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

June 11, 2019
State Capitol, Room 322
Santa Fe

The first meeting of the Revenue Stabilization and Tax Policy Committee for the 2019 interim was called to order by Senator Carlos R. Cisneros, chair, on Tuesday, June 11, 2019, at 8:30 a.m. in Room 322 of the State Capitol in Santa Fe.

Present
Sen. Carlos R. Cisneros, Chair
Rep. Javier Martínez, Vice Chair
Sen. Pete Campos
Rep. Doreen Y. Gallegos
Rep. Roberto "Bobby" J. Gonzales
Rep. Susan K. Herrera
Sen. Gay G. Kernan
Rep. Antonio Maestas
Rep. Rod Montoya
Sen. Clemente Sanchez
Sen. William E. Sharer
Sen. John Arthur Smith
Rep. James R.J. Strickler
Rep. Jim R. Trujillo
Sen. Peter Wirth

Absent
Rep. Jason C. Harper
Sen. Mark Moores
Sen. George K. Munoz

Designees
Rep. Christine Chandler (attending as a guest)
Rep. Tim D. Lewis
Sen. Bill Tallman
Rep. Martin R. Zamora (attending as a guest)

Rep. Abbas Akhil
Rep. Eliseo Lee Alcon
Rep. Cathrynn N. Brown
Sen. William F. Burt
Rep. Micaela Lara Cadena
Sen. Jacob R. Candelaria
Rep. Brian Egolf
Rep. Patricia A. Lundstrom
Sen. Nancy Rodriguez
Rep. Andrea Romero
Rep. Angelica Rubio
Rep. Patricio Ruiloba
Rep. Larry R. Scott

Sen. Elizabeth "Liz" Stefanics
Rep. James G. Townsend
Sen. James P. White
Sen. Pat Woods

Staff
Pam Stokes, Staff Attorney, Legislative Council Service (LCS)
Ric Gaudet, Researcher, LCS
Rebecca Griego, Records Officer, LCS
Anthony Montoya, Staff Attorney, LCS

Guests
The guest list is in the meeting file.

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

Tuesday, June 11

Update from the Taxation and Revenue Department (TRD)

Stephanie Schardin Clarke, secretary of taxation and revenue, and Clinton Turner, tax policy director, TRD, updated the committee about developments at the TRD. Secretary Schardin Clarke discussed the executive leadership team at the TRD, which still has several vacancies to be filled. The positions of chief legal counsel, chief economist and director of the Tax Fraud Investigations Division remain empty. The vision of the TRD is to provide fair, consistent and professional tax administration for all New Mexico taxpayers, and the department aims to accomplish these goals by filling vacancies, improving employee retention, providing training and professional development to employees and delivering quality customer service. The TRD was allotted a $91.7 million budget for fiscal year 2020, an increase of 2.4 percent over fiscal year 2019. The TRD is organized into seven divisions, with 1,072 budgeted full-time-equivalent positions, but with only 780 of those positions filled. The 28 percent vacancy rate at the TRD is a major concern, and the department is working on reducing that rate significantly. However, the TRD faces many challenges, including uncompetitive salary ranges at the department and a tight job market in the region.

Secretary Schardin Clarke described the functions of the several TRD divisions, including the Revenue Processing Division, which processes nearly three million tax returns annually for about 20 tax programs; the Information Technology Division, which facilitates upgrades to the GenTax system and ensures system security; the Audit and Compliance Division, which conducts audits and assesses taxes, penalties and interest, as well as makes credit and refund determinations; the Administrative Services Division, which distributes more than $8 billion annually to state, local and tribal governments; the Tax Fraud Investigations Division, which conducts criminal tax fraud investigations; the Motor Vehicle Division, which administers the state's driver's license and motor vehicle registration laws; and the Property Tax Division, which conducts property assessments on certain kinds of property, assists county assessors and manages procedures related to delinquent property taxes. The TRD also handles initial taxpayer protests before the more formal process available through the Administrative Hearings Office (AHO) or the district court and also manages unclaimed property for the state.

Mr. Turner described legislation that the TRD was involved with during the recent legislative session, including the following.

House Bill 162 (Chapter 47): Makes changes to the upcoming administration by the TRD of the premium tax, including putting the tax under the auspices of the Tax Administration Act, requiring information sharing between the TRD and the Office of Superintendent of Insurance and reinstating distributions to the Law Enforcement Protection Fund from premium tax collections.

