Fiscal impact reports (FIRs) are prepared by the Legislative Finance Committee (LFC) for standing finance committees of the Legislature. LFC does not assume responsibility for the accuracy of these reports if they are used for other purposes.

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

		LAST UPDATED	
SPONSOR	Baca/Sanchez	**ORIGINAL DATE**	1/30/24
SHORT TITLE	Dyed Agricultural Diesel Fuel Tax Credit	**BILL NUMBER**	Senate Bill 118
		ANALYST	Graeser

REVENUE*
(dollars in thousands)

Type	FY24	FY25	FY26	FY27	FY28	Recurring or Nonrecurring	Fund Affected
TRD GRT/Comp		($38,900.0)	($40,400.0)	($41,500.0)	($43,700.0)	Recurring	General Fund
TRD GRT/Comp		($26,000.0)	($26,900.0)	($27,700.0)	($29,200.0)	Recurring	Local Governments

Parentheses ( ) indicate revenue decreases.
*Amounts reflect most recent analysis of this legislation.

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT*
(dollars in thousands)

Agency/Program	FY24	FY25	FY26	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
TRD	$12.2	$1.2	$0	$13.4	Recurring	General Fund

Parentheses ( ) indicate expenditure decreases.
*Amounts reflect most recent analysis of this legislation.

Sources of Information

LFC Files
LFC FIRs on 2023's SB360 and HB354

Agency Analysis Received From
Taxation and Revenue Department (TRD)

Agency Analysis was Solicited but Not Received From
Department of Transportation (DOT)

Agency Declined to Respond
New Mexico Department of Agriculture (NMDA)

SUMMARY

Synopsis of Senate Bill 118

Senate Bill 118 (SB118) exempts the sale and use of dyed special fuels—so-called because a dye is added to indicate the fuel is not intended for use in on-road vehicles—from the gross receipts and compensating tax when used for agricultural purposes. Qualifying dyed special fuels are those dyed in accordance with federal regulation for use in agricultural purposes. The bill requires the claimant to separately report the deduction and for TRD annually to report utilization data to the Legislature in the annual tax expenditure report.

The effective date of this bill is July 1, 2024. The bill also provides a sunset date of July 1, 2029.

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. This bill creates 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.

TRD has provided the following analysis of the fiscal implications of the provisions of this bill. Note that TRD expects the entire volume of diesel fuel to claim this exemption, not just the sales for agricultural use. Off-road uses of dyed diesel include construction and forestry.

Estimated Revenue Impact*					**R or NR****	**Fund(s) Affected**
FY2024	**FY2025**	**FY2026**	**FY2027**	**FY2028**		
--	($70,800)	($73,400)	($75,500)	($79,500)	R	General Fund
--	($47,200)	($48,900)	($50,300)	($53,000)	R	Local Governments

From TRD:

> TRD collected data on dyed special fuel reported during FY23 to estimate the future volumes by applying the most recent state road fund forecast produced by the Department of Transportation. TRD assumes all dyed special fuel is utilized for agricultural purposes. To estimate the prices, TRD collected diesel prices reported by the U.S. Energy Information Administration and produced a projection of prices based on the chained price index for consumer fuel produced by the firm S&P. A statewide effective gross receipts tax (GRT) rate was applied to calculate the estimated revenue impact..

In the analysis of last year's SB360, the Department of Transportation reported volumes of dyed diesel as follows:

FY2017: 330,448,986 gallons … 65% as large as taxable special fuel (excluding IFTA).
FY2018: 448,406,653 gallons … 84% as large as taxable special fuel (excluding IFTA).
FY2019: 524,998,010 gallons … 92% as large as taxable special fuel (excluding IFTA)
FY2020: 427,272,899 gallons … 72% as large as taxable special fuel (excluding IFTA)
FY2021: 325,031,794 gallons … 52% as large as taxable special fuel (excluding IFTA)
FY2022: 331,135,193 gallons … 50% as large as taxable special fuel (excluding IFTA).

