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

July 25-26, 2019
State Capitol, Room 322
Santa Fe

The second meeting of the Revenue Stabilization and Tax Policy Committee for the 2019 interim was called to order by Senator Carlos R. Cisneros, chair, on Thursday, July 25, 2019, at 9:01 a.m. in Room 322 of the State Capitol in Santa Fe.

Present
Sen. Carlos R. Cisneros, Chair
Rep. Javier Martínez, Vice Chair (7/25)
Sen. Pete Campos
Rep. Roberto "Bobby" J. Gonzales
Rep. Jason C. Harper
Rep. Susan K. Herrera
Sen. Gay G. Kernan
Rep. Antonio Maestas
Rep. Rod Montoya
Sen. George K. Munoz (7/25)
Sen. Clemente Sanchez
Sen. William E. Sharer
Sen. John Arthur Smith
Rep. James R.J. Strickler
Rep. Jim R. Trujillo

Absent
Rep. Doreen Y. Gallegos
Sen. Mark Moores
Sen. Peter Wirth

Designees
Rep. Christine Chandler
Sen. Nancy Rodriguez (7/26)
Rep. Andrea Romero (7/25)
Sen. Elizabeth "Liz" Stefanics (7/26)
Rep. Martin R. Zamora (attending as a guest 7/25)

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. Tim D. Lewis
Rep. Patricia A. Lundstrom
Rep. Angelica Rubio
Rep. Patricio Ruiloba
Rep. Larry R. Scott
Sen. Bill Tallman
Rep. James G. Townsend
Sen. James P. White
Sen. Pat Woods

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

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.

Thursday, July 25

Welcome and Agenda Overview
Richard Anklam, president and executive director, New Mexico Tax Research Institute, welcomed the committee to the meeting, which was organized as an educational "Tax Summit". The two days of presentations were developed in order to educate policymakers on several pressing tax issues, with a mix of local and national experts delivering presentations.

What Just Happened? In-Depth Review of House Bill 6 (2019)
Stephanie Schardin Clarke, secretary of taxation and revenue, and Emily Oster, deputy secretary of taxation and revenue, discussed with the committee implementation of House Bill 6, passed in the recent legislative session, and provided an update on the Taxation and Revenue Department (TRD). Secretary Schardin Clarke reported to the committee that the TRD recently hired Tim Van Valen as the department's chief legal counsel, and Vince Mares has been hired as the director of the Tax Fraud Investigations Division. The TRD is still looking to fill the position of chief economist. The TRD received a 2.4 percent budget increase for fiscal year 2020, but the department still has an employee vacancy rate of 26 percent. However, staffing levels have increased since the beginning of the year when the agency vacancy rate was nearly 30 percent.

Secretary Schardin Clarke discussed House Bill 6, which was enacted as Laws 2019, Chapter 270. The law reformed multiple areas of tax law, and the TRD is in the process of implementing each change. Many internet sales are now subject to the state's gross receipts tax (GRT), and those sales will be subject to local GRT rates beginning in 2021, with distributions to be made to local governments. The local option imposition of the GRT was delayed for two years because the TRD will need to develop a mechanism to switch most of the GRT base from origin-based sourcing of sales to destination-based sourcing. Tangible personal property and some services will be sourced at the buyer's location, rather than at the seller's location, to allow local governments to impose their GRT increments. However, professional services will remain origin-sourced. The TRD is developing rules to determine what "professional services" means

and is developing a database for sellers to use in determining which GRT rates to impose for all locations in the state. During the implementation period, local governments will receive a pro rata share of GRT distributions totaling $24 million annually.

