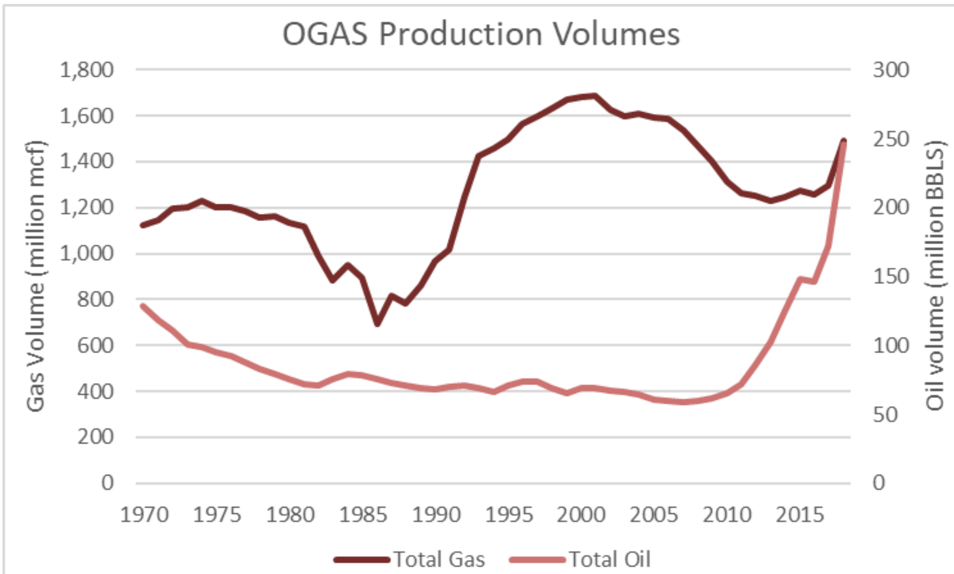
TRD is concerned that the bill language will create conflict and litigation as to how it is applied and how much credit a taxpayer can receive. The standard for receiving this tax credit: "A taxpayer may claim a climate change compliance income tax credit for the taxable year in which the taxpayer incurred costs to comply with executive order 2019-003," is too broad in scope. The bill language does not prescribe how the credit awarded amount is determined. TRD and the Energy, Minerals and Natural Resources Department (EMNRD) will be unable to promulgate rules regarding the certification of the costs as it is indeterminate what costs qualify for the credit. It is unclear from the bill language how often a single taxpayer can claim the credit.

The effective date of January 1, 2019 appears to be premature. As discussed in the methodology discussion, quantifiable standards for meeting the Executive Order have not yet been defined.

The Executive Order has instructed the establishment of a Climate Change Task Force, which will define policies and regulations.

This bill does not contain a delayed repeal date. LFC recommends adding a delayed repeal date.

OTHER SUBSTANTIVE ISSUES



The uptick in natural gas volumes over the last five years is attributed to associated gas from crude oil wells in the Permian (fracked shale oil). In terms of production value, crude oil now generates two and ½ times as much revenue as natural gas.

Memorandum on the status of the federal venting and flaring rules.

https://www.blm.gov/policy/ib-2018-048

April 18, 2018

Subject: Current Status of Waste Prevention Rule – Partially In Effect

On November 18, 2016, the Bureau of Land Management (BLM) published a final rule to address, among other things, the waste of Federal and Indian gas through venting, flaring, and leaks. 81 Fed. Reg. 83,008 (Nov. 18, 2016) (the "Waste Prevention Rule"). The Waste Prevention Rule replaced BLM's Notice to Lessees and Operators of Onshore Federal and Indian Oil and Gas Leases, Royalty or Compensation for Oil or Gas Lost (NTL-4A), which previously governed the royalty-free use of oil and gas, as well as the venting and flaring of oil and gas from onshore Federal and Indian leases.

The Waste Prevention Rule established new regulations for the royalty-free use of oil and gas in 43 Code of Federal Regulations (C.F.R.) subpart 3178 ("subpart 3178"). The Waste Prevention Rule also established new regulations addressing the loss of gas through venting, flaring, and leaks in 43 C.F.R. subpart 3179 ("subpart 3179"). Finally, the Waste Prevention Rule established a requirement for operators to submit a "waste minimization plan" with Applications for Permits to Drill (APD) (see 43 C.F.R. 3162.3-1(j)).