Along with the reported volumes, LFC used the Energy Information Administration (EIA) data on dyed diesel prices over the same period. This is reported in the table below, updated to the current period.

	Gulf Coast No 2 Diesel Ultra Low Sulfur (0-15 ppm) Retail Prices (Dollars per Gallon)
FY17	$2.35
FY18	$2.73
FY18	$2.94
FY20	$2.61
FY21	$2.51
FY22	$3.93
FY23	$4.33
FY24	$3.59

Finally, LFC used the current weighted average gross receipts tax rate for the state of 7.13 percent and determined the following amounts of GRT had been paid on dyed diesel for each year:

	Estimated GRT Paid
FY17	$64,341,199
FY18	$93,966,592
FY19	$104,292,788
FY20	$74,171,043
FY21	$58,234,327
FY22	$92,844,119
AVG:	**$81,308,345**
FY24 YTD est	**$74,401,392**

According to a survey conducted in 2022 by the NM Petroleum Marketers, dyed diesel wholesalers expect selling around 10 percent of products to agricultural users. Given the difficulty in estimating future diesel prices and purchases, for the purpose of this analysis, the cost is equivalent to the annual average GRT paid times the 10 percent expectation for agricultural use. Furthermore, LFC assumed GRT paid followed the general split of other purchases in the state where 60 percent of the impact is to the general fund with the remaining 40 percent of impact experienced by local governments.

Because it is unclear how the tax department would determine which purchases are for agricultural use, the entire cost of the exemption could be up to $80 million to the general fund and $53 million to local governments should all sales of dyed fuel qualify (by misreporting or inability to administer the agricultural use provision). The bill should be clarified to ensure agricultural use is verifiable and reported by those claiming the exemption.

Because of the uncertainty in the proportion of verifiable agricultural use, the table on page one uses TRD's 100 percent estimate times 55 percent, which is the average of 100 percent and 10 percent obtained from the 2022 survey.

Estimated Revenue Impact*					**R or NR****	**Fund(s) Affected**
FY2024	**FY2025**	**FY2026**	**FY2027**	**FY2028**		

--	($38,900)	($40,400)	($41,500)	($43,700)	R	General Fund
--	($26,000)	($26,900)	($27,700)	($29,200)	R	Local Governments

SIGNIFICANT ISSUES

This bill narrows the gross receipts tax (GRT) base. Many New Mexico tax reform efforts over the last few years have focused on broadening the GRT base and lowering the rates. Narrowing the base leads to continually rising GRT rates, increasing volatility in the state's largest general fund revenue source. Higher rates compound issues tax pyramiding, the tax on tax that results from taxing each step in the production of a product or service, and force consumers and businesses to pay higher taxes on all other purchases without an exemption, deduction, or credit.

Dyed diesel and dyed gasoline are exempt from both federal and state motor fuel excise taxes. Motor fuel excise taxes are considered road user fees and dyed fuels are supposed to be used for purposes other than road vehicles (construction equipment, agriculture, generators, etcetera).

The federal government applies excise tax to all clear fuels. New Mexico applies excise taxes to almost all clear fuels. So, if it is clear fuel, it is subject to gasoline or special fuels tax. If it is dyed fuel, it is exempt from gasoline or special fuels tax, and therefore, GRT is applied. By exempting dyed diesel from GRT, it would receive special tax status where no tax is applied, contrary to the LFC-adopted tax policy principle of equity.

TRD adds:

