REVENUE STABILIZATION
AND
TAX POLICY COMMITTEE

2009 INTERIM

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REVENUE STABILIZATION AND
TAX POLICY COMMITTEE

2009 Interim

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2009 APPROVED
WORK PLAN AND MEETING SCHEDULE
for the
REVENUE STABILIZATION AND TAX POLICY COMMITTEE

Members

Sen. John Arthur Smith, Chair	Sen. Timothy M. Keller
Rep. Edward C. Sandoval, Vice Chair	Sen. Gay G. Kernan
Sen. Carlos R. Cisneros	Rep. Ben Lujan
Rep. Nathan P. Cote	Rep. Rodolpho "Rudy" S. Martinez
Rep. Anna M. Crook	Sen. Howie C. Morales
Sen. Dianna J. Duran	Rep. Henry Kiki Saavedra
Sen. Tim Eichenberg	Sen. William E. Sharer
Rep. Keith J. Gardner	Rep. Thomas C. Taylor
Sen. Timothy Z. Jennings	Rep. Jim R. Trujillo

Designees

Sen. Mark Boitano	Rep. Debbie A. Rodella
Rep. Donald E. Bratton	Sen. Nancy Rodriguez
Sen. Kent L. Cravens	Sen. Bernadette M. Sanchez
Rep. Miguel P. Garcia	Sen. John M. Sapien
Rep. Sandra D. Jeff	Rep. Don L. Tripp
Sen. Carroll H. Leavell	Rep. Luciano "Lucky" Varela
Rep. Antonio "Moe" Maestas	Sen. Peter Wirth
Sen. Steven P. Neville	

Work Plan for 2009

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 2009 interim, the committee will:

1. examine stabilization of state revenue by:

a. discussing alternatives to increased taxes for revenue enhancement to generate replacement funds for federal stimulus money and to increase funding for schools;

b. periodically reviewing the revenue status of the state;

c. reviewing each major revenue-generating tax, including trends in revenue generation and the proportionate share each tax plays in the overall state revenue;

d. discussing the effectiveness and the necessity for existing tax exemptions, deductions and credits, their fiscal impact to state revenue and how to augment collections in a cost-effective manner;

e. determining the progress of the taxation and revenue department in establishing a tax expenditure budgeting system;

f. reviewing the potential revenue impact and side effects of increasing the gross receipts tax, increasing the motor vehicle excise tax or reducing pyramiding in the gross receipts tax system; and

g. considering methods to offset the volatility of revenue from oil and gas production in addition to retaining 10 percent reserves;

2. examine property tax issues, including:

a. yield control;

b. possible changes to the limitation on property tax;

c. the effect on property tax revenue of various mechanisms in New Mexico to finance economic development, including tax increment financing, public improvement districts and industrial revenue bonds;

d. the extent of use of industrial revenue bonds;

e. the ability of counties to value property;

f. determining if the current property tax system in the state can be improved or should be revised;

g. how other states impose, limit, value property for tax imposition and collect property tax;

h. the long-term effects of the limitation on property transfers;

i. the differential in residential property taxes resulting from the property tax limit;

j. whether the limit on residential property tax has the effect of increasing commercial property tax rates; and

k. if one percent of state assessed property should be allocated to the property tax division of the taxation and revenue department for training assessors, valuing property and providing IT services.

3. review the personal income tax amendments and corporate income tax proposals

and the fiscal and administrative effects of each; and

4. review findings of pension and investment committees.

B. Other matters that the committee will address include:

1. a review of the effect on tax revenue or tax policy of holding local governments harmless for an unlimited time into the future when eliminating gross receipts taxes;

2. updates on the national effort to streamline sales taxes and sales tax policy;

3. the implementation of new policies to increase the effective collection of the weight-distance tax and the collection, revenue impact, distribution and expenditure of gasoline and other fuel taxes and a comparison with the needs and uses identified;

4. information on various forms of tax reform of interest to the committee;

5. a review of oversight of and access to data from local gross receipts tax collections and distributions;

6. the impact of state regulation on state revenue and an examination of options to improve the efficiency of regulatory action and reduce the time to receive approval or issue a license by the department of environment; energy, minerals and natural resources department; construction industries division of the regulation and licensing department; state engineer; alcohol and gaming division of the regulation and licensing department; and other agencies;

7. a review of the renewable development district bills regarding the positioning of liens above mortgage or other tax liens;

8. the cause of the differential in natural gas prices between the San Juan basin and other natural gas hubs, the arguments for and against additional pipelines to transport the gas and review of the magnitude of the royalties received by the state from natural gas;

9. the possibility of converting all exemptions to credits or deductions for better tracking and evaluation;

10. federal tax law changes and the effect of de-linking the state income taxes from the federal income taxes; and

11. an update from the department of transportation to determine the shortfall in road maintenance and repair revenue; and a discussion of methods for increasing road fund revenue receipts and a comparison of road tax collection mechanisms in New Mexico with other states.

2009 MEETING SCHEDULE

The dates on which the revenue stabilization and tax policy committee will meet are:

Date	Location
June 11-12 (Th-F)	Santa Fe, State Capitol, Room 322
July 14-15 (Tu-W)	Farmington
August 27-28 (Th-F)	Raton
September 14-15 (M-Tu)	Cloudcroft
October 14-15 (W-Th)	Santa Teresa-Deming
November 23-24 (M-Tu)	Santa Fe, State Capitol, Room 322
December 14-15 (M-Tu)	Santa Fe, State Capitol, Room 307

REVENUE STABILIZATION AND
TAX POLICY COMMITTEE

Section 3

June 2009
Agenda
Minutes

Revised: June 8, 2009

TENTATIVE AGENDA
for the
FIRST MEETING IN 2009
of the
REVENUE STABILIZATION AND TAX POLICY COMMITTEE

June 11-12, 2009
State Capitol, Room 322

<u>Thursday, June 11</u>

9:00 a.m.	**Call to Order** —Senator John Arthur Smith, Chair
9:05 a.m.	**Review of Committee Protocol** —Paula Tackett, Director, Legislative Council Service (LCS)
9:30 a.m.	**Basics of Responsible Tax Policy** —Richard Anklam, Director, New Mexico Tax Research Institute (NMTRI) —Tom Clifford, Research Director, NMTRI —Jim Nunns, Tax Policy Director, Taxation and Revenue Department (TRD)
10:30 a.m.	**Review of Enacted Tax and Motor Vehicle Legislation** —Rick Homans, Secretary of Taxation and Revenue —Jim Nunns, Tax Policy Director, TRD —Michael Sandoval, Director, Motor Vehicle Division, TRD
11:45 a.m.	**Adoption of Committee Work Plan and Meeting Schedule** —Pam Ray, Staff Attorney, LCS
12:30 p.m.	**Lunch**
1:45 p.m.	**Property Tax Overview** —Rick Silva, Director, Property Tax Division (PTD), TRD —Michael O'Melia, PTD, TRD
2:45 p.m.	**Post-Session Fiscal Review** —David Abbey, Director, Legislative Finance Committee (LFC) —Katherine Miller, Secretary of Finance and Administration

3:45 p.m. **Film Tax Studies — Comparison and Clarification**
—Dan White, Economist, LFC
—Anthony Popp, Professor, Department of Economics and International Business, New Mexico State University
—Andrew Phillips, Ernst and Young
—Robert Cline, Ernst and Young

4:45 p.m. **Recess**

Friday, June 12

9:00 a.m. **Federal Stimulus Update**
—Governor Toney Anaya, Director, New Mexico Office of Recovery and Reinvestment
—Gene Moser, Principal Analyst, LFC

10:00 a.m. **Overview and Fiscal Impact of Economic Development Programs**
—David Lucero, Principal Analyst, LFC
—Susan Fleischmann, Analyst, LFC

11:00 a.m. **Income Tax — Year-to-Date Revenue Report**
—Jim Nunns, Tax Policy Director, TRD
—Gwendolyn Aldrich, Senior Economist, TRD

12:00 noon **Gross Receipts Revenue Comparisons — Fiscal Years 2008 and 2009**
—Jim Nunns, Tax Policy Director, TRD
—Clinton Turner, Senior Economist, TRD

1:00 p.m. **Adjourn**

MINUTES
of the
FIRST MEETING IN 2009
of the
REVENUE STABILIZATION AND TAX POLICY COMMITTEE

June 11-12, 2009
State Capitol, Room 322
Santa Fe, New Mexico

The first meeting of the Revenue Stabilization and Tax Policy Committee (RSTP) for 2009 was called to order by Senator John Arthur Smith, chair, at 9:10 a.m. in Room 322 of the State Capitol in Santa Fe, New Mexico.

Present	**Absent**
Sen. John Arthur Smith, Chair	Sen. Timothy Z. Jennings
Rep. Edward C. Sandoval, Vice Chair	Sen. Howie C. Morales
Sen. Carlos R. Cisneros	
Rep. Nathan P. Cote (June 12)	
Rep. Anna M. Crook	
Sen. Dianna J. Duran	
Sen. Tim Eichenberg	
Rep. Keith J. Gardner	
Sen. Timothy M. Keller	
Sen. Gay G. Kernan	
Rep. Ben Lujan, Speaker of the House	
Rep. Rodolpho "Rudy" S. Martinez	
Rep. Henry Kiki Saavedra	
Sen. William E. Sharer	
Rep. Thomas C. Taylor	
Rep. Jim R. Trujillo	

Designees

Rep. Sandra D. Jeff	Rep. Donald E. Bratton
Sen. Nancy Rodriguez	Sen. Kent L. Cravens
	Sen. Carroll H. Leavell
	Sen. Steven P. Neville
	Rep. Debbie A. Rodella
	Sen. Bernadette M. Sanchez
	Sen. John M. Sapien
	Rep. Don L. Tripp
	Sen. Peter Wirth

Approved for Attendance
Sen. Mark Boitano
Rep. Miguel P. Garcia (June 11)

Rep. Antonio "Moe" Maestas (June 11)
Rep. Luciano "Lucky" Varela

Other Legislators Attending
Rep. Janice E. Arnold-Jones (June 11)
Sen. Cisco McSorley (June 11)

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

Staff
Pam Ray, Staff Attorney, Legislative Council Service (LCS)
Tim Crawford, Records Manager, LCS
Doris Faust, Staff Attorney, LCS
Kate Ferlic, Staff Attorney, LCS
Ric Gaudet, LCS

Guests

The guest list is in the meeting file.

Copies of all handouts and written testimony are in the meeting file.

Thursday, June 11

Review of Committee Protocol

Paula Tackett, director, LCS, presented a refresher of committee protocol. She began by discussing quorums and said that a quorum for the RSTP is 10 members present since the committee consists of 18 members. Once established, a quorum is presumed to exist unless it is challenged. Committees can meet as a special subcommittee without a quorum, but only for hearing testimony and not for taking action.

Ms. Tackett also discussed the blocking provision for most committees, in which a majority of those members appointed from the house or senate can block the action of the committee. She explained the per diem and travel reimbursement system for the legislature and asked members to indicate their preferred method of being contacted for committee business.

Raúl Burciaga, assistant director, LCS, discussed the difficult task of scheduling committee meetings during the interim to avoid scheduling conflicts. He said that the current proposed schedule minimizes conflicts as much as possible for voting members of committees, but that the scheduling is not able to address conflicts for advisory members.

Clarification of voting privileges of advisory members was requested by the committee. Ms. Tackett said that committee chairs can allow action to be taken through "no objection" motions or voice votes, typically when dealing with uncontroversial or procedural motions. However, if an objection does occur, or if a vote is taken in which a count of yeas and nays is needed, only voting members are allowed to vote. In the case of the RSTP, designees are considered voting members for the meeting they are attending.

Another comment from the committee dealt with the tendency of the committee to hear and endorse legislation without fiscal impact reports (FIRs) being produced. A committee member indicated that he does not want to vote on proposed legislation this interim unless an FIR is available. Ms. Ray said that she has discussed this issue with the Legislative Finance Committee (LFC) and the Taxation and Revenue Department (TRD). The intention is to have all proposed legislation in draft form in October so that FIRs can be prepared, and the committee will be able to take informed votes starting in November. She said that the committee will begin hearing proposed bills as soon as possible. Jim Nunns, tax policy director, TRD, said that it is important to have actual legislation to prepare an FIR.

Basics of Responsible Tax Policy

Richard Anklam, director, New Mexico Tax Research Institute (NMTRI), Tom Clifford, research director, NMTRI, and Mr. Nunns provided the committee with an overview of the elements required to generate responsible tax policy.

NMTRI's View of Basic Principles and Current Issues in New Mexico's Tax Policy

Mr. Clifford introduced to the committee the basic principles that the NMTRI believes should guide state and local tax policy. Those principles include adequacy, efficiency, equity, administrative and compliance simplicity, comprehensiveness and accountability.

<u>Adequacy</u>: "Revenues should be adequate to provide an appropriate level of those goods and services best provided by the public sector."

One way to examine the issue of revenue adequacy is to compare the size of the state and local government sector in New Mexico with that of other states. As a relatively poor state, New Mexico faces a higher demand for services to low-income residents and a smaller tax base from which to fund these services. New Mexico's tax collections as a percentage of personal income is seven percent above the national average. New Mexico has a high sales (gross receipts) tax structure but a low property tax. Income taxes are about average, said Mr. Clifford.

Mr. Clifford discussed how New Mexico taxes businesses in comparison to other states. Businesses benefit from the relatively low property tax rate structure, but they are burdened by the high sales tax on business inputs. Generally, New Mexico taxes businesses at 4.6 percent of the gross state product, which is slightly lower than the national average. However, if severance taxes are included in the comparison, the percent rises to 6.0 percent, much higher than the national average. High severance taxes on the mineral extraction industry pose a challenge for policymakers, because the high revenues to the state could be at risk if major price shifts or technological developments occur, possibly making New Mexico a less-desired location for extraction industries.

Mr. Clifford discussed another indicator of tax burden, measuring the size of government (expressed as tax revenue) per capita. Accounting for inflation, the NMTRI analyzed collection of gross receipts tax (GRT), property tax and personal income tax (PIT) per capita from 1987 to 2007. All tax types showed a steady increase over the 20-year period, but GRT collections per capita increased the most, from around $1,000 to nearly $1,600, while PIT per capita increased from under $400 to close to $600. Property tax data increased slightly, but data were only available for a nine-year period. In summary, said Mr. Clifford, real per capita collections of GRT revenue are approximately three times as large as those for the PIT or property tax.