The Waste Prevention Rule became effective on January 17, 2017. However, many of the subpart 3179 requirements were to be phased in over time, and would not become operative until January 17, 2018.[1] Notably, the Subpart 3178 regulations for royalty-free use and the subpart 3179 provisions for determining when the loss of gas is "avoidable" or "unavoidable" (43 C.F.R. 3179.4) and for requiring the filing of a waste minimization plan with APDs, among others, have been in effect since January 17, 2017.

Almost immediately, the rule was challenged in Federal Court by industry groups and the States of Wyoming, Montana, North Dakota, and Texas. On January 16, 2017, the U.S. District Court for the District of Wyoming denied a preliminary injunction of the Waste Prevention Rule. Wyoming v. U.S. Department of the Interior, 2017 WL 161428 (D. Wyo.) (Jan. 16, 2017). This litigation was later stayed in light of administrative efforts to suspend and revise the Waste Prevention Rule.

On December 8, 2017, the BLM issued a final rule suspending certain requirements [2] established in the Waste Prevention Rule until January 17, 2019. 82 Fed. Reg. 58,050 (Dec. 8, 2017) (the "Suspension Rule"). The Suspension Rule was challenged in Federal Court by the States of California and New Mexico and a coalition of 17 conservation and tribal citizen groups. On February 22, 2018, the U.S. District Court for the Northern District of California granted a preliminary injunction of the Suspension Rule, meaning that the Suspension Rule will not have effect during the litigation of the Suspension Rule. California v. Bureau of Land Management, 2018 WL 1014644 (N.D. Cal.) (Feb. 22, 2018).

Separately, on February 22, 2018, the BLM published a proposed revision of the Waste Prevention Rule for public comment. 83 Fed. Reg. 7924 (Feb. 22, 2018) ("Revision Rule"). The BLM's proposed Revision Rule would rescind certain requirements introduced in the Waste Prevention Rule and would revise Subpart 3179, such that it would more closely align with NTL-4A.

Following the preliminary injunction of the Suspension Rule, the plaintiffs who had initially challenged the Waste Prevention Rule in the U.S. District Court for the District of Wyoming filed motions to lift the stay on that litigation and either proceed to a decision on the merits or stay the Waste Prevention Rule pending the administrative revision of the rule. On April 4, 2018, the U.S. District Court for the District of Wyoming stayed the litigation of the Waste Prevention Rule pending finalization or withdrawal of the proposed Revision Rule and stayed implementation of certain provisions of the Waste Prevention Rule. Wyoming v. U.S. Department of the Interior, 2:16-CV-0285-SWS (D. Wyo.) (April 4, 2018). Specifically, the court stayed implementation of the Waste Prevention Rule's "phase-in" provisions.

The stayed "phase-in" provisions are:

- 43 CFR 3179.7 (gas capture percentage requirement)
- 43 CFR 3179.9 (measuring and reporting volumes of gas vented or flared)
- 43 CFR 3179.201 (equipment requirements for pneumatic controllers)
- 43 CFR 3179.202 (requirements for pneumatic diaphragm pumps)
- 43 CFR 3179.203 (storage vessels)
- 43 CFR 3179.301 - 3179.305 (leak detection and repair)

Please note that the court's stay of the Waste Prevention Rule is narrower than the suspension that BLM sought to impose with the Suspension Rule. For example, the requirement that the operator submit a waste minimization plan with its APDs and the provisions of the Waste Prevention Rule pertaining to well drilling and well completions are not included in the court's stay and remain in effect.

All provisions of the Waste Prevention Rule that were not stayed by the court's order are currently in effect. In other words, all the provisions of the Waste Prevention Rule in subparts 3178 and 3179 that are not listed above among the stayed "phase-in" provisions are currently in effect.

If you have any questions, please contact me at 202-208-4201, or your staff may contact Catherine Cook, Acting Division Chief, Fluid Minerals, at 202-912-7145.

Signed by: Authenticated by:
Timothy R. Spisak Robert M. Williams

ALTERNATIVES

WHAT WILL BE THE CONSEQUENCES OF NOT ENACTING 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.

