MINUTES
of the
THIRD MEETING
of the
REVENUE STABILIZATION AND TAX POLICY COMMITTEE

September 14-15, 2017
State Capitol, Room 322
Santa Fe

The third meeting of the Revenue Stabilization and Tax Policy Committee for the 2017 interim was called to order by Senator Carlos R. Cisneros, chair, on Thursday, September 14, 2017, at 9:59 a.m. in Room 322 of the State Capitol in Santa Fe.

Present
Sen. Carlos R. Cisneros, Chair
Rep. Jim R. Trujillo, Vice Chair
Rep. Sharon Clahchischilliage
Rep. Roberto "Bobby" J. Gonzales
Rep. Jason C. Harper
Sen. Gay G. Kernan
Rep. Antonio Maestas (9/14)
Sen. George K. Munoz
Sen. Clemente Sanchez
Sen. William E. Sharer (9/14)
Sen. John Arthur Smith
Rep. James R.J. Strickler (9/14)
Rep. Carl Trujillo
Sen. James P. White
Sen. Peter Wirth

Absent
Rep. Tim D. Lewis
Rep. Javier Martínez
Sen. Mark Moores

Designees
Sen. William F. Burt
Rep. Bill McCamley
Rep. Rod Montoya
Sen. Pat Woods (attending as guest 9/14)

Rep. David E. Adkins
Rep. Eliseo Lee Alcon
Rep. Cathrynn N. Brown
Sen. Jacob R. Candelaria
Rep. Daymon Ely
Rep. Bealquin Bill Gomez
Rep. Debbie A. Rodella
Sen. Nancy Rodriguez
Rep. Patricia Roybal Caballero
Rep. Angelica Rubio
Rep. Patricio Ruiloba
Rep. Tomás E. Salazar
Rep. Larry R. Scott

Rep. Nathan P. Small
Sen. Elizabeth "Liz" Stefanics
Rep. Candie G. Sweetser
Sen. Bill Tallman

(Attendance dates are noted for members who did not attend the entire meeting.)

Staff
Pam Stokes, Staff Attorney, Legislative Council Service (LCS)
Jeff Eaton, Research and Fiscal Policy Analyst, LCS
Ric Gaudet, Researcher, LCS
Tessa Ryan, Staff Attorney, LCS

Guests
The guest list is in the meeting file.

Handouts
Handouts and other written testimony are in the meeting file.

Thursday, September 14

Revenue Forecast
Jon Clark, chief economist, Legislative Finance Committee (LFC), Clinton Turner, chief economist, Department of Finance and Administration (DFA), and Elisa Walker-Moran, chief economist, Taxation and Revenue Department (TRD), presented the Consensus Revenue Estimating Group's (CREG's) August 2017 update to the state's revenue estimate to the committee. The CREG is composed of the professional economists from the DFA, TRD, LFC and Department of Transportation. The group periodically provides revenue estimates for the state as a basis for annual budgeting. Mr. Turner began by discussing the economic outlook for New Mexico and the nation. The United States' gross domestic product is expected to continue to grow at a rate between two and three percent for the next few years. Inflation is expected to return to long-term averages, climbing above two percent in fiscal years 2019 and 2020. Interest rates are also finally beginning to rise above the historically low rates in effect for the past eight years.

In New Mexico, employment growth has slightly outpaced recent forecast levels, and the CREG predicts a one percent increase in the number of jobs held in the next year. Most of the growth has occurred in the Rio Grande corridor, with southeast New Mexico job levels remaining flat in fiscal year 2017. However, there has been a recent surge in economic activity in that region due to oil and gas activity. The northwest quadrant of the state continues to decline economically, with San Juan and Rio Arriba counties experiencing their lowest taxable gross receipts levels in 13 years. San Juan County has lost 14 percent of its jobs in the past eight years.

Gross receipts tax (GRT) revenue has been increasing slightly in the past two fiscal years, but the growth has been imbalanced across the state. In fiscal year 2016, Lea and Eddy counties saw a combined GRT revenue decrease of $180 million, followed by smaller decreases in fiscal year 2017. These large decreases outweighed the modest growth seen in the Rio Grande corridor. The oil sector has seen recent growth, and southeastern New Mexico is poised to see substantial economic growth this year. After a two-year plummet in the number of drilling rigs operating in the state, New Mexico currently has 68 active rigs, the vast majority located in Lea and Eddy counties. Oil prices have also been relatively stable, hovering around $50.00 per barrel the past two years. Oil volumes have also begun to increase since November 2016 and show signs of future growth.