> Currently, receipts from special fuels are subject to the gross receipts and compensating tax due to the language of Section 7-9-26 NMSA 1978 that only exempts receipts from special fuels on which the special fuels excise tax has been paid. Because receipts from dyed special fuels are deductible from taxable receipts when applying the special fuels excise tax pursuant to Section 7-16A-10(E) NMSA 1978, such receipts are not receipts on which the special fuels excise tax has been paid and are therefore subject to the gross receipts and compensating tax under Section 7-9-26 NMSA 1978.
>
> If this legislation is enacted, receipts from the sale or use of the subset of dyed special fuels used for agricultural purposes will not be subject to any tax at all. Tax & Rev understands that the purpose of the legislation is to encourage the use of dyed special fuels in agriculture. However, the creation of a special exemption for the sale or use of a particular category of fuels goes against sound tax policy by: (i) distorting the market for agricultural fuels generally; (ii) adding complexity to the tax code for both taxpayers, increasing the burden of tax compliance, and for Tax & Rev, increasing administrative costs; and, (iii) violates principles of horizontal equity by favoring consumption of certain fuels that are otherwise similar in application and use to other fuels. Furthermore, allowing one kind of fuel to escape all taxation encourages abuse of the deduction through mis-categorization and misreporting, especially as deductions are self-reported, rather than needing to be claimed like a credit. Adding this deduction would therefore also increase the burden and complexity of audits.
>
> GRT rests upon the general presumption that all receipts of a person engaged in business in New Mexico are subject to the gross receipts tax and that this rate represents the rate upon

which the State collects taxes on transactions.[1] GRT represents the largest recurring revenue source for the state General Fund at around 34%, about 80% of municipal revenue, and 30% of county revenue.

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 deduction and other information to determine whether the deduction is meeting its purpose.

ADMINISTRATIVE IMPLICATIONS

TRD will need to update forms, instructions, and publications and make information system changes, which is expected to take approximately 20 hours and two existing full-time employees. In addition, TRD estimates that implementing the bill will require approximately 220 hours of IT staff time and $12,210 of staff workload costs.

Estimated Additional Operating Budget Impact*				R or NR**	Fund(s) or Agency Affected
FY2024	FY2025	FY2026	3 Year Total Cost		
--	$1.2	--	$1.2	NR	Tax & Rev – ASD – staff workload cost
$12.2	--	--	$12.2	NR	Tax & Rev – ITD – staff workload cost

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

TECHNICAL ISSUES

TRD suggests specifying the federal regulation mentioned in Section 1 Subsection A

OTHER SUBSTANTIVE ISSUES

LFC staff have long noted the rationale for separating highway use taxes, including on-road fuel taxes, from the gross receipts and compensating tax provisions may make little sense in the current era. On-road fuel taxes are declining primarily because of the increased fuel efficiency of modern cars, light trucks and heavy, long-haul trucks. This is in an environment where the gross receipts or compensating tax applied to the price of fuel would generate far more money for the state road fund than the current fixed tax per gallon fuel taxes. It should simultaneously be noted the state road fund's costs rise with inflation, while their revenues do not. The debate over off-road fuel taxation is only a sidenote to the larger discussion of appropriate funding for the state road fund.

In assessing all tax legislation, LFC staff considers whether the proposal is aligned with committee-adopted tax policy principles. Those five principles:

- **Adequacy**: Revenue should be adequate to fund needed government services.
- **Efficiency**: Tax base should be as broad as possible and avoid excess reliance on one tax.
- **Equity**: Different taxpayers should be treated fairly.
- **Simplicity**: Collection should be simple and easily understood.

[1] Section 7-9-3.5(A)(1) NMSA 1978.

- **Accountability**: Preferences should be easy to monitor and evaluate

In addition, staff reviews whether the bill meets principles specific to tax expenditures. Those policies and how this bill addresses those issues:

Tax Expenditure Policy Principle	Met?	Comments
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.	✓	Proposed in last year's SB360 and HB354**.**
Targeted: The tax expenditure has a clearly stated purpose, long-term goals, and measurable annual targets designed to mark progress toward the goals.		No purpose established
Clearly stated purpose	✘	
Long-term goals	✘	
Measurable targets	✘	
Transparent: The tax expenditure requires at least annual reporting by the recipients, the Taxation and Revenue Department, and other relevant agencies		
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.		
Public analysis	✓	
Expiration date	✓	
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.		
Fulfills stated purpose	✘	
Passes "but for" test	✘	
Efficient: The tax expenditure is the most cost-effective way to achieve the desired results.	?	
Key: ✓ Met ✘ Not Met ? Unclear		

IT, JF, BG, LG/al/hg