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

June 25, 2018
State Capitol, Room 322
Santa Fe

The first meeting of the Revenue Stabilization and Tax Policy Committee for the 2018 interim was called to order by Representative Jim R. Trujillo, chair, on Monday, June 25, 2018, at 9:00 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. Tim D. Lewis
Rep. Antonio Maestas
Rep. Javier Martínez
Sen. Mark Moores
Sen. George K. Munoz
Sen. Clemente Sanchez
Sen. William E. Sharer
Rep. James R.J. Strickler
Sen. James P. White
Sen. Peter Wirth

Absent
Sen. Gay G. Kernan
Sen. John Arthur Smith
Rep. Carl Trujillo

Designees
Sen. Pete Campos (attending as a guest)
Rep. Bealquin Bill Gomez (attending as a guest)
Sen. Nancy Rodriguez
Sen. Elizabeth "Liz" Stefanics (attending as a guest)
Sen. Pat Woods

Rep. David E. Adkins
Rep. Eliseo Lee Alcon
Rep. Cathrynn N. Brown
Sen. William F. Burt
Sen. Jacob R. Candelaria
Rep. Daymon Ely
Rep. Bill McCamley
Rep. Rod Montoya
Rep. Debbie A. Rodella
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 Legislators
Rep. Larry A. Larrañaga
Rep. Patricia A. Lundstrom
Sen. Howie C. Morales

Staff
Pam Stokes, Staff Attorney, Legislative Council Service (LCS)
Erin Bond, Research Assistant, LCS
Ric Gaudet, Researcher, LCS

Guests
The guest list is in the meeting file.

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

Monday, June 25

Post-Session Fiscal Review
Jon Clark, chief economist, Legislative Finance Committee (LFC), and Dawn Iglesias, economist, LFC, gave a presentation to the committee about the state's financial outlook following the regular legislative session. Ms. Iglesias said that rising revenues and reserve levels allowed the legislature to appropriate $259 million more for fiscal year 2019 than was made in 2018. The extra appropriations include $90 million for state employee compensation increases while still maintaining reserve levels at 10 percent. Recurring revenues are finally expected to exceed fiscal year 2015 levels in fiscal year 2018, and revenues for each month in the current fiscal year have been above monthly levels for the two previous fiscal years. Revenue collections for the fiscal year through April increased 14.8 percent from the previous fiscal year and were $307 million higher than was predicted by the January 2018 consensus revenue forecast.

The primary driver for the surge in revenues is from increased production in the oil and gas industry. Oil production is up 33 percent compared to last year, and gas production is up five percent. Oil prices have also risen and are $4.00 per barrel higher than what the revenue forecast estimated. Matched taxable gross receipts have increased 13.6 percent for the first three quarters of fiscal year 2018, and most of that increase is attributable to the oil and gas industry.

Mr. Clark reviewed the following notable tax legislation debated during the recent legislative session:

- Senate Bill 99 (Chapter 62) created a gross receipts tax (GRT) deduction for certain military-related construction services;

- House Bill 79 (Chapter 46) created a GRT deduction for the sale of certain items by New Mexico small businesses on the Saturday after Thanksgiving;

- Senate Bill 231 (Chapter 36) provides foster youth employment income and corporate income tax credits of up to $1,000 per foster youth employed;

- House Bill 35 (Chapter 48) increases the distribution of liquor excise tax revenue to the Local DWI Grant Fund and provides a distribution to the newly created Drug Court Fund;

- House Bill 194 (Chapter 56) allows taxpayers to present alternative evidence in lieu of a nontaxable transaction certificate for the purpose of claiming a deduction from gross receipts;

- House Bill 245 (Chapter 58) clarifies a definition for purposes of deducting certain construction-related material from gross receipts;

- House Bill 223 (Chapter 57) transfers collection of the premium tax and other related insurance taxes to the Taxation and Revenue Department (TRD);

- House Bill 329 (Chapter 77) allows truckers from Mexico operating within a 10-mile region of the international border to obtain longer-term special fuel user permits;

- Senate Bill 192 (vetoed) would have imposed a daily surcharge on certain health care facilities to leverage federal Medicaid dollars; and

- Senate Bill 17 (vetoed) would have imposed the GRT on the contractor of a national laboratory if the contractor is a nonprofit organization.