Oil and gas revenues make up a significant portion of the general fund, and Mr. Clifford presented a chart that tracked oil and gas collections and the percent of general fund deposits made by collections from that industry. The volatility of oil and gas revenues makes it difficult to provide for reliable state budgeting. Mr. Clifford provided suggestions for the state to better manage oil and gas revenue volatility. First, the state should continue its practice of maintaining 10 percent reserves as a hedge against volatility. Second, he suggested designating a portion of revenues as "nonrecurring" once prices reach a certain level deemed unlikely to be maintained. Next, industry experts should be consulted in an attempt to understand and incorporate their methods of financial risk management. Last, the consensus revenue estimating group should establish a standard of conservatism in estimating oil and gas revenue.

Finally, Mr. Clifford mentioned the NMTRI's dismay at the lack of discussion in the recent legislative session about the tax policy merits of a proposal to increase the GRT to fund education. He said that almost no debate occurred about the economic or tax policy aspects of increasing the tax and its potential pyramiding problems. Studies need to be done to estimate the economic impacts of increasing the GRT. Although finding a funding source for the educational funding formula may be necessary, increasing the GRT may not be the best method, said Mr. Clifford.

<u>Efficiency</u>: "State and local taxes should cause the least possible disruption of the private economy."

Mr. Anklam discussed the principle of tax efficiency, especially as it relates to pyramiding of taxes. Since New Mexico relies so heavily on the GRT, the question arises as to whether this imbalanced revenue system is likely to create economic distortions. If the assumption is correct that the GRT is typically shifted forward to buyers in the form of higher prices, businesses that make significant purchases from in-state vendors have a higher burden than if those purchases are made with out-of-state vendors. In addition, businesses that have relatively large property holdings compared to expenditures, like utilities, for example, benefit from the current structure. Mr. Anklam said that most of the ultimate burden of the reliance on the GRT is borne by New Mexico households and is likely to be regressive in its impacts.

Although comprehensive tax reform may be needed, in the interim, Mr. Anklam suggested not providing for any more state or local GRT increases. Additionally, the NMTRI takes a skeptical view of using the tax code to provide economic incentives, regardless of the worthiness of the targeted activity, because those incentives tend to reduce the tax base and put upward pressure on tax rates and increase the burden of existing businesses.

Mr. Anklam then discussed the NMTRI's view of the corporate income tax (CIT) and of various proposals to increase the CIT rate. A common argument made in favor of increasing the CIT has been that it can offset the various loopholes corporations have in avoiding state and federal taxes. Many companies shift income among their separate legal entities in order to avoid paying CIT in a particular state. However, Mr. Anklam suggested that this problem may be overstated, and he presented evidence that shows that the state's CIT collections have actually increased relative to gross state product over the last 20 years. Although the CIT revenues have fluctuated, there is no downward trend that would suggest that CIT avoidance activity has increased. Mr. Anklam referred to a recent New Mexico Supreme Court case, in which KMart was blocked from using one of the most common tax avoidance schemes, trademark license fees, to avoid CIT liability. He said that administrative and court action targeting abusive tax practices may be a better tool than merely raising the CIT on all corporations.

The committee questioned what was meant by "targeting abusive tax practices". Mr. Anklam said that term generally refers to the activity of a business to specifically avoid paying taxes. Mr. Nunns said that in the aftermath of the *KMart* decision, many companies are paying the state back taxes for similar transactions.

The committee also questioned how prevalent the practice is of misstating the value of rental property and other real estate. Mr. Anklam said that it is a very common tax cheating problem.

Mr. Anklam then discussed the NMTRI's biggest problem with the idea of raising the CIT: that it is hard to justify from the standpoint of good tax policy. First, the original justification for taxing corporations as a privilege of access to capital markets and of the privilege of limited liability is no longer valid today, since C-corporations are no longer the only business entity with that privilege. Second, the argument that the CIT contributes to the progressivity, and thus the fairness, of the tax system is suspect, said Mr. Anklam. Since some economic experts have claimed that the CIT is essentially a tax on the apportionment factors of sales, payroll and property, and since all of those factors are already taxed, there seems to be no justification for an additional tax that only applies to certain businesses. In addition, taxing the sales factor again may cause even more pyramiding issues. Finally, Mr. Anklam questioned the idea of the CIT being justified because of the benefits corporations receive from state and local public services. That argument is weakened, he claimed, because it only applies to certain business entities and not all of them.

Equity: "Tax policy should be fair and equitable toward similarly situated taxpayers."

Mr. Anklam provided an update on the status of the Streamlined Sales and Use Tax Agreement (SSUTA) that has been adopted by 22 states. The goal of the SSUTA is to remedy the disparate treatment of in-state vendors and out-of-state vendors and provide a uniform, simplified, equitable sales tax structure for businesses. The SSUTA also encourages Congress to allow the taxation of remote sellers and will prevent sales tax base erosion from the increase in e-commerce. New Mexico has cleared a few of the major obstacles to joining the agreement, since the agreement was modified to mitigate the effects to local governments due to New Mexico's unique source-based GRT compared to most states' destination-based sales taxes. New Mexico still has many technical changes to make, including changing certain reporting requirements, changing certain aspects of the food deduction to comply with the agreement's definition of "food", adopting other definitions so that terminology used is uniform in all states and developing a database that links an address with a vendor in order to determine state and local tax rates. Significant statutory changes will need to be made in order for New Mexico to join the SSUTA, said Mr. Anklam.

Mr. Anklam also discussed the issue of property tax "lightning" — spikes in property tax assessment and severe property tax inequities — which occurs because of different statutes in the Property Tax Code. For example, property valuation increases generally are limited to three percent per year. The county assessors are also required to value properties at their full and correct value, but this only occurs when a property is sold. Often, a new homeowner will be shocked to discover that property taxes increase significantly upon change of ownership. This problem is somewhat exacerbated by the fact that the limit on valuation increases pushes property taxes higher on the rest of the property tax base, including businesses and new homeowners. The NMTRI recommends a comprehensive study of the property tax system in New Mexico, which would require a significant amount of information from county assessors.

Tax Incentive Accountability: "Deviations from established tax policy in pursuit of economic development, social or other goals should be well reasoned and pursued only when established tax policies are not significantly undermined and the results of such deviations can subsequently be measured and evaluated."

New Mexico currently has over 40 statutes providing economic development incentives at an annual cost to the state of more than $80 million. There are both positive and negative aspects to these incentives, said Mr. Anklam. The NMTRI suggests thoroughly evaluating any proposed incentive, including an evaluation of the goals the incentive is trying to reach; how the incentive interacts with existing tax statutes; and how much state and local incentives are being provided or proposed. Finally, the NMTRI advocates specific reforms to existing incentives to make them easier to use and to improve accountability.

TRD's View of Principles of Tax Policy

Mr. Nunns gave the TRD's viewpoint of responsible tax policy, which, while reiterating many of the principles contained in the NMTRI's presentation, also expressed concert that the focus was not on the broader principles but on some "rules of thumb" that are used to interpret these principles.

Adequacy: "The tax system should generate sufficient revenues to pay for government spending."

Mr. Nunns said that this principle generally means that budgets should be balanced, since they are required constitutionally not to deficit spend, with tax revenues equal to spending. The adequacy principle does not provide any guidance on what the level or mix of government spending should be. Simply stated, tax policy should favor generating enough revenue to fund the services the state provides.

Efficiency: "Taxes should interfere as little as possible with relative prices."

This principle has the goal of a tax structure that does not affect significantly the cost of goods, services, interest rates or wages in comparison to each other.

Equity:

The equity principle has two components: "horizontal" equity means that similarly situated individuals should pay similar taxes; and "vertical" equity means that individuals' tax burdens should reflect their ability to pay. Mr. Nunns pointed out that the equity principle only applies to individuals and not to businesses.

Simplicity: "Taxes should be designed to minimize taxpayers' cost of complying with the tax and the cost of tax departments to administer the tax."

Mr. Nunns contrasted tax principles with "rules of thumb" and how they sometimes are not consistent with the principles. He used the NMTRI's published rules of thumb to elucidate his point. One rule of thumb the NMTRI advocates is that "tax bases should be as broad as possible so that tax rates can be as low as possible to raise the necessary revenues". Mr. Nunns said that while it is true that economic distortions due to changes in relative prices are minimized with lower tax rates, it is also true that an overly broad tax base can significantly distort relative prices. As an example, using the broad tax base rule, having as broad of a tax base as possible for the GRT would also mean that the pyramiding effect would be strengthened. According to the NMTRI's rule, this would be a desirable outcome, since the tax base would be the broadest. However, as pointed out earlier, the NMTRI has identified GRT pyramiding as a significant problem.

Another rule of thumb the NMTRI espouses is that "businesses engaged in similar commercial activities should be subject to the same level of taxation". Mr. Nunns pointed out that the equity principle does not apply to businesses and that the "fairness" of a tax is related to the efficiency principle and not the equity principle. Even using the efficiency principle, there are plenty of situations in which businesses engaged in similar activities should be taxed at different levels, including taxing coal-fired power plants differently than clean energy facilities, to mitigate differential environmental impacts.

Inevitably, conflicts arise, said Mr. Nunns, among the four principles of tax policy when they are used to guide tax legislation, which requires making tradeoffs. Examples of such conflicts include the GRT, which, according to the efficiency principle, should apply to all final sales but would cause conflict with the simplicity principle if "isolated and occasional sales" were also taxed. Another example would be to tax the users of roads on efficiency grounds to compensate for damage to roads and the environment, but such a tax would most likely violate the simplicity principle and possibly the equity principle.

Mr. Nunns concluded his remarks by contending that tax expenditures, which usually consist of deductions, exemptions and credits, are really not intended to be an integral part of tax policy; rather, they are incentives designed to achieve a particular purpose that use the tax system to administer the program. There is no inherent conflict between tax expenditures and tax policy principles because the tax system is merely the administrative mechanism by which the state provides the tax expenditures, or more accurately, the incentives. Thus, said Mr. Nunns, tax expenditures generally should not be evaluated using the four tax policy principles, but should be evaluated instead by looking at the intended and actual outcomes of the policy.

The committee questioned how New Mexico compares with other states in its level of severance taxes. Mr. Clifford said that in order to compare accurately with other states, other related taxes, like property taxes, need to be included in the analysis, but that New Mexico falls somewhere in the middle compared to other states.

Another query of the committee was whether New Mexico is in danger of losing extractive industries due to its severance tax structure. Mr. Clifford said that he will provide to the committee a recent University of Wyoming study that studied that issue in many states.

The committee also asked if other states have taken a different approach to minimizing risk to the treasury from volatile oil and gas prices. Mr. Clifford said that Alaska diverts a large portion of its oil revenue so its general fund is not completely dependent on that source.

Referring to the NMTRI chart that describes GRT revenue increases compared to PIT revenue, a member of the committee noted that the steep GRT revenue increase coincided with the 2003 cuts in the PIT. He postulated that as taxes are reduced, spending goes up, which probably accounts for some of the GRT revenue spike. He also suggested that the reserves were illusory and, by including the Severance Tax Permanent Fund as part of the general fund reserves, state reserves could be made to look even more substantial. That fund, which is untouchable by the legislature or executive, will add to the already mostly meaningless other "reserve" funds backing the general fund reserves to bring New Mexico to an astounding 75 percent reserve level, he said.

The committee questioned why having an "overly broad tax base" is a problem. Mr. Nunns explained that sales between businesses are generally an undesirable tax revenue stream because it increases the relative value of products and ends up taxing items multiple times. That issue generally is that inefficiencies result in distortions of the tax base due to multiple taxation of the same service or input. Another example is the fact that the state generally disallows deductions for employee expenses since it would be too difficult to administer such a deduction. However, those are real costs, which are then added to the tax base, making the PIT tax base bigger than it really should be.

The committee commented that the state has lost revenue from internet sales not being taxed. It was suggested that the federal government track and tax internet sales and apportion the revenue to the states.

Another committee member suggested that the data indicating sales taxes as a percent of personal income are probably skewed because they do not reflect economic activity occurring on tribal land. That activity is not taxed by the state. The TRD tax policy principles are beneficial reminders to committee members. The state should identify out-of-state businesses doing business in New Mexico in order to get them to pay their fair share of taxes.

A question arose from the committee regarding whether the state had a more responsible tax policy prior to 2003, when the PIT and capital gains tax were reduced, amounting to more than $468 million in lost revenue to the state. Questioned was whether it was a responsible tax policy to tax a person making $24,000 per year at the same rate as a person making $24 million. Mr. Clifford said that it is difficult to define "responsible". The 2003 tax cuts were aimed at the efficiency principle in an attempt to create a more attractive climate for businesses and individuals to locate in the state. He cautioned that people may not move to New Mexico if there is too high of a PIT. Mr. Nunns said that there were provisions to benefit low-income people in that tax package. He said that the tax cuts met the adequacy principle until this past year. The committee noted that the low-income comprehensive tax rebates have amounted to only $50 million, compared to the nearly $500 million reduction in income taxes to New Mexico's wealthier residents. It appeared that New Mexico did away with its formerly responsible tax policy. It may be a very popular policy but not a very responsible one. Mr. Clifford acknowledged that although New Mexico's tax policy overall might be slightly regressive, the state spends its revenues in a manner that helps to restore the progressivity to income taxes.

The committee asked what the state needs to do to participate in the SSUTA. Mr. Nunns said that a study on that issue is being completed, and he will forward the results to the committee. New Mexico will need to revise its GRT statutes and how the tax is imposed and will need to bring its statutes into compliance with uniform rules.

Review of Enacted Tax and Motor Vehicle Legislation

Rick Homans, secretary of taxation and revenue, Mr. Nunns and Michael Sandoval, director, Motor Vehicle Division (MVD), TRD, reviewed tax and motor vehicle legislation adopted or introduced in the 2009 legislative session.

Legislation That Became Law

- <u>CIT Estimated Payments (Senate Bill 80; Laws 2009, Chapter 4).</u> This law restored the first quarter estimated payments that were erroneously deleted a few years ago and clarifies that withholding and oil and gas proceeds withholding payments are estimated payments. The bill is estimated to raise a total of $58 million in fiscal year 2009.

- <u>Changes to Cigarette Tax and Enforcement Statutes (Senate Bill 219; Laws 2009, Chapter 197).</u> The bill made changes to ensure New Mexico's compliance in enforcing the Master Settlement Agreement with tobacco product manufacturers; amended the Cigarette Tax Act and the Cigarette Enforcement Act to conform rules and definitions and to improve enforcement; extends from 10 to 30 days the time distributors have to affix stamps; applies the tobacco products tax to samples and gifts of tobacco products; exempts tribal sales from taxation; and creates a felony offense of knowingly making a materially false statement in any record required to be kept pursuant to the Cigarette Tax Act.

