

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

**September 20-21, 2018
State Capitol, Room 322
Santa Fe**

The third meeting of the Revenue Stabilization and Tax Policy Committee for the 2018 interim was called to order by Representative Jim R. Trujillo, chair, on Thursday, September 20, 2018, at 9:05 a.m. in Room 322 of the State Capitol in Santa Fe.

Present

Rep. Jim R. Trujillo, Chair
Sen. Carlos R. Cisneros, Vice Chair
Rep. Sharon Clahchischilliage
Rep. Roberto "Bobby" J. Gonzales
Rep. Jason C. Harper
Rep. Antonio Maestas (9/20)
Rep. Javier Martínez (9/20)
Sen. George K. Munoz
Sen. Clemente Sanchez
Sen. William E. Sharer
Sen. John Arthur Smith
Rep. James R.J. Strickler
Sen. James P. White
Sen. Peter Wirth

Designees

Sen. William F. Burt
Rep. Bealquin Bill Gomez
Rep. Bill McCamley (9/21)
Rep. Rod Montoya
Sen. Elizabeth "Liz" Stefanics (9/20,
attending as a guest)
Sen. Pat Woods

Absent

Sen. Gay G. Kernan
Rep. Tim D. Lewis
Sen. Mark Moores
Rep. Carl Trujillo

Rep. David E. Adkins
Rep. Eliseo Lee Alcon
Rep. Cathrynn N. Brown
Sen. Pete Campos
Sen. Jacob R. Candelaria
Rep. Daymon Ely
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
Rep. Candie G. Sweetser
Sen. Bill Tallman

Guest Legislator

Senator Linda M. Lopez (9/20)

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

Staff

Pam Stokes, Staff Attorney, Legislative Council Service (LCS)
Erin Bond, Research Assistant, LCS
Felicia Garcia, Intern, LCS
Ric Gaudet, Researcher, LCS
Sara Wiedmaier, Research Assistant, LCS

Guests

The guest list is in the meeting file.

Handouts

Handouts and other written testimony are in the meeting file.

Thursday, September 20

Revenue Forecast

Jon Clark, chief economist, Legislative Finance Committee (LFC); Clinton Turner, chief economist, Department of Finance and Administration (DFA); and Jon Monforte, acting secretary, Taxation and Revenue Department (TRD), presented the Consensus Revenue Estimating Group's (CREG's) revenue forecast to the committee. Mr. Turner began by emphasizing the fact that the revenue estimate is performed by the professional staff economists of the DFA, TRD, Department of Transportation and LFC. Since the January CREG forecast, revenues have grown tremendously, leaving fiscal year 2018 with an extra \$500 million on the books. Current fiscal year and fiscal year 2020 revenues are also expected to grow, with \$1.17 billion in new revenue available for fiscal year 2020. However, since much of this new revenue is attributed to the volatile oil and gas sector, Mr. Turner said that the state should target at least a 20 percent reserve level as a hedge against future downturns.

The national economy is expected to grow by three percent in fiscal year 2019 and between one percent and two percent the following two years. Inflation is expected to increase to between two percent and three percent in the next two years. The three years of historically low inflation appear to be over, and the rate is expected to remain in the range most economists

consider optimal. New Mexico employment numbers are expected to continue to grow at 1.4 percent in fiscal year 2019 and drop to .8 percent the following year. The unemployment rate has also dropped to 4.7 percent, the lowest level the state has seen in almost a decade.

Gross receipts tax (GRT) revenues have rebounded since fiscal year 2017, mostly due to the huge increase in oil and gas production in the Permian Basin and increased economic activity in the Albuquerque metropolitan area. Out-of-state GRT revenues also increased, partially due to the collection of the state portion of the GRT by online retailer Amazon. The volatility in GRT revenue in Eddy and Lea counties is strongly correlated to the rig count in those counties. The Permian Basin rig count has climbed from fewer than 10 in 2016 to nearly 100 in 2018.

The General Fund witnessed approximately 14.8 percent recurring revenue growth in fiscal year 2018 and is expected to grow by eight percent in the current fiscal year, slowing to three percent growth in fiscal year 2020. Fiscal year 2019 reserve levels are expected to end at 34.2 percent of recurring spending levels. Mr. Turner said that although those levels seem very high, they could very quickly drop to almost nothing during an economic downturn.