The General Fund revenue forecast projects moderate growth over the next two fiscal years. The largest revenue increases are expected from a nearly three percent increase in GRT revenue and a nine percent increase in investment income. Oil and gas revenues are expected to decrease slightly, due to income from lease bonuses decreasing but with increasing volumes. GRT revenue is expected to have an average 3.5 percent growth over the next five fiscal years.

Ms. Walker-Moran discussed the TRD's revenue reports and projections. Fiscal year 2017 General Fund revenues are expected to be $140 million more than was projected in the December 2016 estimate, and fiscal year 2018 revenues are expected to increase $12 million from that estimate. However, fiscal year 2019 through fiscal year 2021 revenues are expected to be lower than originally estimated. Personal income tax (PIT) and corporate income tax (CIT) revenue projections have decreased, while GRT revenue projections have increased.

The CREG does not anticipate an economic recession during fiscal year 2018 but predicts continued moderate growth. The economic downturn of 2008 put negative pressure on consumer spending in New Mexico, which is now showing signs of growth. The recent start of GRT collection by Amazon will contribute to revenue growth. Health care spending will continue to increase, and since most health care purchases are not subject to the GRT, this will put downward pressure on GRT revenue.

One reason why GRT revenue is reported as stronger than predicted and PIT revenue weaker than predicted is because some tax payments were not matched to the correct tax returns. The TRD has identified $91 million in tax payments that have been made by taxpayers without submitting a matched tax return. The TRD's GenTax system temporarily assigns unmatched tax collections as GRT revenue until the correct tax program can be associated with the payments. For some reason, a large number of unmatched tax payments have been made in the past year, resulting in higher than expected GRT revenue and sluggish PIT revenue. TRD staff has been investigating the spike in unmatched tax payments. Much of the unmatched payments belong in the PIT program, which means that the revenue will end up in the General Fund rather than part of it being distributed to local governments if it were GRT revenue. TRD staff has also been investigating the sudden decline in CIT revenues. It appears that some corporate taxpayers have previously made overpayments on their estimated CIT returns, and many have been recently requesting refunds of those payments. These overpayments pose a risk to the revenue estimate potentially in the tens of millions of dollars and are one reason why CIT revenue is so volatile.

Mr. Clark discussed with the committee concerns the LFC has about anomalies in reported revenue data. A significant portion of the $140 million in increased forecast GRT revenue was not correctly attributed to a tax source. Accounting, reporting and taxpayer behavior uncertainties overshadowed much of the modeling used to forecast revenues, leading to significant risks to the forecast. Other data anomalies included a June 2017 TRD GRT revenue report of $33 trillion, a figure several decimal places incorrect; and an apparently wildly divergent effective GRT rate in 2017, ranging from more than six percent to 2.5 percent. Mr. Clark suggested that making changes to the TRD's tax administration system could alleviate some of these problems with data. Currently, each taxpayer uses the same combined reporting system (CRS) number for several tax programs. This system might be outdated, and a new method of reporting taxes could significantly reduce reporting problems.

GRT revenues have also been declining due to internet sales. Although Amazon started collecting the state GRT for its transactions with customers in the state, it does not collect the local option GRTs, nor does it collect tax from sales made by third-party vendors. Third-party vendor sales account for about 50 percent of Amazon's sales, which represents millions of dollars in foregone revenue to the state.

Most local governments in New Mexico charge for or tax the privilege of providing internet service within their jurisdiction. However, legislation recently enacted by Congress will prohibit such taxation beginning in 2021, which could result in significant revenue losses for local governments.

The Pueblo of Pojoaque will soon begin casino revenue-sharing payments to the state after a two-year hiatus, resulting in a net increase of $5 million to the state annually. However, it is unclear whether the pueblo will be required by a federal court to pay the estimated $12 million in unpaid revenue-sharing payments since 2015. Mr. Clark said that if the state does not receive this money, the pueblo will have effectively been granted a two-year tax holiday, which event should be gravely concerning to policymakers.