- <u>Extension of Life of Investment Tax Credit and Double-Weighted Sales Factor for Manufacturers (Apportionment of Income) (House Bill 75; Laws 2009, Chapter 147).</u>

- <u>Tax Increment Development District (TIDD) Oversight (House Bill 451; Laws 2009, Chapter 179).</u> The law adds notice requirements to the secretaries of finance and administration and taxation and revenue and to the director of the LFC; makes the secretary of finance and administration a member of all TIDD boards; and provides for a distribution of remaining balances in debt service funds, after bonds have been retired, to the governments that dedicated the revenue.

- <u>Winrock/Quorum Town Center TIDD (Senate Bill 467; Laws 2009, Chapter 58).</u> The bill authorizes up to $137 million in bonding for TIDDs 1 and 2 and $27 million for TIDD 3 for an urban infill project on the site of the Winrock Mall.

- <u>Estimated Future Property Tax Information to Buyers (House Bill 261; Laws 2009, Chapter 165).</u> The law requires sellers to disclose to potential buyers, prior to making an offer, a county assessor's estimate of what the property tax will be based on the asking price; the county assessor's estimate must contain a disclaimer that the estimate is based on the asking price, but that the actual "current and correct" valuation may be higher or lower than the asking price; and prospective buyers may waive the disclosure requirement. Immunity from any liability for providing incorrect information was included in the bill for those required to provide the information.

- <u>Confidentiality (House Bill 257; Laws 2009, Chapter 243).</u> The bill adds new key definitions; adds general rules governing the confidentiality of tax information; provides that tax information can only be used for specific, official purposes; provides that tax information cannot be revealed without specific statutory authorization; reorganizes information release exceptions into groups of related entities; and conforms penalty provisions.

- Alternative Vehicle Registrations (House Bill 12; Laws 2009, Chapter 156). The bill provides a five percent discount for motor vehicle registrations made by phone or the internet, which is mostly offset by the credit card fee charged; and appropriates certain fees and charges to the MVD and makes them nonreverting.

Failed Legislation

Several key tax-related bills that failed the legislature were discussed by Secretary Homans. They include a PIT simplification bill; a bill to completely rework how the CIT and franchise tax are imposed; a bill that would have provided a revenue stream for the public school funding formula; a bill to grant approval of the SunCal TIDD; a bill to make technical changes to the TIDD statutes; a bill to address the unintended effects of the three percent limitation on valuation of property; a bill to allow state residents to withhold taxes as a pass-through entity and to make that withholding quarterly; a bill to require withholding on all payments for film performing artists; a bill to improve the combined reporting system (CRS) and to raise the threshold level that requires monthly reporting to the CRS; and a bill to correct food and medical deductions and to provide for a better system for taxpayers in disputes with the TRD.

The committee questioned the progress of the selection of the contract for a sole-source provider of a database for the sale of driver registration information. Secretary Homans explained that there had previously been six contracts with companies to provide driver data, but that four of them had expired. The Purchasing Division of the General Services Department had notified the TRD that it needed to follow a request for proposals (RFP) process in order to properly enter into a new contract.

The committee expressed concern that a bill to specifically give the TRD the power to establish such a database failed in 2004, but now the TRD seems to be circumventing the legislature's intent. It was speculated that the state stands to gain a significant amount of revenue from that system and that businesses needing services from the database will be charged too much. Secretary Homans responded by saying that the 2004 legislation was only to set up a governance committee to oversee the sale of driver information. The TRD already has the statutory authority to provide driver information to certain entities, so long as the state receives a royalty for the service. The proceeds from the fees first will go to pay for the actual costs of the database, and the rest go toward the operations of the MVD. He said that the state will collect $4.95 per record request. It is difficult to know how much end users will pay, because some of the data will be re-sold to other entities. He said that the national average cost for driver records is $7.00.

Further concern was expressed that the TRD should have waited for an opinion from the attorney general before proceeding. There are unresolved questions as to whether the TRD has the legal authority to perform this function. Another concern was that existing contracts that could have been renewed were allowed to expire. Secretary Homans said that the end result of the new system will be much better than the previous systems. Two of the contracts are still in effect and will be phased out as the new system is put into place. The contracts that expired were not able to be renewed due to the terms of the contracts. He also said that he informed the attorney general personally that the TRD was proceeding with a new contract and asked if there were any concerns with the process; he has not heard back from the Attorney General's Office (AGO). Finally, Secretary Homans discussed several concerns with some of the previous contracts, including serious confidentiality breaches and a lack of data security.

A question from the committee sought to determine why the Foundation for Open Government is opposed to this particular procurement. Secretary Homans said that one newspaper publisher told him that as the government moves toward relying on electronic governance, the print media, which often relies of the publication on legal notices to survive, is slowly becoming obsolete. Although this database has nothing to do with newspapers or legal notices, Secretary Homans said that he understands newspaper publishers' concerns.

It was noted by a committee member that the size of the state's contribution to the approved TIDDs was quite large, especially in comparison to the local contribution. Secretary Homans responded that it is the TRD's responsibility to implement the policy that the legislature sets, but that the department is open to more policy discussion about TIDDs in the future.

Returning to the sole-source MVD information technology contract, a member commented that the state needs to hire more in-state firms and that there should be some competition allowed between information vendors.

Secretary Homans was asked what the expected revenues to the state will be from the new information database contract. In addition, he was asked to clarify whether the attorney general gave passive approval to the proposed contract. Secretary Homans said that the state expects to receive $4 million to $5 million annually. He said that he informed the attorney general that the TRD was proceeding deliberately with the contract. The TRD has not received any response from the AGO.

Property Tax Overview

Rick Silva, director, Property Tax Division (PTD), TRD, and Michael O'Melia, deputy director, PTD, TRD, gave the committee an overview of their responsibilities and the status of the property tax system in the state from the perspective of the PTD. Property tax is the second largest tax base in the state, accounting for $1.4 billion in revenue per year, said Mr. Silva. Compared to other states, New Mexico ranks near the lowest in terms of total property tax revenue; property tax as a percentage of total state and local taxes; per capita property tax; and property tax as a percentage of personal income.

Some of the key aspects of property tax in New Mexico are that property tax is an alternative source of revenue to local gross receipts taxes and state-supported spending;

property tax generates the revenues for debt service for state and county infrastructure; and property tax is the most stable source of recurring revenue for local government. Property tax revenue in 2008 was distributed to school districts (32.1 percent), counties (30.7 percent), municipalities (14.3 percent), higher education institutions (9.8 percent), health facilities (8.5 percent) and the remainder to state debt service and conservancy districts.

The PTD does not generally collect property taxes; that responsibility lies with counties. The division acts to provide limited oversight of county assessors, as well as providing assessments for special types of properties and multi-county properties; certifies the property tax base for all counties; performs some appraisals and technical assistance for counties; evaluates county assessors; coordinates training; pursues collection efforts on delinquent accounts; and has the authority to sell delinquent properties as a last resort. The PTD funds 80 percent of its budget from fees and collections, said Mr. Silva.

Mr. Silva reviewed some of the pending regulation changes the PTD is contemplating, including changes to the sales ratio study, agricultural valuation, obsolescence of property and veterans' and disabled valuations.

Finally, Mr. Silva identified some of the major property tax issues facing the state, including the following.

- Lack of assessment uniformity, often caused by rapid increases or declines in home values; the limitation on residential value increases and exceptions to that limitation; and the yield control formula.

- Requirement for more reliable data, including the need for better financial modeling capabilities; the need for better data on commercial and multi-family properties; the need for full disclosure, which would result in better and less expensive assessments; and the need to enforce existing affidavit regulations.

- Low-income relief. Mechanisms currently in law do not always reach their intended recipients.

- Residential property tax disclosure. New laws have been enacted to warn potential home buyers of possible large increases in property valuations, but this will probably still be an issue.

- Statewide computer-assisted mass appraisal system. Most counties still do not have this system, which results in more uniform assessments.

Questions from the committee included how personal property assessments are performed. Mr. Silva said that county assessors distribute questionnaires to businesses based on federal Schedule C tax returns.

In addition, the committee wanted to know about the attempt in Bernalillo County to move to a two-year valuation cycle rather than a one-year cycle. Karen Montoya, Bernalillo County assessor, said that she requested that change in order to slow down the rapid rate of valuation increases, especially during the current economic downturn. The PTD has denied that request. Mr. Silva said that the PTD is still working with the Bernalillo County assessor on this issue.

The committee has heard from some county assessors that they will be unable to comply with the new law that requires county assessors to provide an estimate of the future property taxes to potential home buyers. Mr. Silva said that the problem is that some small counties, with limited assessor staff, will not be able to provide the estimate within 24 hours as the law requires. In addition, multiple requests may be held by a real estate agent until there are several to request, and in Bernalillo County, the daily requests can be numerous.

Senator Rodriguez requested that PTD staff investigate an apparent calculation error in the handout detailing the amounts distributed to various entities. She said she wants to ensure that all the money is being distributed properly.

Concern was expressed regarding outreach to low-income residents not being sufficient, and that people are still at risk of losing their homes because they do not know about the available property tax relief programs. The PTD was asked to provide an FIR of legislation that would exempt from taxation residential property for elderly residents over 75 years of age with incomes under $15,000 per year, and also exemptions for disabled persons with the same income category. Mr. O'Melia said that the PTD will try to gather that information, but he is not sure if the PTD's data collection abilities are sophisticated enough to provide an exact estimate.

Another question was in regard to the number of valuation protests the PTD oversees each year. Mr. Silva said he is not sure how many will reach the PTD, but that there are over 7,000 protests filed with just Bernalillo County this year.

It was pointed out that after 10 years of delinquency, a tax liability on a property becomes void. When asked how much money this is costing the state and counties each year, Mr. Silva said that there are currently 78,000 delinquent properties in the state, and the PTD usually can handle 12,000 per year. He said that he does not know how much money is delinquent or how much revenue is lost due to property liability being dropped from the rolls.

Also noted was that Bernalillo County has 27,000 mobile homes that have property tax liabilities greater than the value of the homes. The committee sought information about how to fix that problem. Mr. Silva said that mobile homes are considered chattel, which is personal property, and the counties deal exclusively in that province.

Another question raised was how the PTD is dealing with one property owner in Socorro County who reportedly has delinquent property tax accounts for 9,000 properties.

Mr. Silva said that the PTD is currently negotiating with that individual, and he hopes to enter into a payment plan to recover the liabilities. Mr. O'Melia said that the PTD can sell delinquent properties, but only does so as a last resort after exhaustively attempting to make arrangements with the owner.

The committee asked how the PTD receives revenue. Mr. O'Melia said that the state receives penalties, interest and a portion of delinquent tax paid. Extra collections go into a reserve fund to cover more lean years. He estimated the reserve fund balance to be $1.1 million, and said he expects the PTD to use about $400,000 of it this year to cover expenses.

Another member asked whether New Mexico's property tax system is regressive or progressive. Mr. O'Melia said that the PTD conducts a progressivity study every year and is currently in the middle of that study. He said that New Mexico is mostly neutral on the progressivity scale.

Concern was expressed regarding the reliability of PTD figures showing New Mexico to have a relatively low property tax burden when the most common complaint heard from business owners is that valuations and assessments are too high. The member asked how many properties are not assessed, which tends to drive up assessments on the rest of the properties. Mr. Silva said that the PTD does not have that information, and most county assessors do not know, either. He said that the PTD only has the statutory authority to ensure that county assessors are following the law. There is no way for the PTD to fix current inequities unless statutes are changed.

It was suggested by the committee that, eventually, the state will need to take over the duty of performing all valuations and assessment of properties.

The PTD was asked to report back to the committee on a solution to fix the residential tax discrepancies that develop on transfers of residential property due to the three percent valuation limitation.

Post-Session Fiscal Review

David Abbey, director, LFC, and Katherine Miller, secretary of finance and administration, updated the committee on the fiscal status of the state since the legislative session.

Mr. Abbey began by reviewing the economic situation leading up to the 2009 legislative session and how the legislature tackled the problem. New Mexico state government faced a $454 million shortfall for fiscal year 2009 before the start of the session. The first priority of the legislature and the governor was to enact a solvency package consisting of four prongs: first, revenue measures were enacted to capture first- quarter CIT payments (SB 80) and to transfer money from various funds, which measures were predicted to generate $148 million; next, $164 million in appropriation reductions was enacted; third, $152 million in capital outlay projects was voided; and last, $56 million was transferred from reserves.

The legislature then turned its focus toward the need to enact a balanced budget for fiscal year 2010. The February 2009 revenue estimate revised downward fiscal year 2010 revenues by an additional $282 million from the December 2008 estimate, projected to be $5.5 billion. Energy revenues and CIT revenues were the major portion of the new shortfall. The federal government pledged $1.9 billion in stimulus money, some of which was incorporated into the fiscal year 2010 operating budget. By the end of the legislative session, a $5.49 billion budget was approved, which was nine percent smaller than the original fiscal year 2009 budget. The fiscal year 2010 budget, as a hedge against more economic troubles, maintains high reserve levels. The only capital outlay package approved in 2009 was from severance tax bond proceeds, and most of that money was directed toward critical-need state projects. No local legislative projects were funded.

The general fund outlook for fiscal years 2011 and 2012 so far look better than the current cycle. Revenues to the state are expected to grow 4.9 percent in the upcoming two fiscal years. However, spending must increase $275 million each year just to maintain the current program level budgeted for fiscal year 2010. Additionally, more than $450 million in new revenue will be needed, most of which consists of replacement of federal stimulus money.

Finally, Mr. Abbey said that the state is still facing about a $170 million shortfall for fiscal year 2009, but federal revenues and transfers will be able to balance the books. He said that PIT and CIT collections are lower than expected, and the boost in CIT revenue from the first-quarter payment requirement is also lower than predicted.

Secretary Miller gave an update on the current fiscal situation and said that the Department of Finance and Administration's (DFA's) numbers agree with the LFC's numbers. The budget saw a nine percent reduction in revenues, and a three percent reduction in spending. The federal stimulus money that covered the shortfall will have to be replaced with state money fairly soon, she said.