Acting Secretary Monforte discussed in detail the sources of recurring revenue to the General Fund. Approximately \$425 million of the additional \$924 million in extra expected revenue since the January 2018 revenue forecast is from GRT revenue. Oil- and gas-related taxes account for an additional \$324 million, and expected increases in personal income tax (PIT) revenue account for \$149 million. Oil and gas activities accounted for one-third of the growth of taxable gross receipts (TGR) in fiscal year 2018, and construction and manufacturing TGR growth was in the double digits. Other factors accounting for TGR growth include the Albuquerque Rapid Transit system construction, Amazon's payment of the GRT for online purchases, transportation and warehousing services growth and an increase in professional services activities.

PIT revenues have increased for the past two years, and recent federal tax reform legislation will yield an extra \$54 million in recurring state revenue. Most of that increase will be paid by residents with more than two dependents. Legislation enacted in 2017 to put excess oil and gas emergency school tax revenue into the Tax Stabilization Reserve will mean that about \$135 million in the current fiscal year and \$177 million in fiscal year 2020 will be set aside. Acting Secretary Monforte said that the legislature should consider treating some of the new revenue the state is generating as nonrecurring. Oil and gas revenue, which accounts for most of the new revenue, is historically volatile and can easily drop dramatically in less than one year. The state also received more than \$200 million in federal mineral lands bonus payments from oil and gas leases this fiscal year. Bonus payments are one-time payments and should not be included in recurring revenue.

The TRD is studying how to implement the U.S. Supreme Court's *South Dakota v. Wayfair, Inc. (Wayfair)* decision, which allows states to impose sales taxes on interstate online transactions. The court removed the requirement that nexus be established before goods can be

taxed, but it recommended that there be a minimum threshold for businesses to be subject to taxation, that state taxation systems be simplified and streamlined with other states' systems and that taxation of online purchases be prospective only. The TRD can adopt regulations to comply with some of the court's guidance but will need legislative action to change how transactions are sourced if local option taxes will be collected. The legislature needs to ensure that out-of-state businesses be treated the same as in-state businesses. Acting Secretary Monforte said that the legislature should probably also clarify that the TRD be allowed to collect the GRT from sales made through online third-party sales platforms.

Mr. Clark discussed the risks associated with classifying new revenue as recurring revenue. In 2006, the state had a huge spike of revenue, which was subsequently budgeted into recurring appropriations. After the economic crash that began the following year, New Mexico struggled to maintain its budgets for several years and has only recently enacted budgets at the same level as 2006. An oil and gas industry downturn could be just as bad for New Mexico's economy and the state budget as was the recession 11 years ago, cautioned Mr. Clark.

The CREG has begun performing stress tests for volatile revenue sources to measure the impacts of upturns and downturns on General Fund levels. If oil prices rise dramatically to \$100 per barrel, the state would see upwards of \$1.2 billion in additional revenue. However, if oil prices drop to \$35.00 per barrel, oil production would begin to decline, severance tax collections would decrease by at least \$200 million, bonus payments from lease sales would drop and GRT revenues would drop significantly. The state could lose nearly \$1.3 billion in revenues from the drop in oil prices.

Questions and comments from committee members included the following.

- Was the CREG recommendation of a 20-percent reserve level unanimous? Mr. Clark said that setting a reserve level is a policy decision for the legislature to make, but the CREG used that number as a reasonable and cautious starting point. The nearly \$1.2 billion in excess revenue projected for fiscal year 2020 already includes an expected fiscal year 2020 reserve level of 20 percent. The CREG cautions the legislature to not treat all of that excess revenue as recurring, however. If much of that money is budgeted into recurring appropriations, then reserve levels should also be increased.
- Acting Secretary Monforte was asked to give an update on litigation involving a GRT deduction for chemicals and reagents. Acting Secretary Monforte said that the current case involves about \$212 million in potential liability for the state. The Court of Appeals moved the hearing date to October 2018.
- How much of the \$1.2 billion in new money should be set aside to allow for relatively risk-free tax reform legislation? Acting Secretary Monforte said that the tax reform legislation from the 2018 session had a risk of \$200 million associated with it. He

suggested that the state consider implementing tax reform over a few years. Mr. Turner said that for some tax reform ideas, it will be impossible to accurately model a revenue estimate.