Questions and comments from committee members included the following.

- How can the TRD data errors be eliminated in the future? John Monforte, acting secretary of taxation of revenue, said that the TRD has confidence in the current tax reporting system. He distributed a handout that explained the divergent effective tax rates noted by the LFC, stating that LFC staff used an incorrect column in the spreadsheet data. He said that there has to be a balance in the tax reporting system between taxpayer-friendliness and system control. The system is very taxpayer-friendly, which means that taxpayers can enter data incorrectly, even after being prompted by the system to verify the entry. He agreed that data needs to be reviewed before final reports are distributed. However, he said that the TRD is not allowed to fix erroneous claims; only taxpayers can. Ms. Walker-Moran said that a recent update to the GenTax system made it less likely that taxpayers could inadvertently click on the wrong button when entering data.

- The TRD has reconciled some of the $140 million discrepancy in the 60-day GRT line item, but when will the remaining $70 million be reconciled? Ms. Walker-Moran said that the TRD is still examining returns to find the remaining discrepancies. One possible explanation is that some income tax credits requested by taxpayers showed up in the 60-day GRT report. She said that the money in that line item will remain in the General Fund and not be distributed to local governments.

- The TRD should not publish reports before they are verified for accuracy. There are too many data anomalies to have much faith in the numbers that the TRD is reporting. Municipalities and counties are also very concerned that they are not getting correct distributions. Ms. Walker-Moran said that the TRD does not publish interim reports and is required to publish the data it has, whether that data is accurate or not. However, the TRD is investigating how it can identify errors prior to publication.

- As food prices increase due to the impact of recent hurricanes, hold harmless GRT payments to local governments will also increase. This is because of the fact that local governments get paid a portion of all deductions claimed against the GRT for the purchase of food. This will hurt the state General Fund.

- What is the forecast for construction in New Mexico? Mr. Turner said that residential housing permits are still not growing but that property sales prices are increasing. This could lead to more demand for housing. Currently, the Facebook data center project and oil and gas development account for most of the increase in construction-related GRT revenue.

- TRD data shows that Rio Arriba County has a negative GRT revenue growth rate, yet several large businesses have located in the county recently. Mr. Turner said that taxable gross receipts in Rio Arriba County have declined by more than five percent in recent years. New businesses in the county may not have offset those losses.

- The LFC notified the TRD of a large discrepancy in the 60-day GRT report more than a year ago, and the TRD still has not been able to explain much of the discrepancy. Acting Secretary Monforte said that the technology the TRD is using will take some time to fix. The department needs some data analytics tools and internal controls. However, he said that data anomalies are always happening because taxpayers make mistakes in entering data.

- How is the TRD handling recent litigation over a claimed $90 million CIT credit involving chemical reagents and municipalities concerning incorrect GRT distributions? Acting Secretary Monforte said that the state's position on the chemical reagents issue is that the payments being claimed as overpayments were actually due the state and should not be refunded. Ms. Walker-Moran said that the CREG does not forecast the outcome of any litigation, but it does attempt to identify any potential liabilities.

- All of the tax reporting discrepancies and sudden increases in taxpayer errors are troubling. The TRD budget should not have been cut, because it is the primary revenue-collecting state agency.

- Health care spending is constantly increasing, but most of that activity is not taxed. Hold harmless payments to local governments for food and medical GRT deductions hurt the state's financial situation even more.

- Has the TRD quantified the CIT overpayments in recent years? That money does not belong to the state, so it should not be included in the budget. Ms. Walker-Moran said that the TRD is trying to estimate the amount of overpayments made by corporate taxpayers. Mr. Turner said that if the DFA is able to identify a tax overpayment, that money does not get deposited into the General Fund.

Agency Analysis of Recent Tax Reform Proposals

Mr. Clark, Ms. Walker-Moran and Dawn Iglesias, economist, LFC, discussed with the committee the fiscal impacts of recent proposed tax reform legislation.

<u>Senate Bill 123 (2017 Regular Session)</u>

Mr. Clark and Ms. Iglesias discussed Senate Bill 123 from the 2017 regular legislative session, which would eliminate most tax expenditures and many tax programs but would tax nearly all economic activity at a much lower GRT rate. This comprehensive tax reform proposal was so broad in scope that the TRD and LFC were unable to estimate its fiscal impact. However, this tax reform proposal, along with another tax reform bill proposed by Representative Harper, was the impetus for a special appropriation enacted in 2017 to contract with an independent company to perform an expert tax analysis study. The study, when completed, will be able to better estimate the impacts of these and other tax reform proposals.

