

**SUBJECT:** Creating tax incentives for certain water desalination facilities

**COMMITTEE:** Ways and Means — committee substitute recommended

**VOTE:** 8 ayes — Burrows, Guillen, Martinez Fischer, Murphy, Noble, Sanford, Shaheen, Wray

0 nays

3 absent — Bohac, Cole, E. Rodriguez

**WITNESSES:** For — Kevin Thimmesch, Eureka Resources; Brent Halldorson, Fountain Quail Water Management, LLC; Bill Stevens, Texas Alliance of Energy Producers; Paul Choules, Texas Desalination Association; (*Registered, but did not testify*: Katherine Carmichael, 98th Meridian Foundation's Board of Directors; Paula Bulcao, BP America, Inc.; Gil Bujano, BPX Energy; Steve Perry, Chevron USA; Caleb Troxclair, EOG Resources and Parsley Energy; Chris Hosek, Fountain Quail Energy Services; Kyle Frazier, Kyle Frazier Consulting; Amy Maxwell, Marathon Oil Company; Bill Stevens, Panhandle Producers and Royalty Owners Association; Mindy Ellmer, Poseidon Water; Zachary Roesch, Produced Water Society; Trace Finley, Seven Seas Water; James LeBas, Texas Chemical Council; Carlton Schwab, Texas Economic Development Council; Billy Howe, Texas Farm Bureau; Joshua Grimes)

Against — (*Registered, but did not testify*: Dick Lavine, Center for Public Policy Priorities; Cyrus Reed, Lone Star Chapter Sierra Club)

**DIGEST:** CSHB 2545 would create franchise and severance tax incentives for certain water desalination facility operations.

**Tax credit.** A permit holder that produced fresh water of usable quality at a desalination facility and had all necessary state and federal permits would be eligible for a credit against the franchise tax.

A "desalination facility" would mean a facility that treated source water

under the jurisdiction of the Texas Commission on Environmental Quality (TCEQ) or the Railroad Commission that had a high total dissolved solids concentration, such as water produced in oil or gas drilling, to produce fresh water of usable quality for public, agricultural, industrial, environmental, and other beneficial uses, and began initial operations on or after January 1, 2020.

The total amount of the credit for each 1,000 gallons of treated source water would be equal to:

- 50 cents if the source water had a total dissolved solids concentration of more than 5,000 milligrams per liter;
- \$1 if at least half of the source water had a total dissolved solids concentration of more than 30,000 milligrams per liter;
- \$5 if at least half of the source water had a total dissolved solids concentration of more than 50,000 milligrams per liter; and
- \$17 if at least half of the source water had a total dissolved solids concentration of more than 90,000 milligrams per liter.

The resulting fresh water would have to be put to beneficial use in Texas.

The permit holder could treat source water with differing total dissolved solids concentrations and would be entitled to prorate the credit by the duration of processing time associated with each concentration.

**Limitations.** Treated water could be counted only once to determine the amount of the credit. Only one permit holder could claim a credit for the same treated water. The total credit claimed could not exceed the amount of franchise tax due during a tax reporting period after all other applicable tax credits.

**Carryforward.** If a permit holder was eligible for a credit exceeding the limitation, the permit holder could carry the unused credit forward for up to five consecutive reports.

A carryforward would be considered the remaining portion of a credit that

could not be claimed in the current year and would be added to the next year's installment of the credit.

**Monthly statements and certification.** To be eligible for a credit, a permit holder would have to submit to TCEQ monthly statements including:

- the metered volume in gallons of treated source water;
- the total dissolved solids concentration of the source water;
- the processing time associated with each concentration; and
- the total dissolved solids concentration of resulting fresh water.

The permit holder also would have to apply to TCEQ for certification that it had treated source water that qualified for a tax credit, and the resulting fresh water was put to beneficial use. Any information TCEQ determined was necessary also would have to be included with the application.

TCEQ would have to immediately notify the comptroller in writing if a permit holder that previously received a certificate was not eligible for the certified credit or if TCEQ took any action or discovered information affecting the permit holder's eligibility.

**Application.** The permit holder would have to apply for the credit with the tax report for the period the credit was claimed, including a copy of each relevant certificate issued by the TCEQ and any other information required by the comptroller. The burden of establishing eligibility for the credit would be on the permit holder.

**Transfer of credits.** A permit holder that earned a credit could sell or assign all or part to an entity that also could sell or assign part of that credit. There would be no limit on the total number of transactions for the sale or assignment of a credit but, all transferred credits claimed for a tax reporting period would be subject to the maximum total limitations.

An entity to which a credit was transferred could apply all or part of that credit against either a franchise tax or oil and gas severance taxes. The

total credit claimed could not exceed the amount of tax due during a reporting period after all applicable tax credits, but the entity could carry forward unused credits.

The entity transferring a credit and the entity to which a credit was transferred would have to jointly submit written notice of the transfer to the comptroller within 30 days of the transfer. The requirements for the notice are specified in the bill.

The sale or assignment of a credit would not extend the period for which a credit could be carried forward and would not increase the total amount of the credit that could be claimed.

A credit earned or purchased by a partnership, limited liability company, S corporation, or other pass-through entity could be allocated to the partners, members, or shareholders of the entity in accordance with the provisions of any agreement to be and without regard to the ownership interest in the desalination facility claiming the credit.

**Credit expiration date.** The provisions of the bill related to the tax credit would expire December 31, 2024. The expiration date would not affect the carryforward of a credit or credits for which a taxable entity was eligible based on water treated before that date.

**Tax exemption.** The bill would require a permit holder to exclude from its total revenue used to calculate franchise tax margins any amount received by a permit holder from the sale of minerals or materials extracted from water by a desalination facility. This provision would expire December 31, 2024. A taxable entity could exclude amounts from its total revenue only on a report originally due on or after the effective date and before January 1, 2025.

The bill would take effect January 1, 2021, and would apply only to a report originally due on or after that date.

SUPPORTERS CSHB 2545 would incentivize water desalination operations by creating a

**SAY:** franchise tax credit to operators treating high-salinity water to provide a new source of water for beneficial use in the state. With Texas' rapidly increasing population and vulnerability to drought, the demand on water supplies keeps expanding and the available surface water is dwindling. However, there are vast reserves of brackish groundwater, gulf seawater, and water produced from oil and gas operations that can be treated for usable purposes.

The bill would help desalination facilities with the high energy costs of treating brackish water, sea water, and produced water, which requires more pressure in the treatment process than conventional water supplies. A tax credit on the treatment of unusable water would remove impediments to the advancement of desalination, providing a new source of water, creating a new water market in Texas, and reducing the need to inject water produced by oil and gas operations in disposal wells.

The credit created by the bill would be scaled according to the concentration of total dissolved solids in the water to be treated, ensuring that desalination facilities receiving water that needed more costly treatment would have access to a larger credit to cover those costs.

**OPPONENTS SAY:** CSHB 2545 would provide a tax credit for entities treating produced water, such as from an oil and gas drilling operation, that according to the bill's fiscal note could have a cost to general revenue. There are concerns that a total dissolved solids (TDS) concentration of 5,000 milligrams per liter is too low to for credits, since the water at this TDS concentration is saline water, not brine water. It would be more appropriate to set the lowest concentration eligible for a tax credit at 10,000 TDS, which would be similar to what some entities treating water in the state currently receive and treat.

**NOTES:** According to the Legislative Budget Board, the implications of the bill cannot currently determined, but the bill could result in a negative fiscal impact depending on the extent of innovation in water desalination technology.