# REVENUE STABILIZATION AND TAX POLICY COMMITTEE

# 2012 INTERIM

Prepared by the Legislative Council Service
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REVENUE STABILIZATION AND
TAX POLICY COMMITTEE
2012 Interim

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# Section 1

# 2012 INTERIM
# Annual Report and Summary

**Revenue Stabilization and Tax Policy Committee Summary**
**Representative Edward C. Sandoval, Chair**
**Senator Tim Eichenberg, Vice Chair**

**SUMMARY OF WORK COMPLETED**
**2012 Interim**

The Revenue Stabilization and Tax Policy Committee held seven meetings in 2012. Bill endorsements were completed on the second day of the December meeting, at which 16 of the 24 bills under consideration were endorsed.

This year, the tax that was discussed in the most detail was the corporate income tax (CIT). There have been many concerns raised about New Mexico's CIT rates and the way the state apportions income for multistate companies. In August, a hearing was held at Intel, and the committee received information from several sources about the need for a single sales factor apportionment formula, as well as the need for lowering the highest CIT rate from 7.6% to either 6.4% or 4.9%. Although there was much ongoing discussion about these proposals, there was not an endorsement of a bill because clarity was not reached on how the bill should be structured. Specifically, the committee tries to maintain revenue neutrality when giving tax incentives, which means that revenue anticipated to be lost from the incentive should be made up in some other way. The suggested mechanism for generating revenue to offset the loss in revenue from lowering the CIT rate was to repeal some of the tax expenditures in existing law or to require combined reporting. Some of the tax expenditures considered for repeal included the investment credit, the high-wage jobs tax credit, the rural job tax credit, the technology jobs tax credit and the research and development small business tax credit.

Two bills were endorsed by the committee to address the higher-than-expected costs of the high-wage jobs tax credit. The committee saw provisions in both bills that it would like to see in a final bill, and it will probably combine them into one bill at some point during the 2013 legislative session.

Another topic that was brought to the committee by several parties was that of creating an independent tax hearing office. There is a national concern that tax hearing officers are too tightly controlled by taxation departments and are subject to undue influence from the secretaries of those departments. The committee did not endorse this proposal at this time, but it will most likely be introduced in the 2013 session or be revised and brought before the committee again next year.

The release of the 2012 New Mexico Tax Expenditure Report, required by Executive Order 2011-071, was also of importance to the committee. Secretary of Taxation and Revenue Demesia Padilla and John Tysseling, chief economist, Taxation and Revenue Department, presented a summary of the report at the September meeting. The committee expressed concern that the report appeared to be incomplete since it did not include a significant number of tax expenditures; nor did it include evaluations and cost-effectiveness determinations mandated by the executive order or recommendations or details on the report's key findings.

REVENUE STABILIZATION AND
TAX POLICY COMMITTEE

# Section 2

# 2012 INTERIM
# Work Plan
# Schedule

**2012 APPROVED**
**WORK PLAN AND MEETING SCHEDULE**
**for the**
**REVENUE STABILIZATION AND TAX POLICY COMMITTEE**

**Members**

Rep. Edward C. Sandoval, Chair
Sen. Tim Eichenberg, Vice Chair
Sen. Mark Boitano
Rep. Donald E. Bratton
Sen. Carlos R. Cisneros
Rep. Anna M. Crook
Sen. Clinton D. Harden, Jr.
Sen. Timothy Z. Jennings
Sen. Timothy M. Keller
Sen. Gay G. Kernan
Rep. Ben Lujan
Rep. Rodolpho "Rudy" S. Martinez
Sen. Howie C. Morales
Rep. Henry Kiki Saavedra
Sen. John Arthur Smith
Rep. Thomas C. Taylor
Rep. Jim R. Trujillo
Rep. Bob Wooley

**Designees**

Sen. Rod Adair
Rep. Ray Begaye
Sen. William F. Burt
Rep. Zachary J. Cook
Rep. Brian F. Egolf, Jr.
Rep. Miguel P. Garcia
Rep. Thomas A. Garcia
Rep. Roberto "Bobby" J. Gonzales
Sen. Eric G. Griego
Sen. Phil A. Griego
Rep. Sandra D. Jeff
Rep. Antonio Lujan
Rep. Antonio "Moe" Maestas
Sen. George K. Munoz
Sen. Steven P. Neville
Rep. Debbie A. Rodella
Sen. Nancy Rodriguez
Sen. Bernadette M. Sanchez
Sen. John M. Sapien
Sen. William E. Sharer
Rep. James R.J. Strickler
Rep. Don L. Tripp
Rep. Luciano "Lucky" Varela
Sen. Peter Wirth

**Work Plan**

The Revenue Stabilization and Tax Policy Committee is a statutorily created joint interim legislative committee. Pursuant to Section 2-16-3 NMSA 1978, the committee is directed to "examine the statutes, constitutional provisions, regulations and court decisions governing revenue stabilization and tax policy in New Mexico and recommend legislation or changes if any are found to be necessary . . . ".

A. In the 2012 interim, the committee will:

1. examine the tax code and all other taxes not compiled in the tax code and discuss each tax based on sound tax policy principles and the contribution to state revenue made by each tax;

2. review the revenue status of the state, examine current revenue sources and discuss changes to revenue sources to ensure adequacy of revenue, including tax preparation

fraud and the effectiveness of Taxation and Revenue Department oversight and enforcement of tax collection;

3. review the effectiveness and value to the state of tax incentives, suggest changes to achieve state goals, including the benefits of transferability of income tax credits, and observe progress on projects benefiting from tax incentives;

4. examine the effect of expanded deductions for manufacturing consumables and construction on the stability of revenues of local governments and review the impact of hold harmless provisions to ameliorate the negative impact to local revenues of gross receipts deductions;

5. review trends in state investment earnings, including trends in the balances of the Severance Tax Permanent Fund and the land grant permanent funds, review the Utah proposal on federal royalty distribution and review the revenue received by the state from gaming within the state and the progress of tribal-state gaming negotiations;

6. review the capital outlay process, the balances remaining in outstanding projects and the estimates of funds previously appropriated and available for future projects, and discuss proposed changes to improve the process; and

7. determine legislative actions necessary to implement changes identified by committee members that will improve the tax system in New Mexico.

B. The committee proposes creation of a joint subcommittee with the New Mexico Finance Authority Oversight Committee and the Economic and Rural Development Committee to identify sources of revenue that can be used to support transportation needs in New Mexico. The committee will hear a final report on subcommittee action.

C. The committee will study federal legislation to provide for local taxation of internet sales and determine what specific actions must be taken to enable New Mexico to comply with the provisions of the law adopted. Expert guidance will be sought to prepare the state for maximizing the benefit of the federal proposals.

**Revenue Stabilization and Tax Policy Committee**
**2012 Approved Meeting Schedule**

| Date | Location |
| --- | --- |
| June 18 | Santa Fe, State Capitol, Room 322 |
| July 16-17 | Santa Fe, State Capitol, Room 322 |
| August 30-31 | Rio Rancho and Albuquerque |
| September 17-18 | Las Cruces |
| October 29-30 | Santa Fe, State Capitol, Room 322 |
| November 21 | Santa Fe |
| December 10-11 | Santa Fe, State Capitol, Room 322 |

REVENUE STABILIZATION AND
TAX POLICY COMMITTEE

# Section 3

# June 2012
# Agenda
# Minutes

**TENTATIVE AGENDA**
**for the**
**FIRST MEETING IN 2012**
**of the**
**REVENUE STABILIZATION AND TAX POLICY COMMITTEE**

**June 18, 2012**
**State Capitol, Room 322**
**Santa Fe**

**Monday, June 18**

| | | |
|---|---|---|
| 9:30 a.m. | **Call to Order**<br>—Representative Edward C. Sandoval, Chair |
| 9:35 a.m. | **Post-Session Fiscal Report**<br>—David Abbey, Director, Legislative Finance Committee |
| 10:35 a.m. | **Organizational Business — Work Plan and Schedule**<br>—Pamela Ray, Staff Attorney, Legislative Council Service (LCS)<br>—Damian Lara, Staff Attorney, LCS<br>—Pam Stokes, Staff Attorney, LCS |
| 11:05 a.m. | **2012 Tax Legislation**<br>—Tom Clifford, Secretary, Department of Finance and Administration (DFA) |
| 12:15 p.m. | **Lunch** |
| 1:20 p.m. | **High-Wage Jobs Tax Credit Issues**<br>—Tom Clifford, Secretary, DFA<br>—John Tysseling, Chief Economist, Taxation and Revenue Department<br>—Debra Inman, Vice President, Albuquerque Economic Development |
| 2:20 p.m. | **Ernst & Young Business Tax Burden Study**<br>—Richard Anklam, President and Executive Director, New Mexico Tax Research Institute |
| 3:30 p.m. | **Adjourn** |

**MINUTES**
**of the**
**FIRST MEETING IN 2012**
**of the**
**REVENUE STABILIZATION AND TAX POLICY COMMITTEE**

**June 18, 2012**
**Room 322, State Capitol**
**Santa Fe**

The first meeting of the Revenue Stabilization and Tax Policy Committee for 2012 was called to order by Representative Edward C. Sandoval, chair, on Monday, June 18, 2012, at 9:42 a.m. in Room 322 of the State Capitol in Santa Fe.

**Present**
Rep. Edward C. Sandoval, Chair
Sen. Mark L. Boitano
Rep. Donald E. Bratton
Sen. Carlos R. Cisneros
Rep. Anna M. Crook
Sen. Clinton D. Harden, Jr.
Sen. Timothy Z. Jennings, Senate President Pro Tempore
Sen. Gay G. Kernan
Rep. Rodolpho "Rudy" S. Martinez
Sen. Howie C. Morales
Rep. Henry Kiki Saavedra
Sen. John Arthur Smith
Rep. Thomas C. Taylor
Rep. Jim R. Trujillo
Rep. Bob Wooley

**Absent**
Sen. Tim Eichenberg, Vice Chair
Sen. Timothy M. Keller
Rep. Ben Lujan, Speaker of the House

**Designees**
Sen. William F. Burt
Sen. Bernadette M. Sanchez
Rep. Luciano "Lucky" Varela

Sen. Rod Adair
Rep. Ray Begaye
Rep. Zachary J. Cook
Rep. Brian F. Egolf, Jr.
Rep. Miguel P. Garcia
Rep. Thomas A. Garcia
Rep. Roberto "Bobby" J. Gonzales
Sen. Eric G. Griego
Sen. Phil A. Griego
Rep. Sandra D. Jeff
Rep. Antonio Lujan
Rep. Antonio "Moe" Maestas

Sen. George K. Munoz
Sen. Steven P. Neville
Rep. Debbie A. Rodella
Sen. Nancy Rodriguez
Sen. John M. Sapien
Sen. William E. Sharer
Rep. James R.J. Strickler
Rep. Don L. Tripp
Sen. Peter Wirth

**Staff**
Pam Ray, Staff Attorney, Legislative Council Service (LCS)
Ric Gaudet, LCS
Damian Lara, Staff Attorney, LCS
Pam Stokes, Staff Attorney, LCS

**Guests**

The guest list is in the meeting file.

**Handouts**

Handouts and other written testimony are in the meeting file.

**Monday, June 18**

**Post-Session Fiscal Review**

David Abbey, director, Legislative Finance Committee (LFC), presented the committee with a review of the state's fiscal situation. The legislature and governor enacted a balanced budget for fiscal year 2013, with projected reserves of over nine percent. In addition, significant capital investments were authorized, and agreement was reached on the size and scope of tax cuts. However, many significant unresolved issues remain, including the slow economic growth of the state, the need to improve educational outcomes, state pension fund solvency, Medicaid expansion, funding for road projects and local capital projects, Unemployment Compensation Fund solvency and Lottery Tuition Fund depletion.

Recurring revenue projections for fiscal year 2013 are set at $5.65 billion, which is seven percent lower than the peak revenues in fiscal year 2009. Two-thirds of state revenues are generated from gross receipts and income taxes, with the remaining portion coming from the energy sector, investment revenue and miscellaneous sources. Fiscal year 2013 revenue is projected to be five percent higher than fiscal year 2012 appropriation levels. However, some of this "new money" may be offset by the expiration of public employee pension swaps enacted during the recession. The General Appropriation Act of 2012 allocated 43 percent of total appropriations toward public schools; 20 percent toward Medicaid; 13 percent toward higher education; seven percent toward public safety; and 17 percent toward all other state government functions.

Mr. Abbey discussed several ongoing issues addressed by the legislature in the recent session. Several educational reform initiatives were funded, including $9.4 million for the Pre-K and K-3 Plus programs; $8.5 million for the early reading initiative; $3.5 million for interventions for low-performing schools; $2.5 million for short-cycle assessments; and $1 million to develop a new teacher evaluation system. A new higher education funding formula was developed last year, with more emphasis on educational outcomes. The formula funds outcomes, including increased certification and degree granting, especially in priority work force areas and for financially at-risk students. The new formula also funds faculty workload based on completed coursework, rather than enrollment.

The legislature enacted gross receipts tax (GRT) deductions that will have a negative impact on general fund revenues. In addition, attention needs to be paid to the revenue impact of the high-wage jobs tax credit, which has dramatically increased in the past fiscal year. Mr. Abbey also discussed the need for capital outlay reform, especially regarding statewide versus local projects, and the need for a stable source of transportation project funding.

The solvency of public employee retirement funds continues to be studied. The unfunded accrued actuarial liabilities of the two state-funded retirement funds total $10.8 billion. Increased investment returns on the funds are not sufficient to create solvency. Other changes need to be made, such as reducing the cost-of-living allowance, increasing the minimum age of retirement or closing loopholes.

Finally, Mr. Abbey discussed the solvency of the Unemployment Compensation Fund. One area of concern is the scope of ineffective charges being levied against employers with the most claims. Ineffective charges include charges in which benefits paid out on behalf of an employer exceed the contributions made by that employer. Employers with the most claims have limited incentive to control unemployment costs and are being subsidized by employers at lower rates. The Workforce Solutions Department has reported that under current law, employers will be required to contribute taxes under the highest contribution schedule.

Questions and comments from committee members included the following.

- Does the LFC have any concerns about restrictions on educational funding that are set by the legislature but are not being implemented by the executive? Mr. Abbey said that there was a minor dispute regarding the interpretation of Pre-K funding language. Overall, however, there do not appear to be any significant issues of executive overreach.

- There will be $500 million in federal funds to pay for the expansion of Medicaid. However, the state will be required to cover more of the cost in a few years. A study needs to be performed to examine the availability of health care practitioners who serve Medicaid and Medicare patients.

- Some executive agencies have not been willing to provide information to legislative committees.

- Even with 130,000 new enrollees in the Medicaid system, it appears that New Mexico will still have an uninsured rate of about 20 percent.

- What is the status of the Public Education Department's new teacher evaluation system? Mr. Abbey said that the Legislative Education Study Committee is investigating that new system, which appears to be not aligned with the current statutory evaluation system.

- The state's future liabilities for federally funded programs will probably increase, given the likelihood of federal budget cuts.

**2012 Tax Legislation**

Tom Clifford, secretary of finance and administration, gave a presentation to the committee on significant tax legislation in the 2012 legislature. The Martinez Administration's budget priorities include sustainable budgets, education reform, competitive tax policies, meeting fundamental needs, protecting public safety and achieving an efficient and accountable government. Since fiscal year 2001, state government spending has increased almost 70 percent. This unsustainable growth rate exceeds the combined growth of the population and inflation of an average of 3.9 percent. However, limited spending growth in fiscal years 2012 and 2013 has meant that the state has been able to maintain its general fund reserves close to 10 percent of appropriations. Any future excess revenue growth should be used for one-time spending needs and tax reform.

Fiscal year 2012 revenue grew by nine percent, compared to the original forecast of 2.3 percent. Oil and gas revenues accounted for about 50 percent of this growth. However, GRT revenue also grew by 7.4 percent, and personal income tax revenues grew by 10 percent.

Several tax measures were passed by the legislature and signed into law. Certain costs for construction-related services and construction equipment leasing are now deductible from gross receipts. Manufacturing inputs that are consumed during the process will be deductible, phased in over a five-year period. To mitigate the impacts of these deductions on small cities and counties, those entities will receive an increased share of revenue-sharing from the state. The fiscal impact to the state of the manufacturing input deduction was underestimated by 100 percent. The new estimate reduces state revenue by $80 million annually.

The legislature enacted pass-through entity withholding reforms to streamline paperwork requirements. Oil and gas remitters can now use federal information returns to comply with the new state requirements. Other pass-through entities will report annually, rather than quarterly, and reporting dates now conform with federal reporting dates.

A veterans employment tax credit was enacted to encourage employers to hire recently discharged veterans. Up to $1,000 of wages can be claimed for veteran employees who were hired as new employees within two years of their discharge. The credit can be claimed for one year for each employee hired.

Several pieces of legislation did not pass the legislature, including bills to:

- simplify taxation on small businesses by exempting them from the GRT if total receipts are less than $50,000;

- provide for a deduction from gross receipts for research and development services sold directly to the United States Department of Defense;

- provide a credit from personal income tax liability for military retirement income, which legislation was aimed at recruitment of a skilled labor force to New Mexico; and

- reform and clarify provisions of the high-wage jobs tax credit.

Two bills were passed by the legislature but vetoed by the governor. The first bill would have required mandatory combined reporting for certain types of large retail establishments. Secretary Clifford said that the entire corporate income tax (CIT) structure needs to be reformed. He said that the governor is open to discussing combined reporting as part of an overall reform of the CIT. The other bill would have allocated a portion of the motor vehicle excise tax to the State Road Fund. Secretary Clifford said that the administration is not opposed to such an idea but that this change would require budget adjustments.

The Taxation and Revenue Department (TRD) wants to implement many administrative reforms, including establishing independent hearing officers, establishing an independent tax ombudsman, applying uniform and more transparent rulemaking, extending filing and protest periods and reforming non-taxable transaction certificate rules to improve predictability for businesses.

Questions and comments from committee members included the following.

- How should the state proceed with the goal of establishing a broad tax base with lower rates? Secretary Clifford said that taxes should be based on consumption, rather than investment. Much of the tax base on consumption has been removed in the past several years.

- Many jobs being created in the state cannot be filled by New Mexico's work force. The state needs to provide much better education to children.

- What will the general fund reserve level be at the end of fiscal year 2012? Secretary Clifford estimated reserve levels will be about 12 percent.

- The legislature and executive should study many of the recommendations made by the Blue Ribbon Tax Reform Commission in 2003.

- Is there an estimate of how much the newly enacted veteran employment tax credit will cost? Secretary Clifford said that the TRD will research that question.

- The capital outlay process needs to be reformed. The committee should examine options for reform, with input from the Department of Finance and Administration (DFA).

Secretary Clifford said that the administration wants a better evaluation process for local projects. The Local Government Division of the DFA is currently working with local governments to get better information about their proposed projects.

**Organizational Business — Work Plan and Schedule**

Ms. Ray, Ms. Stokes and Mr. Lara presented the proposed work plan and schedule for the committee for the 2012 interim. After discussion by committee members and addition of a few items to study, the committee adopted the work plan. In the 2012 interim, the committee will:

1. examine the tax code and all other taxes not compiled in the tax code and discuss each tax based on sound tax policy principles and the contribution to state revenue made by each tax;

2. review the revenue status of the state, examine current revenue sources and discuss changes to revenue sources to ensure adequacy of revenue, including tax preparation fraud and the effectiveness of TRD oversight and enforcement of tax collection;

3. review the effectiveness and value to the state of tax incentives, suggest changes to achieve state goals, including the benefits of transferability of income tax credits, and observe progress on projects benefiting from tax incentives;

4. examine the effect of expanded deductions for manufacturing consumables and construction on the stability of revenues of local governments and review the impact of hold harmless provisions to ameliorate the negative impact to local revenues of gross receipts deductions;

5. review trends in state investment earnings, including trends in the balances of the Severance Tax Permanent Fund and the land grant permanent funds, review the Utah proposal on federal royalty distribution and review the revenue received by the state from gaming within the state and the progress of tribal-state gaming negotiations;

6. review the capital outlay process, the balances remaining in outstanding projects and the estimates of funds previously appropriated and available for future projects, and discuss proposed changes to improve the process; and

7. determine legislative actions necessary to implement changes identified by committee members that will improve the tax system in New Mexico.

**High-Wage Jobs Tax Credit Issues**

Debra Inman, vice president, Albuquerque Economic Development, John Tysseling, chief economist, TRD, and Secretary Clifford discussed with the committee the high-wage jobs tax credit. Ms. Inman began by discussing the importance of the credit for attracting employers to the state and provided some recommendations for making the credit more cost-effective. The credit is considered one of New Mexico's premier incentives for recruiting new businesses. She mentioned the recent creation of 900 jobs in Albuquerque as a result of the credit at Lowe's, Bendix/King, Tempur-Pedic and General Mills. A group of business development organizations has met with executive agency representatives to discuss how the tax credit provisions can be reformed, without reducing the attractiveness of the incentive. Several important cleanup items have been identified, including the need to define "wages", increase the eligible wage rate for urban areas, clarify the definition of "eligible employer", limit the amount of time a company can apply for approval of the credit and extend the expiration date of the credit. Ms. Inman said that the legislature should avoid placing a cap on the amount of tax credit available. That would create uncertainty around the availability of the credit and cause companies to discount the credit when comparing incentives among states.

Mr. Tysseling gave an overview of the high-wage jobs tax credit and its recent fiscal impact. The credit can be claimed against 10 percent of qualified wages for new jobs. A high wage is defined as more than $40,000 annually in urban areas and $28,000 in rural areas. The new job must be eligible for the Job Training Incentive Program or the business must make more than 50 percent of its sales outside New Mexico in order to qualify for the credit. From fiscal year 2006 to fiscal year 2011, the amount of credit claimed ranged from $700,000 to $14 million, averaging $5.7 million. However, in fiscal year 2012, the fiscal impact of the credit is expected to top $48 million.

In fiscal years 2011 and 2012, most of the credits approved by the TRD have been awarded to a few companies. About 30 percent of the claims approved in those years were from job creations more than two years prior to the application for the credit. Data from the applications for the credit suggest that approximately 3,000 new jobs were created that qualified for the credit in the past two fiscal years.

Mr. Tysseling said that the TRD is concerned that a company may claim the credit after a merger, with the "new" jobs from the absorbed company being claimed for the credit. Another concern is that once New Mexico emerges from the current recession, there could be a huge increase in the amount of credit claims.

Secretary Clifford said that the mergers of two companies should not constitute the creation of new jobs. He also said that, currently, the high-wage jobs tax credit can be claimed in addition to other credits or incentives for the same job.

Questions and comments from committee members included the following.

- The working group that is currently looking at ways to reform the high-wage jobs tax credit should have included legislators. Ms. Inman was requested to include legislators who have recently introduced legislation on the subject in the group's future meetings.

- Did the TRD establish clear rules regarding the approval process for the credit? Mr. Tysseling said that the language in statute does not allow the TRD to restrict the definition of "wages".

- Why was there such a huge increase in claims for the credit in fiscal year 2012? Mr. Tysseling said that there are several consulting firms that have been recently marketing the availability of the credit to their business clients.

- It might be a bad idea to grant the credit in rural areas with such a low wage threshold, as that could attract undesirable industries to an area. Mr. Tysseling said that, currently, there is very little use of the credit in rural areas.

**Ernst & Young Business Tax Burden Study**

Richard Anklam, president and executive director, New Mexico Tax Research Institute, presented to the committee the final report of the update to the Ernst & Young Business Competitiveness Study. The Council on State Taxation (COST) commissioned a study with the accounting firm Ernst & Young to determine the state rankings of a hypothetical investment in each state. The study looked at the effective tax rate and return on investment after 30 years. In that study, New Mexico ranked last. The main reasons for the poor ranking were that the state taxes corporations higher than average, it uses an equally weighted income apportionment formula and nearly all business services are subject to the GRT. Mr. Anklam said that the COST study, like other previous tax-burden studies, did not account for state incentives. Taking into account incentives the state provides would improve New Mexico's ranking.