House Bill 6 made several changes to tax law, including:

- imposing the GRT mostly equally on all hospitals, which will provide increased revenue that can then be used to leverage federal Medicaid money to increase reimbursement rates for hospitals;

- increasing the motor vehicle excise tax from three percent to four percent and dedicating the increased revenue for two years to road improvements in southeastern New Mexico and, after that, to the State Road Fund and the Local Governments Road Fund;

- increasing the cigarette tax from $1.66 to $2.00 per pack; lowering the tobacco products tax to $.50 per cigar; and imposing the tobacco products tax at a 12.5 percent rate on e-cigarette liquid and at $.50 per closed-system cartridge;

- modifying personal income tax (PIT) provisions, including increasing the working families tax credit (WFTC) from 10 percent to 17 percent; decreasing the capital gains deduction for income above $1,000 from 50 percent to 40 percent; restoring dependent deductions to offset recent federal tax changes; and conditionally imposing a new top marginal PIT rate of 5.9 percent for high-income earners; and

- making changes to the corporate income tax (CIT) system by requiring combined or consolidated reporting for multistate companies, changing the sales factor in the CIT apportionment formula to market-based sourcing and allowing net operating losses of companies currently filing as separate entities to continue to be claimed, even though they will soon be required to file as a unitary group.

Secretary Schardin Clarke discussed other TRD-related legislation recently enacted into law. Senate Bill 2 (Chapter 87) made changes to the Film Production Tax Credit Act to authorize $195 million in tax credit payments to eliminate the current backlog of credit claims. The legislation set a new yearly aggregate cap of $110 million and tasked the Economic Development Department with managing the film budget and certification process to ensure the annual cap is not exceeded. "New Mexico film partners" that have made a 10-year commitment to making productions in the state are excluded from the $110 million cap. In addition, film productions located in certain rural areas of the state are eligible for an extra five percent credit.

Senate Bill 129 (Chapter 157) made changes to the tax protest process and extended time lines for tax protests to be informally resolved with the TRD before being adjudicated by the

Administrative Hearings Office (AHO). The legislation also modified AHO protest procedures and added qualified persons who are able to represent taxpayers at protest hearings.

Deputy Secretary Oster discussed implementation of the transfer of the administration of the premium tax from the Office of Superintendent of Insurance to the TRD. House Bill 162 (Chapter 47) made changes to legislation enacted in 2018 that provided for the transfer of the tax administration to the TRD. The new law specifies that the Insurance Premium Tax Act falls under the auspices of the Tax Administration Act, which gives the TRD the tools it needs to audit taxpayers and enforce compliance and also gives taxpayers the same rights that other taxpayers have under other tax programs. The TRD will request funding in the next legislative session to enable administration of the premium tax within the TRD's GenTax system, which is the software system that the department uses to administer most tax programs.

Finally, Deputy Secretary Oster discussed implementation of House Bill 479 (Chapter 274) that de-earmarked several local option GRT increments, allowing the revenue from those increments to be used for general purposes. Changes in the TRD's GenTax system will not be significant because the legislation will not impact actual distributions to local governments but will provide them with greater flexibility to manage their finances.

Questions and comments from committee members included the following.

- How much money in Medicaid reimbursements will be generated from the imposition of the GRT on all hospitals? Clinton Turner, tax policy director, TRD, said that the imposition is expected to generate $100 million in new tax revenue. The General Appropriation Act of 2019 included $100 million in additional money for Medicaid reimbursements, which will generate a three-to-one federal match.

- What can the legislature do to help the TRD improve its performance? Secretary Schardin Clarke said that the TRD budget is not the limiting factor in employee recruitment and retention. The department has been able to add only 30 people to its statewide workforce recently. New state employee policies related to fitness and wellness programs should help, as well as TRD policies that encourage employees to gain additional education credentials.

- The state significantly increased taxes this past legislative session but then gave much of the additional revenue to the film industry.

- Confusion about how the compensating tax is being imposed by the TRD is affecting small businesses across the state. One appliance dealer has been fined by the TRD for not paying compensating taxes on appliances purchased for resale, which is not how the law is intended. Deputy Secretary Oster said that the mission of the TRD is to treat all taxpayers fairly. The audit selection process is entirely data-driven, and

attempts are made to resolve tax liability issues before the costly audit process is initiated.

- New Mexico residents want public safety, good infrastructure and a quality educational system, but these all cost money. Previous administrations have decimated the TRD, and the current secretary inherited a mess.