Mr. Clark discussed issues that the committee should consider during the interim, including the need to maintain higher reserve levels due to the heavy reliance of the state on the energy sector, possible legislation to hedge against negative impacts on certain New Mexico households resulting from recent federal tax reform, potential large revenue risks from new interpretations of the chemicals and reagents GRT deduction, legislation to align the GRT structure with a recent U.S. Supreme Court decision on internet sales and possible GRT reform legislation to broaden the tax base and lower rates.

Questions and comments from committee members included the following.

- Why was New Mexico's credit rating recently downgraded by Moody's? Mr. Clark said that the state's economy has long-term structural issues and an overreliance on volatile revenue sources. In addition, large unfunded pension liabilities contributed to the rating downgrade.

- What is the status of the many tax protests with which the TRD is involved? Mr. Clark said that the LFC requested more detailed information from the TRD about the nature of current tax protests but has not yet received a response. The legislature also needs more information from the department about the chemicals and reagents GRT deduction that is being exploited by some taxpayers.

- Is the entity that was recently awarded a contract to operate Los Alamos National Laboratory (LANL) a nonprofit organization? Mr. Clark said that Texas A&M University, which is part of the consortium that was awarded the contract, has indicated that the entity is applying for status as a nonprofit organization.

- What will be the impact on New Mexico taxpayers of recently enacted federal tax reform legislation? Mr. Clark said that the August consensus revenue forecast will provide detailed estimates of the impact on various categories of residents.

- How much money is expected to be deposited into the Tax Stabilization Reserve from excess oil- and gas-related tax revenue? Ms. Iglesias said that excess revenues are scheduled to begin in fiscal year 2019. The January revenue forecast estimated that $15 million would be transferred to the reserve but that the number will be much higher based on recent expansion of oil production in the state.

- Insufficient pipeline capacity in southeastern New Mexico has meant that oil has been sold at a discount. This has probably cost the state hundreds of millions of dollars in royalty and tax payments.

- The state's economy is in need of diversification, but that will not happen unless its tax codes are reformed.

- Local governments surrounding LANL will suffer if they lose a significant portion of their GRT base from the operation of the laboratory by a nonprofit entity. Most GRT increments are already bonded against future revenue, and that revenue stream may be jeopardized.

Discussion of Work Plan and Meeting Schedule

Ms. Stokes discussed with the committee its proposed work plan and meeting schedule for the 2018 interim. The committee is proposing to hold six meetings during the interim in Santa Fe for a total of 11 meeting days. The proposed work plan includes broad areas of study, including options for taxing internet sales; the effects of federal tax reform on New Mexico's tax structure; the increasing reliance on the oil and gas sector for the state's revenues; the effectiveness of tax incentives; taxation of the health care industry; issues related to the transfer to the TRD of the administration of the premium tax; and the effectiveness of the TRD in administering tax credits, tax protests, taxpayer advocacy, data analytics and distributions to local governments. The committee would also be tasked with determining any legislative changes that will improve the state's tax system and revenue stabilization. The July meeting of the committee will be designated a "Tax Summit", in which various national and state experts will provide testimony on many current tax issues.

Ms. Stokes said that the committee is proposing to retain the services of the New Mexico Tax Research Institute (NMTRI) to assist in the development of the summit. After discussion of the idea, a motion was adopted, with one vote against, to contract with the NMTRI.

A member requested that the committee study the possibility of legalizing sports betting in New Mexico, including any possible revenue impacts that may happen from that legalization. The item was added to the proposed work plan.

The committee adopted the amended work plan unanimously.

Tax Study Final Report

Andrew D. Phillips, principal, Quantitative Economics & Statistics (QUEST), Ernst & Young, LLP (EY); Caroline Sallee, senior manager, QUEST, EY; and Robert Buschman, Ph.D., senior research associate, Center for Fiscal Research, Georgia State University, presented the final report of the tax study commissioned by the legislature. Mr. Phillips said that EY was commissioned to develop a tax analysis model for the legislature's use, undertake an analysis of the degree of pyramiding in the GRT, analyze the distributional impacts of various tax changes on households and businesses and assess the strengths and weaknesses of New Mexico's tax system.