A coalition of New Mexico private- and public-sector entities decided to fund a more thorough study, comparing New Mexico to several surrounding states, taking into account other factors besides tax burden. The coalition engaged Ernst & Young to expand on the previous study, but limit the scope of the study to eight surrounding states. The study accounted for incentives in the tax calculations and added more industries in the scope of the study. The study estimated the impacts of several policy options on the state's competitiveness, including changing the GRT or CIT, providing GRT deductions for manufacturing inputs and services, allowing for single- and double-weighted sales factor elections for calculating corporate income and providing a GRT deduction on manufacturing equipment.

The results of the new study ranked New Mexico favorably compared to eight other states, after incentives were accounted for. Across all industries, New Mexico had the fourth-lowest effective tax rate. For the service sector, New Mexico had the second-lowest rate, but the manufacturing sector had the third-highest rate. Across all industries, the average effective tax rate for businesses was 6.0 percent. The study looked at how changes in tax laws would affect New Mexico's ranking, including changing the weighting factor to apportion the CIT, providing GRT exemptions for certain business transactions and changing the CIT rate. The results of the study showed that allowing for a single-weighted sales factor in calculating the CIT would put New Mexico's effective tax rate on businesses at 2.0 percent, making it the most business-friendly state in the region.

The Ernst & Young study concluded that while the average tax burden for New Mexico businesses before incentives are factored in is more than twice other states' average rates, certain industries benefit tremendously from tax incentives, which reduce the effective tax rate significantly. However, the high CIT rate of 7.6 percent, the traditional method of calculating the CIT and the high incidence of GRT taxes, especially on the manufacturing industry, are almost certainly impeding economic growth, according to the study. New Mexico is somewhat competitive, depending on the industry and the individual situation of a business. If a business is not eligible for incentives, it faces a much higher effective tax rate than in other states.

After the study was completed, the legislature enacted GRT deductions for certain construction services and for inputs consumed during the manufacturing process. The new law significantly addressed the pyramiding aspect of the GRT for some industries, which makes New Mexico's effective tax burden ranking even better. Renewable energy equipment manufacturing and computer and electronics manufacturing now have the second-lowest effective tax rate in the region, compared to the highest and third-highest rankings prior to the legislation's enactment.

Questions and comments from committee members included the following.

- What happened to the solar manufacturing company that decided to locate in Arizona instead of New Mexico, which had cited the state's high tax burden as one reason for not choosing New Mexico? Mr. Anklam said that the company canceled its plans to locate a manufacturing plant in Arizona after the national economy soured.

- The state may be able to bring down some business tax rates by broadening the tax base. Mr. Anklam agreed and said that the state can no longer rely on the federal government to increase the state's economic activity. The only way to improve the economy, at least in the near future, is by increasing private-sector investment.

- Many states have been forced to change their tax structures and rates in the past two years to cope with declining revenues. New Mexico's rankings may improve more if the study were to use 2012 data.

There being no further business, the committee adjourned at 3:45 p.m.

REVENUE STABILIZATION AND
TAX POLICY COMMITTEE

# Section 4

# July 2012
# Agenda
# Minutes

**Revised: July 13, 2012**

**TENTATIVE AGENDA**
**for the**
**SECOND MEETING IN 2012**
**of the**
**REVENUE STABILIZATION AND TAX POLICY COMMITTEE**

**July 16-17, 2012**
**State Capitol, Room 322**
**Santa Fe**

**<u>Monday, July 16</u>**

| | |
|---|---|
| 9:30 a.m. | **Call to Order**<br>—Representative Edward C. Sandoval, Chair |
| 9:35 a.m. | **Sales Tax Versus Gross Receipts Tax (GRT)**<br>—Jim O'Neill, Consultant<br>—Richard Anklam, President and Executive Director, New Mexico Tax Research Institute |
| 10:45 a.m. | **Hold Harmless Costs and Local Government Concerns**<br>—John Tysseling, Chief Economist, Taxation and Revenue Department (TRD)<br>—Bill Fulginiti, Executive Director, New Mexico Municipal League<br>—Tito Chavez, Governmental Affairs Consultant, New Mexico Association of Counties |
| 12:00 noon | **Lunch** |
| 1:15 p.m. | **Tax Expenditure Report**<br>—Demesia Padilla, Secretary of Taxation and Revenue<br>—Tom Clifford, Secretary of Finance and Administration<br>—John Tysseling, Chief Economist, TRD |
| 2:30 p.m. | **GRT Exemptions**<br>—Pamela Ray, Staff Attorney, Legislative Council Service (LCS)<br>—Damian Lara, Staff Attorney, LCS |
| 3:30 p.m. | **Recess** |

**<u>Tuesday, July 17</u>**

| | | |
|---|---|
| 9:30 a.m. | **Reconvene**<br>—Representative Edward C. Sandoval, Chair |
| 9:35 a.m. | **GRT Deductions**<br>—Pamela Ray, Staff Attorney, LCS<br>—Damian Lara, Staff Attorney, LCS<br>—Pam Stokes, Staff Attorney, LCS |
| 11:15 a.m. | **Modified Combined Tax Liability Deductions**<br>—Pamela Ray, Staff Attorney, LCS<br>—Jim O'Neill, Consultant |
| 12:00 noon | **Lunch** |
| 1:15 p.m. | **Premium Tax Update**<br>—John Francini, Superintendent of Insurance, Public Regulation Commission (PRC)<br>—Jolene Gonzales, Deputy Superintendent, Insurance Division, PRC |
| 3:15 p.m. | **Adjourn** |

**MINUTES**
**of the**
**SECOND MEETING IN 2012**
**of the**
**REVENUE STABILIZATION AND TAX POLICY COMMITTEE**

**July 16-17, 2012**
**Room 322, State Capitol**
**Santa Fe**

The second meeting of the Revenue Stabilization and Tax Policy Committee (RSTP) for 2012 was called to order by Representative Edward C. Sandoval, chair, on Monday, July 16, 2012, at 9:40 a.m. in Room 322 of the State Capitol in Santa Fe.

**Present**
Rep. Edward C. Sandoval, Chair
Sen. Tim Eichenberg, Vice Chair
Rep. Donald E. Bratton
Sen. Carlos R. Cisneros (7/17)
Rep. Anna M. Crook
Sen. Clinton D. Harden, Jr.
Sen. Timothy M. Keller
Sen. Gay G. Kernan
Rep. Rodolpho "Rudy" S. Martinez
Sen. Howie C. Morales (7/16)
Rep. Henry Kiki Saavedra
Sen. John Arthur Smith
Rep. Thomas C. Taylor
Rep. Jim R. Trujillo
Rep. Bob Wooley

**Absent**
Sen. Mark Boitano
Sen. Timothy Z, Jennings, President Pro Tempore
Rep. Ben Lujan, Speaker of the House

**Designees**
Sen. William F. Burt (7/16)
Rep. Brian F. Egolf, Jr. (7/16)
Rep. Luciano "Lucky" Varela (7/17)
Sen. Peter Wirth

Sen. Rod Adair
Rep. Ray Begaye
Rep. Zachary J. Cook
Rep. Miguel P. Garcia
Rep. Thomas A. Garcia
Rep. Roberto "Bobby" J. Gonzales
Sen. Eric G. Griego
Sen. Phil A. Griego
Rep. Sandra D. Jeff
Rep. Antonio Lujan
Rep. Antonio "Moe" Maestas
Sen. George K. Munoz
Sen. Steven P. Neville

Rep. Debbie A. Rodella
Sen. Nancy Rodriguez
Sen. Bernadette M. Sanchez
Sen. John M. Sapien
Sen. William E. Sharer
Rep. James R.J. Strickler
Rep. Don L. Tripp

**Guest Legislators**
Rep. Luciano "Lucky" Varela (7/16)
Rep. James E. Smith (7/16)

(Attendance dates are noted for those legislators present in the same capacity for the entire meeting.)

**Staff**
Pam Ray, Staff Attorney, Legislative Council Service (LCS)
Damian Lara, Staff Attorney, LCS
Pam Stokes, Staff Attorney, LCS
Rebecca Griego, Records Officer, LCS

**Guests**
The guest list is in the archives meeting file.

**Handouts**
Handouts and other written testimony are in the meeting file and can be accessed at www.nmlegis.gov.

**Monday, July 16**

**Sales Tax Versus Gross Receipts Tax (GRT)**
James (Jim) P. O'Neill, consultant, O'Neill Consulting, explained that the GRT is a successor to New Mexico's emergency school tax, enacted in 1934 and made permanent in 1935. A relatively new notion at the time, a tax of 2% was imposed to replace the property tax revenue that was severely diminished during the Great Depression. The emergency school tax was imposed on everyone engaged in business, including service providers, many of whom were also property owners and were not paying their property taxes. The emergency school tax is still imposed on certain activities involving oil and natural gas. In 1966, the GRT was part of a consciously designed restructuring of the state revenue system and resulted in the enactment of the Gross Receipts and Compensating Tax Act (Act). Other taxes had recently been imposed, such as the personal income tax, the resources excise tax and the severance taxes, as part of a new tax system designed by Franklin Jones, Jack Deason and Woody Woodcock, now considered the deans of New Mexico's current tax system. Tax law can be written to list every transaction subject to taxation or to broadly define the taxable activity, such as the privilege of engaging in business. Mr. O'Neill explained that of the two approaches to developing the GRT,

the state chose the latter. Mr. O'Neill focused his discussion on the following three general policies embodied in the design of the GRT: 1) employ a base that is as broad as possible; 2) impose the tax on the seller, rather than the buyer; and 3) administer the tax at the state level, controlling the option of local governments to impose or collect local taxes and imposing uniformity on the tax base and rate throughout the state. This reduces the administration costs of the tax. The legislature controls the authorization for deductions or other tax benefits if the tax is a statewide tax.

A broad base results in the state's ability to keep the tax rate low while still providing adequate revenue. Mr. O'Neill noted that the combination of a broad base and low rate introduces the least amount of interference with the marketplace. Additionally, the point of imposition of the tax is on the seller, who then generally passes on the tax to the purchaser at the point in the transaction in which the good or service leaves the stream of commerce.

Sellers are not required to separately identify the tax on an invoice as they pass it along to the next buyer. The early GRT rate was low and so a great deal of pyramiding was tolerated in the GRT system as tax was added by each seller receiving receipts in the transaction. When the tax rate increased, however, pyramiding became viewed as a negative aspect of the tax system requiring correction. There are several reasons for having the incidence of the GRT fall on the seller that benefit New Mexico. One is to capture taxes on transactions with the federal government not otherwise permitted to be taxed if the tax is imposed on the purchaser. Two court cases have upheld New Mexico's right to tax goods and services sold to the federal government: *United States v. New Mexico*, 581 F.2nd 803, 10th Cir. (1978); and *United States v. New Mexico*, 455 U.S. 720 (1982). In addition, imposition of the tax on the seller allows the state to consider all receipts from construction activity to be receipts from sales of construction services.

The uniform system of the GRT, which is centrally administered, minimizes administrative costs to both the taxpayer and the tax collectors and ensures evenhandedness across the state. Moreover, tying the local governments to the GRT builds in local government resistance to pressures by special interests for special exemptions or deductions from the tax. Mr. O'Neill concluded his presentation by stating that the Act requires a reading of a number of provisions together to discern its key principles and that the tight link between local government revenues and the state GRT base is very deliberate.

Richard L. Anklam, president and executive director, New Mexico Tax Research Institute, explained that not all sales taxes are the same, but they generally are transactional taxes imposed on transactions involving tangible personal property and some services. The power of a local jurisdiction to impose a tax is authorized by the state legislature or constitution. Mr. Anklam noted that since the GRT is imposed on the seller, it is the seller who may claim any refunds, credits or deductions. Under the U.S. Constitution, in order to impose the GRT on a seller, that seller must have a nexus with the state. Constitutional nexus is generally viewed as an in-state physical presence. The lack of constitutional nexus for some electronic-based companies has been the source of various deliberations in Congress leading to the streamlined sales tax efforts and proposed legislation such as the Mainstreet Fairness Act, an act that could have a significant impact on New Mexico. Mr. Anklam said that Congress is likely to pass a bill to address the issue this year.

**Questions and Answers**

In response to a question, Mr. O'Neill said that allowing a local government to impose and administer its own GRT is not as efficient or effective as the current uniform system administered centrally and might require the local government to hire a third-party contractor to impose and collect the tax, which brings added concerns. Mr. O'Neill suggested providing local governments with more flexibility to impose local option taxes as well as to allow the taxes to be spent on general purposes as an alternative.

Mr. O'Neill also confirmed that the most stable source of revenue is the property tax, and a GRT with a low rate and broad base would be a close second in terms of stability of revenue generated, especially given New Mexico's low and stable population and the progression of the national and state economy from tangible goods to services.

Mr. O'Neill also answered that, in 1966, and soon after the implementation of the GRT, the inherent pyramiding of the GRT was largely ignored because of the relatively low rate when the GRT was first imposed.

**Hold Harmless Costs and Local Government Concerns**

John C. Tysseling, chief economist, Taxation and Revenue Department, said the fiscal year (FY) 2012 estimated costs of the hold harmless provisions for food was $103.1 million and for medical was $34.5 million, for a total of $137.6 million. The annual growth rate over four years for medical was 7.8% and for food was 3.3%, for a combined total of 4.4%. Mr. Tysseling explained that the distributions to the municipalities and counties were contingent on the food and medical deductions reported.

William F. Fulginiti, executive director, New Mexico Municipal League, stated that the restriction of state revenues should not deprive municipalities of actual revenue. The GRT constitutes up to 75% of a municipality's general funds. On average, the food and medical distributions accounts for 8% of municipal budgets, but for some municipalities, it is as high as 38%. The handout from Mr. Fulginiti has tables showing the amount of GRT attributed to each municipality and the percent of the municipality's general funds that the GRT supplies. Mr. Fulginiti said the municipalities are very concerned with the potential loss of the food and medical distributions and, as a result, have begun to look at various scenarios, including a decoupling of the state GRT from local governments. Mr. Fulginiti stated that at the municipal level, if all the deductions were repealed, municipalities would be able to cut the local option GRT rate in half.

Tito Chavez, lobbyist, New Mexico Association of Counties, said that there are 17 county option tax increments, but the revenue is restricted to certain purposes. Mr. Chavez said that for counties, the GRT makes up as much as 50% of the county budgets. Mr. Chavez also stated that property taxes are not as stable due to foreclosure and pending lawsuits regarding county assessments of property values. Mr. Chavez noted that of the four county GRT increments allowed, the first two are enacted by all but two counties and the last two are enacted by 25 and 21 counties, respectively.

**Questions and Answers**

In regard to a question, Mr. Tysseling said that the local option increments are in place to keep the tax rates and differentials on the GRT from varying widely. Mr. Tysseling also said the distributions are frozen at the set rate to avoid the risk of GRT dependency.

Upon inquiry from a committee member, Mr. Fulginiti responded that the percentage of an individual municipality's budget attributable to the food and medical distribution is dependent on the presence and type of retailer and amount of commercial activity in the municipality.

**Tax Expenditure Report**

Thomas Clifford, secretary, Department of Finance and Administration, mentioned that Executive Order 2011-071 required a tax expenditure budget. Secretary Clifford said a tax expenditure for the purpose of the report was a special deduction rather than a general provision to address pyramiding of the tax. Similarly, exclusions from tax as a result of the coupling of the state income tax with that of the federal income tax would not be considered a tax expenditure in the report. In terms of the GRT, a similar working definition would be used to identify tax expenditures. Secretary Clifford said that general exclusions that apply to everyone, certain dual taxation provisions and differentials would not be considered tax expenditures. In evaluating and estimating the costs of the expenditures, Secretary Clifford stated that accountability should be balanced with efficiency. Specifically, Secretary Clifford said that seeking too much information in the Combined Reporting System (CRS) form would bog down the system and create too much delay in returning revenue to the local governments and might upset the fragile ability of the state to process state employee checks.

Demesia Padilla, secretary, Taxation and Revenue Department, said a draft of the report was completed and is currently being reviewed by the Office of the Governor. Secretary Padilla stated that a template was developed to evaluate each tax expenditure using economic and generally accepted tax policy principles rather than policy determinations. A tax expenditure template was developed for each expenditure to provide continuity in the current report and future reports; 400 templates were compiled. Secretary Padilla remarked that for GRT deductions and exemptions that are not reported, the value is uncertain, but that requiring additional reporting is expensive and impractical. She continued to say that the North American Industry Classification System codes allow the department to extrapolate the value of certain tax expenditures.

**Questions and Answers**

Secretary Padilla replied to a question by saying that since the tax expenditure report was drafted pursuant to an executive order, the department provided a draft to the Office of the Governor for review before finalizing the report in case the office requested additional work on the report.

A committee member said that the report should be developed pursuant to state statute, and each tax expenditure authorized should include reporting requirements. Secretary Clifford said that not all tax expenditures need reporting requirements built into the language of the statute, especially if the expenditure applies to a broad or general category.

A committee member provided some background regarding Section 9-15-56 NMSA 1978 and the reporting requirements for new tax incentives. Secretary Clifford said that in terms of the GRT and the CRS, forms requiring too much reporting on a monthly basis would have an impact on the ability of the department to process the returns and, in turn, payroll for all state employees in a timely manner. He continued to say that information regarding the benefits of tax expenditures in creating jobs and economic growth in the state are best obtained by surveying sample businesses rather than reporting the information on CRS forms.

**Committee Request**

The committee requested that staff provide a comparison of the provisions of Executive Order 2011-071 and SB 47 from the 2011 regular session.

**Act Exemptions**

Ms. Ray and Mr. Lara presented the exemptions found in the Act. Ms. Ray began by pointing out that there are 46 exemptions in the Act. Ms. Ray, Mr. Lara and Ms. Stokes established five categories of exemptions, deductions and credits in the Act: 1) preemption and taxes enacted in lieu of the GRT, compensating tax or governmental GRT; 2) exemptions that help define the base on which the GRT, compensating tax or governmental GRT is imposed; 3) exemptions that reduce pyramiding; 4) exemptions that are for the public good; and 5) exemptions that appear to be policy decisions of the legislature.

Exemptions generally should be used to define the base or to reflect some area where the state either cannot tax due to federal law or is imposing a tax already and imposition of the GRT, compensating tax or governmental GRT would impose a second tax on the same transaction. There are some cases where dual taxes are considered acceptable. In New Mexico, double taxation is found on alcoholic beverages. Exemptions are inappropriate for tax benefits for a single industry or other policy purpose. An exemption is not reported, and in Subsection A of Section 7-9-5 NMSA 1978, any person who is engaged solely in transactions specifically exempt from a tax imposed by the Act "shall not be required to register or file a return under that act". As a result, the legislature can only surmise what revenue is being lost due to the 10 policy exemptions set forth in numbers 37 through 46 of the booklet.

Some exemptions are not set forth in separate sections but are found in the definitions of "engaging in business", such as the third-party web site content provider exemptions and the third-party provider of call center services if those services are located in New Mexico. These two exclusions from the definition of "engaging in business" would be more appropriately placed as separate exemptions or deductions. The department is also barred in Section 7-9-7.1 NMSA 1978 from collecting compensating tax from nonbusiness purchasers of tangible personal property first used in New Mexico. Exemptions from GRT are provided generally for services performed out-of-state but used first in-state. For many of these transactions, the compensating tax is imposed if a deduction or exemption is not available for the transaction. There are compensating tax exemptions for the use of tangible personal property in New Mexico that is purchased out-of-state by the U.S. government, the state and political subdivisions. Personal effects that an individual moves into the state for use in an initial residence or for nonbusiness use are exempt from compensating tax. Nine anti-pyramiding exemptions exist, including exemptions for receipts from the sale of agricultural raw products or services that are required to prepare those products for market. There are compensating tax exemptions for equipment purchased out-of-state and used in-state for railroads, aircraft and spacecraft for the transport of passengers or property. There are several oil and gas equipment and services exemptions, especially when the oil or gas is consumed to process, store or transport the product, as through a pipeline. Section 7-9-41.2 NMSA 1978, an exemption for fuel for certain railroad activities, never became effective and should be repealed. Exemptions for the public good are generally those that support the efforts of certain charitable organizations. Purchases using food stamps are exempt from paying GRT. Dues and registration fees and other income of nonprofit social, fraternal, political, trade, labor or professional organizations are exempt from GRT, as long as the receipts are not from an unrelated business enterprise. Receipts of a minister from performing religious services are exempt from GRT. Also, receipts of disabled street vendors are exempt from payment of GRT.

The legislature has chosen to exempt some other activities from GRT. Many of these exemptions should be rewritten as deductions. Sales from concessions at Isotopes Park are exempt from GRT. Student books sold at university book stores are exempt from GRT. Homeowners association dues are exempt from GRT. Spacecraft fuel is exempt from GRT and compensating tax. Receipts earned from mowing lawns or yard sales are exempt from GRT, as are other receipts from isolated or occasional sales or leasing of tangible personal property or services, and like the disabled street vendor's receipts, probably are too difficult to capture and administer and so should remain exemptions. Receipts from purses from New Mexico horse racetracks are exempt for jockeys, horsemen and trainers. Another exemption that would be more difficult to administer than warranted by the amount of revenue gained is the exemption from receipts earned by an umpire, referee or scorekeeper at New Mexico Activities Association athletic events involving New Mexico schoolchildren as participants.

Some exemptions should be scrutinized; however, most of the exemptions currently in law are best left as exemptions.

The committee recessed at 2:55 p.m.

**<u>Tuesday, July 17</u>**

**Act Deductions and Credits**

Ms. Ray, Mr. Lara and Ms. Stokes presented the Act's deductions, and Mr. Lara presented the credits found in the Act. Ms. Ray provided an overview of the deductions. She noted that there are 81 deductions, and again they are divided in five categories, as are the exemptions. Her comments can be found in the handouts entitled "Deduction and Credit Script". She noted the differences among exemptions, deductions and credits. Exemptions are tax relief that makes the tax nonpayable, requiring no reporting of gross receipts, no calculation of compensating tax or no reporting of governmental gross receipts, depending on the tax to which the exemption applies. Deductions require reporting of gross receipts acquired and then subtraction of the amount of receipts that are deductible; the tax rate is then applied to the difference to determine the tax liability. Credits are amounts that are subtracted from the taxpayer's tax liability and generally have reporting requirements so that at the very least the department can determine the amount of revenue foregone due to each credit. Tax benefits provided by the Act are generally in the form of deductions.

The breakdown of the deductions in the categories is as follows:

A. deductions due to preemption or taxes imposed in lieu of a tax in the Act;

B. deductions that constitute the base on which the GRT, the compensating tax or the governmental GRT is calculated;

C. deductions to reduce pyramiding;

D. deductions that promote the public good; and

E. deductions that have been adopted for policy reasons by the legislature.

Again, the deductions that appear to exist for policy reasons are those that should be most closely scrutinized to determine if they remain necessary, effective and beneficial to the state.

Mr. Lara discussed anti-pyramiding deductions. These include several that were adopted during the 2012 legislative session, such as the deduction for consumables used in the manufacturing process. Deductions for receipts that are from a sale for resale are found in Sections 7-9-47 and 7-9-48 NMSA 1978; provided that an appropriate nontaxable transaction certificate (NTTC) is provided to the seller (taxpayer) by the purchaser who will resell the tangible personal property or service. Sections 7-9-51 and 7-9-52 NMSA 1978 are deductions for construction materials or services that are sold or leased, again with the provision of an appropriate NTTC. The deductions reinforce that it is necessary for the vendor to obtain an NTTC in order to take an exemption and that deductions are generally available only if the service or tangible personal property is to be resold to a consumer who will be paying GRT. Most deductions are for the entire amount of receipts from a transaction; however, Section 7-9-77 NMSA 1978 provides a deduction for 50% of the value on which compensating tax is calculated for agricultural implements, farm tractors, aircraft or vehicles not required to be registered for on-road driving purposes. Other deductions are for receipts from the sale to a farmer or rancher of feed and accessories or other inputs.