House Bill 6 Implementation and Unfinished Business

The committee heard a discussion from local government representatives and tax practitioners about issues created by the passage of House Bill 6 and the change to destination-based sourcing for the GRT. The panel included Brian Moore, government relations and lobbyist, New Mexico Counties; William F. Fulginiti, executive director, New Mexico Municipal League (NMML); Jim O'Neill, Esq., consultant, NMML; Bobbi Kay Nelson, C.P.A., Atkinson & Co.; Scott Woody, Esq., Gallagher & Kennedy, P.A.; and Suzanne Wood Bruckner, C.P.A., Esq., Sutin, Thayer & Browne, P.C.

Mr. Moore said that it was good policy to share some state revenue from taxing internet sales with local governments during the transition to destination-based sourcing of transactions. The TRD has been dysfunctional for years, and he said that he was glad to see it beginning to turn around. Local governments want a seat at the table whenever big policy decisions are being made that may affect local revenues, he said.

Mr. Fulginiti expressed his gratitude to the legislature for finally addressing the internet sales issue. This will level the playing field somewhat for in-state businesses. He also said that the NMML has been advocating enactment of a local compensating tax, which was enacted in 2019. Although some local governments may lose some GRT revenue from the switch to destination-based sourcing, most will witness revenue increases.

Mr. O'Neill said that the taxation of internet sales and the provision of local option GRT revenue to local governments from those sales will have the effect of making local government tax bases more opaque, because a significant part of the tax base will not be located in the local government's jurisdiction. He also said that the definition of "professional services", which will be origin-based in calculating GRT liabilities, needs to be better defined, perhaps by tying the definition to a state-licensed profession.

Ms. Bruckner discussed the impacts of House Bill 6 on the business community. She said that the TRD needs to provide early guidance on how GRT sourcing rules will be implemented before any final rules are issued. Tax practitioners also need to provide input into how those changes should be implemented. Businesses will need to be informed about what new information they will need to maintain in order to comply with the changes. Corporations in New Mexico will also soon need guidance on CIT changes, especially regarding how market-based sourcing for the sales factor will be implemented. In addition, companies will need

guidance on how they will be able to carry forward any net operating losses during the transition to combined reporting.

Ms. Nelson said that her tax practice deals mostly with small businesses. GRT sourcing changes will be a very big issue for businesses to cope with. Many small businesses do not have much expertise in tax law, and the TRD will need to provide training for practitioners and businesses. Ms. Nelson commented that in 2019, the TRD has been responsive to all of her inquiries, which responsiveness has not been present at the department in many years.

Mr. Woody said that businesses want clear tax laws and regulations and that the TRD needs full funding in order to run a smooth tax program that provides fair and consistent treatment to taxpayers. He discussed a few issues relating to the upcoming change to GRT sourcing rules, including the need to calculate tribal-state splits in areas where the state collects tribal GRT revenue; fixing sourcing rules for leasing of real property before 2021; and developing sourcing rules regarding retail deliveries versus customer pickups.

Questions and comments from committee members included the following.

- The legislature should consider repealing the authority for local governments to impose hold harmless GRT increments now that they will be receiving GRT revenue from internet sales.

- How will services be sourced for calculating GRT liability? Ms. Bruckner said that professional services will remain origin-based but that most other services will switch to destination-based sourcing.

Tax Administration: Best Practices for Working with Practitioners and Businesses to Develop Clear Rules, Reduce Conflict and Improve Collection and Compliance

Nancy Prosser, Esq., general counsel, Texas Comptroller of Public Accounts (TCPA), discussed with the committee how the TCPA approaches rulemaking related to taxes. The TCPA is headed by a statewide elected official in Texas and oversees fiscal and tax administration for the state. The Tax Policy Division is responsible for writing rules based on statutory tax law. Ms. Prosser emphasized the importance of well-written rules to minimize disputes and litigation, allow for better use of staff time and promote better customer service. The TCPA is bound by statutory and legal precedent in developing and applying rules, including the concept that an agency cannot make a rule merely by issuing a letter to a taxpayer; that rules have the force of law; that agencies must follow their own rules; and that if a statute is vague, courts usually defer to an agency rule for clarity. Although state law does not require consultation with stakeholders prior to adopting a rule, the TCPA has established such input as a critical component of rulemaking.