<u>Analysis of Current Tax System in New Mexico</u>

EY performed a comparative analysis of New Mexico and several neighboring and peer states, including Arizona, California, Colorado, Hawaii, Nevada, Oklahoma, Oregon, Texas and Utah. New Mexico's GRT rate of 5.125 percent is average compared to the peer states, and when factoring in a weighted average of state and local sale tax rates, it ranks even better. New Mexico also has low personal income tax (PIT) rates compared to most of its peers. New Mexico's GRT revenue is more volatile than most of the peer states, but it is also less reliant on the GRT than other states are on their sales taxes. New Mexico is also less reliant than its peers on PIT revenue, the volatility of which is lower than other states due, in part, to its lower share of business and capital gain income.

During the period of fiscal years 2005-2016, GRT revenue generally followed the trend of economic activity in the state. However, over the longer period of 1998-2016, revenue from the

GRT has grown more slowly than the state gross domestic product (GDP). PIT revenue grew faster than total personal income over this same period.

The tax analysis determined that the amount of state and local taxes borne by businesses in the state is 6.4 percent of state GDP, which is higher than the U.S. average and the peer state average. Business taxes per private sector employee equaled $7,000, compared to the nationwide average of $5,800. New Mexico residents, however, are relatively less burdened by the PIT than residents in peer states. About 45 percent of gross receipts in fiscal year 2017 were classified as taxable for firms with annual receipts of over $10 million. For smaller businesses with annual receipts of less than $100,000, more than 70 percent of their gross receipts were taxable. The GRT is also a fairly regressive tax. Taxpayers with incomes less than $17,000 pay almost 10 percent of their incomes as GRT taxes, while those with incomes above $338,000 pay 1.3 percent of their income as GRT taxes. New Mexico's PIT structure is fairly progressive for individuals with incomes up to $100,000 due to the presence of credits that provide targeted relief to low-income taxpayers. Effective tax rates for businesses in New Mexico, before the application of various credits and deductions, are higher than the average of the peer states. However, for certain industries, such as manufacturing and services, effective tax rates are lower than the peer average.

GRT Model

Ms. Sallee presented the GRT model, which is able to model proposed changes in GRT law and provide an estimate of the effects. The model uses data from fiscal year 2016, which can be updated each year and are contained inside an Excel workbook. TRD RP-80 data were categorized into standard industry classifications, with reported gross receipts, deductions and gross tax estimated. Each industry was also ranked according to the dollar amount of deductions taken. The model also estimates changes made to compensating tax laws using similar data, and it estimates the distributional effects of tax proposals on various classes of households. Tax expenditures that have been estimated by the TRD or LCS were included, and many that did not have a calculated dollar amount were estimated using national data. Some tax expenditures are closely related, so EY attempted to account for overlap and cascading effects of eliminating one expenditure. This is particularly true in the health care sector, in which several deductions and exemptions cannot be measured independently of each other.

The model can estimate revenue impacts from a single change or multiple changes made to GRT deductions, exemptions and credits and provides a tax rate that would make the changes revenue neutral. It reports the value of the changes by industry and the distributional effect of the changes. In addition, the model can estimate the changes that could occur in the PIT program to offset revenue changes in the GRT program.

PIT Model

Dr. Buschman discussed with the committee the PIT model, which is able to model proposed changes in the PIT program and provide an estimate of the effects. The PIT model is also Excel based and is able to provide reports detailing tax law changes on taxpayers by filing status, PIT-B status and itemizer status, in addition to income level. Data were obtained for PIT filers from the TRD for tax year 2015, but they can be updated annually. The model was modified to include federal tax reform changes, including eliminating personal exemptions, increasing the standard deduction and adjusting itemized deductions. He recommended that a full analysis be performed of the adjustments made to accommodate federal tax law changes to ensure accuracy of the model, as subsequent PIT data become available. The model also provides a distributional analysis for proposed PIT changes.

Questions and comments from committee members included the following.

- How accurate is the PIT model, since the TRD was unable to provide complete information for EY to complete the model? Dr. Buschman said that the model used itemized deduction data from the federal government because the state does not have the data in sufficient detail.

- The tax model presented by EY is a good framework for modeling future proposed tax law changes. The confidentiality statutes should be modified to allow the TRD to release more taxpayer data to the LFC.

Adjournment

There being no further business, the committee adjourned at 1:00 p.m.