

Colorado Legislative Council Staff Fiscal Note

**STATE and LOCAL
REVISED FISCAL IMPACT**

(replaces fiscal note dated February 13, 2007)

Drafting Number: LLS 07-0723

Date: March 26, 2007

Prime Sponsor(s): Rep. McKinley
Sen. Romer

Bill Status: House Appropriations

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TITLE: CONCERNING THE CLARIFICATION OF THE GENERAL ASSEMBLY'S INTENT TO INCLUDE MACHINERY USED TO PRODUCE ELECTRICITY IN THE EXEMPTION FROM SALES AND USE TAX FOR PURCHASES OF MACHINERY USED TO MANUFACTURE TANGIBLE PERSONAL PROPERTY.

Fiscal Impact Summary	FY 2006-2007	FY 2007-2008	FY 2008-2009
State Revenue General Fund*	(\$4,951,967)	(\$9,530,200)	(\$3,503,750)
State Expenditures	\$0	\$0	\$0
FTE Position Change	0.0 FTE	0.0 FTE	0.0 FTE
Effective Date: Upon signature of the Governor			
Local Government Impact: See Local Government Impact section			

* *These estimates do not reflect additional wind and solar projects beyond those that have been identified below. Additional projects will be necessary for utilities to meet the requirements of Amendment 37. This fiscal note will be updated as information on future projects becomes available.*

Summary of Legislation

This bill, *as amended by the House Finance Committee*, specifies that machinery used to produce electricity from either (1) renewable resources, including wind energy; or (2) in a facility that entered into a power purchase agreement that was fully executed before November 7, 2006, is exempt from Colorado sales and use tax. The bill applies to all audits, assessments, appeals, refund claims and transactions pending on or after the bill's effective date.

Background

Colorado sales and use tax law exempts machinery used in Colorado in manufacturing tangible personal property for sale or profit (Section 39-26-709, C.R.S.). In February 2001, the Department of Revenue (DOR) issued a determination (DD-567) holding that this exemption applied to machinery used in the production of electricity. In November 2006, the DOR issued another determination (DD-598), holding that the exemption *did not* apply to machinery used in the production of electricity. Although each determination relates only to the facts of each particular case, the DOR's most recent determination (DD-598) is presumed to reflect the state's current expectation regarding sales and used tax collection related to the production of electricity. However, this determination is currently under appeal in court. The appeal process is expected to take at least two years. The passage of this bill would have no impact on that litigation.

State Revenue

Assuming DD-598 represents the state's current expectation regarding sales and use tax revenue collection relation to electricity production, this bill will result in a loss in General Fund revenue of \$4,951,967 in FY 2006-07, \$9,530,200 in FY 2007-08 and \$3,503,750 in FY 2008-09. Passage of this bill would eliminate potential future state revenue from sales tax related to renewable electricity generation. The types of renewable energy generation that could be impacted need further clarification, but at a minimum, include wind and solar.

Wind Energy. There are three wind energy projects currently under development that would be affected by this bill totaling 775 MW (about 500 turbines). Each turbine includes about \$1.5 million in parts, which implies \$42,045 per turbine in state sales tax ($\$1.5 \text{ million} * .02803 = \$42,045$), or a total of \$21,022,500. These projects commenced in the beginning of 2006, and are scheduled for completion by the end of 2008. This fiscal note assumes a uniform construction schedule over this time period, and that no tax was paid prior to the issuance of DD-598. Taxes paid between the issuance of DD-598 and the effective date of this bill are allocated to FY 2006-07 on an accrual accounting basis. The amount of sales tax revenue foregone from these wind projects as a result of this bill is thus \$4,671,667 in FY 2006-07, \$7,007,500 in FY 2007-08 and \$3,503,750 in FY 2008-09.

Centralized Solar Energy. An 8 MW centralized solar project near Alamosa with about \$50 million in investment is scheduled to be operational by the end of 2007. It is estimated that in projects like these, roughly half of the investment is for hardware. Foregone sales tax from this source would total about \$700,750 ($\$25,000,000 * .02803 = \$700,750$). Since construction is just beginning this month, passage of this bill would result in a sales tax revenue loss of \$280,300 in FY 2006-07 and \$420,450 in FY 2007-08.

Commercial Solar Energy. Individual commercial scale solar projects range up to 2 MW in size, but an average project is about 300 to 400 KW. Currently, 22 MW worth of these projects are under review at the PUC, with a decision expected in May. Once approval is given, these systems could be installed within the next fiscal year. While the total that will be approved is unknown, the best estimate is 15 MW. On average, each MW translates to \$5 million in hardware, so the sales tax impact for FY 2007-08 is \$2,102,250 ($\$75 \text{ million} * 0.02803 = \$2,102,250$).

Other renewable energy projects would also be impacted by this legislation. Moreover, the bill also exempts machinery used in the production of electricity at non-renewable facilities for which a power purchase agreement was fully executed before November 7, 2006. This fiscal note will continue to be updated as more information becomes available.

In addition, passage of this bill would eliminate state revenue from sales tax related to future renewable electricity generation. However, Xcel is currently ahead of the renewable energy generation requirements established in Amendment 37 (existing agreements take them out to the 2015 requirements), and to date, has not solicited proposals for other renewable energy generation agreements.

Other State Impacts

Based on the March 2007 Legislative Council Staff revenue forecast, there is enough revenue to fully fund the diversion to the Highway Users Tax Fund (HUTF) under the provisions of SB 97-1 for the next five fiscal years and have additional revenue flow into the General Fund excess reserve. Under the provisions of HB02-1310, revenue in the General Fund excess reserve is diverted two-thirds to the HUTF and one-third to capital construction. The revenue reduction resulting from this bill would reduce the amount of money available for diversion to the HUTF and to capital construction. In FY 2006-07 this amounts to \$3,301,311 from the HUTF and \$1,650,656 from capital construction. For 2007-08, this amounts to \$6,353,467 from the HUTF and \$3,176,733 from capital construction.

Local Government Impact

Local governments whose sales tax is collected by the DOR will also see a decrease in sales/use tax revenues as they are also subject to the DOR determination. Home rule municipalities are unaffected by the bill.

Departments Contacted

Local Affairs Revenue