The TCPA tax policy staff has 33 members, including several attorneys and non-attorney tax experts, two rules liaisons for formatting and an editor. Most staff members have other

responsibilities in addition to writing rules. The division also gets input about proposed rules from other divisions as needed. Staff receive training on how to write rules that match technical and legal terms but that are also understandable to stakeholders. Rulemaking is a time-consuming and complicated process, with an average of 350 days needed for a rule to be adopted. When a rulemaking process is initiated, a team of staff members is identified and a planning memorandum is issued setting out the process. Then outside stakeholders are identified and asked for input prior to a rule being developed. Stakeholders usually include a tax practitioner advisory group and a business advisory group, each with its own particular point of view. The TCPA also hosts webinars, issues monthly bulletins and actively seeks public comment via its website.

Questions and comments from committee members included the following.

- How do stakeholders get chosen for providing input into a rulemaking process? Ms. Prosser said that there is a relatively small group of regular tax practitioners who participate in rulemakings. Input is also solicited from the State Bar of Texas, the local association of accountants, tax professionals from large companies and key industry players for the particular subject.

- Industry groups will always have their own self interest at stake when providing input for rules. Ms. Prosser agreed and said that the TCPA's first obligation is to follow the law, not what the industry wants. She said it is always better to have as many stakeholders at the table early, even if the industry viewpoint is not adopted.

Federal Tax Cuts and Jobs Act of 2017 (TCJA) Conformity and Federal Child Tax Credit and Earned Income Tax Credit Reforms; State Taxation of Marijuana

Richard C. Auxier, research associate, Urban-Brookings Tax Policy Center, Urban Institute, discussed with the committee changes made by the TCJA that affect states and discussed recent trends in state taxation of recreational marijuana.

TCJA Conformity

The TCJA made significant changes to the federal income tax system in 2017, which affected states that had linked their tax codes to federal tax law. Most states link definitions of income to federal adjusted gross income, which the TCJA did not change very much. However, the TCJA eliminated personal exemptions, nearly doubled the standard deductions and doubled the child tax credit. For most taxpayers, this meant a federal tax reduction. However, many taxpayers in states that coupled tax provisions to personal exemption amounts, like New Mexico, ended up paying higher state income taxes. Married couples and heads of households with multiple dependents generally paid higher New Mexico PIT because they were no longer able to claim personal exemptions for their dependents.

The legislature in 2019 enacted legislation to address this issue by allowing a deduction from income in the amount of $4,000 for every dependent beyond the first one claimed and by

increasing the WFTC from 10 percent to 17 percent. The legislation targeted most taxpayers negatively affected by the TCJA but missed some taxpayers and benefited higher income earners the most.

Mr. Auxier discussed other reforms the state could consider if its goal is to assist working families, including eliminating the new dependent deduction and replacing it with a generous child tax credit and expanding the WFTC to childless workers and younger workers. He said that many parents with dependents are unable to claim the WFTC because another parent is claiming that person as a dependent for tax purposes.

Marijuana Taxes

Mr. Auxier discussed state taxation of recreational marijuana. Before a state decides to tax recreational marijuana, it needs to decide what policy goals it hopes to achieve from the taxation, some of which may conflict. For example, setting a tax rate that maximizes state revenue will not help in eliminating the illegal market for marijuana. The goals of tax policy of marijuana are only one facet of a much larger issue surrounding its legalization. Licensing, regulation, criminal justice issues and drug abuse issues are even more critical than tax policy goals.

Currently, 12 states allow recreational marijuana, and seven of those states have a marijuana tax system in place. There are many possible ways of taxing marijuana, including as a percentage of the retail or wholesale price, based on weight and based on the amount of tetrahydrocannabinol (THC) in products. Several states tax marijuana as a percentage of its retail value, with tax rates ranging from 10 percent to 37 percent. This is a relatively simple tax system to understand and administer, but tax revenues will decrease as the retail price of marijuana falls, as witnessed in Colorado between 2014 and 2017. The retail price of one gram of marijuana flower fell from $14.05 to $5.35 during that time, with a corresponding drop in tax revenue.