- If federal and state regulators destroy the oil and gas industry, as was done to the coal industry, New Mexico will not have a tax base. In San Juan County, efforts are being made to develop the tourism economy, but tourism jobs are no replacement for oil and gas or coal jobs.
- Has the TRD sent letters to out-of-state online vendors informing them of an intent to collect the GRT from them? Acting Secretary Monforte said that no such effort has yet been attempted.
- How does the CREG determine which revenues are recurring? Mr. Clark said that there is no statutory guidance on how the CREG should assign revenues, unlike in some other states. The CREG examines revenues from previous years to estimate that number, but the group only assigns revenue as recurring or nonrecurring if it is clearly in one category.
- Why is the price received by New Mexico producers of oil much lower than published prices for West Texas intermediate (WTI) crude oil? Mr. Turner said that New Mexico currently lacks pipeline capacity, so much of the oil produced is first trucked. Severance and other taxes paid on oil are based on the actual price paid and not on the WTI price. The state loses at least \$150 million annually in severance taxes because of the price differential.
- How many wells have been drilled but not yet activated in the Permian Basin? Dawn Iglesias, economist, LFC, said that currently there are 3,000 drilled but not activated wells, compared to 2,000 last year. Most of those wells are associated with the lack of pipeline capacity. Once wells are activated, they generate very little GRT revenue, but they start generating severance and related tax revenues. Much of the GRT revenue received that is related to the oil and gas industry is not recurring because it is generated from the one-time drilling and completion of wells.
- New Mexico should put the majority of its extra revenues into reserves, because the oil and gas boom will not last forever.
- The oil and gas industry is the main economic driver in the state, and one reason for the sudden increase in activity is because more than 600 drilling permits were approved shortly after the Trump Administration began. The state should have more than 20 percent reserves, and it should use at least \$270 million in excess revenue as a hedge for tax reform legislation.

- The coal and oil and gas industries have paid for state and local government operations for decades. As renewable energy gains more market share of the energy supply, a mechanism to tax that industry needs to be developed.

Adoption of Minutes

The minutes of the July 25-27, 2018 meeting of the committee were adopted without changes.

Tax Protest Issues

Acting Secretary Monforte and Brian VanDenzen, chief hearing officer, Administrative Hearings Office (AHO), discussed with the committee the process involved in resolving tax protests. Mr. VanDenzen began by giving a history of the AHO, which was created in 2015 to establish an independent entity for tax protest hearings, separate from the TRD. The AHO now also hears motor-vehicle-related appeals from the Motor Vehicle Division of the TRD. Taxpayers generally must file an administrative protest with the TRD that, if it is not resolved, is forwarded to the AHO within 45 days. Taxpayers who were denied a refund also have the option of filing a civil action in the district court. Once a protest reaches the AHO, it is either given a merits hearing within 90 days or, if the case is complex, given a scheduling hearing first, followed by a merits hearing. At a scheduling hearing, the AHO attempts to get both parties to communicate, which sometimes allows for the discovery of areas of potential agreement. A scheduling hearing also sets deadlines for discovery and motions, and a formal merits hearing date is set.

At a merits hearing, which is by statute confidential, a taxpayer generally has the burden of proof to overcome the presumption of the correctness of the TRD ruling. Hearings are conducted in a quasi-legal setting, in which testimony is given under oath and is subject to cross-examination. After the hearing, an administrative law judge reviews the hearing record and prepares a written final decision and order, which contains detailed findings of fact, a discussion addressing the arguments made and conclusions of law in the matter. Appeals of AHO decisions can be made to the Court of Appeals. Currently, there are 27 appeals of AHO decisions pending before the court.

The number of tax protests in the state has grown tremendously in the past several years — from 34 in 2008 to 493 in 2017. Some of these protests are resolved administratively by the TRD, but the majority are eventually heard by the AHO. With this large caseload, it takes, on average, almost 200 days to resolve each protest.