The fiscal year 2009 solvency plan has come close to its estimates. The capital outlay reversions were mostly reverted, except for a few projects that already had let contracts. Appropriation reductions were made through the SHARE accounting system, and other entities that had reductions have been billed. She expects the actual reductions to be within $2 million of the budgeted reductions.

Secretary Miller presented scenarios for the completion of fiscal year 2009, depending on actual revenues that the state collects. With a $50 million shortfall in revenue, the state can absorb the shortfall without using federal stimulus money. At shortfalls of $100 million or $200 million, the state will need to transfer money from the newly created New Mexico Recovery and Reinvestment Fund, which was set up to follow strict federal guidelines on how stimulus money could be spent.

A committee member asked how far off the CIT first-quarter estimated payments were from predictions. Mr. Abbey said that the state received $22 million from the new reporting date, but the prediction was for $28 million. He said he expects $20 million to $25 million in CIT collections for the second quarter.

Film Tax Studies — Comparison and Clarification

Dan White, economist, LFC, Anthony Popp, professor and head of the Department of Economics and International Business, New Mexico State University (NMSU), and Andrew Phillips and Robert Cline, Ernst and Young, presented an overview of the analyses completed by Professor Popp, principal author, NMSU study, and Mr. Phillips and Mr. Cline, principal authors, Ernst and Young (E&Y) study, assessing the economic impact of the film production tax credits on New Mexico's economy.

<u>LFC Analysis</u>

Mr. White began with an introduction of the film industry's presence in New Mexico since 2003 and described the various tax credits and incentives available for the industry. From 2001 to 2007, motion picture and video production employment increased nearly 800 percent. In the first three quarters of fiscal year 2009, about $48 million in film production tax credits had been approved, which represents a 1,600 percent increase in a five-year period. Incentives that the state provides to the film industry include a 25 percent film production tax rebate, a film crew advancement program, a pre-employment training program, zero percent production loans from the State Investment Council (SIC) and direct capital expenditures.

In 2008, the LFC commissioned a study of the return on investment (ROI) of the film production incentives. The study was performed by the Arrowhead Center of NMSU, under the direction of Dr. Popp. The study measured the cost of film production incentives against the estimated amount of new film spending in fiscal year 2008 (through April 2008). During the study period, $152.8 million of new spending in New Mexico occurred, which resulted in approximately $5.5 million in additional state taxes. That amounted to an ROI of $.14 gained per $1.00 spent.

The study's authors reasoned that the calculated ROI is probably understated due to the fact the analysis accounted for only one-half of the job growth in the industry since 2001 and due to the exclusion from the analysis of film projects that did not qualify for the tax credit. However, this understating of the ROI was in part tempered by the study's assumption that some of the qualified film projects would have occurred in New Mexico regardless of the tax credit.

Mr. White then described the E&Y study of the ROI of the film industry, which came to very different conclusions than the Arrowhead Center (NMSU) study. The E&Y study found $44.1 million in additional state tax revenue in calendar year 2007, which showed an ROI of $.94. Additionally, the study calculated local government revenue, which showed an extra $.56 to be added to the ROI.

Mr. White described how the two studies came up with such divergent results. The E&Y study used unusually high incomes in its assumptions, using New York City wage levels of $91,000 versus the NMSU study figures of $35,000. The E&Y study also included the very large one-time capital expenditure of the Albuquerque Studios, which probably skewed the results somewhat. The E&Y study also extrapolated data from a Tourism Department study of the effect of the film industry on tourism. While the NMSU study estimated the tourism effect as well, it used more conservative assumptions than the E&Y study.

Mr. White said that it was not possible to determine if the E&Y study used a methodology to exclude certain sectors from its standard economic modeling program in order to avoid double-counting of those sectors it studied separately. The E&Y study also included property taxes in the study, while the NMSU study did not. Finally, the period of time of the two studies was different, with the NMSU study evaluating the first three quarters of fiscal year 2008 and the E&Y study covering calendar year 2007.

In conclusion, Mr. White said that while the NMSU study's ROI is most likely understated and that the E&Y study is overstated, neither study shows results that the state is gaining revenue from the film production credits. Although the recent growth in the New Mexico film industry has had undeniably significant economic impacts on the state, said Mr. White, it appears that these impacts thus far have not generated sufficient additional tax revenues to offset the costs to the state.

<u>NMSU Analysis</u>

Dr. Popp also provided the committee with a comparison of the two studies. In addition to the differences identified by Mr. White, Dr. Popp presented the following conclusions:

- The two studies had different charges, with the NMSU study only showing returns to the state, while the E&Y study showed returns to state and local governments.

- Both studies showed a substantial change in industry employment and income.

- Major differences in the methodology include tourism spending, capital expenditures, property taxes, time frame, non-qualifying expenditures, tax rates and labor compensation proportion of expenditures.

- The E&Y study omits state costs from the SIC loans still outstanding, job training and direct capital outlay for various film-related programs and projects at public colleges.

- The E&Y study attributed nearly all employment in the film industry to the film production incentives.

Dr. Popp then presented an analysis of the two studies that calculated the effects of the different methodologies and assumptions the two studies used. Using this comparison, Dr. Popp showed that when all of the variables in the two studies are made comparable, the E&Y study shows an ROI of $.25, versus the NMSU study ROI of $.14.

E&Y Response

Mr. Phillips and Mr. Cline presented to the committee via telephone, since they had last-minute transportation difficulties. Mr. Cline began by saying that Dr. Popp presented an accurate summary of the differences in the two studies. He said that it is important to take into account not only the public sector benefits (or losses), but also the private sector benefits from state incentives. He also said that the E&Y study was comprehensive in that it studied both state and local government impacts. One of the strengths of the E&Y study is that its study separates out the various economic components and fiscal impacts.

Mr. Phillips said that the E&Y study looked at film production, film tourism and capital expenditures in relation to state expenditures. Film production expenditures were obtained from the New Mexico Film Division of the Economic Development Department, and direct labor costs accounted for two-thirds of production costs. Approximately 2,000 direct jobs were created, creating $253 million in wages, and 1,800 indirect jobs were created, which were estimated using standard economic modeling software. Finally, Mr. Phillips reported that a Tourism Department study found that 3,800 tourism jobs are directly related to the film industry. A total of 9,200 jobs can be attributed to the film industry in New Mexico, which corresponds to $71 million in additional state and local taxes, for a combined ROI of $1.50, or $.94 if local government revenue is excluded.

The committee asked about the economic modeling methodology used by both studies, including whether the studies measured indirect tax impacts. Dr. Popp said that both studies used the same modeling software, which is standard for such studies. That software does measure indirect tax impacts. He said that the economic modeling methodology of both studies was similar, but the assumptions were different.

It was suggested by the committee that it would be useful to extend this kind of study over a number of years, since there are always yearly distortions in ROI studies.

The committee questioned whether a film industry would still be in New Mexico if there were no state incentives. A committee member indicated that the film industry has a large presence in New Mexico because of the incentives. Dr. Popp responded by agreeing that the film industry is undoubtedly much larger due to the incentives, and that there has been a large economic impact from the industry, but he also said that there was a film industry in New Mexico before the incentives began, and there would most likely still be one (although much smaller) if the incentives were ended.

It was postulated by a committee member that with the recent conclusion of the film actors strike, New Mexico should see another spike in film production activity.

Committee members asked that the committee be provided with the Tourism Department study that analyzed the tourism component of the film industry. Mr. Phillips said that a few of the components of the study were adjusted downward, but he feels that it is a credible study.

Recess

The committee recessed at 5:05 p.m.

Friday, June 12

The committee reconvened at 9:05 a.m.

Federal Stimulus Update

Governor Toney Anaya, director, New Mexico Office of Recovery and Reinvestment (NMORR), Dona Cook, chief deputy director, NMORR, Gene Moser, principal analyst, LFC, and Paul Aguilar, principal analyst, LFC, updated the committee on federal stimulus funds targeted for New Mexico.

NMORR Presentation

Governor Anaya began by saying that Governor Richardson created the temporary NMORR in April 2009 by executive order, whose unofficial motto is "ensure no dollar is left behind". The office's purposes are to facilitate compliance with the federal American Recovery and Reinvestment Act of 2009 (ARRA), to identify available funding opportunities through the act, to conduct extended outreach to state and local entities, to keep stakeholders informed of funding opportunities and to ensure that New Mexico competes effectively for funds.

Although initial allocations showed New Mexico receiving $1.9 billion in federal stimulus funds, the state now stands to receive more than $3 billion, said Governor Anaya. In addition to the state direct share, New Mexico can compete for a portion of $74 billion available in competitive grants. Other parts of the ARRA stimulus package include $288 billion in tax relief to individuals and businesses and $30 billion in bonding authority nationwide for businesses and communities. Estimated stimulus funding includes $738 million for Medicaid, $470 million for public education, $420 million for environment-related programs and projects, $369 million for infrastructure, $296 million for transportation projects, $246 million for benefits to individuals and families, $191 million for higher education programs, $115 million for unemployment benefits, $82 million for energy efficiency projects, $58 million for other government services and $14 million for public safety projects.

One area of funding that has caused some confusion around the state is for infrastructure, transportation and environment projects, said Governor Anaya. Because of federal regulations, the NMORR is only working with existing applications for projects that are "shovel-ready" for the current funding cycle. He expects a new round of funding for projects to become available this winter, and his office has been encouraging communities to submit applications for the next funding cycle.

With $74 billion available nationally in competitive grants, the NMORR is working with the newly created Competitive Grants Advisory Team to apply for as much grant funding as possible. The state will be applying for grants for broadband, green grid and health information technology projects, and is looking into green jobs programs. The NMORR is inviting any public or private entity interested in those areas to collaborate in this process. Governor Anaya said that a tremendous spirit of cooperation has developed, and the state is in a very good position to receive large competitive grants.

Ms. Cook briefed the committee on how the NMORR is overseeing and tracking all of the ARRA money coming to the state. New Mexico created one fund to budget, track, account for and monitor all of the federal stimulus money, and the DFA also set up separate SHARE codes for each state agency receiving stimulus money. The office also provides guidance to state agencies on compliance with federal regulations, which are still changing. Although the federal government allows up to 10 percent of funding to be used for administrative costs, the NMORR has a goal of keeping those costs to under five percent.

The NMORR has been working with the State Treasurer's Office and the State Board of Finance to ensure that cash flow does not become a problem, since most ARRA funds are disbursed on a cost-reimbursement basis. The office is preparing for new federal quarterly reporting requirements and is preparing to review the status of agency compliance with federal requirements. Finally, the NMORR is currently establishing a process to conduct audit and compliance oversight and to prevent federal audit exceptions. Ms. Cook said that intense federal scrutiny is expected on the expenditure of ARRA funds. New Mexico will be prepared to give detailed reports for all ARRA expenditures, she said.

LFC Presentation

Mr. Moser began his presentation by saying that although the governor pocket vetoed a bill to give the LFC oversight of ARRA funds, the NMORR has been very cooperative in providing any information the LFC has requested. The LFC decided to wait until June to start tracking actual expenditures, since the process is still being organized. The major concern that the LFC has with the expenditure of ARRA money is to make sure the state is not obligating itself into creating new recurring expenditures.

Mr. Moser divided the stimulus package into two rough parts: fiscal stabilization in order to shore up New Mexico's budget; and infrastructure. Just in the transportation sector, the Department of Transportation (DOT) has identified over $16 billion in unmet highway needs, but only $30 billion is available nationally. New Mexico will use its share toward completing GRIP I projects, but will still be $350 million to $450 million short.

Another concern the LFC has is how competitive grants will be chosen by the NMORR. As an example, the DOT is trying to coordinate all affected communities to submit one grant request for the U.S. Highway 491 project. That is an example of good collaboration. The DOT and LFC are concerned that without collaboration, individual communities will flood the federal government with grant funding requests, with the end result that less money will be awarded to New Mexico.

Mr. Aguilar discussed some of the details of the stimulus money. The stimulus money is not recurring revenue, and it is important that entities not treat it as such. Some school districts are trying to be creative with how they spend the money. For example, Albuquerque Public Schools indicated that it wants to use some of the stimulus money to give teachers a pay "bonus" instead of using its operational revenue to establish pay raises. The Public Education Department (PED) has said that this is an inappropriate use of stimulus funds, said Mr. Aguilar.

There has been some confusion about reversion dates for Title I and IDEA-B funds, said Mr. Aguilar. Don Moya, deputy secretary of public education, said that school districts will need to encumber all stimulus funds within 18 months, but that they will be able to spend the money for an additional 27 months.

Mr. Aguilar said that a new federal requirement that states have an educational longitudinal data system in place has spurred the governor to create by executive order the New Mexico Data Warehouse Council.

The committee questioned if funding is available for libraries and colonias and to address flooding issues. Governor Anaya said that there is currently no funding available for library infrastructure. Colonias are eligible for funding for various infrastructure projects. Regarding flood mitigation, he said that all money currently available flows through existing state programs, and he is not sure if any provide for flood mitigation projects.

In response to a question regarding how much ARRA money has been spent to date, Ms. Cook said that data available to the NMORR, which is one month old, indicates that $103.8 million has been spent.

Also asked was when the stimulus money will have an effect on the state's economy. Governor Anaya said that that economic effects are starting to happen, since many projects are beginning. Another not-so-noticed effect is that the state will not be experiencing widespread layoffs.

The committee questioned whether individual schools can apply for competitive grant funding. Governor Anaya said that they are eligible, but the NMORR is discouraging individual entities from applying for grants. He wants a more collaborative process, which will lead to better success in getting funded.

A question arose regarding how priorities for funding highway projects are set. Specifically, the question referred to U.S. Highway 491, which had some funding that was taken away recently. Mr. Moser said that the U.S. Highway 491 project has been funded in increments, but never fully. When the governor committed to making the highway a four-lane highway, that increased the cost significantly. Mr. Moser said that the State Transportation Commission committed in May to make the highway project a priority.

Governor Anaya concurred, and said that the DOT has not yet made final decisions about which projects to fund.

Another question from the committee was whether education money would be distributed in time for school districts to avoid a cash flow crisis. Mr. Moya said that the PED and the federal government have been discussing this issue. He said that he is now confident that the money will be distributed before July 1.

Concern was expressed that many nonprofit organizations that provide essential state services are being squeezed to the breaking point. Governor Anaya said that nonprofit entities are eligible for various types of grant funding, just not recurring funding.

The committee questioned whether any money is available to assist individuals with propane bills. Governor Anaya said that stimulus money is not available for fuel costs, but that the money can be spent for energy retrofitting of homes.