Deductions classified for the public good include those to encourage low-cost housing and loan costs, the sale of state-approved lottery tickets and donations of tangible personal property to charitable organizations. State credit unions are put on similar footing to federal credit unions by the deduction provided in Section 7-9-61.2 NMSA 1978.

There are 44 deductions that have been classified as "policy" deductions. Several deal with aerospace services. Wind and solar generation equipment receipts may be deducted pursuant to Section 7-9-54.3 NMSA 1978. Other deductions for solar energy and electric generating facilities can be found in Sections 7-9-112 and 7-9-114 NMSA 1978. Receipts from warehousing, threshing, harvesting, growing, cultivating, transporting and processing agricultural products are deductible pursuant to Section 7-9-59 NMSA 1978. Section 7-9-57.2 NMSA 1978 allows a deduction for receipts of a software development company located in rural New Mexico. Receipts from provision of logistics services provided by companies along the international border to support border trade initiatives also are deductible from gross receipts. There are several deductions that apply to newspapers and magazines. Almost all of the receipts of hospitals may be deducted from gross receipts, as are receipts from selling prosthetic devices, prescription drugs and oxygen. Several more agricultural deductions exist: one, in Section 7-9-62 NMSA 1978, is for 50% of the receipts from sales of agricultural equipment to be deducted from gross receipts similar to the compensating tax exemption found in Section 7-9-77 NMSA 1978. Another partial exemption is for 55% of the receipts from selling jet fuel or the value of jet fuel first used in New Mexico in Sections 7-9-83 and 7-9-84 NMSA 1978. Section 7-9-76 NMSA 1978 sets forth a deduction for receipts of a travel agent for commissions paid by maritime transport companies, interstate airlines, railroads and passenger buses for booking, referral, reservation or ticketing service rendered. The value of equipment used to enrich uranium is deductible pursuant to Section 7-9-78.1 NMSA 1978, and receipts from selling uranium hexafluoride and enriching uranium are also deductible under Section 7-9-90 NMSA 1978. Sections 7-9-92 and 7-9-93 NMSA 1978 are the food and medical deductions that require the state to reimburse the local governments for the various gross receipts distributions the local governments forego as a result of these deductions. A deduction for property sold or leased to or other services performed for a film production is found in Section 7-9-86 NMSA 1978.

Other deductions are for receipts from biomass equipment sales and biodiesel fuel equipment sales and for construction equipment used in a building project for a nonprofit organization or foundation. Receipts from nonathletic events on the New Mexico State University campus are also deductible from gross receipts. Receipts from staging professional boxing, wrestling or martial arts contests are also deductible from gross receipts. Section 7-9-109 NMSA 1978 authorizes a deduction from gross receipts of receipts from veterinary services or supplies provided by a veterinarian.

The deductions from receipts of the sale of fuel for locomotives or from the value of fuel used for locomotives on which compensating tax would be based can be found in Sections 7-9-110.1 and 7-9-110.2 NMSA 1978. Receipts from selling or leasing services or tangible personal property used to develop or construct an electric generating facility or a recycled energy project are also authorized. Deductions for transmission of electricity using electric conversion technology or for receipts from services provided by a market exchange dealing in the transmission of electricity are found in Sections 7-9-103.1 and 7-9-103.2 NMSA 1978. These deductions were adopted during the 2012 legislative session.

Mr. Lara presented eight tax credits that are found in the Act. The first several credits are offsets for similar taxes paid to another state for goods and services. Section 7-9-88.2 NMSA 1978 authorizes a credit against GRT liability for receipts from the sale of coal severed from Navajo Nation land in an amount equal to 75% of the Navajo Nation tax liability. The other five credits are for installation of biodiesel equipment, selling a service for resale, hospital receipts and certain unpaid health care services provided by a medical doctor or osteopathic physician.

**Modified Combined Tax Liability Credits**

Finally, Mr. O'Neill and Ms. Ray presented information on modified combined tax liability credits, which are reported on the CRS form used for reporting GRT, compensating tax, withholding tax and other monthly reported tax liabilities. Mr. O'Neill discussed some changes in the wording of the definition of "modified combined tax liability" that would make the definitions in the eight credits discussed:

1. more uniform;
2. easier to administer; and
3. less confusing.

Mr. O'Neill presented a bill draft with the changes necessary to amend the definition appropriately. The following are the credits in which the definition of "modified combined tax liability" may be found:

1. rural job tax credit;
2. investment credit;
3. technology jobs tax credit;
4. high-wage jobs tax credit;
5. advanced energy combined reporting tax credit;
6. research and development small business tax credit;
7. affordable housing tax credit; and
8. alternative energy product manufacturers tax credit.

The final tax credit mentioned should be in the Act, but was drafted as a separate article, Sections 7-9E-1 through 7-9E-11 NMSA 1978. This is the Laboratory Partnership with Small Business Tax Credit Act. It provides that a tax credit may be claimed only against a taxpayer's GRT liability.

**Premium Tax Update**

John Franchini, superintendent of insurance, and Jolene Gonzales, deputy superintendent, Insurance Division, Public Regulation Commission, provided a handout giving current information about the collection of premium tax by that division. Superintendent Franchini began by saying that premium taxes are applicable to insurance companies, health maintenance organizations, New Mexico casualty companies, nonprofit health care plans, prepaid dental plans, property bail bonds agents, purchasing groups, risk retention groups, self-insureds and title insurance companies. The rate paid by nonhealth insurers is 3.003% of gross premiums. Health insurers pay a surtax of 1% of gross premiums, or 4.003% in total. Premiums include any additional amount charged the insured, including policy fees, risk purchasing group fees and inspection fees. The health care surtax is not charged on dental or vision insurance sold pursuant to contracts. Insurance plans sold to the state or its subdivisions to cover retired or active employees are not subject to premium tax. Businesses that are self-insured for workers' compensation are not considered insurance companies transacting insurance business for purposes of the premium tax.

Premium tax is paid in lieu of all other taxes (*see* Section 59A-6-6 NMSA 1978). This is interpreted very broadly and allows insurance companies to avoid paying corporate income tax, personal income tax, GRT and other taxes other than property tax on property located in New Mexico. Premium taxes are paid quarterly on the fifteenth day of each month following the close of the calendar quarter. Payments are in April, July, October and January.

There are deductions and credits that may be taken against premiums and premium taxes due. There is a 50% credit for health alliance pool payments, a 75% credit for payments by medical insurance pool policyholders if they receive payments in whole or in part from the federal Ryan White CARE Act, the Ted R. Montoya Hemophilia Program of the University of New Mexico Health Sciences Center, the Children's Medical Services Bureau of the Public Health Division of the Department of Health or any other program receiving state funding or assistance. There is also a 50% tax credit for medical insurance pool payments made.

Erroneous payments may be claimed within three years of the date the erroneous payment is made, which the superintendent of insurance may authorize. Premium taxes erroneously paid or overpaid may either be refunded or credited against the tax due.

Page 15 of the handout was discussed by Ms. Gonzales. She noted that the Insurance Department Suspense Fund balance in FY 2011 was about $223.6 million after reductions from charge-backs, refunds and the transfer of $192,000 to the secretary of state. The suspense fund includes premium taxes paid totaling $109.8 million, surtaxes paid totaling $36 million, $60 million from the Premium Tax Fire Fund, fees, penalties and other deposits. Distributions were then made to:

A. the Insurance Operations Fund in the amount of $8.9 million;
B. the Fire Protection Fund in the amount of $67.5 million; and
C. Carrie Tingley Children's Hospital in the amount of $25,700.

Of the remaining $147.2 million, 10%, or $14.7 million, was distributed to the Law Enforcement Protection Fund. The final balance of $132.5 million was deposited in the general fund.

Page 16 of the handout describes suggestions that might be introduced as legislation.

The committee adjourned at 11:55 a.m.

REVENUE STABILIZATION AND
TAX POLICY COMMITTEE

# Section 5

# August 2012
# Agenda
# Minutes

**Revised: August 27, 2012**

**TENTATIVE AGENDA**
**for the**
**THIRD MEETING IN 2012**
**of the**
**REVENUE STABILIZATION AND TAX POLICY COMMITTEE**

**August 30, 2012**
**Intel Building RR5**
**Rooms 114 A & B**
**Rio Rancho**

**August 31, 2012**
**Mid-Region Council of Governments**
**Board Room**
**809 Copper Avenue NW**
**Albuquerque**

**Thursday, August 30**

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|---|---|
| 9:00 a.m. | **Call to Order**<br>—Representative Edward C. Sandoval, Chair, Revenue Stabilization and Tax Policy Committee (RSTP) |
| 9:05 a.m. | **Intel Tour (Invitation Only)**<br>—Liz Shipley, Government Relations Manager, Intel |
| 10:00 a.m. | **Corporate Income and Franchise Tax Revenue Update and Trends**<br>—Demesia Padilla, Secretary of Taxation and Revenue<br>—John Tysseling, Chief Economist, Taxation and Revenue Department (TRD) |
| 11:00 a.m. | **Corporate Income Tax (CIT) Overview**<br>—Richard Anklam, President and Chief Executive Officer, New Mexico Tax Research Institute |
| 12:00 noon | **Lunch** |
| 1:00 p.m. | **Perspective on CIT Structure**<br>—Richard Minzner, Lobbyist |
| 2:00 p.m. | **Intel — Single Sales Factor Apportionment Formula**<br>—David Slater, State Taxation Division, Intel |

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|---|---|
| 2:30 p.m. | **Perspective on CIT Structure**<br>—Gerard Bradley, Research Director, New Mexico Voices for Children |
| 3:30 p.m. | **Association of Commerce and Industry (ACI) Concerns**<br>—Marcus Mims, Chair, Tax Committee, ACI<br>—Timothy R. Van Valen, Member, Board of Directors and Executive Committee, ACI |
| 4:15 p.m. | **Transferrable Tax Credits**<br>—Ethan Epstein, Tax Credit Alliance, LLC |
| 5:00 p.m. | **Recess** |

**Friday, August 31**

| | |
|---|---|
| 9:00 a.m. | **Reconvene**<br>—Representative Edward C. Sandoval, Chair, RSTP |
| 9:05 a.m. | **Revenue Forecast**<br>—Demesia Padilla, Secretary of Taxation and Revenue<br>—Leila Burrows, Chief Economist, Department of Finance and Administration<br>—Elisa Walker-Moran, Chief Economist, Legislative Finance Committee |
| 10:15 a.m. | **Personal Income Tax (PIT) Revenue Update**<br>—Demesia Padilla, Secretary of Taxation and Revenue<br>—John Tysseling, Chief Economist, TRD |
| 11:15 a.m. | **PIT Structure Overview**<br>—Jim O'Neill, Consultant |
| 12:30 p.m. | **Adjourn** |

**MINUTES**
**of the**
**THIRD MEETING IN 2012**
**of the**
**REVENUE STABILIZATION AND TAX POLICY COMMITTEE**

**August 30, 2012**
**Intel Building RR5, Rio Rancho**

**August 31, 2012**
**Mid-Region Council of Governments**
**Albuquerque**

The third meeting of the Revenue Stabilization and Tax Policy Committee (RSTP) for 2012 was called to order by Representative Edward C. Sandoval, chair, on Thursday, August 30, 2012, at 10:22 a.m. in Room 114 of Intel Building RR5 in Rio Rancho.

**Present**
Rep. Edward C. Sandoval, Chair
Sen. Tim Eichenberg, Vice Chair
Rep. Donald E. Bratton
Sen. Carlos R. Cisneros
Rep. Anna M. Crook
Sen. Clinton D. Harden, Jr.
Sen. Timothy Z. Jennings, Senate President Pro Tempore
Sen. Timothy M. Keller (8/30)
Rep. Rodolpho "Rudy" S. Martinez
Sen. Howie C. Morales
Rep. Henry Kiki Saavedra
Rep. Thomas C. Taylor (8/30)
Rep. Jim R. Trujillo
Rep. Bob Wooley (8/31)

**Absent**
Sen. Mark L. Boitano
Sen. Gay G. Kernan
Rep. Ben Lujan, Speaker of the House
Sen. John Arthur Smith

**Designees**
Rep. Thomas A. Garcia
Sen. William E. Sharer

Sen. Rod Adair
Rep. Ray Begaye
Sen. William F. Burt
Rep. Zachary J. Cook
Rep. Brian F. Egolf, Jr.
Rep. Miguel P. Garcia
Rep. Roberto "Bobby" J. Gonzales
Sen. Eric G. Griego

Sen. Phil A. Griego
Rep. Sandra D. Jeff
Rep. Antonio Lujan
Rep. Antonio "Moe" Maestas
Sen. George K. Munoz
Sen. Steven P. Neville
Rep. Debbie A. Rodella
Sen. Nancy Rodriguez
Sen. Bernadette M. Sanchez
Sen. John M. Sapien
Rep. James R.J. Strickler
Rep. Don L. Tripp
Rep. Luciano "Lucky" Varela
Sen. Peter Wirth

**Guest Legislators**
Rep. Conrad D. James (8/30)
Sen. David Ulibarri

(Attendance dates are noted for those members not present for the entire meeting.)

**Staff**
Pam Ray, Staff Attorney, Legislative Council Service (LCS)
Ric Gaudet, LCS
Pam Stokes, Staff Attorney, LCS

**Guests**
The guest list is in the meeting file.

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

**<u>Thursday, August 30</u>**

**Intel Tour**
Members of the committee went on a tour of the Intel manufacturing plant prior to the meeting being called to order.

**Corporate Income and Franchise Tax Revenue Update and Trends**
Demesia Padilla, secretary of taxation and revenue, and John Tysseling, chief economist, Taxation and Revenue Department (TRD), gave a presentation to the committee on the structure of the corporate income tax (CIT) and possible changes to the tax. The CIT is imposed on the taxable income of a corporation, which is based on federal taxable income with a few differences: New Mexico allows only five years for a business to carry forward net operating losses (NOLs); and the state does not tax interest from United States debt obligations or foreign

dividends. A corporation's business income tax is then computed on its income from all business activities worldwide and then apportioned to the New Mexico portion of that activity. New Mexico uses the standard three-factor apportionment formula, which evenly weights a corporation's payroll, sales and property factors in New Mexico compared to its total of those factors worldwide.

CIT revenue has historically been volatile, and it has recently seen large fluctuations. CIT revenue peaked in fiscal year 2007 at $460 million, followed by a fiscal year 2010 slump to $170 million. CIT revenue has been steadily increasing since that year and is expected to reach $293 million in fiscal year 2012. The CIT generally accounts for only five percent of general fund revenues. Secretary Padilla said that the state may be sending the wrong message to the business community about locating in New Mexico due to the high tax rates and complexity of the tax.

Approximately 20,000 corporations file CIT returns annually in the state. CIT growth sectors, based on the number of companies filing returns, include manufacturing; wholesale trade; finance and insurance; and professional, scientific and technical services. However, the sectors that generate the most CIT revenue include the oil and gas, manufacturing and management sectors. As an example, the oil and gas sector accounts for nearly one-fourth of CIT revenues, but it has only four percent of the total number of corporations in the state.

More than 18,000 corporations use the separate filing method, with the remaining companies filing combined or consolidated returns. Sixty percent of corporations reported an NOL in 2010. Seventeen percent reported taxable income greater than $1 million, generating $215 million in revenue for the state. The remaining 23 percent of corporations reported smaller earnings and generated only $7 million in revenue. The top 100 corporate taxpayers in the state in 2010 paid $167 million in taxes, which accounts for 75 percent of the CIT revenue. Of those 100 companies, only four have corporate headquarters in the state. Those companies also have a different distribution of taxes paid according to each apportionment factor. Most of the liability is not due to the sales factor but, instead, to the property factor.

Changing the CIT rate from a top bracket of 7.6 percent to 6.4 percent would cost the state around $60 million annually. Changing the rate to a flat 4.8 percent would cost the state about $150 million.

Questions and comments from committee members included the following.

- Have there been any studies of the offset to state revenue loss from a lowering of CIT rates by a potential increase in corporate activity? Secretary Padilla said that there have not been any specific studies in New Mexico to analyze that question. However, every dollar lost in CIT revenue shows up as a proportional increase in personal income tax (PIT) revenue.

- When Intel chose to build a new manufacturing facility in Arizona instead of New Mexico, was the availability of computing the CIT using a single-sales factor an important factor in that decision? Liz Shipley, government relations manager, Intel, said that the single-sales factor apportionment formula was a consideration in the company's decision, but it was not the only one. Intel expects to have about $10 billion in property assets in the state within 10 years. Allowing a single-sales factor would significantly reduce the company's tax liability.

- What percentage of the oil and gas and other mining category can be attributed to mining? Mr. Tysseling said that the oil and gas sector accounts for the great majority of that category.

- What accounts for the large increase in CIT revenue in fiscal year 2011 but a projected slight drop in revenue for fiscal year 2012? Swaroop Chary, economist, TRD, said that many companies still have NOLs on their books, so they can continue to reduce their tax liability.

**CIT Overview**

Richard Anklam, president and chief executive officer, New Mexico Tax Research Institute, gave a presentation to the committee about how the CIT operates in New Mexico. Forty-six states impose some type of income-based tax on corporations. Corporations pay tax on profits at the corporate level, and owners of corporations pay taxes as individuals. Small- to medium-sized businesses typically do not pay the CIT, mostly due to the fact that many businesses are organized as some form of pass-through entity. A state income tax calculation is based on the filing method, taxable income, apportionment method, tax rate and available incentives and credits.

The state CIT is very complex to administer and to comply with. Compared to revenue generated, this complexity is significant, rendering the CIT an exceptionally inefficient form of taxation. Because the CIT is generally imposed on larger, multistate companies, the impact of a state's CIT may affect the amount of economic activity or investment a corporation makes in that state.

Many states, including New Mexico, allow multistate corporations to file their tax returns as separate entities. Many states require multistate corporations to file on a unitary combined basis, which captures a portion of the entire company's earnings, apportioned to the state share of the business. The filing method for multistate corporations must be considered along with the apportionment method. New Mexico uses the standard apportionment formula, in which the three factors of property, payroll and sales are equally weighted. This formula was developed many decades ago to provide a uniform method for states to tax multistate corporations. The formula is reasonable, but it is somewhat arbitrary.

New Mexico's CIT structure has been substantially the same for decades, but other states have been changing their CIT structure dramatically. Rate reductions, alternative apportionment methods and requiring combined reporting are all common in the western states. These developments, in addition to the NOL limitation of only five years and the tiered rate structure of the CIT, have made New Mexico less business-friendly over time. There are several CIT reform options, but each one has policy and revenue considerations. The most equitable approach to CIT reform would be to enact CIT rate reductions, but that approach is also the most expensive approach if meaningful relief is desired. Another reform idea is to provide alternative apportionment formulas, such as a single-weighted sales factor (SSF). Some states have mandated that apportionment formula, but others have allowed companies to elect which apportionment formula to use. This would allow those industries, such as utility companies, to continue to use the standard three-tier formula rather than being penalized by switching to the SSF formula. Mr. Anklam suggested that if New Mexico were to allow such an election, those elections should not be allowed on a year-to-year basis. Another, more targeted, CIT reform approach would be to allow an optional SSF for certain industries deemed important to the state's economic development goals.

The prospect of requiring combined filing by multistate corporations has been a controversial subject in New Mexico for the past decade. All other surrounding states that have the CIT have required combined reporting. However, this approach is complex and may not bring in much more revenue to the state. Mr. Anklam suggested that if separate filing is continued, the legislature could consider providing reasonable "addback" provisions to capture some of the earnings of multistate corporations that can be attributed to the state. This law change would have substantially the same impact that requiring combined reporting would have.

Mr. Anklam mentioned several other CIT reform options, including much-needed technical clarification and cleanup; elimination of the "throwback" rule, which penalizes certain manufacturers; extension of the carryforward of NOLs for more than five years; and the establishment of independent hearing officers.

**Perspective on CIT Structure**

Richard Minzner, lobbyist, gave the committee his perspective on the CIT. Nearly all of New Mexico's CIT revenue is paid by large, multistate corporations. Most local businesses pay no CIT at all. The most important factor in the CIT law for many corporations is the apportionment formula. New Mexico uses the standard three-factor formula, which discourages investment and employment by corporations in the state. If New Mexico were to require combined reporting, the adverse impact of the apportionment formula would be magnified for many companies. That prospect, coupled with the state's very high CIT top-bracket rate of 7.6 percent, makes the state not very business-friendly and discourages new investment.

The recent attempts in the legislature to require combined reporting have shown how difficult it is to establish meaningful CIT reform. The current provisions allowing separate reporting is one of the few incentives the state provides for corporations to invest or stay in the state. Requiring combined reporting should not happen without a comprehensive approach — one that looks at changing tax rates and the apportionment formula. Mr. Minzner suggested that rather than requiring combined reporting, which would penalize many companies, the state could enact addback provisions, which would allow the state to recapture some legitimate tax revenue from some companies that attempt to evade paying the CIT through complex corporate structuring.

Questions and comments from committee members included the following.

- What should New Mexico do about NOL carryforwards? Mr. Minzner said that NOLs should be allowed to be carried forward for 10 to 15 years. He said that it would not be a good idea to allow companies to immediately monetize NOLs through refunds.

- How should New Mexico reform its CIT system? Mr. Minzner said that the state could lower the CIT rate, allow companies to elect to use an SSF apportionment formula and enact addback provisions. These three reforms would make the state much more business-friendly, while preventing illegitimate tax evasion strategies.

**Intel — SSF Apportionment Formula**

David Slater, State Taxation Division, Intel; Ms. Shipley; and Brian Rashap, site manager, Rio Rancho plant, Intel, discussed with the committee Intel's desire to be allowed to use an SSF in apportioning its income. Mr. Slater said that the current three-factor formula discourages corporations from making capital investments in New Mexico. In fact, it encourages in-state companies to invest outside of the state. Allowing an SSF apportionment formula would substantially change the investment environment in the state. New Mexico is already behind other states, being the only state in the region that does not have an SSF formula. Whenever Intel contemplates a new investment, it models the tax impact the new investment would have on the company. Investments in New Mexico cost more in taxes than investments made in other states.

Questions and comments from committee members included the following.

- How has Arizona recently changed its apportionment formula laws? Mr. Slater said that Arizona recently switched from a double-weighted sales factor formula to an SSF formula. That formula is being phased in over a five-year period, from 80 percent to 100 percent.

- What are the drawbacks to providing an SSF apportionment formula? Mr. Slater said that there certainly may be short-term revenue impacts, but the situation needs to be looked at dynamically. This change will encourage new capital investment and employment, which will increase tax revenues. If an SSF formula is required, rather than it being elective, some industries will end up pay more taxes, but the manufacturing sector will benefit.

- Intel has brought many high-wage jobs to central New Mexico. However, it needs to provide more outreach to rural areas. Ms. Shipley said that Intel is a major sponsor of the MESA program, which provides math and science programs to students. It also hosts approximately 100 students each summer at the plant to encourage students to study engineering.

- What is the average starting salary for engineers at Intel? Mr. Rashap said that, depending on the area of study, new engineers earn a starting salary of between $70,000 and $90,000.

- Was New Mexico's lack of an SSF formula the deciding factor in Intel's decision a few years ago to not build a new manufacturing facility in the state? Mr. Rashap said that was one factor in the decision. However, other factors, including work force readiness and infrastructure availability, played a role in the decision.

**New Mexico Voices for Children Perspective on CIT Structure**

Gerard Bradley, research director, New Mexico Voices for Children, discussed with the committee his organization's view of the CIT and current reform ideas. CIT revenue has historically been between three percent and eight percent of annual general fund revenues, and it is expected to be 6.5 percent of revenues in fiscal year 2013. Any change to the CIT structure to benefit businesses will cost the state money.

Mr. Bradley discussed requiring combined reporting by multistate corporations. The goals of requiring combined reporting include stopping CIT avoidance based on artificially shifting income to commonly owned corporations to other jurisdictions and ensuring that a corporation's CIT liability to New Mexico is the same, regardless of the corporation's legal structure. Currently, 23 states require combined reporting.

