BILL ANALYSIS AND FISCAL IMPACT REPORT
Taxation and Revenue Department

January 24, 2024

Bill: SB-40 **Sponsor:** Senator William P. Soules

Short Title: Geothermal Heat Pump Tax

Description: This bill amends Sections 7-2-18.24 and 7-2A-24 NMSA 1978 to extend the geothermal ground-couple heat pump tax credit to taxable years beginning on or after January 1, 2024, and through December 31, 2034. It also removes the carryforward for the personal income tax credit and instead makes it refundable. The annual cap on both the income tax credit and corporate income tax credits is also increased from $2 million to $16 million for each tax program.

Effective Date: Not specified; 90 days following adjournment (May 15, 2024). Applicable to taxable years beginning on or after January 1, 2024.

Taxation and Revenue Department Analyst: Asif Rasool

Estimated Revenue Impact*					R or	
FY2024	FY2025	FY2026	FY2027	FY2028	NR**	Fund(s) Affected
--	($1,150)	($1,160)	($1,170)	($1,170)	R	General Fund

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

Methodology for Estimated Revenue Impact: To estimate the fiscal impact, Tax & Rev utilized internal data from applications for the existing Geothermal Income Tax Credit, which limits purchases and installation to December 31, 2020. Tax & Rev calculated the base amount by averaging the applications for the credit over a 5-year period, excluding Tax Years 2020 and 2021 due to the COVID-19 pandemic's effects.

Firstly, the fiscal impact calculation takes the base amount and applies a 1% year-over-year growth rate based on market analysis conducted by Grand View Research[1]. In their market analysis published in August 2020, the firm projected a 7.2% growth in the geothermal heat pump market between 2020 and 2027. For this estimate, the growth rate was annualized to approximately 1% year-over-year.

Additionally, Tax & Rev incorporated an 83% growth rate on the base amount to account for the newly introduced refundability of the credit. This growth rate was calculated based on the amount of credit claimed between fiscal years 2009 and 2010 from the Renewable Energy Production Tax Credit. This credit was made refundable for projects that commenced operations after 2008, and this data was used to estimate the initial change in the growth rate.

Policy Issues: While tax incentives can support specific industries or promote desired social and economic behaviors, the growing number of such incentives complicate the tax code. Introducing more tax incentives has two main consequences: (1) it creates special treatment and exceptions within the code, leading to increased tax expenditures and a narrower tax base, which negatively impacts the General Fund; and (2) it imposes a heavier compliance burden on both taxpayers and Tax & Rev. Increasing complexity and exceptions in the tax code is generally not in line with sound tax policy.

[1] Geothermal Heat Pumps Market Size Report, 2020-2027 (grandviewresearch.com)

The extension of the credit still includes a sunset date and places a cap on the total amount of credit that can be claimed in a taxable year, although the cap is raised from $2 million to $16 million. Tax & Rev supports the inclusion of sunset dates, as they allow policymakers to assess the impact of a credit before deciding whether to extend it. The 2021 Tax Expenditure report[2] shows that from tax year 2017 to tax year 2020, on average there were 205 taxpayers claiming the current credit for an aggregate annual amount of $450 thousand. During that time, the $2 million cap was never reached. Converting the credit to a refundable credit is assumed to increase the demand for heat pumps as detailed in the revenue impact.

Technical Issues: As the current credit already sunset as of December 31, 2020, Tax & Rev recommends that instead of amending this credit, that a "new" credit be created as was done recently with the Solar Market and Sustainable Building credits. This will allow smoother administration by Tax & Rev. The current credit permits taxpayers to carryforward their credit amounts up to 10 years. A new credit adds complexity in needing to separately track credits that are refundable and nonrefundable. Taxpayers who have carryforwards under the existing law would not be permitted to claim a refund. There are approximately $2 million in pending carryforwards for the recently expired credit in the GenTax system. However, the language of the carryforward provision on page 2 lines 17 through 20 is repealed under this proposal. The repeal could create legal issues for Tax & Rev should taxpayers who installed a system between 2010 and 2020 submit a credit claim and expect to carry it forward to future tax years. These claims may be invalid with the proposed repeal. It would also be preferable to have two separate credits for purposes of Tax & Rev's annual Tax Expenditure Report.

There is no language in Section 2 (the CIT credit) to make the credit refundable on par with Section 1 (the PIT credit). Tax & Rev recommends consistent language for personal income tax and corporate income tax filers to avoid confusion. The corporate income tax credit is left as a carry-forward credit, further creating inconsistency between that credit and the personal income tax credit, and increasing complexity, and the possibility of return errors, for taxpayers, as well as complicating the administration of the credit.

Tax & Rev recommends the cap be on credit certification rather than on credit claims as tracking that on the return creates more uncertainty for taxpayers as to whether their credit will fit under the cap. During filing season, Tax & Rev receives thousands of returns each day and cannot ensure credits are processed on a first come first serve basis.

On page 4, lines 2 through 8 and page 6, line 25 through page 7 line 6, the proposed language indicates that a claim for the geothermal credit will not be allowed if a claim for 2021 sustainable tax credit is made. Tax & Rev suggests that this language be placed under the certification criteria for EMNRD as they also certify projects for the 2021 sustainable tax credit. EMNRD will have detailed information to confirm the bill language that the "geothermal ground-coupled heat pump is not a component of the qualification for the 2021 sustainable tax credit and thus deny or approve the geothermal credit. This will also ensure that a taxpayer is thoroughly certified for all conditions of the credit.

Other Issues: The $16 million cap is referred to by the income tax or corporate income tax act in each section D for Sections 1 and 2, page 3 line 9 and page 6 line 21. This will result in up to $32 million available annually for these credits. If the intent is only for a $16 million combined cap it is recommended to update the language to add the corporate income tax credits to this section. Suggested language: "D. The department may allow a maximum annual aggregate of sixteen million dollars ($16,000,000) in geothermal ground-coupled heat pump tax credits approved under the Income Tax Act and Corporate Income and Franchise Tax Act. "

On page 3, lines 11 and 12, there is not a value in requiring Tax & Rev to approve applications for the tax

[2] See https://www.tax.newmexico.gov/forms-publications/ for published annual Tax Expenditure Reports

credit. “Applications shall be considered in the manner received by the department”- This credit is certified for eligibility by EMNRD. Tax & Rev suggests this be removed.

Administrative & Compliance Impact: Tax & Rev will need to update forms, instructions, and publications. Implementing this bill will have a low impact on the Information Technology Division (ITD), approximately 200 hours or about one and a half months and an estimated staff workload cost of $11,100. These updates will be incorporated into annual tax year revisions.

Estimated Additional Operating Budget Impact*				R or NR**	Fund(s) or Agency Affected
FY2024	FY2025	FY2026	3 Year Total Cost		
--	$11.1	--	$11.1	NR	Tax & Rev- ITD staff workload

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

Related Bills: Similar to SB45, 2023 Legislative Session