The committee requested more detail regarding how school districts will be spending their funding. Governor Anaya said that Secretary of Public Education Veronica Garcia has stressed that districts need to be very careful on how they spend the money.

Another question was in regard to $57 million in discretionary funding that the governor can direct. Governor Anaya said that the administration is still deciding how to prioritize that grant.

It was stressed that there is a need for a post-audit review to ensure that programs comply with the ARRA. Governor Anaya said that he has met with the state auditor twice, and the NMORR is setting up a compliance office. The federal government will require a separate audit for each agency receiving more than $500,000. The state auditor said the extra auditing should not cost state agencies more than they are already paying for their regular auditing.

Adoption of Committee Work Plan and Meeting Schedule

Ms. Ray discussed with the committee the proposed work plan and meeting schedule. She presented a list of items the committee is proposing to study during the 2009 interim, and committee members made several additional requests for areas of study. Committee members also requested changes to meeting dates and locations, specifically requesting that the New Mexico Legislative Council allow a meeting in Raton August 27-28, switching the Cloudcroft meeting to September 14-15 and switching the Santa Teresa-Deming meeting to October 14-15. The committee adopted the work plan and schedule, subject to council approval. A copy of the approved work plan and schedule will be included with the July meeting materials.

Overview and Fiscal Impact of Economic Development Programs

David Lucero, principal analyst, LFC, and Susan Fleischmann, analyst, LFC, presented information to the committee regarding the cost of economic development programs implemented by the state. Mr. Lucero began by describing some of New Mexico's competitive disadvantages for economic development, and the recent Beacon Hill Institute's ranking the state thirty-eighth among states. That institute found that New Mexico ranked very low on many indicators, including health insurance, educational levels, mathematical skills, savings rate, high-speed internet lines and murder rate. The institute found that while the state has done a good job in improving its standing in some areas, including new jobs and small businesses, its under-investment in human capital development threatens the state's capacity for future economic growth.

Mr. Lucero said that economic incentives the state provides to attract business are fragmented among several agencies and performance outcomes. He identified several "best practices" for economic development incentives. Those include: a statewide strategic plan with one entity championing the plan; incentive agreements; incentives linked to performance; job retention requirements; and incentive clawbacks for non-performance. Mr. Lucero said that best-practice states include Utah, North Carolina, Delaware, Minnesota and Texas.

Mr. Lucero highlighted Utah's economic development strategic plan, which includes virtually no risk to the taxpayer; no capital investment incentives; performance milestones required in each incentive agreement; job retention requirements; sustainable job requirements; and clawback requirements. Since 2004 and until the recent national economic downturn, Utah has increased jobs from three percent to five percent, while New Mexico's job growth has only increased jobs from two percent to three percent.

While Utah only gives incentives after businesses have proven certain milestones, New Mexico has the opposite approach to incentives. In addition, New Mexico's incentives are scattered across state and local agencies, and performance outcomes are rarely measured. Additional problems include no statewide plan or budget, inconsistent and fragmented data collection and accounting, lack of consistent statewide performance outcomes and, in most cases, low-level performance measures. In conclusion, Mr. Lucero said that a new approach should be taken toward economic development in the state.

The committee questioned what the state should do differently. Mr. Lucero said that one possibility would be to create a unified board, composed of all the entities that oversee incentives, to create a statewide strategic plan with performance measures. He envisioned an organization in structure similar to the Interagency Behavioral Health Purchasing Collaborative. He also recommended looking into providing post-performance incentives, rather than the current practice of "buying jobs".

Another question from the committee was what the per capita income in Utah is. Mr. Lucero said that he would provide that information.

Concern was expressed by committee members regarding the value of some incentives that only provide a limited number of jobs. When those incentives are coupled with industrial revenue bonds, educational funding is also affected, since property tax collections decline. The committee said New Mexico needs to tie economic development tax credits to performance.

Also of concern was that some incentives have attracted less-desirable industries, rather than industries that enable employees to climb the career ladder. Mr. Lucero said that the state did a good job in developing the film industry and could do the same for developing "green" jobs.

Income Tax — Year-to-Date Revenue Report

Mr. Nunns and Gwendolyn Aldrich, economist, TRD, updated the committee members on the status of income tax revenues received by the state for calendar year 2009. Mr. Nunns began by describing how the consensus revenue estimate is developed. The Consensus Forecast Group is composed of career economists from the TRD, DFA, LFC and DOT. Estimates are now made in February, July, October and December and sometimes before special sessions. Forecasts for each tax attempt to take into account the economic outlook, changes in tax law, changes in administrative procedures and changes in accounting rules that will affect revenues over the forecast period.

For recent PIT and CIT forecasts, many special factors were taken into consideration, including tax law changes that changed 2007 liabilities but were paid by the state in fiscal year 2009 and federal law changes that gave extra depreciation allowances. The TRD also began imposing a penalty for underpayment of estimated taxes, and two accounting procedures were adopted that affect short-term estimates.

Ms. Aldrich described to the committee the five major components of PIT revenues, which include withholding, estimated payments, oil and gas proceeds withholding, final settlements and tentative payments and refunds.

The February 2009 consensus revenue estimate compared with accruals shows that PIT revenues are $47 million below the expected amount, and CIT revenues are $36.9 million lower than expected.

Mr. Nunns said that the TRD, DFA and LFC are looking at ways of improving revenue forecasts. One initiative involves economists and accountants from these agencies meeting to discuss how accounting procedures affect revenues. Finally, the TRD is drafting a new revenue forecasting manual that will document in detail how revenue forecasts are prepared. DFA and LFC economists will also contribute to the manual, he said.

It was noted by the committee that if 14 percent of current PIT revenues are due to penalties and interest, it demonstrates that many businesses are experiencing cash flow problems. Mr. Nunns said that the current revenue forecast did not take into account that many small businesses are in effect using the state as a creditor.

It was suggested that to predict the extreme volatility of oil and gas prices, economists should consult with local industry experts and use New Mexico industry trends, in addition to national forecasts.

Gross Receipts Revenue Comparison — Fiscal Years 2008 and 2009

Mr. Nunns and Clinton Turner, senior economist, TRD, provided the committee with a brief comparison of the revenue received by the state from gross receipts taxes for fiscal years 2008 and 2009. Mr. Turner began with a county map of New Mexico, showing the percentage of gross receipts generated in each county, with Bernalillo, Chaves, Dona Ana, Eddy, Lea, McKinley, San Juan and Santa Fe counties constituting the vast majority of economic activity in the state. Most of those counties have also experienced a reduction in gross receipts in the first three quarters of fiscal year 2009, with the notable exceptions of the oil- and gas-producing counties. However, as a whole, the state has seen increased gross receipts in fiscal year 2009, though not as robust as in previous years. Finally, Mr. Turner segregated gross receipts by category and identified the nearly two percent decline in retail trade and the minimal increase in construction activity as the major factors in the economic slowdown.

It was noted that the big jump in construction activity in southeastern New Mexico is probably due to the construction of the new Louisiana Energy Services enrichment facility.

Adjournment

There being no further business, the committee adjourned at 12:50 p.m.

REVENUE STABILIZATION AND
TAX POLICY COMMITTEE

Section 4

July 2009
Agenda
Minutes

Revised: July 9, 2009

TENTATIVE AGENDA
for the
SECOND MEETING IN 2009
of the
REVENUE STABILIZATION AND TAX POLICY COMMITTEE

July 14-15, 2009
Henderson Fine Arts Center
Farmington, New Mexico

Tuesday, July 14

9:00 a.m.	**Call to Order** —Senator John Arthur Smith, Chair
9:05 a.m.	**Welcome and Update** —Carol Spencer, President, San Juan College —Bill Standley, Mayor, Farmington —James Henderson, Chair, San Juan County Commission
10:15 a.m.	**Energy Tax Comparison Across States** —Beatrice Lucero, Senior Economist, Taxation and Revenue
Department	(TRD)
11:15 a.m.	**Production Update, Regional Market Differentials, Oil and Gas Forecasting Process** —Laird Graeser, Chief Economist, Department of Finance and Administration —Beatrice Lucero, Senior Economist, TRD —Rebecca Gutierrez, Economist, Legislative Finance Committee (LFC)
12:30 p.m.	**Lunch**
1:15 p.m	**Valuing Oil and Gas Property** —Rick Silva, Director, Property Tax Division (PTD), TRD —Michael O'Melia, Deputy Director, PTD, TRD —Mitch Bonney, Bureau Chief, State Assessed Properties Bureau, PTD, TRD
2:45 p.m.	**Managing Volatility of Oil and Gas Revenue** —Thomas Clifford, Chief Economist, LFC

3:45 p.m.	**Motor Vehicle Code Recompilation** —Rick Homans, Secretary of Taxation and Revenue —Michael Sandoval, Director, Motor Vehicle Division, TRD
4:45 p.m.	**Recess**

Wednesday, July 15

9:00 a.m.	**Capital Gains Taxes** —Richard Anklam, Executive Director, New Mexico Tax Research Institute (NMTRI)
10:30 a.m.	**Blue Ribbon Tax Reform Commission Review and Recommendations** —Jim O'Neill, Consultant
11:30 a.m.	**Cable Industry Property Valuation and Tax Update** —Pat Dolahanty, Vice President and Treasurer, Cable One —Scott Scanland, Lobbyist, Arizona-New Mexico Cable Association
12:30 p.m.	**Adjourn**

MINUTES
of the
SECOND MEETING IN 2009
of the
REVENUE STABILIZATION AND TAX POLICY COMMITTEE

July 14-15, 2009
Henderson Fine Arts Center
San Juan College
Farmington, New Mexico

The second meeting of the Revenue Stabilization and Tax Policy Committee (RSTP) for 2009 was called to order on July 14, 2009 by Senator John Arthur Smith, chair, at 9:10 a.m. in the Henderson Fine Arts Center of San Juan College in Farmington, New Mexico.

Present	**Absent**
Sen. John Arthur Smith, Chair	Sen. William E. Sharer
Rep. Edward C. Sandoval, Vice Chair	
Sen. Carlos R. Cisneros	
Rep. Nathan P. Cote	
Rep. Anna M. Crook	
Sen. Dianna J. Duran	
Sen. Tim Eichenberg	
Rep. Keith J. Gardner	
Sen. Timothy Z. Jennings	
Sen. Timothy M. Keller	
Sen. Gay G. Kernan	
Rep. Ben Lujan, Speaker of the House	
Rep. Rodolpho "Rudy" S. Martinez	
Sen. Howie C. Morales	
Rep. Henry Kiki Saavedra	
Rep. Thomas C. Taylor	
Rep. Jim R. Trujillo	

Designees	
Sen. Steven P. Neville	Rep. Ray Begaye
	Sen. Mark Boitano
	Rep. Donald E. Bratton
	Sen. Kent L. Cravens
	Rep. Miguel P. Garcia
	Rep. Sandra D. Jeff
	Sen. Carroll H. Leavell
	Rep. Antonio "Moe" Maestas
	Rep. Debbie A. Rodella
	Sen. Nancy Rodriguez
	Sen. Bernadette M. Sanchez

Sen. John M. Sapien
Rep. Don L. Tripp
Rep. Luciano "Lucky" Varela
Sen. Peter Wirth

Other Legislators Attending
Rep. James R.J. Strickler (July 15)

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

Staff
Pam Ray, Staff Attorney, Legislative Council Service (LCS)
Doris Faust, Staff Attorney, LCS
Ric Gaudet, LCS

Guests

The guest list is in the meeting file.

Handouts

Copies of all handouts and written testimony are in the meeting file.

Tuesday, July 14

Welcome and Update

Carol Spencer, president, San Juan College, welcomed committee members to the college. She said that the college's budget has been affected by recent oil and gas price volatility and the current budget has already been cut by three percent. So far, the college has not had to layoff any employees, but if revenues continue to decline, furloughs may become necessary. Enrollment at the college is increasing tremendously, with 14,000 students expected to enroll for the fall 2009 semester.

Bill Standley, mayor of Farmington, briefed the committee on the city's fiscal state. He said that the Farmington metropolitan area ranks among the lowest in the nation for unemployment, demonstrating the long-term commitment of the extraction industry to the area. Although the city has received 10 percent less in gross receipts tax (GRT) revenues from natural-gas-related activities, there has been a two percent increase in retail GRT collections this year. He said that property tax valuations for the area are down a bit from last year. Finally, Mayor Standley told the committee that the Public Service Company of New Mexico (PNM) recently completed a $300 million upgrade to its power plant, which has improved the air quality. The area ranks seventh in the nation for short-term air particulates, he said.

James Henderson, chair, San Juan County Commission, described recent developments in San Juan County. The county is moving toward establishing zoning ordinances, since much of the recent growth in the county has been in unincorporated areas.

The county is also trying to develop alternatives to septic systems, which have been causing problems in some areas. The regional medical center was completed in November 2008, and a substance abuse and DWI facility will be completed soon. Finally, Dr. Henderson said that the county is attempting to find funds to chip seal the Chaco Canyon road.

Tony Atkinson, the new president of the New Mexico Association of Counties (NMAC), introduced himself to the committee and said that the NMAC would present its concerns to the committee in September. He said that the NMAC will reappoint a property tax education committee this year. A committee member asked if county assessors will be able to comply with the newly enacted real estate property tax disclosure law, which requires county assessors to disclose estimated property taxes on properties to potential buyers. Mr. Atkinson said that he did not think that compliance would be very difficult.

The committee asked about GRT trends in Farmington. Mayor Standley said that although GRT collections from last year are up slightly, there has been a 12 percent drop in the past two months. He said that Farmington has the highest occupancy rate in the state and that a new Marriott hotel is being constructed. The price of natural gas determines whether operators keep wells operating, which affects GRT collections. With the average price of natural gas down significantly from last year, many operators are instead recapitalizing and waiting for the price to go back up before pumping again. In addition, the new pit rules promulgated by the Energy, Minerals and Natural Resources Department (EMNRD) had an initial large negative impact on well drilling and operation. Some companies have moved operations across the border into Colorado, he said.

A committee member said that the Four Corners economy has a huge impact on the state. The state's budget had been set based on natural gas prices of $4.70 per million British thermal units (MMBTU), but the average price that day was only $2.98 per MMBTU. The member said he expects a special session in the fall because revenues are seriously declining.

A committee member asked if nonprofit entities in the Farmington area have suffered from the economic downturn. He expressed concern that people in need of services will not be cared for if nonprofits close. Mayor Standley said that the extraction industries have been huge contributors to nonprofits in the past. He said that the key to helping people thrive is in creating jobs. He also said that fundraising by the United Way in Farmington exceeds the level raised in Albuquerque.