Mr. Bradley then discussed how various apportionment formulas affect tax liabilities of a company and how adopting an SSF formula would affect state revenues. By adopting an SSF formula, the only factor used in computing the CIT would be sales. Property and employment would be discounted completely. Using revenue estimates from 2008, he calculated that the CIT tax base would be reduced by more than 50 percent if an SSF formula were allowed, which in fiscal year 2013 would cost more than $175 million.

Finally, Mr. Bradley discussed the "throwback" rule, which provides that certain sales are classified as New Mexico sales in order to prevent the emergence of profits that are not taxed by any other state. He suggested that the legislature not eliminate this provision, which would lead to further tax avoidance by some corporations.

Questions and comments from committee members included the following.

- Tax policy in New Mexico does not favor the manufacturing industry.

- The previous large budgets New Mexico had were mostly based on the price of oil. Those surpluses should have been put into reserves rather than put into a recurring budget cycle.

- Can New Mexico provide revenue-neutral CIT reform by broadening the tax base and lowering the rate? Mr. Bradley said that the proposals he has seen thus far would not be revenue neutral. The $150 million to $175 million cost of switching to an SSF formula would not be offset by the most generous revenue estimates of $50 million from mandatory combined reporting.

- Forty years after adoption of the standard apportionment formula, New Mexico faces new economic realities. Adopting an SSF formula may cost the state some tax revenue, but it may also benefit from new job creation and capital investment.

- Intel may eventually close its Rio Rancho plant if New Mexico does not reform its tax policy.

**Association of Commerce and Industry Concerns**

Marcus Mims, chair, Tax Committee, Association of Commerce and Industry (ACI), and Timothy Van Valen, ACI board director, discussed with the committee the CIT-related issues with which the ACI is concerned. The ACI supports:

- enactment into law of an SSF apportionment formula for the CIT. An SSF formula is favorable to businesses that sell to out-of-state customers and tends to bring new money into the state by attracting business investment and job creation. Mr. Van Valen also said that an SSF formula would be broad-based and not pick winners and losers;

- elimination of the throwback rule for the sales factor computation. This law increases the sales factor of corporations and artificially attributes sales to New Mexico if the state in which a corporation's customer is based has no jurisdiction to tax the customer. Leaving this provision intact would thwart the goal of adopting an SSF formula;

- reduction of the highest CIT rate from 7.6 percent to 4.9 percent. This would make New Mexico more competitive with surrounding states and would tax all businesses at the same maximum rate. Currently, limited liability companies and other pass-through entities and sole proprietorships pay the CIT at a maximum 4.9 percent;

- clarification that the state's treatment of NOLs is governed by provisions of the federal Internal Revenue Code of 1986. New Mexico statutes do not expressly address whether the state follows federal rules for the use of the NOL deduction. The TRD rules tend not to follow federal rules on NOL deductions following a merger or acquisition of a company. In addition, New Mexico statutes allow a five-year NOL carryforward, but federal law allows a 20-year period;

- a stable and predictable tax system. New Mexico suffers from a perception that it has an unstable and unpredictable tax system because legislation is often introduced to change business incentives and to change CIT reporting methods;

- fair tax administration. The TRD should not adopt retroactive rules. It also needs to provide effective advance notice to taxpayers of tax policies and develop those policies in a transparent public process rather than through an audit process or litigation;

- replacement of TRD hearing officers with independent, external hearing officers. New Mexico is one of the few states that do not have independent hearing officers. TRD hearing officers are perceived as being biased toward the TRD's position, which reduces confidence in the tax administration system;

- a comprehensive state economic development plan. Tax legislation too often inequitably picks winners and losers and is often geared toward political and economic special interests. There has been little effort to establish a comprehensive statewide economic development plan; and

- transparency and accountability for tax incentives that also protect taxpayer confidentiality and proprietary information. New Mexico is less likely to attract new business if proprietary information is made public by the acceptance of a tax incentive. Tax expenditure budgets can be crafted to give the public an incorrect view of exemptions or deductions that are not really tax expenditures versus those that are indeed created to incentivize a business activity.

The ACI opposes any attempt to eliminate the option for multistate corporations to file separately. Elimination of filing method options would make New Mexico even less attractive than it is now for new investment. Changing filing methods for businesses that are already in New Mexico would be fundamentally unfair.

Questions and comments from committee members included the following.

- Many corporate branches that start up in a new state are not profitable for a few years, yet the overall company may turn a profit. Requiring combined reporting in such a situation is not fair to the new company. Mr. Van Valen said that research data suggest that the state would not see much of a revenue increase from mandating combined reporting.

- The ACI representatives were asked to come up with a workable solution to help attract new business to the state and also maintain tax revenues to the state.

**Transferable Tax Credits**

Ethan Epstein, Tax Credit Alliance, LLC, presented a bill draft to the committee to allow several existing tax credits to be transferred to other taxpayers. He recommended that the angel investment credit, the credit for preservation of cultural properties, the job mentorship tax credit, the solar market development tax credit and the rural health care practitioner tax credit be made transferable, which would allow those credits to be sold to other taxpayers if their full value cannot be used by the original taxpayer.

The committee recessed at 4:36 p.m.

**Friday, August 31**

The committee reconvened on Friday, August 31, 2012, at 9:07 a.m. at the Mid-Region Council of Governments building in Albuquerque.

**Revenue Forecast**

Secretary Padilla; Leila Burrows, chief economist, Department of Finance and Administration; and Elisa Walker-Moran, chief economist, Legislative Finance Committee, presented to the committee the August 2012 consensus revenue forecast. Fiscal year 2012 revenues have been revised upward since the December 2011 forecast by $218 million, at $5.476 billion. Fiscal year 2013 estimates have been revised upward of $18 million, and fiscal year 2014 revenues have been revised upward by $120 million, at $5.922 billion. Fiscal year 2012 general fund ending balances are $706 million, or 12.9 percent of recurring appropriations, and fiscal year 2013 ending balances are estimated to be $736 million, or 13 percent of recurring appropriations. For fiscal year 2014, the state expects to see $272 million in new money, which is defined as fiscal year 2014 projected revenues less fiscal year 2013 recurring appropriations. However, scheduled changes to public employee retirement contributions and transfers from the Tobacco Settlement Permanent Fund will reduce the amount of new money to $198 million.

Secretary Padilla discussed the recently enacted gross receipts deduction for certain items consumed during the manufacturing process. She said that some rural electric cooperatives have indicated that they may not use the deduction because its requirements are too burdensome. She also said that the film production tax credit now requires the credit to be applied for when a taxpayer files its income tax return, which has caused some problems with the timing of the credit. The high-wage jobs tax credit has seen a large increase in use in the past two years, and there are some loopholes that need to be fixed with that credit. Some companies have claimed the credit after a merger in which no new jobs were created.

Questions and comments from committee members included the following.

- Is there a lookback limit to the high-wage jobs tax credit? Secretary Padilla said that some companies are going back to 2004 job creations to claim the credit. There should be a limit to when a company may claim a credit for previous activity.

- The threshold of $28,000 to claim a high-wage jobs tax credit is too low.

- The Department of Transportation will soon need to make a $500 million payment for the purchase of Burlington Northern Santa Fe Railroad tracks, and it will also soon need to invest $113 million for track repairs.

**Minutes**

The minutes of the July 16-17, 2012 committee meeting were adopted without correction.

**PIT Revenue Update**

Secretary Padilla, Mr. Chary and Jeff Bjarke, senior economist, TRD, discussed with the committee the PIT. New Mexico's top marginal PIT rate is 4.9 percent, which is very close to the rate imposed by surrounding states. The PIT is the general fund's second-largest revenue source, and it is expected to raise $1.6 billion in fiscal year 2013. Historically, PIT revenue has steadily increased since 1999, except during the 2008 economic recession when revenues dropped more than 20 percent.

Less than one percent of PIT filers file "married filing separately" because that tax bracket is more expensive than other brackets. Fifty-five percent file as "head of household or "married filing jointly", and the remaining 44 percent file as single individuals or estates or trusts. While those with taxable income under $50,000 make up 80 percent of PIT filers, they account for 55 percent of PIT revenue. Filers earning more than $100,000 account for six percent of PIT filers and 21 percent of its revenue. The average tax liability in New Mexico has hovered around $1,000 for the past four years, with an average $100 in tax credits applied to each person.

Questions and comments from committee members included the following.

- The PIT is not progressive enough and should have a higher tax margin than the current 4.9 percent. Secretary Padilla said that many people earning less than $25,000 take advantage of multiple credits available to low-income people.

**PIT Structure Overview**

Jim O'Neill, consultant, gave the committee a primer on the structure of the PIT. New Mexico's PIT is levied on every resident individual and on every nonresident deriving any income in the state. "Individual" includes estates, trusts and fiduciaries. The PIT is not imposed on Native Americans earning income within their tribe's territory. Also excluded from taxation is income earned by foreign diplomatic and military personnel. If a person has been employed in New Mexico 15 days or fewer, PIT payment and withholding are not required.

New Mexico piggybacks on federal law to calculate the PIT, with some important modifications. While this method makes calculation of income much simpler for taxpayers and preparers, a certain amount of sovereignty is ceded to the federal government with this practice. NOLs for PIT purposes are treated differently than the federal government, mainly by disallowing carrybacks of NOLs and allowing them to be carried forward for only five years.

New Mexico has a progressive income tax schedule, although the top margin rate was reduced to 4.9 percent in 2004, rendering the PIT essentially a flat tax. There are 28 PIT rebates and credits, many of which target low-income persons. The income tax system is designed to return to qualifying low-income persons a portion of other taxes paid to the state. Many people receive a refund from the state from PIT calculations of more than they have actually paid in income taxes.

The state requires employers to withhold income taxes from employee earnings, and it requires withholding from certain types of pass-through entities and proceeds from oil and gas operations. Against the recommendation of nearly all economists, most wage earners prefer to have too much in withholding in order to ensure a significant refund at the end of the tax season, which results in the state having a large interest-free cash flow boost most of the year.

Mr. O'Neill discussed the 11 plans in statute allowing taxpayers to donate a portion of their income tax refund to various worthy causes. He said it is not clear how much this system costs the state to implement compared to revenue generated. Finally, he identified several obsolete statutes in the Income Tax Act that could be repealed.

Questions and comments from committee members included the following.

- Does each agency that desires to intercept wages from identified individuals need to recertify its list of individuals to intercept wages? Mr. O'Neill said that process happens annually. Keeping individuals on a list indefinitely could raise due process concerns.

- Many state agencies do not pay their vendors in a timely fashion. Vendors who are owed money by state agencies should be allowed to use the Tax Administration Act's interest and penalty provisions to charge agencies fines for not paying on time.

- The Fort Bayard National Cemetery should be added to the list of tax refund beneficiaries because that cemetery is quickly running out of space and needs to acquire more land.

There being no further business, the committee adjourned at 11:00 a.m.

REVENUE STABILIZATION AND
TAX POLICY COMMITTEE

# Section 6

# September 2012
# Agenda
# Minutes

**Revised: September 10, 2012**

**TENTATIVE AGENDA**
**for the**
**FOURTH MEETING**
**of the**
**REVENUE STABILIZATION AND TAX POLICY COMMITTEE**

**September 17-18, 2012**
**Pan American Center, Barbara Hubbard Room**
**New Mexico State University**
**Las Cruces**

**<u>Monday, September 17</u>**

| | |
|---|---|
| 9:00 a.m. | **Call to Order**<br>—Representative Edward C. Sandoval, Chair |
| 9:05 a.m. | **Welcome from New Mexico State University President**<br>—Barbara Couture, President, New Mexico State University |
| 9:35 a.m. | **Union Pacific Fuel Yard and Burlington Northern Santa Fe Railway Update**<br>—Zoe Richmond, Director, Public Affairs, Union Pacific Railroad<br>—Andrew Johnsen, Assistant Vice President, State Government Affairs, Burlington Northern Santa Fe Railway Company (BNSF)<br>—David Uphaus, Director, Tax Department, BNSF<br>—Dennis Kearns, Legislative Counsel, State Government Affairs, BNSF |
| 10:45 a.m. | **New Mexico (NM) Lottery Revenue Update and Legislative Lottery Scholarship Fund Status**<br>—Tom Romero, Chief Executive Officer, NM Lottery<br>—Adriana Binns, Director, Marketing and Communications, NM Lottery<br>—Glenn Walters, Deputy Secretary, Higher Education Department |
| 11:45 a.m. | **Lunch** |
| 1:00 p.m. | **Gaming — Revenue and Trends, Tribal-State Revenue Sharing**<br>—Frank Baca, General Counsel and Acting Executive Director, Gaming Control Board (GCB)<br>—David Norvell, Member and Acting Tribal Gaming Representative, GCB |

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| 2:30 p.m. | **Lincoln County Business Retention Tax**<br>—Demesia Padilla, Secretary of Taxation and Revenue<br>—John Tysseling, Chief Economist, Taxation and Revenue Department (TRD)<br>—Alan Morel, Lincoln County Attorney<br>—Sandi Aguilar, Representative, Ruidoso Downs Racetrack and Billy the Kid Casino |
| 3:30 p.m | **Tax Expenditure Report**<br>—Demesia Padilla, Secretary of Taxation and Revenue<br>—John Tysseling, Chief Economist, TRD |
| 4:45 p.m. | **Recess** |

**<u>Tuesday, September 18</u>**

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| 9:00 a.m. | **Reconvene**<br>—Representative Edward C. Sandoval, Chair |
| 9:05 a.m. | **Horse Racing Update**<br>—Vince Mares, Executive Director, State Racing Commission |
| 10:30 a.m. | **Patient Protection and Affordable Care Act — Revenue Outlook Update**<br>—Bill Jordan, Policy Director, New Mexico Voices for Children (NM Voices)<br>—Nick Estes, Deputy Policy Director, NM Voices<br>—Gerard Bradley, Research Director, NM Voices |
| 12:00 noon | **Adjournment** |

**MINUTES**
**of the**
**FOURTH MEETING IN 2012**
**of the**
**REVENUE STABILIZATION AND TAX POLICY COMMITTEE**

**September 17-18, 2012**
**Pan American Center, Barbara Hubbard Room**
**New Mexico State University**
**Las Cruces**

The fourth meeting of the Revenue Stabilization and Tax Policy Committee (RSTP) for 2012 was called to order by Representative Edward C. Sandoval, chair, on Monday, September 17, 2012, at 9:05 a.m. in the Barbara Hubbard Room of the Pan American Center at New Mexico State University (NMSU) in Las Cruces.

**Present**
Rep. Edward C. Sandoval, Chair
Sen. Tim Eichenberg, Vice Chair
Rep. Donald E. Bratton
Sen. Carlos R. Cisneros
Rep. Anna M. Crook
Sen. Clinton D. Harden, Jr.
Sen. Timothy M. Keller
Sen. Gay G. Kernan (9/17)
Rep. Rodolpho "Rudy" S. Martinez
Sen. Howie C. Morales
Rep. Henry Kiki Saavedra
Sen. John Arthur Smith
Rep. Jim R. Trujillo

**Absent**
Sen. Mark L. Boitano
Sen. Timothy Z. Jennings, Senate President Pro Tempore
Rep. Ben Lujan, Speaker of the House
Rep. Thomas C. Taylor
Rep. Bob Wooley

**Designees**
Rep. Ernest H. Chavez (attending as a guest)
Rep. Zachary J. Cook
Rep. Antonio Lujan
Sen. George K. Munoz
Rep. Debbie A. Rodella (attending as a guest 9/17)
Sen. William E. Sharer

Sen. Rod Adair
Rep. Ray Begaye
Sen. William F. Burt
Rep. Brian F. Egolf, Jr.
Rep. Miguel P. Garcia
Rep. Thomas A. Garcia
Rep. Roberto "Bobby" J. Gonzales
Sen. Eric G. Griego

Sen. Phil A. Griego
Rep. Sandra D. Jeff
Rep. Antonio "Moe" Maestas
Sen. Steven P. Neville
Sen. Nancy Rodriguez
Sen. Bernadette M. Sanchez
Sen. John M. Sapien
Rep. James R.J. Strickler
Rep. Don L. Tripp
Rep. Luciano "Lucky" Varela
Sen. Peter Wirth

**Guest Legislators**
Sen. Mary Kay Papen
Rep. Richard D. Vigil (9/18)

(Attendance dates are noted for members not attending the entire meeting.)

**Staff**
Pam Ray, Staff Attorney, Legislative Council Service (LCS)
Ric Gaudet, LCS
Damian Lara, Staff Attorney, LCS
Pam Stokes, Staff Attorney, LCS

**Guests**
The guest list is in the meeting file.

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

**<u>Monday, September 17</u>**

**Welcome from NMSU President**
Barbara Couture, president, NMSU, welcomed the committee to the university campus. The university opened in 1890 as a land grant college focusing on agriculture and engineering. Today, the university has extensive research and economic development activities in many more arenas. The Arrowhead Center since 2004 has participated in 300 business research projects, which has contributed greatly to the state's economic climate. The linkage of research and economic development partnerships has made the university a major economic engine for the state. NMSU has a presence throughout New Mexico, with extension agents in every county and with 13 agricultural experiment stations. Total enrollment at the university is 28,000, with 9,000 students at the main campus in Las Cruces. President Couture mentioned the new Barnes and Noble bookstore and café, which is an example of a successful partnership with private enterprise on the campus.

Questions and comments from committee members included the following.

- The Range Improvement Task Force, which receives funding from NMSU, plays a vital role in assisting ranchers in obtaining grazing permits. This program should continue to be funded.

- Is the high school located on the NMSU campus part of the Las Cruces Public School District? President Couture said that it is part of the school district. Students are selected to attend the school based on their economic and social situations. The school focuses on college readiness and allows students to earn an associate degree at the school.

- What progress has been made with the Santa Fe Higher Learning Center? The issuance of local bonds has already been approved, but the project appears to be on hold. President Couture said that NMSU's cost-benefit analysis of the program was not favorable. The university was unable to cover the costs associated with the learning center.

- What has happened regarding the nursing program at the Dona Ana branch of NMSU? President Couture said that in August 2012, the nursing program at Dona Ana Community College was not re-accredited by a national accreditation body. The university immediately offered all currently enrolled students at the community college the option to transfer to the main campus nursing program and offered scholarships to those students. So far, more than 70 students have transferred. The community college is currently acting to remedy the accreditation problems and has re-applied for accreditation. The main reasons for failing accreditation were that the college did not have a good faculty-to-student ratio and not enough faculty with master in nursing degrees.

LCS staff was requested to investigate whether state regulation of nursing education programs is redundant, since national accreditation is the most important factor for a school's ability to train employable students.

**Union Pacific Fuel Yard and Burlington Northern Santa Fe Railway Update**

Zoe Richmond, director of public affairs, Union Pacific Railroad, Andrew Johnsen, assistant vice president, state government affairs, Burlington Northern Santa Fe Railway Company (BNSF), David Uphaus, director, Tax Department, BNSF, and Dennis Kearns, legislative counsel, state government affairs, BNSF, discussed with the committee the status of ongoing rail projects and proposed legislation to expand the scope of a gross receipts tax (GRT) deduction for railway companies. Ms. Richmond discussed the progress made on the Union Pacific intermodal facility in Santa Teresa. Legislation passed in 2011 granted a deduction from gross receipts for locomotive fuel for a railroad company that invests $100 million in a railroad locomotive refueling facility and that has the project commence prior to July 1, 2012. Union Pacific has so far spent $40 million on the project since 2011, mostly on site preparation, and will begin actual construction of the facility soon. The fueling facility and intermodal ramp are expected to be completed in 2015, assuming no delays in permitting or due to weather.

Ms. Richmond said that the Taxation and Revenue Department (TRD) will need to notify the LCS and the New Mexico Compilation Commission by July 1, 2013 that the project is in compliance with the legislation, giving effect to the section of law granting the GRT deduction.

Mr. Johnsen, Mr. Uphaus and Mr. Kearns discussed with the committee BNSF's desire to have legislation enacted to allow more types of investment across the state to qualify for the fuel deduction. Legislation from the 2012 legislative session to do that nearly passed the legislature, but the clock ran out before final passage could occur. BNSF has already invested hundreds of millions of dollars in railroad facilities and would like to invest more if the state's tax policy is more favorable. To a large extent, the state's tax policy drives capital investment in new facilities and upgrades.

Questions and comments from committee members included the following.

- Why was there an embargo on cargo in Monahan, Texas, in May 2012? Ms. Richmond said that in the railroad industry, "embargo" means that there is too much cargo to be moved quickly. She said that the situation in Texas was resolved quickly after the embargo became apparent. Mr. Kearns said that the proposed legislation would provide incentives for railroad companies to invest in short-line improvements. Many lines currently do not have enough annual traffic to justify large-scale improvements.

- What is happening with the maintenance issue on the track between Raton and Lamy? Mr. Johnsen said that there has been a delay in the negotiations with the New Mexico Department of Transportation. He clarified that BNSF has full responsibility to maintain that track. However, if Amtrak wants to operate its cars at a higher speed, it would be responsible for the extra investments needed.

- How is Union Pacific working with local schools to train the work force? Ms. Richmond said that a proposed amendment to the GRT deduction section would have forced the company to partner with local schools. However, Union Pacific is not an education provider, she said. The company has donated $100,000 to the community college to jump start the work force training process. David Lopez, representing the Mesilla Valley Economic Development Alliance, said that his organization has developed surveys, trying to match current skills with the current student population. John Walker, associate vice president, Dona Ana Community College, said that the school is ready to provide work force training. The college is also working with Sunland Park and Chaparral high schools.

- Would providing BNSF with the option to calculate its corporate income tax liability using a single-weighted sales factor, rather than the proposed GRT deduction, be a more effective option to provide tax relief? Mr. Uphaus said that he would investigate how that change would impact BNSF's tax liability.

**New Mexico Lottery Revenue Update and Lottery Tuition Fund Status**

Tom Romero, chief executive officer, and Adrianna Binns, director of marketing and communications, New Mexico Lottery Authority, and Glenn Walters, deputy secretary, Higher

Education Department (HED), presented to the committee an update on lottery revenues and projections for fund balances. In fiscal year (FY) 2012, the authority realized $133.9 million in gross revenue. By statute, the lottery is required to return a minimum of 50 percent of proceeds to players in the form of prizes and 30 percent to the Lottery Tuition Fund. The remaining revenue is allocated to cover the costs of products, retailer commissions and administrative costs. Forty-one million dollars was deposited into the fund last FY.

Mr. Romero discussed the effect that the statutory requirement of maintaining a monthly 30 percent return to the Lottery Tuition Fund has had on the operations of the authority. That requirement makes it difficult for the authority to operate as a sales and marketing organization; limits its ability to respond to changing market conditions; and does not allow for reserve balances. The requirement could become a significant problem if vendor contract terms increase as a result of changes in the lottery industry. The authority has been forced to eliminate retailer and employee sales incentives, reduce staffing from 68 to 56 full-time-equivalent employees and reduce prizes to players. This reduction in payout has led to a dramatic reduction in instant game sales since FY 2007. The average payout in 2007 was 63 percent, while today it is only 58 percent, which is the lowest payout in the nation. While instant game sales have decreased recently, sales of drawing games have increased. Powerball and Mega Millions have contributed to the overall stability of net revenues in the past few FYs.

Deputy Secretary Walters discussed Lottery Tuition Fund balance projections with the committee. By FY 2014, the fund is expected to have negative balances, given the current revenue and scholarship trends. Since FY 2009, expenditures from the fund have exceeded revenues being deposited. Most higher education institutions have also raised tuition rates, which has further hurt fund balances. If there is insufficient money in the fund, the HED will be forced to reduce the amount each student receives in scholarship funding.

Questions and comments from committee members included the following.

- When was the 30 percent monthly return requirement enacted? That requirement has only hurt the authority's ability to be flexible. Mr. Romero said that the requirement was enacted in 2007. In 2007, the authority provided a 27 percent return to the fund. By 2009, the authority was able to comply with the 30 percent requirement.