Another tax scenario, adopted by Alaska and California and being considered in Maine, is to tax various components of marijuana at different rates based on weight. For example, Alaska taxes marijuana buds at $50.00 per ounce and $15.00 per ounce for the remainder of the plant. The benefits of this tax structure include that tax revenue is stable even if retail prices fall and that it might discourage illegal sales of legally grown products because once a plant has been taxed, there is little incentive to sell the product on the illegal market. However, this taxing structure can also encourage retailers to produce more potent products in order to reduce their overall tax liability. Illinois in 2020 will begin to tax marijuana based on THC levels, which should also be a more stable revenue stream that is not dependent on price. However, THC content is not always directly correlated to the level of intoxication a person may experience when consuming the product. Finally, states could have government-run stores sell marijuana, similar to state-run liquor stores. This could raise more money than other tax regimes, but it also puts the state in the awkward position of selling marijuana, which is still illegal at the federal level.

Questions and comments from committee members included the following.

- New Mexico should not legalize marijuana merely to raise revenue. There will always be social costs associated with marijuana use that outweigh revenue gains. In Colorado, legalization of recreational marijuana actually made the illegal market bigger. Mr. Auxier said that California is experiencing similar issues with the illegal market. But researchers have pointed to the burdensome licensing system, and not the tax rate, as a reason why the illegal market is still very large.

- New Mexico's low-income comprehensive tax credit (LICTR), originally enacted to offset the regressivity of the GRT, has not been modified in more than 30 years. The legislature recently raised the WFTC arbitrarily, without any data to inform that change.

- New Mexico is very close to legalizing recreational marijuana. Bipartisan legislation in 2019 provided for a 17 percent tax rate based on retail price, plus an excise tax of nine percent.

Improving Personal Income and Pass-Through Tax Compliance after Federal Audit Changes

Helen Hecht, Esq., C.P.A., general counsel, Multistate Tax Commission (MTC), discussed with the committee model legislation developed by the MTC to allow states to capture audit adjustment revenue from pass-through entities (PTEs) audited at the entity level by the Internal Revenue Service (IRS). Partnership and other PTE income has surpassed corporate income in the United States, and one key reason is that income is only taxed at the individual level, rather than at the entity level and then again at the individual level, as is the case with corporations. As the structure of partnerships has grown increasingly complicated, sometimes with multiple levels of partnerships and thousands of partners, it has become difficult for the IRS to correctly assess tax liability based on the reported income of the partnership. In 2015, Congress enacted legislation that allowed the IRS to audit large partnerships and assess tax liability at the entity level, instead of the individual level. The IRS has adopted rules that are now in effect to implement the legislation.

Most states have the ability to assess state tax liability on corporations and individuals based on the results of a federal audit. However, states do not have the ability to assess that liability on PTEs. The MTC spent more than two years working with several taxpayer and practitioner groups to develop model legislation for states to enact that would allow them to assess tax liability at the entity level following a federal audit. If New Mexico does not enact this legislation, it will lose out on tax revenue it would otherwise be entitled to.

Questions and comments from committee members included the following.

- Do the new IRS rules apply to tax year 2019? Ms. Hecht said that the rules have recently taken effect but that prior years' audit tax liabilities can now be assessed at the entity level.

- Which state income tax rate would be applicable for audit assessments? Ms. Hecht said that the highest PIT rate would apply for PTEs assessed at the entity level, which is the same structure at the federal level.

Adoption of Minutes

The minutes from the June 11, 2019 meeting of the committee were adopted without changes.

Recess

The committee recessed at 4:12 p.m.

Friday, July 26

The committee was reconvened by Senator Cisneros on Friday, July 26, 2019, at 9:01 a.m.