A committee member asked about the San Juan College budget. Ms. Spencer said that the college's budget was cut by the legislature by $800,000 and that the current revenue projections for the year are down 2.5 percent. She said that although enrollment is increasing at the college, the state higher education funding formula does not increase funding correspondingly for a couple of years. She said that the community college board has made a commitment to keeping tuition low, but that it did raise rates this year.

A committee member commented that downturns in the oil and gas industry seem to show up in the Farmington economy six to 12 months later. He cautioned that the area may have not seen the full impacts of the downturn. Another committee member said that Farmington has the highest per capita gross receipts in the state. He also said that he did not understand why Santa Fe County is so resistant to energy development.

Energy Tax Comparison Across States

Beatrice Lucero, senior economist, Taxation and Revenue Department (TRD), briefed the committee about how different states tax coal and other energy resources. There are four basic types of coal, with increasing carbon content and corresponding heat values: lignite, subbituminous, bituminous and anthracite. New Mexico deposits are subbituminous and bituminous. Energy production is the primary use for coal and accounts for approximately 50 percent of all electricity produced in the United States. In 2008, total coal production in the U.S. was nearly 1,200 million short tons (MST), with New Mexico accounting for 25.6 MST that year. Although producing a relatively small quantity of coal, New Mexico is the third-largest subbituminous producing state. Average coal prices vary by state, often due to the type of coal being produced and whether the mines are surface or underground. The average price per ton of coal in the U.S. in 2007 was $26.20, and the New Mexico average was $29.91. Ms. Lucero noted that the extremely low average price for Wyoming coal skewed the national average downward.

All of New Mexico's coal is currently produced in the San Juan Basin, said Ms. Lucero. Sulfur content of New Mexico coal is generally lower than the national average, which means that coal from New Mexico burns cleaner. About 69 percent of New Mexico coal is sent to electric generating stations in New Mexico, with the remainder being shipped by rail to Arizona. Coal is used to produce 77 percent of the electricity produced in New Mexico. Ten years ago, the coal-based percent was 86 percent. Increased electricity generation from natural gas and renewable sources account for the shift, said Ms. Lucero.

Severed coal in New Mexico is taxed at $.57 per short ton for surface coal and $.55 per short ton for underground coal, with the revenues being distributed to the Severance Tax Bonding Fund. In addition to the severance tax on coal, a coal surtax is imposed on some of the coal produced in New Mexico. The tax has varied over the years and is currently set at $1.02 per short ton of surface coal and $.99 per short ton for underground coal. A complicated set of exemptions from the coal surtax has been enacted, with the result today that less than one-half of coal severed in New Mexico is subject to the surtax. New Mexico coal is also subject to the resources excise tax, which is actually composed of the resources tax, the processors tax and the service tax. Currently, only the resources tax is in effect. After deductions, including deductions made for royalties paid, the resources tax is imposed at .75 percent of the value of the coal. The final tax imposed on coal is the conservation tax, which is imposed on the value of the coal, after deductions, at the rate of .19 percent. Nearly all of the collections made pursuant to the resources tax and the conservation tax are distributed to the general fund.

Comparing underground and surface coal and surtax-exempt and nonexempt operations, Ms. Lucero concluded that the per unit tax and higher prices received for underground coal result in much lower effective tax rates for underground coal than for surface coal. Ms. Lucero also calculated revenue losses to the state from the exemption from the coal surtax, which in 2008 totaled $9.2 million.

In order to calculate the total taxes imposed on coal and its effective tax rates, Ms. Lucero also factored in property taxes on coal properties and the GRT, which is imposed on the sale of nearly all coal in New Mexico. The total average production taxes on coal (severance taxes, etc.) are imposed at the rate of 4.11 percent of the total value of the coal. Nonproduction taxes (GRT, property tax) added 6.23 percent to the tax rate. In total, New Mexico has an effective tax rate on coal of 10.34 percent.

Ms. Lucero briefly discussed some of the rationale for taxing natural resource production, including offsetting the negative environmental consequences of exploration, production, transportation, refining and combustion of the resource.

Ms. Lucero then compared production and nonproduction taxes of coal to oil and natural gas in New Mexico. While coal in New Mexico on average is taxed at a total effective rate nearly three percent higher than oil or natural gas, comparing different types of coal production shows that underground coal has production taxes much lower than all other resources. In addition, by comparing total effective taxes when measured per MMBTU, per short ton of carbon content or per short ton of carbon dioxide emissions, coal is shown to be taxed at much lower rates than oil or natural gas.

Ms. Lucero compared New Mexico's effective tax rates on coal with other western states. Although this type of analysis is difficult to perform because of the many different types of tax systems in place, taxes were categorized into production taxes, property taxes and sales taxes. New Mexico's total effective tax rate of 10.34 percent was lower than Montana's 14.51 percent, but was higher than the four other states that were studied. Although New Mexico taxes are high compared to most other western states, Wyoming, which produces the most coal in the nation, has an effective tax rate of 9.75 percent, very close to New Mexico's tax rate.

Ms. Lucero next described the structure of taxes on oil and gas in New Mexico and compared tax rates with other states. Both oil and gas are taxed at slightly different rates using the same taxation structure. The oil and gas severance tax, the oil and gas emergency school tax and the oil and gas conservation tax are based on the value of the severed product, and the production ad valorem tax and the production equipment ad valorem tax are imposed essentially in lieu of property taxes, said Ms. Lucero. The total current production taxes on oil amount to 8.27 percent; and on natural gas, 8.97 percent. Compared to eight other oil- and gas-producing states, New Mexico ranks in the middle for taxation of oil and below the middle for taxation of gas.

Finally, Ms. Lucero compared oil and gas combined tax and royalty rates with the same other states, which would apply only to production on state lands. Under this comparison, total royalties and taxes paid to New Mexico are the second lowest, only above Colorado. However, Ms. Lucero noted that a recent Colorado attorney general ruling allowed that state to increase its severance taxes without regard to a provision in its constitution limiting revenues collected by the state. Immediately after that ruling, severance taxes on coal were increased, and those taxes on oil and gas are expected to increase soon.

A committee member asked how many people in New Mexico are employed by energy companies. Ms. Lucero said she will provide that number to the committee. Another committee member said that the TRD research did not reflect income taxes imposed on energy production, which unfairly skewed the results. Ms. Lucero responded that states tax income very differently and that her research focused on the production of resources.

A committee member asked why some coal production is exempt from the coal surtax. Ms. Lucero said that she did not know why the exemptions were enacted, but she said that the two underground mines that currently benefit from the exemption, BHP Navajo and BHP San Juan, both have no transportation costs, are vertically integrated and have long-term contracts in place.

A committee member asked whether the royalty comparisons factored in federal royalties. Ms. Lucero said that this study did not study federal royalties. She said that although New Mexico generally receives one-half of federal royalties, it would not be accurate to factor those royalties into a state-by-state comparison of effective taxes and royalties.

A member of the committee said that many oil and gas companies moved to Colorado following the EMNRD's onerous pit rules. He also suggested that the Oil Conservation Division of the EMNRD change a rule to allow wells every 80 acres rather than the current 160 acres. That rule change would reduce operating costs and reduce the need to maintain so many roads. He said that New Mexico should give tax breaks to companies operating oil rigs, which provide decades of employment, rather than film companies, which come and go with short-term productions.

A committee member commented that although New Mexico has about-average tax rates for resource extraction, it has high regulatory costs. Another committee member said that the EMNRD pit rule has actually increased air particulate hazards because residue from well sites must now be hauled away, rather than allowing for remediation on-site.

Production Update; Regional Market Differentials; Oil and Gas Forecasting Process

Ms. Lucero, Laird Graeser, chief economist, Department of Finance and Administration (DFA), and Becky Gutierrez, economist, Legislative Finance Committee (LFC), briefed the committee on how state agencies forecast oil and gas revenues for the state. Mr. Graeser described the basic model for estimating oil- and gas-related revenues to the general fund. That model entails calculating the gross production value from actual volumes produced and the Oil and Natural Gas Administration and Revenue Database (ONGARD) reported price; deducting royalties and processing and transportation costs to calculate the net taxable value; calculating taxable obligations; and multiplying that amount by an estimate of the percent of obligations that actually will be paid to the state. That model gives state economists an ability to predict what the revenues to the general fund will be.

Ms. Lucero expanded on the methodology presented by Mr. Graeser to describe the TRD's oil and gas revenue forecasting process. The department uses many data sources for revenue forecasting, including the ONGARD system, the PIRA Energy Group, Global Insight, the Energy Information Administration (EIA), NYMEX, the New Mexico Institute of Mining and Technology, Platts and the Conoco-Phillips Morning Report. Volumes are predicted using actual historical trends reported in the ONGARD system. Both oil and natural gas volumes have been declining at a one to two percent rate per year. For oil, the consensus revenue group, composed of career economists from the DFA, TRD and LFC, in February 2009 predicted an annual one percent decline in production for fiscal years 2010 through 2012 and a .7 percent decline for fiscal year 2013. Natural gas volumes are predicted to decline over the next four years, but with steeper decline rates, ranging from 1.5 percent to 3.7 percent annually.

Forecasting oil and gas prices has been a more difficult process than forecasting volumes. The TRD uses NYMEX futures contracts, Global Insight's long-term forecasts for West Texas intermediate crude oil and the EIA's long-term forecast for that oil. However, since the prices received by New Mexico producers differ significantly from those forecasts, the TRD maintains a database that reflects historical differentials of average monthly prices by basin. In preparing the February 2009 forecast, the economists used short-term price ratio differentials, due to the extreme volatility of oil prices since August 2008. The consensus revenue group forecast a rate of decline of oil prices for fiscal year 2010 of 24 percent, but prices were expected to increase between nine and 13 percent annually for the subsequent three years. Natural gas prices have seen a similar variation in expected prices in the last year. The TRD uses four sources to forecast gas prices and also uses historical databases to calculate price differentials. The February 2009 consensus forecast expected the average price of gas to decline in fiscal year 2010 by 14 percent but rebound by nearly 30 percent the following year. To finish the oil and gas revenue forecasting model, Ms. Lucero described how deductions and tax credits are factored into the predictions, and finally, an estimate of revenues collected by the state from the various taxes imposed on oil and gas production is produced. While total oil and gas tax revenues are predicted to drop in fiscal year 2010 by more than $300 million from the previous year, revenues are expected to increase in fiscal year 2011 and approach fiscal year 2009 levels by fiscal year 2013.

Mr. Graeser presented to the committee some modeling techniques he is experimenting with in order to better predict oil and gas revenues. In particular, he has begun to track how changes in oil and gas prices affect production levels. As prices rise, companies are encouraged to drill more wells, offsetting the natural decline in volumes somewhat. However, it appears that if production is sensitive to price, there is a lag of about 10 calendar quarters for response time. In addition, Mr. Graeser said that his data show that natural gas production volumes in the San Juan Basin seem to be more a function of technology and geology, but volumes in the Permian Basin seem to be more price sensitive. Mr. Graeser presented data that imply that oil production in the Permian Basin on state and federal leases will increase in the next few years, which will lead to an increase in royalty payments to the state.

Mr. Graeser discussed other complications in predicting oil and gas revenue, including the delay in reporting deductions. While royalties are reported at 98 percent of final value within three months of the due date, transportation and processing deductions are generally not known to that level of accuracy for 17 months. Understanding the delay in reporting helps economists predict quarterly revenues the state will collect. Finally, Mr. Graeser discussed how tracking drilling rigs in the state can lead to better predictions of future revenue.

Ms. Gutierrez described to the committee the oil and gas revenue forecasting process as it relates to federal and state leases. She began with federal lease revenue, which mainly involves knowing the production volumes and the prices of the products. Oil production on federal lands accounts for 42 percent of all oil production in the state, and natural gas production on federal lands accounts for 63 percent. Ms. Gutierrez said that there is typically a three-month lag between the reporting of ONGARD data and federal mineral revenues to the general fund.

The State Land Office manages leases on state land and collects royalties and revenue from rents, leases and bonuses. Royalties from gas production are remitted at 16 percent of value and for oil at 38 percent of value. Revenue is distributed according to the type of collection. Most of the revenue from rents, leases and bonuses is dedicated to the Common School Fund but in effect is deposited into the general fund. Distributions in fiscal year 2008 were $46 million and are expected to be $36 million for fiscal year 2009, said Ms. Gutierrez. Royalties collected are deposited into the Land Grant Permanent Fund, which is invested on behalf of 21 trust land beneficiaries. Three hundred ninety million dollars was distributed to the general fund in fiscal year 2008.

A committee member asked why the TRD projected a 2.4 percent increase in gas production for fiscal year 2011. Ms. Lucero said that this is based on economic recession-related declines and that production would return to expected production levels when the recession ends. The committee member commented that New Mexico's budget will be based on the assumption that the recession will be over by the end of 2009. He also said that the TRD projection of an increase in production skews the rest of the consensus projection, since the other entities involved predict a decline in production during that same period. In addition, the EMNRD's pit rule will probably negatively affect production. The committee member asked for a comparison of several consensus forecasts to actual reported levels.

A committee member questioned the validity of assuming a gas price of $4.80 per MMBTU, when the current price is $2.95. He said that for every $1.00 increase in the price of gas, the state receives about $100 million in revenue.

A committee member asked about the relationship between drilling rigs and production. Mr. Graeser said that oil production of existing wells typically drops 12 to 13 percent per year, but that new wells replace about 10 percent of that loss.

A committee member asked how leases on Indian lands were accounted for in the presentations. Ms. Lucero said she will provide that information. The committee member commented that since royalties are not deductible against ad valorem taxes on private land, it would be beneficial for companies to have leases on state land, which, in turn, would bring more revenue to the state. Finally, he asked whether the February 2009 consensus projection of oil selling at $44.00 per barrel is valid. Mr. Graeser said that the August estimate will probably have a much higher price for oil.

Valuing Oil and Gas Property

Rick Homans, secretary of taxation and revenue, Rick Silva, director, Property Tax Division (PTD), TRD, Michael O'Melia, deputy director, PTD, and Mitch Bonney, bureau chief, State Assessed Property Bureau, PTD, gave a presentation to the committee on how oil and gas property is valued for taxation purposes. Mr. Silva began by discussing the three main property taxes imposed on the industry, including the oil and gas ad valorem production tax, the oil and gas production equipment ad valorem tax and the general property tax. These taxes are all distributed to the regular property tax recipients, including counties, municipalities, school districts and universities, and the actual millage rates are determined in accordance with the system of determining other regular property tax rates. What this means in practice is that the valuation of oil and gas property has an effect on the millage rate of other property taxes, including residential property taxes.