- Why have instant game sales declined so much? Mr. Romero said that vendors report that the payout of 57 percent is too low, turning off potential customers. The slowdown in the economy also has contributed to declining sales. The current focus of the authority is to revitalize instant game sales. Those changes will need to be made slowly, however.

- The legislature should reconsider enacting legislation to allow New Mexico residents to donate a portion of their income tax refund to the Lottery Tuition Fund. That would allow residents who do not play the lottery to contribute to the scholarship program.

● HED staff was asked to provide the committee with graduation rates of students receiving a lottery tuition scholarship. Information on student loan amounts and scholarship amounts per student was also requested.

● The state is wasting money providing scholarships to students who are not prepared to attend college. Deputy Secretary Walters agreed, and said that some students are not ready for college immediately after high school. However, the statutes providing for the scholarships require students to attend college immediately after graduation from a New Mexico high school. Extending scholarship eligibility would help the situation, but further weaken fund balances.

● Have the two vacancies on the board of directors of the authority been filled? Mr. Romero said those positions are still open.

● Playing the lottery seems to be a form of taxation on low-income people. Mr. Romero said that there is a broad player base in New Mexico. The majority of adults in the state play the lottery.

**Gaming — Revenue and Trends; Tribal-State Revenue Sharing**

Frank Baca, general counsel and acting executive director, and David Norvell, member and acting tribal gaming representative, Gaming Control Board (GCB), presented to the committee an update of the board's activities. The board oversaw $134 million in gaming revenue deposited into the general fund in FY 2012. Approximately one-half of that revenue was generated by racetrack and nonprofit casinos licensed by the board and license fees. The remaining portion of the revenue came from tribal casinos, which pay a different percentage of net win than racinos. Revenue from racinos is estimated to slightly decline in FY 2013, but revenue from tribal casinos may grow as much as four percent. A decline in racino gaming tax revenue will also mean a decline in contributions to racetrack purses, which could further weaken the horse racing industry.

Questions and comments from committee members included the following. In addition, the chair allowed members of the public to address the committee.

● Is the Downs at Albuquerque in fiscal trouble? Mr. Norvell said that the Downs reduced its race days, but he was not sure why.

● What is the status of the dispute between the GCB and some tribes regarding the revenue-sharing agreement? Mr. Norvell said that some tribal casinos have been calculating net win differently from the state's method. He said the board hopes to resolve the issue without the need for arbitration or pursuing the legal process. The board will know by the end of 2012 whether the current negotiations will be successful. The issue in dispute is whether free-play is taxable as if it were a form of pay-for-play.

● Are some tribes in violation of their gaming compacts? Mr. Norvell said that could be true.

- The GCB has not disclosed any useful information to the legislature regarding the dispute about the revenue-sharing agreement. The chair of the State Racing Commission (SRC) sits on the GCB, but the GCB apparently is not aware of what is happening at the Downs at Albuquerque. The legislature may need to change what kinds of information the board must disclose to the legislature.

- Class III gaming at racetracks originally was enacted as a means of saving the horse racing industry. The racetracks had enthusiastically endorsed the 26 percent gaming tax that they are now complaining so loudly about. It appears that the industry would prefer that horse racing in New Mexico disappears, and that the state be left with only private casinos with no racetrack activity. Mr. Norvell said that the tribes, which pay between three and 10 percent of their revenues to the state, have a significant advantage over the racinos, which pay about 46 percent of their revenues to the state and race purses.

- Does the GCB have any information about the status of the negotiation process between the governor and some tribes to establish a new gaming compact? Mr. Norvell said that the Office of the Governor has not released any substantive information about the status of those negotiations, except to indicate that the negotiations are under way. Conroy Chino, lobbyist for the Jicarilla Apache Nation and the Pueblo of Acoma and a member of the compact negotiating team, said that meetings between the tribes and the Office of the Governor began in May, but that serious negotiations have not yet begun. He had hoped the negotiation process would be much further along by now.

- Tribes cannot be forced to pay revenue sharing to the state. Any revenue sharing must have consideration for a benefit derived from the state through negotiation. Tribes are not private enterprises but governments, and the services tribes provide complement services provided by the state.

- The only statutory requirement placed on the governor is to negotiate with the tribes in good faith. There is no time frame setting out the process. Mr. Norvell said that some of the compacts will expire in 2015 and that those compacts are currently in negotiation.

- What percentage of net win do the tribal casinos pay to the state? Mr. Norvell said that the tribes operating under the 2001 compact pay eight percent of net win. The tribes operating under the 2007 compact pay between three and 10 percent of net win, depending on how much net win a casino generates. That rate is set to increase beginning in 2015.

- In the revenue-sharing dispute with the GCB, are the tribes claiming they are paying too much? Mr. Baca said that the dispute centers on how net win is calculated, not the percentage of net win paid to the state. The question is whether costs associated with "free play" can legitimately be deducted from gross revenue in the calculation of net win.

- How much money is in dispute regarding the calculation of net win? Mr. Baca said that the disputed amount the GCB wants the tribes to pay to the state is millions of dollars.

- Pamela Gallegos, chief executive officer, Hard Rock Casino, asked the committee members to hear the tribes' perspective. She said that the tribes were under the impression that they were paying the correct amount of revenue sharing, but in 2009, the GCB attempted to collect extra revenue-sharing payments retroactively. Several other tribal representatives asked that the tribes be allowed to present their perspective at a future committee meeting.

LCS staff was instructed to provide an agenda item for the tribal perspective on the calculation of net win at a future meeting of the committee.

**Lincoln County Business Retention Tax**

Secretary of Taxation and Revenue Demesia Padilla, John Tysseling, chief economist, TRD, Alan Morel, Lincoln County attorney, and Sandi Aguilar, representative, Ruidoso Downs Racetrack and Billy The Kid Casino, discussed with the committee the impact on the Ruidoso area of the recently enacted county business retention GRT. The legislation was enacted in an attempt to keep the casino and racetrack in its current location by shifting some of the tax burden from the casino to the rest of the taxpayers in Lincoln County. Lincoln County residents voted to impose a GRT increment to offset lost state revenue from a 50 percent gaming tax credit granted to the business. Any revenue generated from the tax in excess of $750,000 annually is to be distributed to the county for specified purposes. In FY 2012, the county received a distribution of $107,000 from the state.

Mr. Morel said that the special election held in 2010 considering the tax increment was paid for by a nonprofit organization that supported the tax increase. The GRT referendum severely divided the county, but the measure passed.

Ms. Aguilar said that Ruidoso Downs has been able to make capital improvements and increase its marketing and employment levels since the legislation and referendum passed. This has resulted in a 10 percent increase in gaming, racing and other revenue since 2011. She said the legislation has increased economic activity in the area. Although the racino was granted a $750,000 tax incentive, the business has paid more than that amount in new tax liabilities to the state in the form of additional GRTs from capital improvements made and from increased business.

Questions and comments from committee members included the following.

- This legislation is an example of local involvement in economic development initiatives. Although it may be terrible tax policy from a complexity standpoint, it makes local governments pay their share, rather than having the state pay for local initiatives. In addition, concern was expressed about the precedent of allowing a nongovernmental group to pay the costs of holding an election.

- How many gaming machines are located at the casino? Ms. Aguilar said that Ruidoso Downs has 300 machines. The rest of the allotment of 600 machines allowed by statute has been leased out to other casinos.

**Tax Expenditure Report**

Secretary Padilla and Mr. Tysseling presented a summary of the TRD's 2012 tax expenditure report. Tax expenditures were defined in the report to be tax provisions implemented to achieve policy objectives, allowing taxpayers to retain specific economic value. Tax expenditures are taxes not collected, which can be an efficient means of achieving a public purpose. In preparing the report, TRD staff engaged all executive agencies, reviewed all prior tax expenditure analyses and reports, researched TRD data and audit systems, in addition to outside data sources, and compiled more than 400 templates of possible expenditures. Tax expenditures were then compiled into eight categories, including industry-specific expenditures for economic development, improving the business climate, specific public purposes, health care programs and facilities, public welfare, nonprofit enterprises, natural resource policy and any related to Indian nations, tribes and pueblos.

Secretary Padilla and Mr. Tysseling discussed a few dozen of the expenditures listed in the report, giving a brief description of each expenditure and the cost of each expenditure, dating back to 2007, if possible.

Questions and comments from committee members included the following.

- The draft version of the tax expenditure report was much larger than the report published on the TRD's web page. It appears that many pages from the report were removed. Secretary Padilla said that the original report was nearly the same size as the final version. Some pages containing backup documentation were removed.

- Why is there not a summary of the total amount of tax expenditures and a total cost? Secretary Padilla said that there is no total cost figure because many of the expenditure figures are estimates. Mr. Tysseling said that many tax expenditures count against several tax programs, so providing a total number of expenditures would be misleading.

- Many tax expenditures listed in the report's appendix do not appear in the report. For example, the appendix lists the coal tax rate differential as a tax expenditure, but nowhere in the report is it discussed. Mr. Tysseling said that many of the credits, deductions and exemptions are not considered true tax expenditures, so they were not included in the report.

- The new tax expenditure report appeared to be incomplete. More than one-half of the expenditures listed in the appendix are missing from the report. The report given to the committee in 2010 had much more complete data and figures than the current report. Secretary Padilla said that the TRD did not include those expenditures that are not actually tax expenditures. Also, some tax expenditures could not have detail given because disclosing information about a few taxpayers could violate statutory confidentiality provisions.

LCS staff was directed to provide copies of previous tax expenditure reports to members of the committee. TRD staff was requested to provide the committee with the draft tax expenditure report.

- The executive order directing the TRD to create a tax expenditure report mandated that each tax expenditure provide an evaluation and determine its cost-effectiveness. None of that information is provided in the report. If TRD staff is overburdened, it should ask the legislature for the resources to produce a meaningful report. Mr. Tysseling said that the production of the report was a full-time effort for several months by some TRD staff. Cost-benefit analyses are very difficult and time-consuming to perform.

- Does the TRD have the ability to correct overpayments to municipalities from incorrect reporting of gross receipts by businesses? Secretary Padilla said that the TRD needs more authority to penalize businesses that report gross receipts incorrectly. The department is doing more outreach with small businesses to ensure proper location reporting.

- When will the TRD give recommendations on how to reform provisions of the high wage jobs tax credit? Secretary Padilla said that a group of stakeholders is meeting and will make recommendations soon. She said that proposed legislation will be similar to a bill introduced in the 2012 legislative session.

- It is difficult for analysts to score open-ended tax expenditures. The newly enacted construction and manufacturing deductions will be much more costly than originally estimated. Policymakers also need return-on-investment analyses on some tax expenditures. Secretary Padilla suggested that the TRD could spend more time analyzing tax expenditures that cost the most, rather than spending a brief period studying each expenditure.

- The business sector in New Mexico needs a consistent tax policy in order to recognize the state as a good place to do business. Policymakers need to know which tax expenditures have a significant impact on state revenues.

The minutes from the August 30-31, 2012 meeting of the committee were adopted without changes.

The committee recessed at 4:22 p.m.

**<u>Tuesday, September 18</u>**

The committee reconvened on Tuesday, September 18, 2012, with Representative Sandoval chairing the meeting.

**Horse Racing Update**

Vince Mares, executive director, and Beverly Bourget, member, SRC, gave the committee an update on the horse racing industry in the state. The SRC regulates five racetracks in the state. The sixth license allowed by statute, granted for a proposed racetrack in Raton, was revoked by the commission. The issue is currently in court, with the former licensee claiming that due process was not followed in revoking the license. The SRC is currently accepting applications to fill the sixth license and will act on that license once the court issue is resolved.

The SRC has five main areas of focus: licensing, equine drug testing, investigations and enforcement, auditing and accounting and race meet oversight.

The SRC has identified strategies to combat the illegal use of clenbuterol and demorphin. Use of these substances appears to be widespread in the horse racing industry. The commission is in the process of issuing a new request for proposals (RFP) for a laboratory to test the blood of horses. The previous laboratory was unable to identify the presence of demorphin. Once a horse has been tested positive for a banned substance, the commission is unable to keep that horse from racing until due process has been afforded the horse owner or trainer. The horse trainer is allowed to send the blood sample to a different laboratory, which often takes weeks. Trainers have been successful in getting court injunctions against the commission, which allows horses to run in meets, sometimes for several years after they have tested positive.

The SRC is attempting to bring back integrity to the New Mexico horse racing industry. It needs more money in its budget to investigate and prosecute infractions, and it needs to have certified law enforcement officers on its staff. There has been infiltration by Mexican drug cartels into the state's industry. The current SRC budget of $2.1 million should be doubled in order to properly regulate the industry.

The SRC recently joined the Association of Racing Commissioners International, with the $10,000 membership fee being provided by New Mexico racetracks. Membership will allow the SRC use of a modern database to make licensing, accounting and investigation functions easier.

In the past, the SRC was not consistent in how it enforced its rules. The commission has recently adopted new classes of violations, which can hold accountable an owner and veterinarian, in addition to the trainer. Finally, Mr. Mares said that Zia Park is constantly on the commission's radar for unsafe conditions on and off the track.

Questions and comments from committee members included the following.

- The situation at the SRC and within the horse racing industry seems very bleak. Does the governor know the severity of the situation? Mr. Mares said that the chair of the SRC has met with the governor. Ms. Bourget said that the commission's hands are tied, and it can do very little to quickly enforce SRC rules.

- The SRC should be funded by allocating a percentage of purses toward its budget, rather than from the general fund.

- How much money from the gaming portion of racino businesses is allocated toward horse racing purses? Mr. Mares said he would provide the committee with that figure.

- Gaming was permitted at racetracks in an attempt to save the state's horse racing industry. Money from that industry should be used to fix today's problems, rather than having all New Mexicans pay to fix the problem.

- How much money is generated from fines imposed by the SRC? Mr. Mares said he did not know that number, since most fines get deposited into the general fund.

LCS and SRC staff were directed to provide the committee with information detailing the amount and types of fines imposed each fiscal year.

- The chair of the SRC sits on the GCB, but he is prohibited from sharing confidential information with the other members of the SRC. This situation needs to be modified by statute.

- What level of testing would be adequate to ensure a cleaner industry? Mr. Mares said that the current practice of testing the winner and one other horse in a race is inadequate. At least four horses in a race need to be tested.

- What is the current status of the RFP for laboratory blood testing? Mr. Mares said that the RFP is being evaluated in Santa Fe, and he did not know what its status was.

The committee directed LCS staff to send a letter from the committee chair to the Department of Finance and Administration inquiring into the status of the RFP for blood testing.

- Zia Park in Hobbs has said that it does not have enough money to provide a proper track and paddock surface, yet it recently announced plans to build a $2 million steakhouse on the premises.

- The SRC should establish reciprocal agreements with other states to prevent violators from participating in New Mexico meets.

- The SRC has been aware since February 2012 that a new RFP for blood testing was needed, but it still has not been issued.

- A letter dated August 10, 2012 sent to the SRC asked whether horses that had tested positive for illegal substances would be allowed to run in a futurity event. Three days before the event, the legislator received a letter from the commission that staff would be happy to discuss the issue. Mr. Mares said that due process concerns do not allow the SRC to ban a horse from racing until the lengthy process is finished. However, some racetracks have said that any horse that tests positive for an illegal substance will not be allowed to race at their tracks.

- The SRC needs to propose to the legislature specific statutory changes in order for it to better regulate the industry.

- The SRC should adopt a zero-tolerance policy, regardless of whether the due process course is finished. If an employer can immediately fire an employee for testing positive for illegal substances, the SRC should have that same power over whether a horse can race. Mr. Mares said that he does not know whether a rule can be changed or statutes would need to be modified in order to have that power.

- Mexican drug cartels have established a significant presence in the horse racing industry. The SRC should have the power to immediately suspend a license, based on the idea that certain activities pose an imminent threat to the industry.

- Illegal doping of horses should be classified as felonies.

- New Mexico racetracks consistently do not run the statutorily required number of race days. The SRC should announce that it may revoke racetrack licenses on that basis, which would probably result in a quick fix to the problem.

- There is a problem with conflicts of interest on the SRC. One commissioner recently voted against the reinstatement of a license after the person had been exonerated. But that commissioner, who also ran horses at meets, apparently did not want to have the competition from the person. Mr. Mares asked the legislator to provide detailed information to him about the allegation.

- The SRC knew that the Zia Park track was inferior the day it was opened. The park, which cost $40 million to build, sold the next year for $200 million. Principals involved in that project had relatives on the SRC, which could explain the lack of oversight.

- Class III gaming, which was touted as being the savior of New Mexico horse racing, is in fact destroying the industry. There needs to be a complete overhaul of the systems regulating the gaming and horse racing industries.

- The decision to grant a racetrack permit in Raton should never have happened, but that decision came from much higher up than the SRC, months before the decision was formally announced.

- Racino owners do not care about horse racing; they only care about gaming. If a racino does not run its required number of race days, the number of gaming machines allowed at the premises should be proportionally reduced.

- There are many communities across the state that would love to have a horse racing license should an existing license be revoked for noncompliance with the law.

**Patient Protection Act and Affordable Care Act — Revenue Outlook and Update**

Bill Jordan, policy director, and Nick Estes, deputy policy director, New Mexico Voices for Children, gave an update on the revenue outlook of the federal Patient Protection and Affordable Care Act (ACA). The ACA will provide health coverage for 300,000 New Mexico residents, greatly improving their long-term health. The governor has not yet decided whether to participate in the Medicaid expansion associated with the new law. The economics of Medicaid expansion should not be a concern, since the state will collect more than twice the amount of revenue from premium and related taxes that it needs to pay for increased costs of Medicaid during the first seven years of increased coverage. After seven years, revenues will approximately equal the costs associated with the program. This estimate does not include other tax revenues generated from increased coverage, including GRT and personal income tax revenues. Other savings will come from reduced uncompensated care expenses, estimated to be $2 billion over seven years.

Questions and comments from committee members included the following.

- What is the time frame for opting into the Medicaid expansion? Mr. Jordan said that the state could opt in at any time, but it may need some time for planning for the transition to the new system. Increased federal funding begins in January 2014.

- There has been discussion of the state needing to come up with $500 million before the federal money comes to the state. Mr. Jordan said that the $500 million figure is the total amount that the state will need to pay over seven years. In the first year of the program, the state will only need to pay $1 million extra in order to receive hundreds of millions of dollars in Medicaid funding from the federal government.

- A legislator expressed the opinion that the ACA is nothing more than an elaborate Ponzi scheme, in which the federal government props up state governments by borrowing more money. Future generations will be forced to pay that debt. The government needs to create economic prosperity so businesses can thrive and employ more Americans who then can buy health insurance. Mr. Jordan said that the ACA reduces the federal deficit by $200 billion over 10 years.

There being no further business, the RSTP adjourned at 11:51 a.m.

REVENUE STABILIZATION AND
TAX POLICY COMMITTEE

# Section 7

# October 2012
# Agenda
# Minutes

**Revised: October 23, 2012**

**TENTATIVE AGENDA**
**for the**
**FIFTH MEETING IN 2012**
**of the**
**REVENUE STABILIZATION AND TAX POLICY COMMITTEE**

**October 29-30, 2012**
**State Capitol, Room 322**
**Santa Fe**

**<u>Monday, October 29</u>**

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|---|---|
| 9:00 a.m. | **Call to Order**<br>—Representative Edward C. Sandoval, Chair |
| 9:05 a.m. | **Job Creation Incentives Report**<br>—Maria Griego, Program Evaluator, Legislative Finance Committee (LFC)<br>—Brenda Fresquez, Program Evaluator, LFC<br>—Jonathan L. Barela, Secretary of Economic Development (*invited*) |
| 10:00 a.m. | **Microbrewer and Small Winery Volume Limit Changes**<br>—Dan Weaks, Lobbyist, New Mexico Winegrowers<br>—Richard Weber, President, Sierra Blanca Brewery and Rio Grande Brewery<br>—John Gozigian, Marble Brewing Company<br>—Brian Locke, Santa Fe Brewing Company |
| 11:00 a.m. | **Online Sales Taxation Compliance and Necessary Legislative Changes**<br>—Richard Anklam, President and Chief Executive Officer, New Mexico Tax Research Institute<br>—Helen Hecht, Federation of Tax Administrators |
| 12:00 noon | **Lunch** |
| 1:15 p.m. | **Manufacturing and Construction Gross Receipts Tax Deductions**<br>—Tom Clifford, Secretary of Finance and Administration<br>—Demesia Padilla, Secretary of Taxation and Revenue<br>—John Tysseling, Chief Economist, Taxation and Revenue Department |
| 2:30 p.m. | **Laboratory Partnership with Small Business Tax Credit Report**<br>—Jackie Kerby Moore, Sandia National Laboratories<br>—Mariann Johnston, Los Alamos National Laboratory |

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| 3:15 p.m. | **Unemployment Insurance Funding Update**<br>—Celina Bussey, Secretary, Workforce Solutions Department |
| 4:15 p.m. | **Legislative Proposal Discussion**<br>—Staff |
| 5:15 p.m. | **Recess** |

**Tuesday, October 30**

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| 9:00 a.m. | **Reconvene**<br>—Representative Edward C. Sandoval, Chair |
| 9:05 a.m. | **Capital Outlay Report**<br>—Stephanie Schardin Clarke, Director, State Board of Finance<br>—Linda Kehoe, Principal Analyst, LFC |
| 10:15 a.m. | **Sole Community Provider and Indigent Funding Report**<br>—Dan Weaks, Lobbyist |
| 11:00 a.m. | **Retiree Program Solvency Report and Legislative Proposals**<br>—Wayne Propst, Executive Director, Public Employees Retirement Association<br>—Jan Goodwin, Executive Director, Educational Retirement Board<br>—Mark Tyndall, Executive Director, Retiree Health Care Authority |
| 12:00 noon | **Lunch** |
| 1:15 p.m. | **Legislative Proposals**<br>—Senator Timothy M. Keller |
| 2:15 p.m. | **Legislative Proposal Discussion (Continued)**<br>—Staff |
| 3:00 p.m. | **Adjourn** |

**MINUTES**
**of the**
**FIFTH MEETING IN 2012**
**of the**
**REVENUE STABILIZATION AND TAX POLICY COMMITTEE**

**October 29-30, 2012**
**Room 322, State Capitol**
**Santa Fe**

The fifth meeting of the Revenue Stabilization and Tax Policy Committee (RSTP) for 2012 was called to order by Representative Edward C. Sandoval, chair, on Monday, October 29, 2012, at 9:13 a.m. in Room 322 of the State Capitol in Santa Fe.

**Present**
Rep. Edward C. Sandoval, Chair
Sen. Tim Eichenberg, Vice Chair
Sen. Carlos R. Cisneros
Rep. Anna M. Crook
Sen. Timothy M. Keller
Sen. Gay G. Kernan
Sen. Howie C. Morales (10/29)
Rep. Henry Kiki Saavedra
Rep. Thomas C. Taylor
Rep. Jim R. Trujillo

**Absent**
Sen. Mark Boitano
Rep. Donald E. Bratton
Sen. Timothy Z. Jennings, Senate President Pro Tempore
Rep. Ben Lujan, Speaker of the House
Rep. Rodolpho "Rudy" S. Martinez
Sen. John Arthur Smith
Rep. Bob Wooley

**Designees**
Sen. William F. Burt
Rep. Ernest H. Chavez
Rep. Zachary J. Cook (10/29)
Rep. Thomas A. Garcia (10/29), attending as a guest
Sen. Phil A. Griego (attending as a guest on 10/29 and as a designee on 10/30)
Sen. Nancy Rodriguez
Sen. William E. Sharer
Rep. Luciano "Lucky" Varela
Sen. Peter Wirth

Sen. Rod Adair
Rep. Ray Begaye
Rep. Brian F. Egolf, Jr.
Rep. Miguel P. Garcia
Rep. Roberto "Bobby" J. Gonzales
Sen. Eric G. Griego
Rep. Sandra D. Jeff
Rep. Antonio Lujan
Rep. Antonio "Moe" Maestas
Sen. George K. Munoz
Sen. Steven P. Neville
Rep. Debbie A. Rodella
Sen. Bernadette M. Sanchez
Sen. John M. Sapien
Rep. James R.J. Strickler
Rep. Don L. Tripp

(Attendance dates are noted for members not present for the entire meeting.)