Mr. VanDenzen discussed possible statutory changes to make the tax protest hearings process more efficient. The anti-cancellation of debt clause in the Constitution of New Mexico (Article IV, Section 32) makes it impossible for litigants to settle claims for less than the original amount. However, there are many other changes that could streamline the process, including clarifying the subpoena power of the TRD and the AHO; increasing the minimum threshold for a tax protest to be filed and pursued through the AHO; purchasing comprehensive case and docket

management software; and increasing the number of AHO administrative law judges and TRD staff. Mr. VanDenzen mentioned that the AHO's domain could also be expanded to hear all executive agency appeals.

Acting Secretary Monforte discussed the TRD's role in resolving tax protests. In 2016, the protest office of the TRD received 1,900 protests, of which 1,200 were resolved by the protest office. Most protests filed with the TRD are resolved, often by the protestant filing corrected paperwork. Top reasons for taxpayers filing protests in the past several years include missing documents, erroneous reporting of the GRT, the high-wage jobs tax credit, the hospital GRT credit and the chemical and reagents GRT deduction.

Acting Secretary Monforte discussed changes being made at the TRD to decrease the need for tax protests. The department recently established the Business Credit Bureau within the Office of the Secretary to assist with day-to-day determinations and to develop long-term policies. The unit will examine business credits and make recommendations on statutory changes to make the incentives clearer and less susceptible to taxpayer protests. The Legal Services Bureau is also adding staff to assist with quick resolution of tax protests.

Questions and comments from committee members included the following.

- What is the status of the protests involving the chemicals and reagents GRT deduction? Acting Secretary Monforte said there are two cases on that issue pending before the Court of Appeals. There are several other cases still pending at the AHO, which should be resolved once the court rules on those two cases. He said that if the court rules against the TRD position, the GRT deduction will continue to be claimed for the foreseeable future. Currently, the TRD is not advocating any statutory language changes.
- What explains the increase in tax protests and appeals? Mr. VanDenzen said that the perceived fairness of the AHO process probably has encouraged more taxpayers to protest assessments. However, both taxpayers and the TRD seem to appeal low-priority cases with small dollar amounts.
- What discretion does the TRD have to settle tax protests? Acting Secretary Monforte said that TRD attorneys have discretion to settle cases based on the level of doubt that the TRD position will be upheld by the AHO or the court. The TRD has chosen not to settle the chemical and reagents GRT cases because the possible liability to the state is too high.

TRD Business Credit Bureau, Data Analytics Group and Taxpayer Advocate

Acting Secretary Monforte, Aysha Mora, deputy director, Audit and Compliance Division (ACD), TRD, and Tiffany Smyth, taxpayer advocate, TRD, discussed new developments in the TRD designed to assist taxpayers and streamline tax administration. The TRD recently created

the Business Credit Bureau to manage business tax credits and to provide the public with better service. More than \$50 million in business tax incentives was approved in fiscal year 2017. Tax expenditures require continuous review to ensure they are effective and are not being exploited in unintended ways. These unintended consequences can have a significant detrimental impact on the General Fund. The bureau will be staffed by an economist, an attorney, two research analysts and a tax examiner. Its tasks include development and tracking of tax incentives, development of a compliance strategy, providing guidance to other TRD divisions, providing expert consultation to the executive and legislative branches regarding tax incentives, drafting changes to regulations and proposed statutory changes, assisting with the annual Tax Expenditure Report and continuously monitoring tax incentives and attempting to react to any system weaknesses.

Ms. Mora described the activities of the newly created Data Analytics Group, which is part of the ACD. Its mission is to advise senior TRD management of trends and to empower TRD users with advanced analytics tools. Part of the group is involved in developing and testing new technology projects, and the other part of the group uses those tools to design datasets, analyze data, build models for audit selection and help in the prevention of fraud. The ACD has previously used outside data to reduce fraud and better select audit candidates in various tax programs. The new group is currently developing a GRT analytics tool to discover previously unknown patterns and key relationships to identify variables of taxpayer noncompliance. This can then be used to compile likely audit candidates, also resulting in higher TRD collections.