The oil and gas ad valorem production tax is the largest property tax generated by the oil and gas industry, which brought in $184 million in 2008. The tax base is calculated as 150 percent of the value of the oil or gas product after deducting royalties paid to governmental entities and transportation costs. That value is then divided by the uniform assessment ratio of three and multiplied by the applicable millage rate for the location at which the production occurs.

The similarly monikered oil and gas production equipment ad valorem tax is a tax on equipment used in the severing of oil and gas, but the taxable value of equipment is valued based on the value of the severed product, and not the net book value of the equipment, which is how business property for other industries is valued. The tax is calculated by taking 27 percent of the production value, multiplying that by the uniform assessment ratio of one-third and applying the millage rate for that location.

The last property tax assessed on oil and gas industry property is the property tax that is assessed on all property in the state. Certain types of oil and gas property, including pipelines, tanks, meters and plants used in processing, are valued using a statutory special method of valuation. The State Assessed Property Bureau performs assessments on these properties and uses net book value as the basis for valuations.

Mr. Silva then compared property taxation figures of oil and gas property to other types of property. While the weighted average millage rate for all classes of property in New Mexico is 2.8 percent of net taxable value, the average millage rate for oil and gas assets is slightly lower at 2.4 percent. Most taxable property in New Mexico is real property and thus not subject to depreciation. Most oil and gas property, however, is able to be depreciated. Currently, oil and gas assets in the state are depreciated at 44 percent.

An average 2.2 percent of the taxable value of property in New Mexico is protested each year. However, this year, 16 percent of the oil and gas valuation was protested, compared to three percent for other business sectors. One of the key reasons for such high valuation protests, said Mr. Silva, is that current rules for allowing obsolescence claims for depreciated or unused equipment are confusing and new language was recently adopted by the legislature. The division has proposed new rules to govern obsolescence claims, under which companies will need to document an obsolescence claim. That proposed rule has encountered opposition from the oil and gas industry, said Mr. Silva.

A committee member said that he has heard from industry people that the proposed rule seems overly complex and unnecessarily burdensome. Mr. Bonney responded by saying that the rule is merely requiring industry to provide documentation of expectations of its equipment. For example, a pipeline that is designed to operate at 80 percent of capacity is fully functional at that rate of flow. An obsolescence claim would not be valid under those circumstances. He said that the oil and gas industry has requested guidelines on obsolescence claims for 10 years.

A committee member said that it is bad policy for the state to tax certain classes of property based on capacity. Mr. O'Melia said that property tax values are based on actual costs. Obsolescence refers to a mechanism for the industry to reduce valuations based on actual circumstances.

Secretary Homans said that the TRD held a public hearing on the proposed rule and has received feedback from the oil and gas industry. Industry concerns will be taken into account, and if the department makes any substantive changes to the rule, new hearings will be held.

A committee member asked if property valuation litigation involving two oil companies had been resolved. Mr. O'Melia said that the issues have been resolved after seven years of litigation. The PTD ended up negotiating property values with the companies.

A committee member said that industrial property valuations are problematic. Taxes that are paid under protest go to a suspense fund and not directly to the county, which can cause significant budget problems in small counties. Mr. O'Melia agreed, and said that the desire to reduce the amount of valuation protests is the main reason the new rule has been drafted. He said that companies under the new rule will need to document obsolescence. Secretary Homans said that the final rule will be as simple and fair as possible to the oil and gas industry.

The minutes from the June 11-12, 2009 meeting of the committee were adopted without changes.

Managing Volatility of Oil and Gas Revenue

Tom Clifford, chief economist, LFC, gave a presentation to the committee on how the state can better manage oil and gas revenue. Direct and indirect revenues from oil and gas production make a major contribution to financing government in New Mexico. Although those revenues play a major role in government budgets, volatility in prices and production levels as well as long-term sustainability of those revenues create challenges for policymakers. Volatility has increased dramatically since 2000, both from speculation and fundamental factors, said Mr. Clifford.

Mr. Clifford used fiscal year 2008 figures to illustrate the sensitivity of state and local government budgets to price changes in oil and gas. When the price of oil changes $1.00 per barrel, total revenues to state and local governments change a corresponding $8.9 million. A $.10 change in the price of natural gas has a resulting impact of $18.8 million. The huge changes in the prices of both commodities in recent years demonstrate how difficult government budgeting has become, said Mr. Clifford. The negative impacts of overestimating revenues from oil and gas far exceed the positive impacts of underestimating those revenues.

Mr. Clifford discussed four strategies that policymakers could use to manage oil and gas revenue volatility, which include hedging, risk-adjusting revenue forecasts, increasing reserves and making sharper distinctions between recurring and nonrecurring revenue.

Hedging against oil and gas revenue volatility could be used, but hedging contracts would probably cost the state significant premiums. The DFA estimated that insuring the balances of one-fourth of the Severance Tax Permanent Fund for one year would cost $20 million. In addition, after a hedging contract ends, revenues would again become subject to volatility. Mr. Clifford remarked that the state would need to determine the balance between risk and return to the state. Currently, the state accepts the high risk of revenue volatility in order to benefit from the possible gain in return from high prices.

The methodology for generating consensus revenue estimates could also be modified, said Mr. Clifford, including using range estimates that would highlight the level of uncertainty in a given forecast and consulting with industry and economic experts to help assess the risk associated with a forecast. Mr. Clifford also suggested that New Mexico investigate the use of outside experts in helping to determine oil and gas revenue forecasts and volume forecasts.

The third approach the state could take would be using reserves as a risk management tool. However, Mr. Clifford said that because errors in forecasts tend to be compounded in the current year and the budget year, reserves need to be set to cover one and one-half years, rather than the current practice of one year. That would require a 15 percent reserve, up from the current 10 percent.

Finally, the state could classify some revenue as nonrecurring, which could avoid the need to cut services and payrolls in the future while making funds available immediately for short-term uses. However, if the recurring level is set too low, large amounts of revenue would be treated as nonrecurring, and if set too high, projected revenue could easily be higher than actual revenue, requiring that reserves be drawn down.

Mr. Clifford then discussed other issues that may affect the production and revenue generation of the oil and gas industry. He said that severance taxes are generally paid by New Mexico investors, workers and property owners, rather than those entities that use the products. The corporate income tax (CIT) also adds significant tax burdens to the industry, compared to other oil- and gas-producing states. In addition, New Mexico's oil and gas output is in a long-term decline, and without additional investment, the decline will accelerate. That trend requires the state to consider its own policies in relation to the long-term impacts on production.

In conclusion, Mr. Clifford recommended that the state increase general fund reserve targets, use more conservative price assumptions and earmark some revenue for budget stabilization. Finally, Mr. Clifford suggested that the state undertake a comprehensive study of all taxes imposed on the oil and gas industry compared to other states, including different designs for how severance taxes are imposed. Finally, the state should commission an engineering study of the long-term production outlook for oil and gas.

A committee member questioned whether Mr. Clifford was correct in asserting that New Mexico highly taxes the oil and gas industry in relation to other states. He also said that most analyses of tax burdens he has heard have come to very different conclusions, depending on the biases of the presenters.

A committee member said that New Mexico's current reserve includes two funds that actually cannot be used without legislative approval, which amounts to not being reserves at all. In fact, the general fund reserves are actually only two percent, rather than the claimed 10 percent. He agreed that actual general fund reserves need to increase significantly.

A committee member said that although reserves are important, setting a reserve level too high also causes problems. Another committee member agreed and said that reserve levels were increased at the behest of the LFC because oil and gas revenue volatility recently became a major issue.

A committee member wondered whether the oil and gas industry would be interested in having CITs abolished in exchange for an increase in royalties paid. Mr. Clifford said that the CIT structure is very complicated and is volatile as well.

Motor Vehicle Code Recompilation

Secretary Homans and Michael Sandoval, director, Motor Vehicle Division (MVD), TRD, discussed with the committee the need for and proposed process to rewrite and recompile the Motor Vehicle Code. Secretary Homans began by describing the results of a needs assessment completed in 2006, which provided a road map to "fix" the MVD in three key areas: technology, operations and customer service. The assessment made recommendations, many of which are being implemented, including development of a user-friendly web site, a new driver and vehicle registration system, an improved automated call center, the simplification of MVD fees and a rewrite of the Motor Vehicle Code to provide consistent policies and clear direction to MVD staff and customers. Secretary Homans said that sometimes different offices of the MVD provide slightly different interpretations of statute, leading to inconsistencies and problems.

The Motor Vehicle Code is quite extensive and provides the MVD with the authority to administer business functions. Over time, the code has become complex and disjointed and currently contains many conflicts, inconsistencies and areas in need of clarification. These inconsistencies cause confusion and frustration for MVD staff and customers of the agency, said Secretary Homans. Citing just one example, he explained how current statutes relating to vehicle title transfers on death do not specify either how long after death can a vehicle be titled to heirs, nor do they state the standard of proof to be provided. The TRD, partnering with the University of New Mexico Institute of Public Law, worked with affected MVD user groups to identify conflicts, inconsistencies and unclear statutes. Over 60 areas in the code were identified that need improvement, said Secretary Homans.

Mr. Sandoval led the committee through the MVD's proposed time line and revision process of the Motor Vehicle Code. The first stage would be to recompile existing sections into more useful arrangements, including creating new articles in law relating to driver's licenses and identification cards; titles, registrations, plates and permits; and fees and distributions. The MVD is proposing to the New Mexico Compilation Commission that it recompile those sections prior to the 2010 legislative session if possible. Stage 2 of the code rewrite involves making technical and nonsubstantive changes to the code. The following year, the legislature would tackle stage 3, addressing the various substantive issues that need resolving, some of which could be controversial. An example of a minor substantive change includes addressing the inconsistent vision test requirements for renewal of driver's licenses, as licenses can be renewed for either four or eight years. A slightly more problematic substantive issue that needs to be resolved is development of testing, age and motor size requirements for motorcycle endorsements. Finally, DWI statutes have some inconsistencies, but any changes to them will involve major efforts due to the high public interest in that area of law.

The TRD has sent a letter to the New Mexico Compilation Commission requesting that it recompile Motor Vehicle Code statutes. If that recompilation is determined to need legislative action, the TRD will submit recompilation legislation to the 2010 legislature. If the commission recompiles the statutes without legislative action, the TRD will submit stage 2 legislation in the upcoming session.

A committee member said that many rural MVD offices need to call the main MVD office to clarify the interpretation of statutes. She related a story about a young constituent who spent more than one month attempting to fulfill the requirements in obtaining a first-time driver's license. She also suggested having the MVD administer the young driver education course, rather than the Department of Transportation (DOT).

A committee member said that it should not take longer than one day for a person to get a driver's license. He also said that he is opposed to the TRD selling driver information. Finally, he said that tow truck operators have a very difficult time obtaining titles for abandoned vehicles. Secretary Homans said that people already have the right to access driver information via the Inspection of Public Records Act, which is a very cumbersome process. A database to provide that information allows many industries quick access to driver information.

Responding to a question about the cost of the new driver's license and vehicle registration system, Secretary Homans said that the TRD is in the middle of a request for proposals (RFP) process, but that the cost will be in the millions of dollars.

Representative Taylor said that he was very concerned that Secretary Homans provided justification for a sole-source contract the TRD entered into for the driver information database by referring to House Bill 12 of the 2009 session, sponsored by Representative Taylor. Representative Taylor said that the bill mostly provided for a five percent reduction in fees for online vehicle registrations and made certain fees available for the operation of the MVD. The bill had nothing to do with the driver information database, said Representative Taylor, and a letter that Secretary Homans wrote to Senator Smith suggesting that it did was untrue.

Secretary Homans said that he was sorry if Representative Taylor read his letter in the wrong way. He also said that he was bothered by the suggestion that he had been dishonest in discussing the driver information database. He said the project has always been very open, that the contract was not a sole-source procurement and that the TRD has had the ability to provide such a database for several years. What House Bill 12 did, however, was to allow the MVD to keep the royalties and certain fees. That provision was the final step that allowed the MVD to proceed with the RFP. He also said that an audit of one of the previous database contractors, Oso Grande, showed that the company had no control over the security of driver information, which violated both its contract and state law. Finally, Secretary Homans said that the cost of access to the database will be lower than the national average for such information.

The committee requested that Secretary Homans review the letter sent to Senator Smith and provide any clarification or corrections.

A committee member suggested that the TRD include motor vehicle hobbyist groups in pertinent discussions about the Motor Vehicle Code rewrite. He also asked whether tickets issued to motorists by a red-light camera system are reported to the state. Mr. Sandoval said that records of those tickets are not reported.

Committee members suggested that the MVD allow for 24-hour MVD customer services at kiosk stations; that driver's license applicants be allowed to take the driving test the same day as the written test; and that more training be provided to MVD employees.

The committee recessed at 5:25 p.m.

<u>Wednesday, July 15</u>

Senator Smith reconvened the committee at 9:12 a.m.

Capital Gains Taxes

Richard Anklam, executive director, New Mexico Tax Research Institute, presented to the committee issues raised by income tax treatment of capital gains. Capital gains are defined as increases in the value of capital assets. Gains on corporate stocks account for the largest component of U.S. capital gains, with pass-through entity gains and mutual fund distributions making up large shares as well. According to the federal Internal Revenue Service, over 90 percent of net capital gains are classified as long-term gains, or those assets that had been held for more than one year. Since it is difficult to tax capital gains as they accrue value, federal tax law has traditionally taxed gains only upon realization. Long-term capital gains are given preferential tax treatment; they are taxed by the federal government at a lower rate than ordinary income, set at a maximum of 15 percent, compared to an ordinary top income tax rate of 35 percent. Mr. Anklam said that the Obama administration has indicated it wants to maintain a preferential rate for capital gains, but taxed at a higher rate of 20 percent.

For states that "piggyback" on federal tax law, like New Mexico, capital gains are fully included in adjusted gross income and thus are subject to full state taxation. In 2003, in an attempt to attract high-income residents to the state, New Mexico enacted a phased-in deduction from capital gains up to 50 percent. The fiscal impact from those increased deductions in 2006 was about $60 million and about $80 million in 2007.