**Staff**
Pam Ray, Staff Attorney, Legislative Council Service (LCS)
Ric Gaudet, LCS
Damian Lara, Staff Attorney, LCS
Pam Stokes, Staff Attorney, LCS

**Guests**

The guest list is in the meeting file.

**Handouts**

Handouts and other written testimony are in the meeting file.

**Monday, October 29**

**Job-Creation Incentives Report**

Maria Griego and Brenda Fresquez, program evaluators, Legislative Finance Committee (LFC), and Wade Jackson, general counsel, Economic Development Department (EDD), presented competing views on how the state has managed various statutory job-creation incentives. The LFC reviewed the performance of the Job Training Incentive Program (JTIP) and Local Economic Development Act (LEDA), administered by the EDD, and several tax incentives administered by the Taxation and Revenue Department (TRD). Generally, the LFC auditors determined that New Mexico lacks a comprehensive approach for financing and monitoring the performance of job-creation incentives. The lack of a regular, complete tax expenditure budget and the lack of a statewide strategic plan for economic development make the state ill-positioned to invest in incentives that create jobs at a reasonable cost to the state.

Since 2007, the state has issued $64 million in LEDA grants to private entities without meaningful safeguards to ensure that jobs were actually created. LEDA agreements do not include clawback provisions if a company fails to perform according to the grant agreement. The JTIP performance measures do not meaningfully assess the effectiveness of the program. The TRD administers many tax incentive programs, but it is unable to accurately measure forgone revenue or economic growth resulting from those incentives.

The LFC made several recommendations to improve the effectiveness of job-creation incentives, including the following.

- The legislature should formalize in statute public disclosure requirements and clawback provisions for businesses receiving incentives; prioritize incentives based on their cost-effectiveness; enact sunset provisions for all incentives; and establish guidelines for reporting tax credit data to the legislature.
- The EDD should include clawback agreements in its agreements and require local governments to do so when using state funds; establish a standard requirement for

defining job creation; include job-creation reporting in LEDA agreements; establish minimum wage and job-count requirements for JTIP recipients; and require JTIP recipients to report job-retention and wage data for three to five years after receiving funding.

- The TRD should establish a standardized measure of economic return to evaluate job-creation incentives; follow current statutory requirements about reporting of incentives; and use the Pew Center on the States' guidelines to establish criteria for tax expenditure analysis.

Mr. Jackson began his presentation by pointing to recent studies showing that New Mexico's business climate ranks very low compared to surrounding states. New Mexico needs business incentives because the state taxes many goods and services that surrounding states do not tax. For example, New Mexico taxes manufacturing machinery, utility, transportation service, repair service, professional service and custom software expenses of businesses. Without tax incentives, New Mexico would become a very business-unfriendly state. The EDD uses LEDA grants, which create capital infrastructure, and JTIP funding, which trains New Mexico workers, to offset the burdensome tax structure imposed on businesses. However, the legislature could revise the tax code rather than tinker with incentives, which would send a clear message to the business community that New Mexico is business-friendly.

Mr. Jackson noted that EDD incentives constitute only a tiny fraction of all statutory tax expenditures. The EDD oversees about $40 million annually in tax expenditures, while overall state tax expenditures amount to more than $1 billion.

Mr. Jackson described the JTIP and LEDA incentive programs that the EDD oversees, and he defended the department's performance. The JTIP program has been in place since 1972, and since then has assisted in the creation of more than 40,000 jobs by funding more than 1,000 projects. The program is widely considered to be the most successful and important economic development tool in New Mexico. The JTIP program has performance measures and clawback provisions, and there are stringent compliance efforts and post-completion accounting reviews to ensure companies have performed under a contract.

Mr. Jackson then discussed the LEDA program, first by noting that the act's name is the "*Local* Economic Development Act" and that most of the regulatory responsibility falls on the local government entering into an agreement with a business. The legislature generally appropriates funds to the EDD to provide grants to local governments to fund their LEDA projects. The EDD has a formalized evaluation process for granting funding to projects, but that process has been circumvented many times because the legislature has made appropriations for specific LEDA projects. The Schott Solar, Hewlett Packard, Fidelity Investments and Santa Fe Studios projects were directly funded by the legislature, and they account for more than 50 percent of the total amount of LEDA funding since 2007.

The EDD is unable to have clawback provisions in its agreements, because it makes agreements with local governments, not private entities. Local governments may provide for those provisions, but for infrastructure funding projects, there is no money to claw back. If a company that has received infrastructure funding fails in its agreement, the infrastructure reverts back to the local government and remains an asset for other economic development potential.

Questions and comments from committee members included the following.

- LEDA is a program designed for local governments, and the EDD's role in LEDA is minimal. Ms. Fresquez said that the LFC wants the EDD to require that clawbacks be provided in agreements, and that local governments should include the state contribution in clawback provisions.

- The committee should be provided an opportunity to review the Martinez administration's upcoming capital outlay reform proposal.

- Does the EDD have specific tax proposals to spur economic development and job creation? Mr. Jackson said that the EDD will have specific proposals for the committee to consider at its November meeting. He said that New Mexico does not have a competitive climate for multistate companies looking to locate new facilities. The most important change the legislature could enact would be to allow the election of using a single sales factor (SSF) in computing corporate income tax (CIT) due.

- Schott Solar left New Mexico, but its infrastructure reverted to the local government. Why does the EDD need additional powers to claw back from the company? Ms. Fresquez said that when a company ceases operations, residents lose jobs and the state suffers economically.

- Will making an SSF change in statute be revenue-neutral? Mr. Jackson said that such a change would not be revenue-neutral initially. However, companies like Intel have indicated that they would not expand operations in New Mexico without an SSF option.

- Allowing an SSF option needs to be paired with a revenue-generating change, such as requiring combined reporting by multistate corporations. Mr. Jackson said that option is being discussed in the administration.

- The legislature and executive need to have access to sufficient data to evaluate tax expenditures. Sharing of confidential information across agencies will also help the state in that effort.

- Is JTIP and LEDA funding specifically tied to job creation? Mr. Jackson said that the JTIP requires certain job-creation goals in a specific time frame.

**Microbrewery and Small Winery Volume Limit Changes**

Senator Sue Wilson Beffort; Dan Weaks, lobbyist, New Mexico Winegrowers; Richard Weber, president, Sierra Blanca Brewery and Rio Grande Brewery; Jeff Jinnett, Marble Brewing

Company; Brian Locke, Santa Fe Brewing Company; Berkeley Merchant, Abbey Beverage Co.; and Chris Goblet, New Mexico Brewers Guild, presented proposed bill drafts to the committee to increase the threshold amount of beer or wine produced by a company before a higher amount of liquor excise tax is imposed on its production. The winegrowers are proposing that a new taxation tier for wine be set at $0.30 per liter for amounts of wine produced between 950,000 and 1.5 million liters and that the normal tax rate of $0.45 per liter be set at a new threshold above 1.5 million liters. The small breweries are proposing that the threshold amount to qualify for the lower liquor excise tax rate on beer of $0.08 per gallon be raised from 5,000 barrels to 15,000 barrels annually.

Mr. Weaks said that the liquor excise tax on wine produced in New Mexico is about twice as high as surrounding states. Senator Beffort said that small breweries have become economic drivers in many communities across the state. Mr. Weber said that the Sierra Blanca Brewery's excise tax liability will increase from about $1,250 monthly to more than $7,000 once his brewery reaches the current statutory threshold of 5,000 barrels. That ceiling is a significant deterrent to expanding his business. Mr. Berkeley said that microbreweries are ecologically sound small businesses that create jobs. The proposed law change reflects economies of scale in today's brewing industry, a change that will cost the state only about $100,000 annually in forgone revenue. Additionally, a new agricultural sector growing hops has developed in the state. Mr. Locke said that 25 states define small breweries, with a preferred tax rate, as producing at least 15,000 barrels annually. The Santa Fe Brewing Company recently hired seven new full-time employees and is looking to expand even more. Mr. Jinnett said that the Marble Brewing Company, which has already reached the 5,000 barrel threshold in 2012, will pay $35,000 extra in liquor excise tax because of the "tax cliff" in statute. His company has 45 employees with full benefits. Mr. Goblet said that five new breweries have opened in 2012, with eight more projected in the next year. On average, each brewery in the state employs 20 people.

Questions and comments from committee members included the following.

- What was the original rationale for setting the current thresholds for small wineries and breweries? Mr. Merchant said that the thresholds were picked as arbitrary numbers, with no expectation that they would be surpassed. It used to be difficult to sell craft beer, but now everybody seems to prefer it.

- Why did Sierra Blanca Brewery move its production facility from Ruidoso? Mr. Weber said that shipping costs to and from the brewery became prohibitive. The brewery needed immediate access to the I-40 corridor.

- Before the legislature raises the threshold amounts, it needs to consider what impact the change will have on regular wholesalers and manufacturers.

- Have the small brewers and wineries discussed the proposal with the Tourism Department? Mr. Weaks said that his group has had conversations with staff at the department, and it appears that the administration would support the proposal.

**Online Sales Tax Compliance and Necessary Legislative Changes**

Helen Hecht, Federation of Tax Administrators, and Richard Anklam, president and chief executive officer, New Mexico Tax Research Institute, gave the committee an update on pending federal legislation setting the parameters for states to tax online sales. There is growing bipartisan support for such a measure, which would require states to conform to certain minimum requirements aimed at making compliance simpler. A rough estimate of how much extra revenue New Mexico may gain comes to about $70 million, depending on the final version of the legislation. Since New Mexico has a gross receipts tax (GRT) imposed on sellers versus a sales tax imposed on buyers, New Mexico may have more challenges conforming to the legislation. However, initial analysis has suggested that New Mexico could conform its compensating tax to apply to remote sales much easier than changing the structure of the GRT.

If the federal legislation is enacted, states will be required to conform to requirements in order to impose a tax on remote sellers, including having state-level administration, a uniform tax base, exceptions for small businesses, applicable destination rates for each taxing jurisdiction, sufficient notice of rate changes and general sourcing rules. In addition, the legislation may include vendor compensation for collection of taxes and special rules for digital sourcing.

Questions and comments from committee members included the following.

- Does the proposed federal legislation apply to international sales? Ms. Hecht said that the bill would not. Any international taxation would require participation by the federal government.

- The New Mexico legislature may need to enact legislation in the 2013 session if the proposed federal law passes in the next few months.

- Would New Mexico's GRT be considered an applicable tax according to the proposed federal legislation? Mr. Anklam said that most of the GRT generally would be considered an applicable tax but that some changes to its structure would be required.

**Manufacturing and Construction GRT Deductions**

Tom Clifford, secretary of finance and administration, Demesia Padilla, secretary of taxation and revenue, and John Tysseling, chief economist, TRD, discussed with the committee the revised fiscal impact of recent legislation granting deductions from gross receipts for certain manufacturing and construction expenses. The law, enacted during the 2012 legislative session, provided the following principal components:

- a deduction from gross receipts for items sold to manufacturers that are consumed in the manufacturing process, phased in over five years;

- a deduction from gross receipts for the sale of design, architectural, testing and other construction services to a contractor, as long as the construction project is ultimately taxable;

- a deduction from gross receipts for the lease of construction equipment, as long as the construction project is ultimately taxable; and

- a revenue offset to small municipalities and counties to compensate for the loss in their GRT tax base.

Although the initial fiscal impact for full implementation of the law was predicted to be $40 million annually, soon after the legislation was enacted, revised estimates of up to $80 million were projected. The manufacturing consumables deduction accounts for all of the original estimate error. The two principal reasons for the error are that economists used an inaccurate data source to estimate power consumption by manufacturers, and it was determined later that certain oil and gas sector operations would qualify for the new deduction. Secretary Clifford apologized to the committee for the error.

Secretary Padilla said that the TRD is working on rules for the manufacturing consumables deduction. Rules for the construction-related deductions are ready to be issued. The manufacturing sector is a very sophisticated sector, and the TRD is trying to define what qualifies as a consumable in the manufacturing process. Utility companies have expressed concern about the new law, which appears to require that they develop separate billing procedures for the manufacturing sector in order to be able to pass the deduction on to the manufacturer customer.

Questions and comments from committee members included the following.

- Fiscal impact estimate errors are not new. A recent bill to require combined reporting by multistate corporations mysteriously had its $90 million positive fiscal impact reduced to $5 million. The food and medical deductions, which have cost the state hundreds of millions of dollars, were touted by administration economists as being revenue-neutral. Over six years, the current manufacturing consumables estimate will cost $144 million more than originally estimated.

- Local governments will also see their revenues decrease from the new deductions. Secretary Clifford agreed, but he said that the legislation will spur new business activity. The legislation makes a major investment in the state's economy.
- TRD staff was asked to provide the legislature with a report of how much the deduction has been used before the end of the 2013 regular legislative session.

- Does the new legislation provide a deduction for the use of a power source to produce electricity? Secretary Clifford said that an existing section of law already provides for those expenses to be deducted from gross receipts.

The minutes of the September 16-17 meeting of the committee were adopted without changes.

**Laboratory Partnership with Small Business Tax Credit Report**

Jackie Kerby Moore, Sandia National Laboratories, and Mariann Johnston, Los Alamos National Laboratory (LANL), gave a report to the committee on activities of the New Mexico Small Business Assistance Program (NMSBA) operated jointly by the laboratories. The NMSBA is a catalyst for the transfer of cutting-edge technology from the two laboratories to address a wide range of business needs across New Mexico. Each laboratory is allowed to claim a tax credit of up to $2.4 million annually pursuant to expenses incurred in providing technical assistance to small businesses. Since 2000, the NMSBA has provided assistance to 1,876 businesses, most of which are located in rural areas of the state. In 2012, more than 300 businesses have been assisted, with more than $4 million in assistance provided.

Daniel Gagnon, owner of Herbs, Etc., discussed with the committee the assistance given his company by LANL scientists to set better specifications for bacterial contamination testing of its products. LANL also streamlined the company's production to increase manufacturing efficiency. Herbs, Etc. has 31 full-time employees, with more than $1 million in payroll expenses. It recently purchased a new 10,000-square-foot building to expand its operations.

Questions and comments from committee members included the following.

- How much of Herbs, Etc.'s production process is done in New Mexico? Mr. Gagnon said that 95 percent of the company's production is performed in the state. All packaging and marketing is also done in-state.

- Does the NMSBA duplicate activities performed by the Small Business Administration (SBA)? Ms. Kerby Moore said that the NMSBA partners with the SBA and other economic development programs. The NMSBA provides direct technical assistance to small businesses and the SBA provides other services.

**Unemployment Insurance Funding Update**

Celina Bussey, secretary of workforce solutions, gave an update to the committee on the status of the Unemployment Compensation Fund. In November 2011, Governor Martinez convened the Unemployment Compensation Advisory Council, which was charged with formulating policies to help ensure the long-term stability and solvency of the fund. Another goal of the council is to take politics out of the management of the fund, since the legislature for years has delayed statutory increases in the employer contribution schedule. The council is investigating whether to seek legislation to:

- implement a floor and ceiling of the fund to prevent insolvency and to keep it from growing too large;

- overhaul the contribution rate structure and add new schedules and experience rating bands to ensure more gradual, equitable and predictable rate changes;

- set a target fund balance; and

- prevent fraudulent claims and overpayments.

Other areas of discussion the council has engaged in include communication and outreach, material improvements, work search requirements, suitable work requirements, partial benefits, double affirmation and negative account balances. Secretary Bussey described negative account balances, which occurs when employers' accounts have more benefits paid out than contributions received. Some employers have a long history of negative accounts, which causes the rest of the employers to pay for those expenses. These excess payments have become a socialized liability of the unemployment compensation program.

The fund balance as of October 24, 2012 was $54 million. The Workforce Solutions Department is currently in the process of receiving third-quarter contributions. Most contributions to the fund come in the first two quarters. The fund balance is expected to decline until March 2013. Approximately 26,000 people are certifying for unemployment compensation benefits each week, which is a decline from approximately 45,000 people in 2011.

Questions and comments from committee members included the following.

- What is the status of the State Unemployment Trust Fund? Secretary Bussey said that the fund balance of $117 million was transferred to the Unemployment Compensation Fund in 2010.

- The government sector in New Mexico has lost 5,000 jobs in the past year, but state government vacancy rates are still very high.

- What will the employer contribution rate be in 2014? Secretary Bussey said that it should be Schedule 1. The problem with the current contribution schedule structure is that employers in the mid-contribution range that are doing well and being responsible end up paying the most when a rate increase happens. New employers and negative account employers currently pay the same rate.

- Are predictions of a jobless economic recovery proving correct? Secretary Bussey said that the construction sector may never recover to previous levels but that other sectors are recovering.

- Is there a skills gap for workers in New Mexico? Secretary Bussey said that many companies have to recruit qualified workers from out of the state. In addition, the earning potential of New Mexico college graduates tends to be higher outside the state, so many students leave the state after graduation.

The committee recessed at 4:24 p.m.

**Tuesday, October 30**

The committee was reconvened by Representative Sandoval on Tuesday, October 30, 2012, at 9:10 a.m.

**Capital Outlay Report**

Stephanie Schardin Clarke, director, Board of Finance Division, Department of Finance and Administration (DFA), and David Abbey, director, LFC, presented an update on capital outlay bonding capacity, the status of outstanding capital projects and a preliminary draft of possible state agency capital projects to fund. Ms. Schardin Clarke said that the August 2012 estimate of severance tax bonding capacity for fiscal year 2013 was $514 million. After subtracting $179.5 million in supplemental severance tax bonds for public school infrastructure, $33.5 million for water projects, $16.7 million for colonias projects, $16.7 million for tribal projects and $43.9 million for authorized but unissued projects, $223.7 million will be left for allocation by the legislature and executive during the upcoming legislative session.

Mr. Abbey said that the total amount of requested state agency and local government capital outlay for the upcoming session is approximately $2 billion. $300 million was requested by state agencies, of which $72.7 million would be to complete ongoing projects. Higher education institutions and state special schools requested $293.7 million. Local governments requested $1.5 billion for their top three priorities, which generally include requests for roads, water and wastewater facilities and public health and safety facilities. Mr. Abbey noted that the Department of Transportation did not submit a capital outlay request, even though there continues to be more than $900 million in state highway, bridge and maintenance shortfalls. Mr. Abbey then briefly discussed the LFC quarterly report on the progress of ongoing capital projects.

Questions and comments from committee members included the following.

- The LFC staff was asked to provide the committee with fiscal year 2012 capital outlay reversion data.
- Perhaps money allocated toward the Paseo del Norte highway interchange project in Albuquerque should be shifted to the Rio Bravo project because the Paseo del Norte project is not making progress.

- Will the executive submit a capital outlay budget to the legislature, as required by law? Ms. Schardin Clarke said that the Capital Outlay Bureau of the State Budget Division of the DFA is currently working on the executive capital outlay budget.

- The executive appears to be developing parameters for the legislature to make capital outlay appropriations.

- Governor Martinez has told some local government officers that if a capital outlay project is not on the local government's Infrastructure Capital Improvement Plan, she will not approve the project. This may cause some problems for desperately needed projects in communities that are not favored by government officials.

**Sole Community Provider and Indigent Funding Report**

Dan Weaks, lobbyist, New Mexico Hospital Association (NMHA), and Jeff Dye, NMHA, discussed with the committee issues surrounding the Sole Community Provider (SCP) program and county indigent funding. The SCP program began in 1994 in order to supplement funding costs in counties for indigent patients, to create a mechanism acceptable to the federal government to leverage Medicaid funds and to help offset the amount of uncompensated care hospitals provide. Since its inception, $1.2 billion in federal funds has been distributed to SCP hospitals.

The state needs a stable, growing revenue source for the SCP program in order to keep rural hospitals viable. The state has lost $177 million because it has not matched all possible federal funding. Another problem is that the federal government does not allow private hospitals to provide the county match required to get federal funding. Public hospitals do have this ability, though. Most local revenue for the SCP program is generated by the optional second one-eighth percent GRT increment for indigent funding, provided in statute. However, not all counties use the entire revenue stream to compensate hospitals, which has resulted in most hospitals incurring losses from the SCP program. To complicate matters further, 12 counties have enacted the one-sixteenth percent GRT increment for the county-supported Medicaid program, but many of the remaining counties have used a portion of the one-eighth percent indigent funding GRT increment to fund the county-supported Medicaid program. These developments over the years have diluted compensatory funding to hospitals for indigent care and have pitted counties against hospitals.

Mr. Weaks discussed several remedies to correct the funding shortfall. One idea would be to group certain types of state and county spending as "certified public expenditures" in order to leverage a larger federal match without the state or county needing to spend more money. Another idea would be to shift the county obligation, and any associated GRT increment, to fund indigent claims to the state. Currently, hospitals must make biannual requests to a county to receive funding for indigent care. However, there is no guarantee that counties will provide the funding, which makes hospital budgeting very difficult.

Perhaps the most promising solution, said Mr. Weaks, would be to allow counties to impose an assessment on hospitals and use that assessment as a portion of the matching money for federal funding. This would guarantee that counties fully leverage federal money, which would then be distributed to hospitals to pay for uncompensated indigent care. This solution would be a bit like a new tax, but hospitals would probably be in favor of it because it would provide many times as much revenue as the assessment cost.

Questions and comments from committee members included the following.

- Will the hospital assessment be a local option tax? Mr. Weaks said that it would be a local option, since some counties will not need to use the funding mechanism. He said that the administration is open to exploring this proposal further. Mr. Dye said that the 14 private SCP hospitals are forbidden by federal law from using their own funds to provide the federal match.

- Why will county indigent funds be needed once the federal Patient Protection and Affordable Care Act (ACA) is implemented? Mr. Dye said that the ACA will not be implemented immediately. Mr. Weaks said that the legislation could have sunset provisions if needed. However, he said that there will be many uninsured persons after full implementation of the act.

- What is the problem in Santa Fe County? Mr. Weaks said that the county provided Christus St. Vincent Regional Medical Center with only $100,000 in funding for indigent care, which has resulted in the loss of $18 million in federal match money. If the county had fully funded the request, the federal government would have provided a $30 million match.

- How many other states have implemented some sort of SCP funding mechanism for private hospitals? Mr. Weaks said that 47 states have such a mechanism, but not all of them are local options. He said if private hospitals were allowed to provide the match money, they would do so.

- Counties should not leave so much unleveraged federal match money behind.

- The state should assume the responsibility for the SCP program. Many counties have refused to impose either GRT increment. Santa Fe County refused to provide full indigent care funding because of a political dispute over whether Christus St. Vincent will perform certain medical procedures. The hospital is still providing indigent care, but it is currently losing $35 million to $40 million.

- Another possible solution would be for private hospitals to donate money to a special governmental entity, which would in turn provide that money as a match for federal funding.

**Retiree Program Solvency Report and Legislative Proposals**

Susan Pittard, general counsel, Public Employees Retirement Association (PERA); Jan Goodwin, executive director, Educational Retirement Board (ERB); and Mark Tyndall, executive director, Retiree Health Care Authority (RHCA), presented preliminary proposals designed to fully fund the programs in the future.

<u>PERA Proposal</u>

The retirement fund of PERA currently has an actuarial funded ratio of 65.3 percent. In order to reach a 100 percent ratio by 2042, the PERA board recommends making the following changes:

- for employees hired after June 30, 2010, a 1.5 percent increase in employee contributions; a .5 percent reduction in the annual pension factor; increases in the retirement eligibility; averaging of the final five years of salary instead of the current three years; increased vesting requirements; increasing the pension maximum to encourage employees to work longer; a reduction in the cost-of-living adjustment (COLA); and an increase in the length of time before a COLA is given;

- for current active members hired prior to July 1, 2010, a 1.5 percent increase in employee contributions; a reduction in the COLA; a graduated increase in the length of time before a COLA is given; and an increase in the pension maximum; and

- for current retirees, a reduction in the COLA and a suspension of the COLA for return-to-work retirees.