Managing Volatility and Improving Tax Incentives

Jeff Chapman, director, state fiscal health, The Pew Charitable Trusts, and Akshay Iyengar, principal associate, state fiscal health, The Pew Charitable Trusts, discussed with the committee possible strategies for New Mexico to better prepare for economic downturns and to improve its evaluation of tax incentives. Mr. Chapman said that the nation's economy has been growing for a decade, but state finances across the country have not kept up with that growth. New Mexico is one of several states still emerging from the "lost decade", he said. The recession resulted in states foregoing more than $283 billion in revenue since 2009. Nearly one-half of the states are still spending less than they were a decade ago, after adjusting for inflation. State funding for higher education is down by 13 percent, and state funding for K-12 education is down an average of 1.7 percent. However, fortunately for New Mexico, in fiscal year 2020, the state significantly increased K-12 funding. State investment in infrastructure, as a percentage of gross domestic product, is at its lowest level in more than 50 years, and state aid to local governments is still lower than a decade ago.

Mr. Iyengar said that one of the goals of The Pew Charitable Trusts is to assist states in getting away from the traditional "boom-bust" fiscal cycle that is associated with economic upturns and downturns. New Mexico is currently using its excess revenues wisely by not labeling most of it as recurring and by putting much of the excess into reserves. The state's permanent funds have long been considered the best practice for managing revenue from extractive natural resources. Legislation enacted in 2017 to put the excess revenue from the oil and gas emergency school tax into the Tax Stabilization Reserve has also played a role in managing the state's fiscal volatility.

Mr. Chapman said that New Mexico has one of the nation's most volatile revenue streams, being largely based on the oil and gas industry. He made some suggestions for policymakers to consider further stabilizing the state's revenues, including:

- setting a reserve target to allow the state to weather a recession and deciding in advance how any excess revenue should be spent;
- stress testing all revenue streams and expenditures, which would give a better idea of how much risk exists. New Mexico already stress tests many revenue streams, but it should also consider testing expenditures;
- identifying long-term recurring and nonrecurring revenue streams for budget planning; and
- identifying well in advance of a recession what steps to take to mitigate a recession.

Mr. Iyengar discussed tax incentives in New Mexico and said that the state does not have a rigorous evaluation system of tax incentives. New Mexico is now in the minority of states that do not systematically evaluate incentives using historical data.

Questions and comments from committee members included the following.

- In 2008, New Mexico was spending too much money, and by 2009, the state was forced to drastically cut its budget. In 2019, the state dramatically increased its recurring budget again and is treating nonrecurring revenue as if it were recurring. Mr. Iyengar said that policymakers could consider adding other revenue streams to the Tax Stabilization Reserve based on five-year averages.
- Tax incentives to the film industry are essentially an unbudgeted, open-ended risk to the state's fiscal health. Mr. Chapman said that The Pew Charitable Trusts recommends periodic, rigorous evaluation of all tax incentives.
- New Mexico is currently experiencing an increase in revenues, but most of that money is nonrecurring. New Mexico's population has been stagnant for more than a decade, while surrounding states are experiencing large population increases.
- After 70 years, the state should probably delete the word "emergency" from the oil and gas emergency school tax.

New Mexico's PIT

Dawn Iglesias, chief economist, Legislative Finance Committee (LFC), and Janet Peacock, contract consultant, LFC, discussed with the committee the PIT system in New Mexico. Ms. Iglesias said that PIT revenue accounts for about 20 percent of General Fund revenue. PIT

revenue used to account for about 23 percent of General Fund revenue, but the oil and gas boom has increased direct revenues from the GRT and other extraction-related taxes. New Mexico has a fairly low top marginal rate of 4.9 percent, compared to the rest of the nation. However, a new top marginal rate of 5.9 percent for high-income earners may take effect in 2021 if revenues in fiscal year 2020 are less than five percent above fiscal year 2019 revenues.

If the new PIT rate takes effect, the General Fund should receive about $40 million extra annually from the PIT program. Other changes made by House Bill 6 to the PIT program reduce General Fund revenues by about $56 million. The new top bracket would affect about three percent of PIT taxpayers.