Ms. Smyth described the position of taxpayer advocate at the TRD. The taxpayer advocate's role is to provide assistance to taxpayers, identify systemic problems in the department and recommend long-term solutions to those problems. The advocate can assist in resolving taxpayer issues when the normal administrative process has not worked. However, the taxpayer advocate cannot provide relief or a remedy not provided by law or reverse decisions made by the AHO or the courts.

Questions and comments from committee members included the following.

- It is often very difficult to get anybody at the TRD to answer taxpayer questions.
- Using data analytics to select taxpayer audits is much more effective than manual selection and also removes politics from the process. Ms. Mora said that the ACD has changed its approach to tax collections. It is more interested in achieving voluntary compliance by taxpayers, rather than just enforcement through auditing.

New Mexico Cost Burden on the Oil and Gas Extraction Industry

Ms. Iglesias discussed with the committee the results of an LFC analysis of recent studies calculating the total cost burden by states on the oil and gas industry. True comparisons of effective tax rates among states are virtually impossible due to differences in how taxes are imposed and assessed. Most cross-state comparisons only consider severance and production taxes. However, such calculations exclude other taxes and fees that add to the total cost of doing

business, such as rents and royalty payments, income taxes, sales taxes on drilling and other activities, property taxes and motor vehicle and motor fuel taxes. In addition, costs of transportation and processing vary, which can further skew the calculation of effective tax rates.

New Mexico's effective tax rate on oil and gas, when only looking at production tax revenues divided by the taxable value of production, averaged 7.3 percent over the last three years. This rate is based on the taxable value of production, which takes into account transportation and processing costs as well as state and federal royalty payments. When looking at the combined rate of production taxes, ad valorem taxes and royalty payments, the total cost burden averages about 26 percent. This figure, however, is not very useful in state-to-state comparisons, because New Mexico has such a high percentage of state- and federal-owned land. In a recent study comparing production and ad valorem taxes, New Mexico's effective tax rate was 9.1 percent, and it ranked in the middle compared to nine other states. A study in 2018 examined effective tax rates that considered severance, property, income and sales taxes across 16 oil-producing states. That study ranked New Mexico as having one of the highest effective tax rates; however, the study erroneously included royalty payments as taxes paid. LFC staff recalculated the state's effective tax rate using the same parameters less royalty payments and found the effective tax rate to be the sixth highest.

Ms. Iglesias said that the New Mexico Oil and Gas Association recently commissioned Moss Adams LLP to perform a comprehensive study of the relative cost burdens on the oil and gas industry in several states. She introduced Jeff Bjarke, consulting manager, Moss Adams LLP, who described the study. He said that Moss Adams LLP is going to study the industry's total contributions to government across several states, as opposed to doing a standard tax burden study. The company will be asking for help from the LFC, TRD and DFA, and will try to make the study as transparent as possible. The study will attempt to quantify contributions made to state and local governments and will estimate PIT and corporate income tax contributions.

Questions and comments from committee members included the following.

- Colorado should be included as one of the comparison states, and the study needs to include payments made by the industry for the GRT. Mr. Bjarke said that the study will include sales taxes. The study will include New Mexico, Texas, Oklahoma, Colorado, Wyoming and North Dakota. It may also include Utah, Montana and Kansas.

The committee recessed at 4:43 p.m.

Friday, September 21

Reconvene

The committee was reconvened on Friday, September 21, 2018, at 9:10 a.m. by Representative Trujillo.

Sales Tax Simplification and Sourcing

Richard Cram, director, National Nexus Program, Multistate Tax Commission (MTC), Helen Hecht, general counsel, MTC, and Jim O'Neill, consultant, New Mexico Municipal League (NMML), discussed with the committee how states can implement the *Wayfair* decision, specifically regarding how states can source sales. Most states use destination-based sourcing to establish the tax rate, but New Mexico generally uses origin-based sourcing, meaning the tax rate is based on the location of the seller. New Mexico could switch to destination-based sourcing to assess the GRT at the rate of the location of the customer, which would allow for local governments to receive a portion of tax revenue from online sales. However, switching to destination-based sourcing for services and some intangible products could complicate the system. New Mexico has many options so long as it does not tax out-of-state sales more than in-state sales.