ERB Proposal

The Educational Retirement Fund currently has an actuarial funded ratio of 59.8 percent. In order to reach a 95 percent funded ratio by 2043, the ERB board recommends making the following changes:

- a graduated increase in member contributions to 10.7 percent for all members;

- for new members, a minimum retirement age of 55 years; and

- for new members, no COLA until a retiree reaches age 67.

RHCA Proposal

The Retiree Health Care Fund is expected to run a deficit by fiscal year 2019, and fund balances will go negative by fiscal year 2029 under current statutes and the policies of the RHCA. In order to maintain a positive fund balance through fiscal year 2045, the RHCA recommends making the following changes:

- phase out family coverage subsidies for retirees with multiple dependent children;

- increase cost-sharing on prescription coverage;

- increase cost-sharing of pre-Medicare plans;

- implement graduated minimum age requirements to be eligible for subsidies;

- reduce pre-Medicare retiree and spousal subsidies;

- implement enhanced wellness programs; and

- enact legislation to increase employee contribution levels by .75 percent and employer contribution levels by 1.5 percent.

**Legislative Proposal Discussion**

Ms. Ray and Ms. Stokes presented to the committee three proposals for the committee's consideration:

- a bill to decrease the top CIT rate from 7.6 percent to 6.4 percent and also to require combined reporting of tax returns by multistate corporations;

- a bill to provide an SSF for corporations to calculate CIT due and also to require combined reporting of tax returns by multistate corporations; and

- a bill to require taxpayer reporting of certain tax credits and deductions and to provide for legislative review of certain tax credits and deductions.

**Legislative Proposals by Senator Keller**

Senator Keller presented three proposed bills for the committee's consideration:

- a bill to provide for independent hearing officers to hear tax protest and assessment cases. The hearing officers would not be employees of or under the control of the TRD;

- a bill to provide a new commercial activity CIT credit for certain new or expanded business in New Mexico providing economic-based jobs; and

- a bill to provide personal income tax and CIT credits for employers that employ recent New Mexico college graduates.

There being no further business, the committee adjourned at 12:19 p.m.

REVENUE STABILIZATION AND
TAX POLICY COMMITTEE

# Section 8

# November 2012
# Agenda
# Minutes

**Revised: November 19, 2012**

**TENTATIVE AGENDA**
**for the**
**SIXTH MEETING IN 2012**
**of the**
**REVENUE STABILIZATION AND TAX POLICY COMMITTEE**

**November 21, 2012**
**Room 322, State Capitol**
**Santa Fe**

**Wednesday, November 21**

| | | |
|---|---|---|
| 9:00 a.m. | **Call to Order**<br>—Representative Edward C. Sandoval, Chair |
| 9:05 a.m. | **Durable Medical Equipment Gross Receipts Tax Deduction**<br>—Richard Minzner, Lobbyist |
| 9:35 a.m. | **Property Tax Valuation Limit Proposal**<br>—Clyde Ward, Chair, Assessors Affiliate, New Mexico Association of Counties (NMAC)<br>—William N. Campbell III, Chair, Property Tax Task Force, Realtors Association of New Mexico<br>—Gary Perez, Deputy Assessor, Santa Fe County |
| 10:30 a.m. | **County Legislative Priorities**<br>—Paul Gutierrez, Executive Director, NMAC |
| 11:00 a.m. | **Regional Transit Authority Tax Revenue Distribution**<br>—Tony Mortillaro, Executive Director, North Central Regional Transit District<br>—Scott Scanland, Lobbyist |
| 11:30 a.m. | **Manufacturing Consumables Deduction: Implementation and Legislative Changes**<br>—Demesia Padilla, Secretary of Taxation and Revenue |
| 12:15 p.m. | **Lunch** |
| 1:30 p.m. | **Economic Development Department Proposals**<br>—Wade L. Jackson, General Counsel, Economic Development Department |
| 2:00 p.m. | **Committee Proposals**<br>—Legislative Staff |

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|---|---|
| 2:30 p.m. | **Legislative Proposals:  Tax Preparation Fraud**<br>—Senator Timothy M. Keller<br>—Shawn Spruce, Native American Tax Fraud Study<br>—Marvin Ginn, Native American Tax Fraud Study |
| 3:00 p.m. | **Gross Receipts Deduction for Plug-In Electric Vehicles**<br>—Marco Gonzales, Attorney, Lobbyist |
| 3:30 p.m. | **Special Fuel Excise Tax Deduction for Sales of Biodiesel**<br>—Ruben Baca, New Mexico Petroleum Marketers Association<br>—Richard Anklam, President and Executive Director, New Mexico Tax Research Institute |
| 4:00 p.m. | **Adjourn** |

**MINUTES**
**of the**
**SIXTH MEETING IN 2012**
**of the**
**REVENUE STABILIZATION AND TAX POLICY COMMITTEE**

**November 21, 2012**
**Room 322, State Capitol**
**Santa Fe**

The sixth meeting of the Revenue Stabilization and Tax Policy Committee (RSTP) for 2012 was called to order by Representative Edward C. Sandoval, chair, on Wednesday, November 21, 2012, at 9:11 a.m. in Room 322 of the State Capitol in Santa Fe.

**Present**
Rep. Edward C. Sandoval, Chair
Sen. Mark Boitano
Sen. Carlos R. Cisneros
Rep. Anna M. Crook
Sen. Timothy M. Keller
Rep. Rodolpho "Rudy" S. Martinez
Sen. Howie C. Morales
Rep. Jim R. Trujillo
Sen. Pat Woods

**Absent**
Sen. Tim Eichenberg, Vice Chair
Rep. Donald E. Bratton
Sen. Timothy Z. Jennings, Senate President Pro Tempore
Sen. Gay G. Kernan
Rep. Ben Lujan, Speaker of the House
Rep. Henry Kiki Saavedra
Sen. John Arthur Smith
Rep. Thomas C. Taylor
Rep. Bob Wooley

**Designees**
Rep. Ray Begaye (attending as a guest)
Rep. Ernest H. Chavez
Sen. Phil A. Griego
Sen. Nancy Rodriguez
Sen. William E. Sharer
Rep. James R.J. Strickler
Rep. Don L. Tripp
Rep. Luciano "Lucky" Varela
Sen. Peter Wirth

Sen. Rod Adair
Sen. William F. Burt
Rep. Zachary J. Cook
Rep. Brian F. Egolf, Jr.
Rep. Miguel P. Garcia
Rep. Thomas A. Garcia
Rep. Roberto "Bobby" J. Gonzales
Sen. Eric G. Griego
Rep. Sandra D. Jeff
Rep. Antonio Lujan
Rep. Antonio "Moe" Maestas
Sen. George K. Munoz
Sen. Steven P. Neville
Rep. Debbie A. Rodella
Sen. Bernadette M. Sanchez
Sen. John M. Sapien

**Guest Legislators**
Rep. Dennis J. Roch
Rep. Conrad D. James
**Staff**

Pam Ray, Staff Attorney, Legislative Council Service (LCS)
Ric Gaudet, LCS
Damian Lara, Staff Attorney, LCS
Pam Stokes, Staff Attorney, LCS

**Guests**

The guest list is in the meeting file.

**Handouts**

Handouts and other written testimony are in the meeting file.

**Wednesday, November 21**

**Durable Medical Equipment Gross Receipts Tax (GRT) Deduction**

Richard Minzner, lobbyist, presented proposed legislation for the committee's consideration to provide a deduction from gross receipts for sales or rentals of durable medical equipment and medical supplies. This bill did not make its way through the legislature in the 2012 legislative session, partially because the fiscal impact report (FIR) inaccurately claimed up to $12 million in forgone revenue. A new FIR estimates the cost to the state at $1 million annually. Mr. Minzner said that 18 durable medical providers have gone out of business in the past three years. Declining reimbursements from the Medicare program have made it difficult for these local businesses to survive, and the GRT deduction will help.

Questions and comments from committee members included the following.

- The original bill from the 2012 legislative session did not include the rental of equipment. Mr. Minzner said that rentals were added during the committee amendment process. Rentals of durable medical equipment are a sizable portion of the industry.

**Property Tax Valuation Limit Proposal**

Clyde Ward, chair, Assessors Affiliate, New Mexico Association of Counties (NMAC), William Campbell, chair, Property Tax Task Force, Realtors Association of New Mexico (RANM), and Gary Perez, deputy assessor, Santa Fe County, presented a proposal for the committee's consideration to solve the property tax valuation problem that has plagued some counties for more than a decade. New Mexico law was changed in 2001 to require that some residential property values could not be increased by more than three percent per year, in an attempt to protect long-term property owners from steep increases in property taxes. Problems with the valuation cap began soon after the law took effect because the property valuation limitation did not apply to properties that are sold. Those properties were valued at their current and correct value. Within a few years, valuations of recently sold properties were sometimes 50 percent higher than similarly situated properties. An appeals court decision struck down this "tax lightning" portion of the law, and multiple attempts to remedy the situation since then have not been successful.

A large group of interested parties convened a group to solve the property tax lightning problem. The proposal presented to the committee has received the endorsement of the RANM and the Assessors Affiliate of the NMAC. The legislation would bring all residential property valuations to no less than 90 percent of their current and correct values. For primary residences that have been owned for more than 10 years, the value of the properties would not exceed 90 percent of that value (81 percent of the current and correct value). The valuation of properties whose owners have occupied the residences for more than 20 years and who are more than 65 years of age would not exceed 80 percent of the 90 percent valuation (72 percent of the current and correct value). Although some property owners would have a higher valuation than they currently enjoy, mill levies would tend to be reduced as a result of the yield control provisions of the Property Tax Code.

Questions and comments from committee members included the following.

- What would happen to the valuation of a property in which a home on the property reverts back to the parents after their child dies? Mr. Ward said that the proposed legislation does not address family portability of valuations. Mr. Campbell said that once the legislation is passed, that issue could easily be addressed as part of a person's estate planning.

- How many properties are valued at 80 percent of current and correct value? Mr. Ward estimated that one-third of residential properties in some counties are valued at less than 80 percent. Those properties that are valued at 40 percent of current and correct value will never reach 80 percent valuation under current law.

- If property valuations go up, some mill levies will decrease, but operational mill levies are not affected by yield control statutes.

- A property owner with a current valuation of 40 percent of current and correct value will face a massive property tax increase if that person's valuation increases to 81 percent of current and correct value in one year. Mr. Campbell said that if property values increase 20 percent, the mill rate will go down correspondingly. The actual taxes property owners pay should not increase very much.

- What authority does the legislature have to treat single-family homes differently than multifamily homes? Mr. Ward said that the Constitution of New Mexico allows property tax differentials based on age, income and owner-occupancy only.

- The proposed bill seems to equalize the property tax bills of new homeowners at the expense of long-term homeowners. This legislation will be a hard sell for many legislators.

**County Legislative Priorities**

Paul Gutierrez, executive director, NMAC, presented two proposed bills for the committee's consideration. The first proposal would require disclosure to county assessors of the sales price of all real property in the county. Current law requires disclosure of the sales price of residential property. The new law would include vacant land and commercial property in that requirement. Information provided to the county assessor would continue to be confidential and would be used by the assessor to better calculate property values.

The second bill would require the Taxation and Revenue Department (TRD) to hold at least one delinquent property sale in each county each year.

Questions and comments from committee members included the following.

- How would the sales price disclosure work toward improving property valuations for properties that are sold at inflated prices? For example, many properties are sold through real estate contracts at much higher actual prices than they are worth. Mr. Ward said that the sales price information is just one factor in determining property values.

**Regional Transit Authority Tax Revenue Distribution**

Tony Mortillaro, executive director, North Central Regional Transit District, and Scott Scanland, lobbyist, presented proposed legislation for the committee's consideration that would provide a direct distribution of GRT revenue imposed by counties for the benefit of the district. Currently, the state distributes county regional GRT revenue to the county that imposed the tax, which then forwards that revenue to the district.

Questions and comments from committee members included the following.

- What happens to interest income during the collection and distribution period? Mr. Mortillaro said that whichever entity has the cash gets to keep the interest. He said that he would prefer that the regional transit district get the distribution directly, which would allow it to keep any interest generated.

**Manufacturing Consumables Deduction: Implementation and Legislative Changes**

John Tysseling, chief economist, TRD, presented proposed legislation for the committee's consideration that would allow a person who is not the liable taxpayer of GRT to pay the tax due on behalf of another person. The bill is envisioned as a solution to the problem created for utility companies after the enactment in 2012 of a deduction from gross receipts from the sale of items consumed in a manufacturing process. Utility companies had expressed concern over the requirement that they would need to develop separate billing systems for manufacturing customers in order for the deduction to be claimed. Since the beneficiary of the deduction is actually the manufacturer, the legislation would allow the manufacturer to allocate that portion of its utility bill that is not eligible for the deduction, and then pay the GRT due on behalf of the seller of the utility. The bill also removes the reporting requirement that the TRD provide aggregated data to the legislature about the use of the deduction.

Questions and comments from committee members included the following.

- Why is this legislation needed? Mr. Tysseling said that utility companies would have been forced to make extensive modifications to their billing systems. It was decided to shift this burden to manufacturers claiming the deduction.

- Does new legislation need to be enacted allowing proxy methods of measuring consumables by small manufacturers? Mr. Tysseling said that the TRD may need to develop alternative methods of measuring consumables, but that it is not ready to adopt any rules yet. New legislation would probably not be necessary.

**Legislation Proposals of Senator Keller**

Senator Keller presented three proposed bills for the committee's consideration, including:

- a bill, already endorsed by the Science, Technology and Telecommunications Committee, to provide a deduction from gross receipts of sales to a person engaged in technology transfer during the first three years of the buyer's business operations;

- a bill, already endorsed by the Science, Technology and Telecommunications Committee, to provide a credit to be taken against GRT due equal to 50 percent of contributions made to endowment funds of post-secondary educational institutions that promote the commercialization of licensed technology conceived at the institutions; and

- a bill to clarify and strengthen provisions of the high-wage jobs tax credit. The bill differs from the Economic Development Department's (EDD) proposal by requiring reporting of the credit to the legislature; increasing the wage threshold required to qualify for the credit; keeping the 50 percent export requirement for businesses to qualify for the credit; and providing a $25 million annual cap on allowable credits.

**Special Fuel Excise Tax Deduction for Sales of Biodiesel**

Ruben Baca, New Mexico Petroleum Marketers Association, and Richard Anklam, president and executive director, New Mexico Tax Research Institute (NMTRI), presented proposed legislation for the committee's consideration to eliminate the double taxation currently imposed on the sale of biodiesel. Usually, diesel fuel is delivered through a pipeline to a rack terminal. That fuel is not taxable until it is loaded into tanker trucks or rail cars destined for sale in the state. However, biodiesel is usually trucked into the state, mixed with regular diesel at the rack terminal and then reloaded into tanker trucks or rail cars for resale. The biodiesel is taxed when it arrives at the rack terminal and is taxed again after it is blended and reloaded. The legislation would allow amounts of biodiesel received at the rack terminal to be deducted from the total amount of special fuel to be taxed. The blended biodiesel would then be taxed when it leaves the rack terminal to be sold.

**EDD Proposals**

Wade Jackson, general counsel, EDD, presented three proposed bills for the committee's consideration relating to economic development initiatives in New Mexico. The first proposal is a result of the work done in October by the New Century Economy Summit, which was attended by businesspeople, economic development specialists, university faculty, government officials, organized labor representatives and the general public. The bill would reduce the top corporate income tax (CIT) rate from 7.6 percent to 4.9 percent. According to a recent Ernst & Young study, New Mexico has the highest tax burden on new business investment in the country. A 2012 Tax Foundation study ranked the state thirty-eighth in its Business Tax Climate Index. Many states, according to that study, use a gross receipts tax in lieu of a CIT, but New Mexico has both taxes. CIT rates are very likely the single largest determinant of economic growth.

The second proposal from the EDD would allow multistate corporations to use a single sales factor (SSF) in computing CIT due. Current law generally requires corporations to calculate the CIT by equally weighting property, payroll and sales in the state compared to those same factors of the company nationwide. This formula has the consequence of taxing new investment. If a company builds a new facility and hires more employees in New Mexico, its CIT will increase. Moving to an SSF methodology will encourage investment and hiring in the state.

The third proposal would reform provisions of the high-wage jobs tax credit to eliminate loopholes and tighten the eligibility for the credit. The costs to the state of the credit have increased dramatically in the past two fiscal years because companies have been exploiting loopholes in the law. The bill would not allow a credit for mergers that did not create any net new jobs; limit credit claims to one year after the job was created; close the government contractor loophole; use wages and benefits to determine the threshold for the credit; define "wages" and "benefits" with more clarity; and extend the sunset date of the credit to 2020.

Questions and comments from committee members included the following.

- The original Ernst & Young study that claimed New Mexico had the highest tax burden was not accurate. A new study performed by that company and the NMTRI determined that New Mexico had an average tax burden on business investment.

- Although businesses can take advantage of some incentives to reduce their effective tax rate, small businesses would have to spend a significant percentage of their revenue in order to get those incentives. Reducing the CIT rate would be a much simpler and fairer method of improving the business climate.

- The EDD proposal for an SSF does not include mandatory combined reporting. Mr. Jackson said that combined reporting could be on the negotiating table.

- Which industries would be penalized from an SSF? Mr. Jackson said that the SSF would be an option, so nobody would lose from the law change. Retail stores would probably choose to use the traditional three-factor formula in computing the CIT.

- EDD and LCS staff were asked to provide the committee with per capita income figures for the surrounding states in order to understand how the SSF and CIT rate changes will impact incomes.

- In order to lower the CIT rate and provide an SSF, the state needs to broaden the CIT base and eliminate certain "corporate welfare" incentives in statute.

- Small, local retail stores need to be protected. The EDD proposals do not appear to help them in any way. It is not fair that those businesses, which pay income taxes on their profits, must compete with big box stores that use separate reporting loopholes to pay no income taxes in New Mexico.

- Economists always claim that cutting tax rates will spur economic growth. However, when personal income tax rates were slashed in 2004, the state's economy did not grow significantly, and the state lost $700 million in much-needed revenue.

- Companies will not locate in New Mexico if the state does not have a good educational system. The CIT rate is only one factor in a company's decision to invest in New Mexico.

- When CIT rates increase, benefits and wages tend to decrease. New Mexico needs to incentivize new investment.

- What are the reasons for the differences between Senator Keller's high-wage jobs tax credit reform bill and that of the EDD? Mr. Jackson said that increasing the wage threshold would not change the fiscal impact very much. The purpose of the credit is to encourage employers to hire new employees. With the new reforms, there should not be a need for a cap on the amount of credit annually. If the credit is working (i.e., creating new jobs), then a cap is not needed at all. Finally, the elimination of the 50 percent export requirement is actually not a substantive change, since that mirrors the Job Training Incentive Program (JTIP) eligibility. Any company claiming the credit must be JTIP-eligible, which means the business must be mostly engaged in exporting goods or services.

**Gross Receipts Deduction for Plug-In Electric Vehicles**

Representative Trujillo and R.E. Thompson, representing General Motors, presented proposed legislation for the committee's consideration to provide a five-year exemption from the motor vehicle excise tax for the purchase of qualified plug-in electric vehicles. The legislation did not make it all the way through the legislature during the 2012 session, so the company will again try to get it enacted in 2013. The legislation is needed to encourage the growth of the nascent electric car industry. The fiscal impact of the legislation is estimated to be $120,000 annually.

Questions and comments from committee members included the following.

- Why should the state use its tax code to modify consumer behavior?

**Tax Preparation Fraud Proposal**

Senator Keller, Shawn Spruce, First Nations Development Institute (FNDI), and Marvin Ginn, FNDI, presented proposed legislation for the committee's consideration to regulate the tax refund anticipation loan (RAL) industry. Mr. Spruce said that RALs tend to have extremely high fees and interest rates. Some RAL centers have abusive practices such as holding personal documents as security against a loan. RAL centers have targeted Native American communities as an easy way of making money. Mr. Ginn said that the Native Community Finance organization has helped many people get out of expensive and onerous RALs. Some individuals have paid more than 50 percent of their refund to pay back their loan. Senator

Keller said that RALs are mostly unregulated and that the proposed bill would establish certain requirements for the industry.

**Committee Proposals**

Ms. Ray and Mr. Lara presented three bill drafts for the committee's consideration, each of which was drafted in an attempt to make them revenue neutral:

- a bill to decrease the top CIT rate from 7.6 percent to 6.4 percent; to require combined reporting of multistate corporations; and to repeal certain business tax incentives;

- a bill to allow multistate corporations to use an SSF in computing their CIT liability; to require combined reporting by those corporations; and to repeal certain business tax incentives; and

- a bill to lower the GRT rate progressively over several years; and to phase out health-care-related deductions, exemptions and credits taken against the GRT.

There being no further business, the committee adjourned at 3:36 p.m.

REVENUE STABILIZATION AND
TAX POLICY COMMITTEE

# Section 9

# December 2012
# Agenda
# Minutes

**Revised: December 7, 2012**

**TENTATIVE AGENDA**
**for the**
**SEVENTH MEETING IN 2012**
**of the**
**REVENUE STABILIZATION AND TAX POLICY COMMITTEE**

**December 10-11, 2012**
**State Capitol, Room 322**
**Santa Fe**

**<u>Monday, December 10</u>**

| | |
|---|---|
| 9:30 a.m. | **Call to Order**<br>—Rep. Edward C. Sandoval, Chair |
| 9:35 a.m. | **Revenue Forecast**<br>—Demesia Padilla, Secretary of Taxation and Revenue<br>—Tom Clifford, Secretary of Finance and Administration<br>—Elisa Walker Moran, Chief Economist, Legislative Finance Committee (LFC) |
| 10:35 a.m. | **Northern New Mexico College Legislative Proposals**<br>—Ricky Serna, Vice President for Advancement, Northern New Mexico College (NNMC)<br>—Domingo Sanchez, Vice President for Finance and Administration, NNMC |
| 11:20 a.m. | **Senate Memorial 52 — Graduated Gaming Tax for Racetracks**<br>—Jeff Landers, Chair, Gaming Control Board (GCB)<br>—Frank Baca, General Counsel and Acting Executive Director, GCB |
| 12:00 noon | **Lunch** |
| 1:30 p.m. | **Permanent Fund Annual Update**<br>—Stephen Moise, State Investment Officer<br>—Vince Smith, Deputy State Investment Officer<br>—Brent Shipp, Chief Financial Officer, State Investment Council |
| 2:25 p.m. | **Chile Equipment Tax Credit**<br>—Charles Marquez, Lobbyist, New Mexico Chile Association |
| 3:15 p.m. | **State Land Office Annual Status and Revenue Update**<br>—Ray Powell, Commissioner of Public Lands |

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|---|---|
| 4:15 p.m. | **Proposed Legislation — Reporting of Tax Expenditures**<br>—Senator Timothy M. Keller |
| 5:00 p.m. | **Recess** |

**<u>Tuesday, December 11</u>**

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|---|---|
| 9:30 a.m. | **Reconvene**<br>—Rep. Edward C. Sandoval, Chair |
| 9:35 a.m. | **Corrective Action Fund Overview**<br>—Jeff Canney, Program Evaluator, LFC |
| 10:15 a.m. | **Endorsement of Legislative Proposals**<br>—Staff |
| 12:00 noon | **Adjourn** |

**MINUTES**
**of the**
**SEVENTH MEETING IN 2012**
**of the**
**REVENUE STABILIZATION AND TAX POLICY COMMITTEE**

**December 10-11, 2012**
**Room 322, State Capitol**
**Santa Fe**

The seventh meeting of the Revenue Stabilization and Tax Policy Committee (RSTP) for 2012 was called to order by Representative Jim R. Trujillo, temporarily acting as chair, on Monday, December 10, 2012, at 9:30 a.m. in Room 322 of the State Capitol in Santa Fe.