Ms. Peacock discussed with the committee the history and structure of the PIT program and reviewed several deviations from the tax base. The PIT system begins with federal adjusted gross income, and then standard or itemized deductions are subtracted from that amount. To arrive at New Mexico taxable income, other state-specific deductions are applied, such as the capital gains deduction. Then a progressive rate table is applied to specified taxable income brackets, and there are currently three categories of taxpayer: married filing separate; heads of household, surviving spouses and married individuals filing joint returns; and single individuals and estates and trusts. After tax liability has been calculated, various refundable credits and rebates may be taken to offset the tax due, including the WFTC and the LICTR. Many non-refundable tax credits are also available, which mostly apply to businesses.

PIT rates have fluctuated several times since 1933, with the biggest restructuring occurring in 1974, which established 16 tax brackets and set a top marginal rate of nine percent. In 2003, PIT rates were dramatically reduced, and the seven tax brackets in effect at that time were collapsed into four brackets, leaving a relatively inelastic tax structure. Beginning in the 1970s, the PIT program was used as a vehicle to achieve public policy goals besides generating revenue. The LICTR was created to offset the regressivity of the GRT program and was directed at low-income households. The rebate was specifically designed to be refundable, even if the taxpayer did not have any taxable income, because the assumption was that the taxpayer had paid a significant amount of money to the state in the form of GRT payments throughout the year.

In 2003, the state convened the Blue Ribbon Tax Reform Commission, which undertook a comprehensive review of the PIT program and other tax programs. The commission made many recommendations, a few of which have become law. One recommendation was to expand the LICTR program to other income levels with larger credits. Eventually, the legislature enacted the WFTC, which essentially provided for the same measures that were being recommended by the commission. The commission recommended eliminating the 50 percent deduction from net capital gains income and replacing it with a deduction for income realized from the sale of a closely held business. The commission also recommended collapsing the number of taxpayer categories from four into two, but the legislature in 2005 created the three categories that are in current usage. One of the main recommendations from the commission that did not happen was to maintain the GRT taxation on food but raise the LICTR amount to account for inflation and to

offset the regressivity of paying the GRT for food purchases. In 2004, the legislature enacted the GRT deduction for food. The LICTR has not been modified since 1998.

Ms. Peacock discussed several PIT "social benefit" tax expenditures. She said that none of these tax expenditures have been evaluated for their effectiveness, nor have they been evaluated against other possible social benefit strategies. She suggested that some of the incentives might need to be modified or repealed if they are not providing much benefit to taxpayers. However, she cautioned that it would take more study to analyze each incentive to see whether it is effective.

Ms. Peacock discussed several expired PIT provisions, as a history lesson for the committee to consider before enacting new tax incentives. For example, she discussed the history of exempting retiree income from the PIT. From 1967 until 1987, the legislature enacted various provisions exempting certain classes of retirement income from taxation, but in 1989, two courts ruled that this kind of selective exemption discriminated against other incomes that had not been exempted. Any attempt in the future to exempt certain kinds of retirement income from taxation will need to heed these court cases, as well as address the inherent questions of equity involved in exempting some classes of income but not others.

Questions and comments from committee members included the following.

- When the legislature repealed the public employee exemptions from retirement income, it sweetened the deal by creating the Retiree Health Care Authority under the mistaken impression that providing health care to retired public employees would not cost very much. Now, every year the authority gets closer to insolvency, and the program may eventually need to be canceled.

- Some PIT tax incentives cost the state millions of dollars but appear to have very little individual benefit. A tax credit of $14.00 does not do very much for an individual. It might be better to expand some of the credits that are working and repeal the remainder.

- What is the population demographic that will be subject to the new top marginal PIT rate? Ms. Peacock said that the upper income taxpayer category is very volatile. In addition, many of those taxpayers live out of state but apportion some of their income to New Mexico.

- The Governor Bill Richardson PIT rate reductions have cost the state more than $500 million annually since 2004, which has hurt the state. There are two million people living in New Mexico, and one-half of them are living in poverty.

Adjournment

There being no further business, the committee adjourned at 11:58 a.m.