Senate Bill 123 would have reduced the state GRT rate from the current 5.125 percent rate to one percent and would reduce the maximum county and municipal GRT rates to .5 percent each, which would result in a combined state and local maximum rate of two percent. Food and medical hold harmless deductions from the GRT base would be repealed, as would most other GRT deductions, exemptions and credits. Most transactions would be taxed at the new lower rate, including all internet sales, employee wages and property sales. The compensating tax rate and the governmental GRT rate would also be reduced to match the new GRT rate. The

Corporate Income and Franchise Tax Act would be repealed, and the PIT rate would be lowered to a flat 2.5 percent rate, but only for individuals and entities with incomes above certain higher levels. To offset some of the regressivity of the new GRT structure, a tiered refundable GRT credit would be implemented for those individuals with incomes below 210 percent of federal poverty guidelines. The motor vehicle excise tax would be repealed, but sales of motor vehicles would be subject to the GRT. Finally, county obligations to provide for health care funding would shift to the state; the time frame for claiming a credit or refund from a tax program would be reduced; and a temporary amnesty for tax penalties and interest would be implemented.

Senator Sharer said that he wants to simplify New Mexico's tax system and to tax nearly all economic activity at a very low rate. Initially, he came up with a two percent tax rate, but the actual rate to be enacted should be determined by using the tax tool currently being developed by Ernst & Young. The negative impacts of business-to-business pyramiding should no longer be a problem, because the tax rate would be so low.

<u>House Bill 8 (2017 First Special Session)</u>

Ms. Iglesias discussed House Bill 8 from the 2017 first special legislative session, which was similar to House Bill 412 from the 2017 regular legislative session. Both bills were sponsored by Representative Harper in an attempt to reform the GRT and other tax programs. The bill would broaden the GRT base by eliminating most GRT expenditures but would create a limited set of anti-pyramiding provisions for select business-to-business services. The name of the tax would change to the "sales tax" and would be imposed at a lower state rate of 3.6 percent initially, with the TRD recalculating the rate the following year. The current effective state GRT rate is 4.16 percent, after subtracting the municipal 1.225 percent rate and adjusting for sales made outside of municipalities. The 1.225 percent share of the state GRT that is currently distributed to municipalities would be reconfigured as a local sales tax to be transferred to municipalities in the same manner that other local option GRT impositions are currently being made. The 1.225 percent tax rate would be lowered to a rate of .965 percent in an attempt to make the provisions revenue neutral for municipalities.

Medical services would be subject to the sales tax, but the deduction from gross receipts from the sale of food would remain in statute. Most nonprofit organizations, including hospitals, would be subject to the sales tax. The bill was intended to repeal the exemption from sales tax for nonprofit organizations, but that section was inadvertently left intact. The changes being made to the GRT system are intended to be revenue neutral, and any excess revenue generated, after accounting for an assumed annual growth rate, would be distributed to the tax stabilization reserve.

The tax reform bill also renames the compensating tax as the "use tax" and lowers the rate to match the sales tax rate. In addition, local governments would impose a local option use tax at the same rate that their sales taxes are imposed. The health insurance premium surtax would increase to two percent, and insurance companies would lose their "in lieu of all other taxation" exemption from remitting sales tax for goods and services they sell in addition to insurance policies. The bill also increases the motor vehicle excise tax to six percent, up from the current three percent rate, and distributes the new revenue to the General Fund, the State Road Fund and the Local Governments Road Fund.

It was difficult to come up with a fiscal impact report (FIR) for the bill because there are so many interacting variables involved. The TRD did not release an FIR for the bill, but did provide the LFC with many of the figures used in the LFC's FIR. The LFC's FIR for the bill, as introduced with the nonprofit exemption error, shows a cost to the General Fund of more than $100 million each fiscal year. However, there are many assumptions made in the FIR that make the estimate risky, including incorrect assumptions in the bill underlying the fiscal years 2018 and 2019 General Fund revenue caps, errors in the assumed tax base behind the new 3.6 percent sales tax rate, the key technical error in which the nonprofit organization exemption is not repealed and the large estimated range for the cost of the new anti-pyramiding provisions.