The *Wayfair* decision specified several aspects of South Dakota's online transactions law that the U.S. Supreme Court found to be reasonable, including a threshold requirement of \$100,000 in sales or 200 transactions to establish substantial nexus; no retroactive tax liability for out-of-state vendors; and South Dakota's membership in the Streamlined Sales and Use Tax Agreement (SSUTA). The SSUTA provides that member states must provide for state-level administration of sales taxes, simplified tax rate structures, vendor access to software provided by the state and liability protection for vendors relying on state software. For New Mexico to become a member state of the SSUTA, it would need to change at a minimum to destination-based sourcing services and certain leases and rentals, but it could maintain origin-based sourcing for tangible personal property. Destination-based sourcing has some disadvantages, including the difficulty for the seller in determining what the local tax rate for each customer will be. However, newer software programs are capable of calculating tax rates for almost any address in the nation. In-state businesses that make deliveries to customers may also face challenges in calculating taxes under the new regime.

Mr. O'Neill described changes that New Mexico would need to make to become a member of the SSUTA. New Mexico is mostly in compliance with the SSUTA sourcing rules, except in how digital products are sourced and possibly leases of tangible personal property. The SSUTA also prohibits states from imposing limits on or thresholds for claiming deductions. New Mexico only has a few deductions that would need to be modified to meet this requirement, including the GRT deduction for chemicals and reagents. In addition, the SSUTA does not allow states to grant partial deductions, except for food or pharmaceutical drugs. New Mexico has several such deductions that would need to be modified to meet the requirements. Finally, New Mexico should change some exemptions for local option GRT impositions related to transportation services to align with SSUTA requirements.

Questions and comments from committee members included the following.

- How will services that are sold out of state be taxed? Ms. Hecht said that, in general, for destination-based sourcing, the tax rate at the location of the customer will prevail.

However, New Mexico currently has a deduction from the GRT for services that are initially used in another state. There may be situations in which two states impose a sales tax, but New Mexico allows for a credit to be claimed in that situation.

- How would any changes New Mexico makes regarding sourcing apply to the various tribal lands that also impose a version of the GRT? Mr. O'Neill said that there are about 17 tax collection agreements with tribes that are currently in effect. Any changes New Mexico makes will also apply on tribal lands, according to the agreements. In general, tax collected from tribal members is distributed to the tribe, and tax collected from non-tribal members is shared among the tribe, county and state.
- Does New Mexico need to become a member of the SSUTA to collect the GRT from online vendors? Mr. O'Neill said that the state is already mostly in compliance with the SSUTA. It probably is not necessary to actually join.
- New Mexico needs to switch to destination-based sourcing, at least for tangible personal property. Otherwise, local governments will lose out on tax revenue from online transactions.

Payment in Lieu of Taxes (PILTs): An Overview

Steve Kopelman, executive director, New Mexico Counties, and Joy Esparson, government affairs director, New Mexico Counties, discussed with the committee the federal PILT program and how it affects counties. PILTs are reimbursements from the federal government to a county to offset the substantial amount of nontaxable federal land in the county. Not all federal land is eligible for inclusion in the PILT calculation, however. U.S. Department of Energy, National Aeronautics and Space Administration, U.S. Department of Homeland Security and most military property is not eligible to be included, and neither is tribal property. Some counties, such as Catron, Rio Arriba and San Juan, have very high proportions of nontaxable property, and much of that property is often excluded from PILT calculations. The PILT formula considers how many acres in the county are eligible, the population, prior year federal payments from other federal reimbursement programs, state laws, the Consumer Price Index and the year's congressional funding. The 2018 total PILT payment for the state was \$42 million, with the payment per acre ranging from \$.24 in Catron County to \$2.70 per acre in Dona Ana County.

The Secure Rural Schools and Community Self-Determination Act of 2000 (SRS) also provides funding to rural counties and school districts as an offset to the majority of forest reserve funding traditionally provided to forested states in the Pacific Northwest. When the authorization for SRS funding expired in 2014, New Mexico's forest reserve payments dropped from \$9.3 million to \$725,000. Congress reauthorized funding for federal fiscal years 2017 and 2018 but has not yet acted on the upcoming fiscal year. PILT funding, which is not always recurring, is usually put into county general funds. This is a risky revenue source that can change from year to year. SRS funding can only be used for public schools, roads and certain county

services. The bulk of SRS funding the state receives is directed to Catron and Rio Arriba counties.