House Bill 479 (Chapter 274): Removes the earmarks of many local option gross receipts tax (GRT) impositions and allows for general purpose increments by municipalities and counties.

Senate Bill 2 (Chapter 87): Makes changes to the Film Production Tax Credit Act, including increasing the annual credit maximum from $50 million to $110 million and eliminating from the cap certain film production companies that have made a 10-year commitment in the state; provides for an extra five percent credit for productions in rural areas of the state; provides for improved reporting and transparency of credit expenditures; and allocates $195 million in credit payments to reduce the current backlog of credit claims.

Senate Bill 129 (Chapter 157): Changes time lines and procedures relating to tax protests and refund claims to reduce the number of protests that are filed with the AHO and to allow for a longer period in which a protest can be resolved informally at the TRD.

House Bill 6 (Chapter 270): Makes many tax law changes, including providing for GRT taxation of online sales through internet platforms and a delayed local imposition; imposing local compensating taxes; imposing the GRT or governmental gross receipts tax (GGRT) on all hospitals; making changes to the personal income tax (PIT) system; requiring combined reporting of taxes for corporations; increasing the motor vehicle excise tax; increasing the cigarette tax; and imposing the tobacco products tax on vaping products.

Questions and comments from committee members included the following.

- If the top marginal PIT rate is increased for high-income earners, how many residents will that tax increase affect? Mr. Turner said that the TRD does not have an exact number yet, but he estimated that about two percent of PIT return filers would be affected by the rate increase, or approximately 20,000 people.

- The TRD has been consistently understaffed for more than 25 years. The department also needs to provide consistent answers to taxpayers.

- What can be done about the erosion of the GRT base in rural areas of the state? Mr. Turner said that local governments rely on GRT revenue for most of their budgets, and recent economic changes have eroded much of the tax base. With the switch to destination-sourced GRT imposition for goods and some services in 2021, rural local governments will be able to recoup some of that loss.

- With $500 million in outstanding tax protests, there must be something wrong with New Mexico's tax system. Secretary Schardin Clarke said that there are several very large protests and many more smaller protests. She said that some laws and regulations may need to be clarified, which will reduce the number of protests. She also said that there have been internal disagreements at the TRD for nearly a decade about how to perform cost allocation for certain taxpayers. This results in the TRD giving different answers to taxpayers for the same question. The TRD is working on developing standard procedures for all tax programs.

Post-Session Fiscal Review

Dawn Iglesias, chief economist, Legislative Finance Committee (LFC), discussed with the committee the status of the state's finances and economic outlook. More than a decade since the last recession, employment levels and state revenues have finally reached pre-recession levels. However, most of this growth is attributable to the oil and gas industry. The share of state revenues attributable to that industry has increased from 26 percent to more than 35 percent recently. Current trends in oil production are surpassing previous estimates. Average oil production has jumped from 557,000 barrels per day to 821,000 in the past year, and production in the Permian Basin is expected to double in the next five years. Each additional million barrels of oil generates approximately $3 million for the General Fund. Oil production increases alone are expected to generate $120 million more in direct revenue than was estimated in December 2018.

The state has been replenishing fund balances that were used a few years ago to shore up state operational funding. General Fund reserve levels are expected to be at or above 20 percent, and the Tax Stabilization Reserve is expected to continue strong growth from additional oil and gas revenues and from the ability for the fund to retain interest earnings from year to year. Senate Bill 401 of the recent legislative session would have transferred excess federal mineral leasing revenues in excess of the five-year average to the fund, but the legislation was vetoed by the governor.

Heading into the 2019 legislative session, the state faced many challenges but had the benefit of large surpluses to help address those challenges. The national rating service Moody's downgraded the state's bond rating for the second time in two years due to concerns over fiscal stability, educational outcomes, Medicaid growth, pension system solvency and an unbalanced

GRT system. The legislature enacted significant legislation to overcome some of the state's challenges, including:

- appropriating $3.2 billion for public education in fiscal year 2020, a 16 percent increase from the prior year;

- enacting legislation to address court-ordered educational reform to provide funding for at-risk students, extended learning, bilingual and multicultural education and rural schools and to provide teacher pay raises and funding for school transportation, instructional materials and professional development;

- providing significant funding for early childhood education programs and consolidating those services into a new Early Childhood Education and Care Department;

- providing significant funding for economic development programs, including the Job Training Incentive Program and the Local Economic Development Act, and creating a New Mexico Outdoor Recreation Division within the Economic Development Department;

- providing funding for many infrastructure and road needs across the state, including some recurring funding for the State Road Fund; and

- making changes to the state's GRT, PIT and corporate income tax (CIT) programs.