Mr. Clark said that the initial 3.6 percent sales tax rate is likely too low to ensure revenue neutrality. The bill also delegates tax rate-setting to the TRD, which raises constitutional concerns. The rate recalculation provisions in the bill also provide for a maximum General Fund growth of three percent annually. However, the fiscal year 2019 CREG estimate, without the bill taking effect, predicts a growth to the General Fund of 4.5 percent. This discrepancy in assumptions would mean that the sales tax rate for fiscal year 2020 would drop to between 3.35 and 3.4 percent. This is a primary driver in the negative fiscal impact of the bill each year.

The impact on local governments was studied in preparing the FIR, but calculating the impact on each municipality and county will be difficult because the impact of each of the changes will be different, depending on each locality's economic base. However, in general, the fiscal impact on municipalities is likely to be negative, and the impact to counties is likely to be positive.

The anti-pyramiding provisions in the bill are also difficult to estimate because the actual size of the gross receipts base for those deductions is not fully known, and the percentage of that base that will be impacted by the new deductions is also not known. The FIR estimated an impact on the base between $1.1 billion and $2 billion. That wide range of gross receipts base highlights that the actual revenue impact is difficult to determine.

The repeal of various GRT deductions, credits and exemptions should increase the tax base, allowing for a decrease in the sales tax rate. However, it is difficult to calculate the actual size of the new tax base because the impact of some existing tax expenditures is not known and some tax expenditures overlap, leading to incorrect estimates. Anomalies in GRT data need to be fixed so that future tax reform efforts can be correctly estimated.

Representative Harper thanked the panel for its hard work in analyzing the bill and thanked the committee and LCS staff for its work in drafting the bill. He said that he received much feedback about House Bill 412 from the 2017 regular legislative session, which was used to produce House Bill 8 during the special session.

Questions and comments from committee members included the following.

- LFC staff was asked to give an update on the progress of the tax study Ernst & Young is performing for New Mexico. Mr. Clark said that the company is in the early stages of gathering data and is discussing data needs with the TRD. The study will provide tools to analyze future legislation, and it will be built so that as additional data sources become available, they can be incorporated into the model. There have been discussions about studying the CIT and PIT programs, but there might be too many confidentiality issues to make those studies possible.

- The proposed changes to the taxation of health care services would mean that the state will be taxing services that providers and hospitals are unable to pass along to their customers. There is only one other state that allows for taxation of medical services. This will exacerbate the shortage of medical providers in the state.

- The bill sets a tax rate in order to achieve a certain revenue goal, which does not allow for much growth. If the estimated total business-to-business gross receipts totals $2 billion annually, and the state's gross domestic product is about $80 billion, perhaps business-to-business pyramiding is not such a big problem after all.

- The CIT should be repealed because it causes economic distortions and it does not have much impact on the state's budget. If Senate Bill 123 were to pass, everything would be taxed but at a much lower rate. Business-to-business pyramiding would exist but would not matter anymore because businesses would be paying a very low tax rate.

- The $100 million cost in foregone revenues estimated in the FIR for House Bill 8 is based on the CREG's estimate of 4.5 percent growth in the next few fiscal years.

- Would House Bill 8 impose a tax on the sale of property? Mr. Clark said that the bill would not tax property sales but would impose the sales tax on the commissions that Realtors earn from the sale of a property.

- Reimposing the GRT on food would also mean that tourists visiting the state would share some of the state's tax burden.

- The TRD does not have sufficient personnel to do the job with which it is tasked.

- Tax policy does not drive economic growth; consumer spending does.

Recess

The committee recessed at 4:42 p.m.

<u>Friday, September 15</u>

The committee reconvened on Friday, September 15, at 9:00 a.m.