Questions and comments from committee members included the following.

- Why are tribal lands excluded from PILT funding? Ms. Esparson said that Alaskan Native tribes have lobbied against tribal lands being included in PILT calculations, mostly due to large oil and gas reserves in some areas of Alaska. Mr. Kopelman said that the federal government often makes a huge amount of money from federal lands and returns a small portion to the counties. Tribal land, however, does not typically generate any revenue for the federal government.

Distributions to Local Governments: Problems and Issues

William Fulginiti, executive director, NMML, discussed with the committee problems associated with distributions of GRT revenues to municipalities and take-backs of distributions by the state. In 1981, the TRD took back money from a distribution that had been delivered to Artesia. Artesia sued the state on the basis that the state had no statutory authority to take back a distribution, and it won the case in state district court. At that point, the TRD negotiated with the NMML and counties to establish a statute that would allow for adjustments to distributions under certain circumstances. This was the genesis of Section 7-1-6.15 NMSA 1978, which puts limits on how much money can be taken back at a given time and sets limits on how far back a distribution can be adjusted. This system worked for a while, until the TRD reported to the City of Eunice that it owed the state \$2.3 million because of a business that reported income in the wrong location for several years. The city sued the TRD and won the case, based on the fact that the statute did not allow adjustments of distributions to extend beyond one year after the distribution had been made. The TRD, however, continued to ignore the provisions of the statute and has taken distributions back from many other municipalities and counties. Mr. Fulginiti estimated that the amount of money incorrectly taken from local governments in the past two decades is more than \$150 million. The NMML is deciding whether to file a lawsuit to force the TRD to start following the law.

Section 7-1-6.15 NMSA 1978 was amended in 2015, but the TRD interpreted the changes to mean that the department does not need to notify a local government until the take-back amount exceeds 20 percent of the local government's annual distribution. This interpretation has resulted in an absurd situation in which the TRD does not ever notify local governments of adjustments to distributions. The GenTax system that is used by the TRD to administer most tax revenues does not include programming to track distribution adjustments.

Mr. Fulginiti stated that another issue that may need to be addressed by the courts is the inclusion of language in the annual general appropriation act — House Bill (HB) 2 — to include extra administrative fees that the TRD is authorized to withhold from distributions. The NMML has hired an outside attorney who has provided a legal opinion that finds there is no constitutional authority for the legislature to make substantive law changes in HB 2, and if the

legislature wants to grant authority for the TRD to withhold more administrative fees, it needs to make statutory changes to sections of the Tax Administration Act. The NMML has been working with legislative leadership to remove this language from future appropriation acts. Mr. Fulginiti said that, taken together, the distribution adjustments and the extra administrative fees total more than \$260 million in money that belongs to local governments.

Questions and comments from committee members included the following.

- Will the proposed legislation put forth to amend the distribution adjustment statute be identical to Senate Bill 236, adopted nearly unanimously in 2017 but vetoed by the governor? Mr. Fulginiti said that the new legislation will be identical to the previous legislation.
- Does the NMML have estimates for how much each municipality and county is owed in incorrectly adjusted distributions? Mr. Fulginiti said that the NMML has done thorough research to arrive at the more than \$260 million estimate, which includes \$110 million in inappropriate administrative fees. Each local government will need to determine exactly how much is owed, and whether to pursue compensation.
- Do local governments have sufficient expertise and staffing to make a determination of how much they are owed? Mr. Fulginiti said that it would involve a simple arithmetic process to calculate the inappropriate administrative fees, but calculating distribution adjustments may require some auditing to arrive at a final number. The NMML has contracted with experts to assist small local governments in making these calculations.
- Are the distribution adjustment calculations made by the TRD legitimate? Mr. Fulginiti said that taxpayers can claim refunds for misfiling their GRT tax returns going back several years, but the TRD is not allowed to take back those distributions from local governments more than 23 months prior to the current distribution.
- What explanation did the governor give for her veto of Senate Bill 236 in 2017? Mr. Fulginiti said that the governor claimed that the state could not afford at the time to give money back to the local governments.

Adjournment

There being no further business, the committee adjourned at 11:32 a.m.