**Present**
Rep. Edward C. Sandoval, Chair (12/11)
Sen. Tim Eichenberg, Vice Chair
Rep. Donald E. Bratton
Sen. Carlos R. Cisneros
Rep. Anna M. Crook
Sen. Timothy M. Keller
Rep. Rodolpho "Rudy" S. Martinez
Sen. John Arthur Smith
Rep. Thomas C. Taylor
Rep. Jim R. Trujillo
Sen. Pat Woods
Rep. Bob Wooley

**Absent**
Sen. Mark L. Boitano
Sen. Timothy Z. Jennings, Senate President Pro Tempore
Sen. Gay G. Kernan
Rep. Ben Lujan, Speaker of the House
Sen. Howie C. Morales
Rep. Henry Kiki Saavedra

**Designees**
Rep. Ray Begaye (attending as a guest 12/10)
Sen. William F. Burt
Rep. Ernest H. Chavez
Rep. Thomas A. Garcia (attending as a guest 12/10)
Rep. Roberto "Bobby" J. Gonzales
Sen. Phil A. Griego (attending as a guest)
Rep. Sandra D. Jeff (attending as a guest 12/10)
Sen. George K. Munoz (12/11)
Rep. Debbie A. Rodella (attending as a guest 12/10)
Sen. William E. Sharer
Rep. Luciano "Lucky" Varela
Sen. Peter Wirth

Sen. Rod Adair
Rep. Zachary J. Cook
Rep. Brian F. Egolf, Jr.
Rep. Miguel P. Garcia
Sen. Eric G. Griego
Rep. Antonio Lujan
Rep. Antonio "Moe" Maestas
Sen. Steven P. Neville
Sen. Nancy Rodriguez
Sen. Bernadette M. Sanchez
Sen. John M. Sapien
Rep. James R.J. Strickler
Rep. Don L. Tripp

(Attendance dates are noted for those members not present for the entire meting.)

**Guest Legislator**
Sen. Sander Rue

**Staff**
Pam Ray, Staff Attorney, Legislative Council Service (LCS)
Ric Gaudet, LCS
Damian Lara, Staff Attorney, LCS
Pam Stokes, Staff Attorney, LCS

**Guests**

The guest list is in the meeting file.

**Handouts**

Handouts and other written testimony are in the meeting file.

**<u>Monday, December 10</u>**

**Revenue Forecast**

Leila Burrows, chief economist, Department of Finance and Administration (DFA), John Tysseling, chief economist, Taxation and Revenue Department (TRD), and Elisa Walker-Moran, chief economist, Legislative Finance Committee (LFC), presented the December 2012 revenue estimate for the state to the committee. The Consensus Revenue Estimating Group, consisting of career economists at the DFA, TRD, LFC and Department of Transportation, developed the estimate. Since the August 2012 revenue estimate, fiscal year (FY) 2012 revenue has increased $56 million; FY 2013 revenue has been estimated to increase by $20 million; and FY 2014 revenue is expected to increase by $10 million. FY 2014 new revenue, which is defined as FY 2014 recurring revenue less FY 2013 recurring appropriations, is expected to be $283 million. New senior severance tax bond capacity is forecast to be $222 million.

Gross receipts tax (GRT) revenue increased in FY 2012, fueled mainly by increases in the extractive industries and growth in the manufacturing sector. The retail trade and construction sectors, however, continued to perform weakly. Personal income tax (PIT) revenue increased in FY 2012, possibly due to oil and gas withholding provisions recently enacted. PIT growth is expected to be slow in FY 2013. Corporate income tax (CIT) revenues also continue to be sluggish, due to the high level of net-operating loss carryforwards that many corporations are still claiming. Worries about resolution at the federal level of budget negotiations and the possible "fiscal cliff" at the end of 2012 have made economic forecasts difficult. Resolution of these issues will still likely require a long, slow climb to a robust economy, but failure to resolve them could create very difficult economic conditions.

Questions and comments from committee members included the following.

- What is the TRD doing to assist small businesses when they have difficulty paying their taxes on time? Mr. Tysseling said that the TRD cannot waive tax liability for any business.

- Could the large increase in GRT revenue, coupled with anemic growth in CIT revenue, be attributed to the fact that most companies doing business in New Mexico operate as pass-through entities, rather than as corporations? Mr. Tysseling said that interpretation has some merit.

- Has the TRD issued guidelines on how manufacturers will be able to claim the GRT deduction on items consumed during the manufacturing process? Mr. Tysseling said that draft guidelines were released the previous week, and the deduction forms are still being developed. He said that the department is considering introducing legislation to clarify the definitions of "manufacturer" and "consumable", but no decision has been made yet.

- If the legislature extends the locomotive fuel tax deduction to all railroads in the state, what would the fiscal impact be? Mr. Tysseling said that the total fiscal impact would be about $5 million. The current deduction granted to Union Pacific is expected to cost $1.4 million annually.

- TRD staff was requested to research the amount of exports from the state that are subject to the GRT.

- What will happen if the "fiscal cliff" revenue cuts and tax increases happen at the end of the year? Mr. Tysseling said that there would be an immediate impact on salaries, which would in turn impact PIT and GRT revenue.

**Northern New Mexico College Legislative Proposals**

Ricky Serna, vice president for advancement, Northern New Mexico College (NNMC), and Domingo Sanchez, vice president for finance and administration, NNMC, discussed with the committee ideas the college administration has to raise revenue in order to construct dormitories. Northern New Mexico State School was established as a normal school for teachers in the late 1800s. It is a constitutionally created college that has performed the role of a technical-vocational institute and a community college. NNMC is now a four-year baccalaureate-granting school with student enrollment of approximately 2,000 students. Eighty percent of its students come from within a 35-mile radius of the campus. Currently, there is no housing on campus, and the school is limited in its ability to raise money to build such a facility.

College administrators originally developed an idea to provide a local option GRT increment to support capital infrastructure at the college, but subsequently backed off that idea because the tax rate in Rio Arriba County would be too high. Now, it is investigating some sort of public-private partnership, similar to Lobo Village at the University of New Mexico. Another idea would be to enact a law that would allow the college to impose a property tax mill levy. Currently, only community colleges can impose mill levies. It is unclear whether NNMC would need a constitutional amendment to enable it to participate in a mill levy.

Questions and comments from committee members included the following.

- How much will a new dormitory cost to construct? Mr. Serna said that it will cost between $12 million and $14 million.

- What is the status of the salary parity issue at the college? Mr. Serna said that faculty salaries at NNMC are at least $6,000 less than at similar institutions. A $600,000 appropriation for faculty salaries was previously vetoed, with the reason that the college had been in the middle of cleaning up its accounting methods and records. A new appropriation request is being presented to the legislature, which would be allocated exclusively toward increasing faculty salaries.

- NNMC has lower salaries, but it also has the lowest tuition rate in the region. All universities in the state are clamoring for salary parity.

- Why is the graduation rate of 18 percent at NNMC so low? Mr. Serna said that much of NNMC's educational services are remedial in nature. Eighty-two percent of the college's students take at least one remedial course.

- Is the college still under a fiscal watch by the Higher Education Department (HED)? Mr. Sanchez said that the college had been required to report to the HED on a monthly basis, but it is now reporting quarterly. The college will probably be removed from the fiscal watch in 2013.

- The HED's funding formula will financially hurt smaller universities.

- LCS staff was directed to investigate whether NNMC would need constitutional language changes in order for it to seek a property tax levy.

**Senate Memorial 52 — Graduated Gaming Tax for Racetracks**

Frank Baca, general counsel and acting executive director, and Jeff Landers, chair, Gaming Control Board (GCB), discussed with the committee the results of the GCB's study of the possibility of establishing in statute a graduated gaming tax for casinos operating at racetracks, also known as racinos. The horse racing industry in the state is estimated to have an annual economic impact of more than $500 million. Casinos located at horse racetracks have become an integral component of the health of the horse racing industry, and the two industries are inseparable in New Mexico. Some smaller racinos have been struggling to compete with larger racinos, and with tribal casinos that pay a much lower percentage of their net win to the state. In addition, casino operations in Arizona, Colorado and Oklahoma have recently expanded, and it is just a matter of time before gaming operations will be allowed in Texas. A realization inside the industry has taken hold that there is a need to protect the New Mexico gaming industry, instead of continuing battles between small and large racinos and between racinos and tribal casinos.

Senate Memorial 52 of the 2012 legislative session tasked the GCB with studying whether a graduated gaming tax, with smaller racinos paying the gaming tax at a lower rate, would be feasible. After several months and many meetings with all of New Mexico's racinos, the group decided that it will not propose legislation establishing a graduated gaming tax. However, the GCB decided that it will investigate changing some rules in order to reduce the regulatory burden on racinos. In addition, racinos recommended lowering the excise tax on the purchase of new gaming machines, which would have the effect of allowing racinos to purchase some of the newest and most-popular gaming machines. This change could help racinos compete within the larger regional gaming industry. Mr. Baca said that the GCB's core mission is to protect the integrity of the gaming industry, yet it also needs to not regulate the industry out of existence. Mr. Landers said that another idea the racinos may pursue is to offer a credit against gaming tax liability in proportion to the number of live race days held at racinos. This change would benefit the casino side of the operation, while helping the horse racing industry simultaneously.

Questions and comments from committee members included the following.

- Would an increase in the number of gaming machines allowed at a racino help the industry? Mr. Landers said that it would, but the 2007 gaming compacts with tribes operating casinos would need to be renegotiated in order for that change to be possible.

- The horse racing industry has become an unwanted stepchild of the gaming industry.

- Has the GCB met with tribal casinos about their perspective on statutory changes to gaming statutes? Mr. Landers said that the GCB has not had any meetings with tribal casinos relating to Senate Memorial 52.

- The state needs to crack down on the many illegal horse racing venues operating across the state. Those operations are generating millions of dollars, with no revenue going to the state. At the same time, the state is trying to extract more revenue from tribal casinos over the issue of how net win is calculated. Mr. Landers said that the State Racing Commission currently has very little authority to sanction those operations. Legislation is being proposed that would give the commission more authority to close those facilities.

- Any change in tax laws to benefit smaller racinos should include a local government contribution.

**Permanent Funds Annual Update**

Steven Moise, state investment officer, Vince Smith, deputy state investment officer, and Brent Shipp, chief financial officer, State Investment Council (SIC), presented an update to the committee on the status and performance of investment of the state's permanent funds. The balance of the assets invested by the SIC on the day of the committee meeting was $16.058 billion. More than $700 million has been distributed from the permanent funds in the past 12 months to various beneficiaries. The SIC continues to restructure its investment portfolio from a reliance on public equities to a more balanced strategy to include more income-producing investments. The SIC has one more year before it will achieve the investment targets it set.

The SIC is actively pursuing litigation to recover assets lost during the recent financial market collapse. Mr. Moise said that the SIC should be able to announce significant recovery of assets within the next few months. The SIC completed its FY 2012 audit and had no significant findings associated with the audit.

The Land Grant Permanent Fund has a balance of $11.2 billion, with a strong 18 percent growth in the past 12 months. The fund ranks near the top worldwide for one-year growth, but it is still in the third quartile over a three-year period. The Severance Tax Permanent Fund (STPF) grew to $3.96 billion, returning 16 percent in the past year. Growth of the STPF has been reduced in recent years because there have been no significant contributions to the fund in several years. Mr. Moise said that trust funds need regular contributions in order for them to have sustained growth.

Questions and comments from committee members included the following.

- What are typical contract terms between the SIC and an investment manager? Mr. Smith said that it takes four to seven months for the SIC to choose a manager with which to begin negotiations. Payment is usually a flat rate, based on the asset value being managed. All contracts have a 30-day termination clause, for any reason that the SIC chooses.

- Does the SIC still advocate legislation exempting employees of the SIC from provisions of the Personnel Act? Mr. Moise said that the SIC is currently revising its proposed legislation to exempt its employees from some of that act's provisions. In order to exercise the SIC's fiduciary responsibility to the LGPF beneficiaries, it needs more budget autonomy, especially the ability to pay top-quality employees market-rate salaries.

- Mr. Moise was asked to explain what he meant by describing "years of mismanagement" in referring to previous SIC management. Mr. Moise said that the SIC used to have a policy that it would not pay more than 25 basis points to investment managers. That foolish policy had the effect that the SIC could only contract with sub-par managers, whose performance resulted in low investment yields.

**Chile Equipment Tax Credit**

Charles Marquez, lobbyist, New Mexico Chile Association, presented proposed legislation to the committee that would grant compensating tax and GRT deductions for the purchase and installation of certain chile production and processing equipment. The intent of the legislation is to encourage the purchase of agricultural equipment to enable greater production and processing of chile in the state. Mr. Marquez said that recent technological developments will soon allow for mechanical harvesting of green chile plants, which will greatly increase the amount of chile planted in the state.

**Proposed Legislation — Reporting of Tax Expenditures**

Senator Keller presented proposed legislation for the committee's consideration that would require the Consensus Revenue Estimating Group to compile a tax expenditure budget and a dedicated revenue budget of major tax expenditures. In order to reduce the administrative burden placed on executive and legislative agencies to produce the reports, each major tax expenditure would be reviewed every five years, rather than every year, as previously vetoed legislation would have required.

**State Land Office Annual Status and Revenue Update**

Ray Powell, commissioner of public lands, discussed with the committee activities on and revenues generated from state trust lands administered by the State Land Office (SLO). The SLO had another record-breaking revenue year in FY 2012, bringing in $652 million, most of which came from oil and gas lease payments, royalties and bonuses. FY 2013 revenue is expected to drop somewhat but increase again in FY 2014. Construction began on a new ethanol and biodiesel facility on state trust land in Hobbs, which will provide revenue for trust beneficiaries as well as provide economic development and jobs for the area. The office also entered into agreements with the U.S. Fish and Wildlife Service to protect lesser prairie chickens and dune sagebrush lizards, while still allowing agricultural production to occur.

Commissioner Powell said that future revenue growth on state trust lands will come from renewable energy and commercial projects. The state is expected to earn $239 million over the next 30 years just from current projects and new applications for projects. If planned correctly, renewable energy could replace oil and gas revenue when fossil fuel supplies eventually dwindle. Commercial projects that use state trust lands are also a tremendous boon to the economy and the trust beneficiaries. Rather than investing in companies to build production facilities overseas, the SIC should consider investing in companies to build those facilities on state trust land, increasing the state's economic activity. If an investment does not succeed, the SLO would still retain ownership of the capital asset, which could then be leased to another entity.

Questions and comments from committee members included the following.

- Does the SLO work with the New Mexico Renewable Energy Transmission Authority (RETA) in planning renewable energy projects? Harry Relkin, general counsel, SLO, said that SLO staff works very closely with the RETA about possible projects.

- State agencies need to be cognizant of the U.S. Department of Defense's requirements when considering the placement of electricity transmission lines.

- Why will the SLO be charging counties for the use of county roads on SLO rights of way? Mr. Relkin said that this issue has been problematic for decades. A recent U.S. Supreme Court decision mandated the SLO (and other land trust agencies) to receive consideration for all activities done on state trust land. Rather than negotiate and possibly litigate with county governments over the lease of every county road that uses SLO right of way, the office decided another approach was needed. With the cooperation of the New Mexico Association of Counties, the SLO developed a system in which counties will be granted a permanent easement for their roads across state trust lands, and counties would start paying a modest fee for the use of those easements. The SLO is currently discussing those fees with each county, in the hopes that a settlement can be made soon.

- How would a new governmental easement across state trust land be determined? Mr. Relkin said that the SLO legal team would research that issue and report back to the committee.

- How is property tax assessed against business assets located on state trust land? Mr. Relkin said that the land on which property is located is not generally subject to property taxation, and the assets on the land tend to be taxed as belonging to the business that uses the property. However, leases that are for more than 75 years can be treated as if owned by the lessee.

The minutes of the October 29-30 and November 21 meetings of the committee were adopted without changes.

The committee recessed at 4:22 p.m.

**<u>Tuesday, December 11</u>**

The committee was reconvened on Tuesday, December 11, at 9:39 a.m. by Representative Sandoval.

**Corrective Action Fund Overview**

Jeff Canney, program evaluator, LFC, reviewed for the committee the programs associated with the Corrective Action Fund administered by the Department of Environment (NMED). The fund was established to prevent and remediate spills from underground storage tanks (USTs) holding gasoline and special fuel. A petroleum products loading fee, currently set at $110 per 8,000 gallon tanker load, is imposed on distributors to pay for the program. The NMED's Petroleum Storage Tank Bureau administers the UST program, performing inspections and remediation programs.

The LFC program evaluation determined that 66 percent of USTs were in compliance with NMED regulations, which is a lower rate than the national average of 71 percent. The state will need to spend $263 million over the next 20 years to eliminate the 739 contaminated sites in the state. The current remediation process does not follow the U.S. Environmental Protection Agency's recommendations for expedited site assessments and pay-for-performance contracts. Finally, the evaluator determined that the NMED uses 70 percent of the fund balances to pay for the UST program, using the remaining portion for other departmental functions. This percentage of revenues is less than the percentage of the other states.

Questions and comments from committee members included the following.

- The Corrective Action Fund was never intended to be used for above-ground storage tanks, just USTs. During the Richardson Administration, the legislature would take away funding for the NMED for various programs for political reasons. The NMED would then allocate a portion of the fund to replace the lost funding, resulting in less revenue for the UST remediation program.

**Endorsement of Legislative Proposals**

The committee reviewed for endorsement the following bill drafts, most of which had been heard by the committee in prior testimony.

1. CIT Single Sales Factor/Combined Reporting/Repeal Credits. NOT ENDORSED.

2. Economic Development Department (EDD) CIT Single Sales Factor. NOT ENDORSED.

3. CIT Rate Reduced to 6.4%/Combined Reporting/Repeal Credits. NOT ENDORSED.

4. EDD CIT Rates Reduced to 4.9%. NOT ENDORSED.

5. EDD High-Wage Jobs Tax Credit Changes. ENDORSED, Senator Phil A. Griego to sponsor.

6. High-Wage Jobs Tax Credit Amendments. ENDORSED, Representative Martinez to sponsor.

7. TRD Independent Hearing Officers. NOT ENDORSED.

8. Reduce GRT Rates/Phase Out Health Care Deductions. ENDORSED, Representative Trujillo to sponsor.

9. State Graduate Employment Tax Credit. ENDORSED, Senator Keller to sponsor.

10. Technology Transfer GRT Deduction. ENDORSED, Senator Keller and Representative Gonzales to co-sponsor.

11. Technology Commercialization Endowment Fund GRT Credit. ENDORSED, Senator Keller to sponsor.

12. This proposal was removed from consideration.

13. This proposal was removed from consideration.

14. Plug-in Electric Vehicles Motor Vehicle Excise Tax Exemption. ENDORSED, Senator Phil A. Griego and Representative Trujillo to co-sponsor.

15. Regional Transit District Tax Distribution Change. ENDORSED, Senator Cisneros and Representative Trujillo to co-sponsor.

16. Microbrewery Production Limit Increase. ENDORSED, Senator Sue Wilson Beffort to sponsor.

17. Small Winery Production Limit Increase. ENDORSED, Senator Smith and Representative Dona G. Irwin to co-sponsor.

18. Disclosure of All Real Property Sales Affidavits. ENDORSED, Senator Munoz to sponsor.

19. Annual Delinquent Property Sales in Each County. ENDORSED, Representative Martinez to sponsor.

20. Property Tax Valuation Limitation. NOT ENDORSED.

21. Durable Medical Equipment GRT Deduction. ENDORSED, Representative Trujillo to sponsor.

22. Transferable Income Tax Credits. NOT ENDORSED.

23. Manufacturing Consumables Special Agreements to Pay GRT. NOT ENDORSED.

24. Dialysis GRT Deduction. ENDORSED, Senator Cisneros to sponsor.

25. Chile Production GRT Credit. ENDORSED, Senator Munoz to sponsor.

26. Reporting of Tax Expenditures. ENDORSED, Senator Keller and Representative Varela to co-sponsor.

Representative Sandoval thanked the more than two decades of service provided by Ms. Ray, who will be retiring at the end of 2012. The committee and audience gave her a standing ovation, and a bouquet of flowers was presented to the long-suffering staff attorney of the committee, to usher her along in the next stage of her life odyssey.

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

REVENUE STABILIZATION AND
TAX POLICY COMMITTEE

# Section 10

# Legislative Proposal Chart

**Legislative Proposal Chart**

| Draft # | Title | Agency | 202 # | Endorsement & Sponsor |
|---|---|---|---|---|
| 1 | CIT Single Sales Factor/Combined Reporting/Repeal Credits | Committee | .190421.2 | Discussions to Continue; Not Endorsed |
| 2 | CIT Single Sales Factor | Sen. Munoz | .190591.2 | Discussions to Continue; Not Endorsed |
| 3 | CIT Rate Reduced to 6.4%/Combined Reporting/Repeal Credits | Committee | .190422.3 | Discussions to Continue; Not Endorsed |
| 4 | CIT Rates Reduced to 4.9% | Sen. Munoz | .190590.1 | Discussions to Continue; Not Endorsed |
| 5 | High-Wage Jobs Tax Credit Changes | Sen. Phil Griego | .190716.1 | Endorsed & Sen. Phil Griego to Sponsor |
| 6 | High-Wage Jobs Tax Credit Amendments | Sen. Keller | .190575.2 | Endorsed & Rep. Rudy Martinez to Sponsor |
| 7 | TRD Independent Hearing Officers | Sen. Keller | .190486.1 | Not Endorsed |
| 8 | Reduce GRT Rates/Repeal Health Care Deductions | Committee | .190423.1 | Endorsed & Rep. Trujillo to Sponsor |
| 9 | State Graduate Employment Tax Credit | Sen. Keller | .190295.2 | Endorsed & Sen. Keller to Sponsor |
| 10 | Technology Transfer GRT Deduction | Sen. Keller | .190530.1 | Endorsed & Rep. Gonzales to Sponsor |
| 11 | Technology Commercialization Endowment Fund GRT Credit | Sen. Keller | .190531.1 | Endorsed & Sen. Keller and Rep. Gonzales to Co-Sponsor |
| 12 | Plug-In Electric Vehicles GRT Deduction | Sen. Phil Griego | .190258.1 | Endorsed & Sen. Phil Griego and Rep. Trujillo to Co-Sponsor |
| 13 | Regional Transit District Tax Distribution Change | North Central Regional Transit District | .190168.1 | Endorsed & Sen. Cisneros and Rep. Trujillo to Co-Sponsor |
| 14 | Microbrewery Production Limit Increase | Sen. Beffort/NM Brewers Association | .190270.2 | Endorsed & Sen. Beffort to Sponsor |
| 15 | Small Winery Production Limit Increase | NM Winegrowers Association | .190556.1 | Endorsed & Sen. Smith and Rep. Irwin to Co-Sponsor |

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| 16 | Disclosure of All Real Property Sales Affidavits | NMAC | .190719.1 | Endorsed & Sen. Munoz to Sponsor |
| 17 | Annual Delinquent Sales in Each County | NMAC | .190720.2 | Endorsed & Rep. Rudy Martinez to Sponsor |
| 18 | Property Tax Valuation Limitation | Realtors/NMAC | .190607.4 | Not Endorsed |
| 19 | Durable Medical Equipment GRT Deduction | Dick Minzner | .190050.4 | Endorsed & Rep. Trujillo to Sponsor |
| 20 | Transferable Income Tax Credits | Ethan Epstein | .190218.3 | Not Endorsed |
| 21 | Manufacturing Consumables Special Agreements | TRD | .190715.1SA | Not Endorsed |
| 22 | Dialysis GRT Deduction | Sen. Cisneros | .190630.2 | Endorsed & Sen. Cisneros to Sponsor |
| 23 | Chile Production GRT & Comp Deduction | NM Chile Growers Assoc. | .190571.3 | Endorsed & Sen. Munoz to Sponsor |
| 24 | Reporting of Tax Expenditures | Committee | .190876.1 | Endorsed & Sen. Keller and Rep. Varela to Co-Sponsor |