Review of the TRD's 2016 Tax Expenditure Report (TER)

Ms. Walker-Moran reviewed for the committee the TER for 2016 prepared by the TRD. The TER attempts to list all of the exclusions, exemptions, deductions and credits available in statute and whether they are classified as tax expenditures. An exclusion is defined as an amount that is removed in order to define a tax base. For example, taxpayers exclude certain amounts from their base income to derive their net income upon which the PIT is imposed. Exemptions eliminate a legal obligation to report or pay taxes on transactions. Examples of exemptions include the exemption for insurance companies from paying the CIT or the GRT, the exemption from paying the GRT on sales of agricultural products and the exemption for nonprofit organizations from paying the GRT. Generally, if a taxpayer solely engages in exempt transactions, there is no registration or filing obligation. If a taxpayer has some transactions that are taxable and some that are exempt, only the exempt transactions are not reported.

Deductions reduce tax liability by eliminating certain transactions or income from amounts taxpayers are required to report on tax returns. Deductions reduce the tax base for taxpayers before calculating tax due. In the GRT program, taxpayers report their gross amount on the return and then also show the amount of the deduction. Some GRT deductions are combined on a single line of the CRS return, which makes it difficult for the TRD to calculate the amount of specific deductions. Credits are amounts subtracted from the calculated tax liability. Most tax credits are business activity credits that require an application for approval by either the TRD or another certification agency.

A tax expenditure is a deviation from the baseline system of taxation that provides special or preferential treatment to a taxpayer or group of taxpayers. Exclusions to derive the tax base are not tax expenditures. The nature of the statute governs whether a deviation should be classified by the TRD as a tax expenditure. Deviations occur for many reasons, including constitutional or federal preemption, government-to-government comity, to correct an aberration in the tax base or to provide preferential treatment to achieve a policy objective — a tax expenditure. Tax expenditures are usually specific to a subset of the tax base or population to achieve a specific policy objective. The TRD categorized the types of tax expenditure into groups, such as citizen benefit; economic development; environment, conservation and renewable energy; health care; and highly specialized industries.

By far the largest tax expenditure in New Mexico in fiscal year 2016 is the deduction from gross receipts for the purchase of food, costing the state $243 million. The exemption from the GRT for nonprofit organizations costs the state an estimated $90 million. Other high-cost tax expenditures include the health care practitioner services and prescription drugs and oxygen GRT deductions, the working families tax credit, the high-wage jobs tax credit, the film and television tax credit, the capital gains PIT deduction and the medical and health care services GRT deduction. Ms. Walker-Moran pointed out three tax expenditures that have expired or will soon expire, and 16 other tax expenditures that are unused either because the tax expenditure has expired or is not currently being claimed by taxpayers. Several exclusions from the tax base have been eliminated from the 2016 TER, mostly involving natural resource extraction valuation issues. Some exemptions and deductions related to the sale of fuel to other governments have also been removed from the TER. A credit, deduction and exemption related to uncompensated medical care expenses have been added to the 2016 TER. Finally, the TER identifies eight tax expenditures that the legislature should clarify.

Questions and comments from committee members included the following.

- TRD staff was asked to present a report to the committee listing which tax expenditures should be modified or repealed. Ms. Walker-Moran said that some tax expenditures need to be revised in order to be effective. Others may need to be repealed because they are no longer needed. The effectiveness of many tax expenditures also needs to be better studied.

- Many tax expenditures that are tax exemptions should be converted into deductions or credits so that their cost and effectiveness can be measured. Sunsetting tax expenditures is also needed so that the legislature and executive branch can evaluate them periodically.

- The TER should include all tax deviations, regardless of whether the deviations are classified as tax expenditures.

- The legislature needs to close loopholes in tax expenditure statutes and tighten up requirements for receiving an expenditure. Tax expenditure recipients should be required to provide justification for the expenditure, and the TRD and LFC should regularly evaluate their effectiveness.

- How will Ernst & Young get accurate data regarding the impact of the GRT exemptions, for which the TRD has no data available? Mr. Clark said that the contract left open the sourcing for that data. He said that he is concerned that there is no reliable data on those exemptions.

- The TER should indicate some kind of return on investment for each tax expenditure. Ms. Walker-Moran said that when that information is available, the TER reflects the benefits to the state provided by the tax expenditure. However, most tax expenditures do not require detailed reporting by the recipients.

- The governor has vetoed legislation repeatedly requiring the CREG and LFC to evaluate the effectiveness of tax expenditures.

- TRD staff was requested to work with LFC and LCS staff in preparing suggestions for cleaning up or repealing unused and expired tax expenditures.