Questions and comments from committee members included the following.

- The committee should study how to add more money to the Tax Stabilization Reserve without affecting educational programs, which was the reason the governor vetoed Senate Bill 401.

- Why is it so difficult to accurately predict what the fiscal impact of requiring combined reporting for corporations will be? Ms. Iglesias said that there are many variables involved in how much revenue the CIT program generates each year. Most states have a similar problem in forecasting this revenue stream. If the LFC were able to access TRD data about CIT taxpayers, it could generate better fiscal impact reports for proposed legislation affecting corporate taxation.

- How will the taxation of all hospitals impact Medicaid funding? Ms. Iglesias said that the changes to impose the GRT or the GGRT on all hospitals will generate about $70 million annually, which in turn can be used to generate much more federal revenue in matching funds. Hospitals in general will benefit from the change.

- The legislature should not have imposed a high PIT rate on the highest-income earners in the state. Ms. Iglesias said that the LFC has concerns about placing an increasing reliance on revenue from just high earners. It would like to consider a more elastic approach to the PIT rate structure.

- The legislature should study the Wisconsin model of pension solvency to see if New Mexico could benefit from that model.

- Changes to the film production tax credit offset all other revenue-increasing legislation. With such a large tax incentive, the legislature needs to consider whether the incentives are worth the money being spent.

- Even with a huge budget surplus, the legislature still transferred $148 million in fiscal year 2019 to balance its budget. New Mexico has a spending problem, not a revenue problem. It would make much more sense for the state to set aside all of its surplus for use later when the economy has another recession.

- The budget surpluses are an historic opportunity for the state to make transformative investments in education, early childhood education and workforce development. But the legislature also needs to be careful to not spend money frivolously.

Discussion of Work Plan and Meeting Schedule

Ms. Stokes discussed with the committee its proposed work plan and meeting schedule. The committee proposes to meet six times during the 2019 interim, including a joint meeting with the LFC to be held in Red River on August 28-29. The remaining meetings would be held in Santa Fe. The committee proposes to:

- hear from national experts on state and local tax issues that could impact New Mexico and best practice recommendations;

- continue discussions for reform of the Gross Receipts and Compensating Tax Act;

- examine the effectiveness and value to the state of tax incentives and other economic development incentives and the state's ability to report and track the effectiveness of those incentives;

- hear presentations regarding state revenues attributable to the oil and gas industry, including projections from representatives of the Federal Reserve and a comparative analysis study, performed by Moss Adams LLP, of New Mexico and other oil and gas producing states;

- review the state's primary revenue sources and options for revenue stabilization, including increasing the state's reliance on more stable resources, the use of projected record revenues attributable to the oil and gas industry and the risks associated with too much reliance on volatile revenue sources;

- discuss the history of the Income Tax Act and the impact changes to that act, such as adjusting brackets and rates, may have on revenue stabilization;

- discuss the history of the property tax, what the tax funds and how rates in New Mexico compare to rates in other states and analyze the fiscal impact of certain provisions of the Property Tax Code, including the 20-mill limitation and yield control;

- analyze the implications of recent legislative attempts to legalize and tax recreational cannabis;

- review early childhood education funding needs, the economic impact of increasing investments in early childhood education programs and services and options for increasing funding for those programs and services;

- receive updates from the TRD on tax abatement and refund claim protests that pose a risk to revenue projections; and

- determine legislative actions necessary to implement changes identified by committee members that will improve the state's tax system and revenue stabilization.

Committee members suggested adding a few more areas of study related to the GRT program, including compliance and reporting issues for taxpayers involved in the gig economy; the erosion of the GRT base in rural areas and options for counteracting that erosion; and GRT sourcing rules for professional services and whether those rules should be changed to destination sourcing.

The proposed work plan, with the suggested additions, was adopted by the committee.

Adjournment

There being no further business, the committee adjourned at 11:25 a.m.