BILL ANALYSIS AND FISCAL IMPACT REPORT
Taxation and Revenue Department

February 21, 2019

Bill: SB-499 **Sponsor:** Senator William E. Sharer

Short Title: Climate Change Compliance Tax Credits

Description: This bill creates a new credit called the "Climate Change Compliance Income Tax Credit" in the Income Tax Act and the Corporate Income and Franchise Act. To be eligible for the credit, the taxpayer must be subject to the Severance Tax Act, Oil and Gas Severance Tax Act, Oil and Gas Conservation Tax Act, Oil and Gas Emergency School Tax Act, Natural Gas Processors Tax Act or Oil and Gas Ad Valorem Production Tax Act. The credit shall be in an amount equal to the costs to a taxpayer of complying with Executive Order 2019-003. The credit shall be claimed in the year the expenses were incurred and any amount that exceeds the taxpayer's liability may be carried forward for ten consecutive years. The Taxation and Revenue Department (TRD) and the Energy, Minerals and Natural Resources (EMNRD) are tasked to adopt rules that establish a procedure and certification process for this credit.

Effective Date: Date not specified; 90 days following adjournment (June 14, 2019); Applicable to taxable years begging on or after January 1, 2019.

Estimated Revenue Impact*					**R or NR****	**Fund(s) Affected**
FY2019	**FY2020**	**FY2021**	**FY2022**	**FY2023**		
Unknown	Unknown	Unknown	Unknown	Unknown	R	General Fund

* In thousands of dollars. Parentheses ( ) indicate a revenue loss. ** Recurring (R) or Non-Recurring (NR).

Methodology for Estimated Revenue Impact: Executive Order 2019-003 summarizes goals to address climate change and energy waste prevention. It is not yet possible to begin estimating potential costs for taxpayers. Most of the directives would require legislation or other actions in order to come into effect. However, directive number 6, which aims to reduce methane omissions and to prevent waste from the oil and gas sector, appears to be tied directly with the taxpayers proposed to receive the credit in this bill. It appears this directive could come into effect as soon as EMNRD and NMED agree on the regulatory framework. However, until directive 6 has quantifiable reduction standards and it is possible to estimate how those apply to taxpayers, an estimate of the revenue impact from this bill is not feasible.

Policy Issues: This tax credit represents an additional tax expenditure for the state. The bill does not contain a purpose statement for the tax credit, which TRD recommends for new credits to facilitate evaluating them. TRD also recommends sunset provisions in order for legislators to review the impact of credits before extending them. This bill does not contain a sunset date. There is no limit to the amount of credit a taxpayer may receive, nor is there a cap on the amount of credit costs the state will incur annually. This poses a risk to state revenue.

Technical Issues: TRD is concerned that the bill language will create conflict and litigation as to how it is applied and how much credit a taxpayer can receive. The standard for receiving this tax credit: "A taxpayer may claim a climate change compliance income tax credit for the taxable year in which the taxpayer incurred costs to comply with executive order 2019-003," is too broad in scope. The bill language does not prescribe how the credit awarded amount is determined. TRD and the Energy, Minerals and Natural Resources Department (EMNRD) will be unable to promulgate rules regarding the certification of the costs as it is indeterminate what costs qualify for the credit. It is unclear from the bill language how often a single taxpayer can claim the credit.

The effective date of January 1, 2019 appears to be premature. As discussed in the methodology discussion, quantifiable standards for meeting the Executive Order have not yet been defined. The Executive Order has instructed the establishment of a Climate Change Task Force, which will define policies and regulations.

Other Issues: None.

Administrative & Compliance Impact: Based on TRD's experience with the Renewable Energy Tax Credit, the 10-year carryforward has been administratively burdensome. A new position at TRD will be required.

Estimated Additional Operating Budget Impact*				**R or NR****	**Fund(s) or Agency Affected**
FY2019	**FY2020**	**FY2021**	**FY 19-21**		
$0	$70	$70	$140	R	Taxation and Revenue Department

* In thousands of dollars. Parentheses ( ) indicate a cost saving. ** Recurring (R) or Non-Recurring (NR).

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