State Auditor Review of Certain Tax Programs

Timothy Keller, state auditor, and Sarita Nair, chief government accountability officer and general counsel, Office of the State Auditor (OSA), gave a presentation to the committee about the transparency and effectiveness of tax programs. Auditor Keller began by saying that he preferred to call all tax deviations a tax expenditure. Since he was a state senator, he has been trying to get the data needed to analyze the effectiveness of tax expenditures but was constantly running into transparency and confidentiality issues. A thoughtful examination of tax programs and their relative returns on investment is the best practice followed by most states. The OSA is aware that there is insufficient data to develop detailed economic models for all 180 tax breaks identified by the office, 23 of which have no data available at all. The TRD's TER provides information on most tax expenditures but does not discuss many rate differentials, adjustments to value and other types of tax breaks. The OSA's report attempts to examine every tax deviation in order to get a complete picture of New Mexico's tax policy.

Of the nearly $1.5 billion in annual tax expenditures granted by the state, about 50 percent are given to nonprofit organizations, to the extractive industry and to all New Mexicans as broad-based expenditures. The remaining tax expenditures span multiple industries and purposes. The largest tax programs identified by the OSA differed somewhat from the TER's list. Most notable were the inclusion of rate differentials and valuation methodologies for extractive industries, totaling $396 million. The TRD generally does not classify those deviations as tax expenditures because they are considered deviations essential to the functioning of the industry. The rate differential between the motor vehicle excise tax and the average GRT rate was also listed, totaling $67 million annually. The OSA strongly supports requiring broader disclosure for tax expenditures, especially from those expenditures certified by the Economic Development Department and the Energy, Minerals and Natural Resources Department. In addition, many exemptions, which have no reporting requirement, should be converted to deductions with required disclosure. That would allow the state to properly analyze the effectiveness of the tax deviation.

Auditor Keller discussed General Accounting Standards Board (GASB) Statement 77, which will require local governments to disclose the full cost of tax abatement agreements in their fiscal year audits. Local governments will specify all of the tax abatements that affect the revenue stream of the local government, including any overlapping jurisdictions within the local government. For example, industrial revenue bonds will be reported, including the amount of property tax abatement, the amount of GRT revenue affected, any payments in lieu of taxes, the purpose of the abatement, requirements of the tax abatement recipient, clawback provisions and evaluation of the effectiveness of the abatement.

Questions and comments from committee members included the following.

- Some states work out disclosure agreements with taxpayers receiving a tax expenditure in order to study the effectiveness of the expenditure. Can New Mexico do something similar to avoid tax confidentiality provisions? Auditor Keller said that current statutes allow for interagency sharing of certain taxpayer information, but there is much information that cannot be released. He suggested that any proposed tax expenditure legislation include taxpayer disclosure language requiring certain information be released as a condition of receiving the expenditure. The legislature could also enact legislation requiring the TRD to disclose to the LFC and OSA certain kinds of tax expenditure data. The biggest challenge in evaluating tax expenditures is knowing what they actually cost. Transparency in tax programs is crucial, and every tax program should have accountability.

- Will the state be required to comply with GASB Statement 77? Auditor Keller said that the rule will apply to all governments, but it only applies to tax abatements, like industrial revenue bonds. He said that there are very few state-run tax abatements.

- Calling all extractive industry tax deviations "tax expenditures" and using language like "lost revenue" are misleading. There are many economic and governmental constraints imposed on the energy sector, and not all tax deviations were written to give the industry a break. Auditor Keller agreed and said that he is not really concerned about what to call these tax deviations, but he wants to know how much they cost.

- How does GASB Statement 77 define what is a tax abatement? Ms. Nair said that a tax abatement is an agreement with a taxpayer to reduce the tax revenue a government will receive. This could be in the form of an exemption, deduction or reduction in assessed value. A generally available tax deviation is not a tax abatement, however. There needs to exist an agreement between the government and the recipient. Auditor Keller said that the OSA will publish a rule soon stipulating how local governments should identify tax abatements. However, he said that tax abatements in New Mexico are mostly industrial revenue bonds and tax increment development districts. Acting Secretary Monforte said that the TRD has identified 19 possible state-administered tax abatements, but TRD staff is still working on that issue.

Adjournment

There being no further business, the committee adjourned at 11:40 a.m.