It has been argued that New Mexico's generous preferential treatment of the taxation of capital gains reduces the progressivity of the state's income tax structure. Some economists suggest that the 2003 reduction to the capital gains tax base should be modified to restore progressivity to the income tax system. However, other economists counter that argument by claiming that if New Mexico aggressively redistributes wealth, wealthy taxpayers will leave the state, leaving the remainder of its residents in a "race to the bottom". If a business owner sells a business, the person may choose to relocate to another state to avoid paying high capital gains taxes. However, Mr. Anklam suggested that if that is perceived as a problem, the state could specifically target for exemption the sale of closely held businesses. Another argument for maintaining capital gains deductions is that the allowance of a large deduction reduces to some degree the volatility of the state's income tax collections.

Compared to neighboring states, New Mexico has the most generous treatment of the taxation of capital gains. Some states do not have any preferential treatment, while others provide some but limit that preference to investments made in the state.

In conclusion, said Mr. Anklam, if policymakers are considering changes to the structure of capital gains taxation, they might consider limiting preferential tax treatment to

New Mexico investments, which would achieve some of the stated policy goals of the 2003 tax law changes but would not cost the state so much in lost revenue. He cautioned that any reductions to the preferential tax treatment in the short term will not bring in much revenue to the state due to the current state of the economy. After the economy recovers, however, the state would realize more revenue from a less preferential treatment, he said. Another possibility, although seemingly impossible given today's economic realities, would be to expand the capital gains deduction for economic development purposes. This expansion could encourage new business in the state and in the short term would not cost the state very much in lost revenue.

Committee members asked about the reported problem of people who sell businesses and then move to another state to avoid paying New Mexico capital gains taxes. Mr. Anklam said that it is very difficult to gather that sort of data, except anecdotally. The reduction of personal income tax, coupled with deductions from capital gains, most likely have reduced that problem, he said.

A committee member said that tax burdens need to be examined in their entirety and not just individually.

Blue Ribbon Tax Reform Commission Review and Recommendations

Jim O'Neill, former tax policy advisor for the TRD and staff to the 2003 Blue Ribbon Tax Reform Commission, reviewed for the committee the work and recommendations of that commission, much of which is still relevant today. The commission consisted of 23 members appointed by the governor and legislature. The commission met seven times during the 2003 interim, with additional committees meeting to focus on specific tax law areas. The commission considered 196 proposals and adopted 71. About one-third of the commission's recommendations have been adopted in some form since 2003.

Although the commission was created to reform New Mexico's tax system, its ability to make significant reform was hampered by drastic personal income tax (PIT) cuts enacted earlier that year. With much of the state's surplus suddenly taken away, reform proposals that cost money were unable to garner support. Additionally, said Mr. O'Neill, many of the final recommendations from the commission were not favorably received by the governor, who had his own ideas about tax reform. Mr. O'Neill said that the PIT reductions gave assistance to wealthy New Mexicans and did little for low-income people. The governor had proposed removing the GRT on food as a means of giving relief to poor residents, but the commission instead recommended reworking the low income comprehensive tax rebate and increasing the income threshold for the rebate to $48,000.

Other major issues facing the commission included how to raise money for the State Road Fund, which in 2003 already was showing signs of financial unsustainability; inconsistent and possibly unfair tax treatment of certain medical and hospital receipts; lack of accountability of economic development incentives; and how to better structure the CIT to encourage businesses to locate in New Mexico while maintaining the tax as an important revenue source for the state. Many other states have changed the apportionment factors of the

CIT to encourage business relocation, but New Mexico has stayed with the traditional equal apportionment of sales, labor and property. Mr. O'Neill said that although New Mexico probably will benefit from changing the apportionment factors, there will be definite winners and losers from such a change.

Two other outstanding tax issues that still need work are property tax reform, which could benefit from a complete overhaul, and addressing the significant pyramiding issues associated with the GRT.

A committee member commented that other states are now looking at New Mexico's system of taxing services, since much of the country's manufacturing base has left. He also said that although raising taxes always affects somebody, New Mexico needs a balanced budget. Another committee member said that some of the commission's recommendations should be reexamined for possible enactment. He also said that transportation funding in 2003 was becoming a problem, and since nothing was done, it is now a big problem.

A committee member asked about the Streamlined Sales and Use Tax Agreement (SSUTA). Mr. O'Neill said that the SSUTA is an attempt by states to get around a U.S. Supreme Court decision that forbids states from taxing out-of-state mail order sales. Member states agree to tax products uniformly, thus avoiding constitutional issues involved in out-of-state taxation. The problem with New Mexico joining the agreement is that New Mexico has a seller-based GRT, and most other states have a buyer-based sales tax. New Mexico still needs to align its GRT base with the SSUTA base, which will involve some potentially controversial tax law changes.

A committee member asked how much the "hold harmless" food tax deduction provisions enacted for cities and counties cost the state. Mr. O'Neill said that those provisions cost about $200 million annually. The committee member said that removing the GRT on food reduced the GRT base too much and has caused significant revenue issues for the state. Mr. O'Neill said that medical services deductions have also added to the narrowing of the GRT base.

A committee member asked how the State Road Fund issues could be resolved. Mr. O'Neill said that although some earmarked fees have been raised, the primary funding source from the state is the gasoline tax, which has not been raised in many years.

Cable Industry Property Valuation and Tax Update

Pat Dolahanty, vice president and treasurer, Cable One, and Scott Scanland, lobbyist for the Arizona-New Mexico Cable Association, briefed the committee on the cable industry's attempt to keep property valuations of that industry at the county level rather than the state level. Mr. Scanland began by discussing a bill introduced in 2008 by Representative Varela that would require a central assessment for the cable industry. At that time, the industry opposed the bill because it would essentially be another tax. Since then, discussions with the TRD have taken place to come up with a compromise. The main issue now is the interpretation of an antiquated statute dealing with the telecommunications industry, which the department contends applies to the cable industry, and thus, cable industry properties should be assessed by the PTD, rather than county assessors.

Mr. Dolahanty introduced himself to the committee and described Cable One's operations in New Mexico, which consist of 20,000 customers in the state. He said that his company has discussed the state assessment issue with Comcast, and that company has a similar view. If the state assesses the cable industry, valuations will probably be much higher than county valuations. Mr. Scanland said that there should be a level playing field between cable and phone companies.

Mr. O'Melia, responding to a question from a committee member, said that the TRD does not regard the statute in question as antiquated and that cable properties clearly are supposed to be assessed at the state level. He said that one reason why the state valuations will be higher than county valuations is that while the state sets a floor level for fully depreciated assets at 20 percent of original value, counties have a 12.5 percent floor. He said the PTD is willing to work with the industry in resolving that discrepancy.

A committee member suggested that an interim committee that deals with the telecommunications industry should study this issue.

There being no further business, the committee adjourned at 11:45 a.m.

REVENUE STABILIZATION AND
TAX POLICY COMMITTEE

Section 5

August 2009
Agenda
Minutes

Revised: August 26, 2009

TENTATIVE AGENDA
for the
THIRD MEETING IN 2009
of the
REVENUE STABILIZATION AND TAX POLICY COMMITTEE

August 27-28, 2009
Raton Convention Center
901 S. Third Street
Raton

<u>Thursday, August 27</u>

9:00 a.m.	**Call to Order** —Senator John Arthur Smith, Chair
9:05 a.m.	**Welcome** —Joe Apache, Mayor, City of Raton —Whitney Hite, Chair, Colfax County Commission —Don Day, County Manager, Colfax County
9:45 a.m.	**Revenue Forecast Update** —Rick Homans, Secretary of Taxation and Revenue —Laird Graeser, Chief Economist, Department of Finance and Administration —Tom Clifford, Chief Economist, Legislative Finance Committee
10:45 a.m.	**Residential Property Tax Limitation — Litigation Update** —Karen Montoya, Assessor, Bernalillo County
12:00 noon	**Lunch**
1:00 p.m.	**Weight Distance Tax Update** —Rick Homans, Secretary of Taxation and Revenue —Colonel Forrest W. Smith, Director, Motor Transportation Division, Department of Public Safety
2:15 p.m.	**Taxation and Revenue Department (TRD) Legislative Proposals** —Rick Homans, Secretary of Taxation and Revenue —Jim Nunns, Tax Policy Director, TRD
3:30 p.m.	**Public Improvement Districts (PID)** —Robin C. Blair, County Attorney, Colfax County —James Lebus, Chairman, Angel Fire PID
4:45 p.m.	**Recess**

Friday, August 28

9:00 a.m.	**Hold Harmless Tax Provisions — Revenue Impact on State and Local Governments — Status** —Jim Nunns, Tax Policy Director, TRD —Bill Fulginiti, New Mexico Municipal League
10:00 a.m.	**Road Fund and Transportation Infrastructure Revenue Needs** —Gary Giron, Secretary of Transportation
11:00 a.m.	**Raton Racetrack and Casino Update** —David Norvell, Chair, Gaming Control Board —John Monforte, Executive Director, Gaming Control Board —Julian Luna, Executive Director, State Racing Commission
12:30 p.m.	**Adjourn**

MINUTES
of the
THIRD MEETING IN 2009
of the
REVENUE STABILIZATION AND TAX POLICY COMMITTEE

August 27-28, 2009
Raton Convention Center
Raton, New Mexico

The third meeting of the Revenue Stabilization and Tax Policy Committee (RSTP) for 2009 was called to order by Senator John Arthur Smith, chair, at 9:12 a.m. in the Raton Convention Center in Raton, New Mexico.

Present
Sen. John Arthur Smith, Chair
Rep. Edward C. Sandoval, Vice Chair
Sen. Carlos R. Cisneros
Rep. Nathan P. Cote
Rep. Anna M. Crook
Sen. Tim Eichenberg
Sen. Timothy M. Keller (August 28)
Rep. Ben Lujan, Speaker of the House
Rep. Rodolpho "Rudy" S. Martinez
Sen. Howie C. Morales (August 27)
Rep. Henry Kiki Saavedra
Rep. Jim R. Trujillo

Absent
Sen. Dianna J. Duran
Rep. Keith J. Gardner
Sen. Timothy Z. Jennings
Sen. Gay G. Kernan
Sen. William E. Sharer
Rep. Thomas C. Taylor

Designees
Rep. Zachary J. Cook
Sen. Clinton D. Harden, Jr.
Rep. James R.J. Strickler
Sen. Peter Wirth

Rep. Ray Begaye
Sen. Mark Boitano
Rep. Donald E. Bratton
Sen. Kent L. Cravens
Rep. Miguel P. Garcia
Rep. Sandra D. Jeff
Sen. Carroll H. Leavell
Rep. Antonio "Moe" Maestas
Sen. Steven P. Neville
Rep. Debbie A. Rodella
Sen. Nancy Rodriguez
Sen. Bernadette M. Sanchez
Sen. John M. Sapien
Rep. Luciano "Lucky" Varela
Rep. Don L. Tripp

Other Legislators Attending
Sen. Cisco McSorley (August 27)
Rep. Dennis J. Roch (August 28)

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

Staff
Pam Ray, Staff Attorney, Legislative Council Service (LCS)
Doris Faust, Staff Attorney, LCS
Ric Gaudet, LCS

Guests

The guest list is in the meeting file.

Copies of all handouts and written testimony are in the meeting file.

<u>Thursday, August 27</u>

Welcome

Joe Apache, mayor, City of Raton, welcomed the committee to Raton and briefed the members about economic development activities in the area. Ever since the closing of the Kaiser coal mining operation, Raton has had difficulty creating jobs in the area. With the approval of a new racetrack and casino, Raton is set to enter a job-growth period again, he said. Natural resource extraction has always been an important economic sector for the region, and when drilling and mining activities in much of the Vermejo Park area were restricted, the state and city lost much revenue.

Mayor Apache said that gross receipts tax (GRT) collections have declined 13 percent in the first two months this fiscal year compared to last year, and the city has seen a 20 percent decline in occupancy tax collections. He mentioned the creation of the Miners Colfax Medical Center, which combines the operations of the old miners' hospital with a regional hospital. Finally, he said that Raton expects a big boost in tourism from the area roughly 250 miles from the city once the casino opens.

Don Day, county manager, Colfax County, told the committee that Colfax County is a large, remote county with a population of 14,000 and six incorporated municipalities. He reported that the county is managing financially this fiscal year, but that its budget is flat. Mr. Day said that the county detention facility needs upgrades and expansion and that many bridges in the county need repair.

Questions from committee members (and answers) included:

- What is the status of the racetrack/casino? (Preliminary groundwork is starting.)
- What is the difference in sales taxes between Trinidad, Colorado, and Raton? (Trinidad's sales tax is about eight percent; Raton has a GRT of 7.835 percent.)
- Since physicians in Colorado (with a sales tax) do not pay sales tax on their services, yet most physicians in New Mexico do pay the GRT, has it been difficult to attract physicians to Raton? (Raton will be endorsing a resolution soon that will try to attract medical professionals to the area.)

- Which entity owns the learning center? (New Mexico Highlands University acquired the property.)

- What GRT-backed bonds does the city have outstanding? (The community wellness center is backed by a $5.8 million GRT bond. Raton's budget consists of 83 percent GRT revenues, and the new racetrack/casino should stabilize revenues to its general fund.)

Revenue Forecast Update

Rick Homans, secretary of taxation and revenue, Laird Graeser, chief economist, Department of Finance and Administration (DFA), and Tom Clifford, chief economist, Legislative Finance Committee (LFC), presented the committee with the most recent general fund consensus revenue estimates. Mr. Graeser began by reporting that the current recession is expected to be declared over as of July or August 2009, which would mean the national recession would have lasted 17 to 18 months. Job losses in New Mexico are expected to stop by the end of 2009, and economic growth is expected shortly thereafter. After New Mexico deals with fiscal year 2009 and 2010 shortfalls, said Mr. Graeser, revenue growth is likely for fiscal years 2011 through 2014.

Federal stimulus money is expected to help balance the budget for fiscal years 2009 and 2010, which has been hit hard by the current recession. Mr. Graeser said that the key factor to the revenue estimate is not natural gas and crude oil prices, as has been true in the past, but rather a decline in the broad-based revenues that are responsive to the weak economy, including the GRT, personal income tax and motor vehicle excise tax. The consensus revenue group expects $32 million extra revenue for fiscal year 2009 compared to the February 2009 forecast. However, revenues for fiscal years 2010 through 2012 are expected to be only a few million dollars more than the February estimate.

The current forecast for recurring and total revenues for fiscal year 2009 is down $309.1 million and for fiscal year 2010, $432.6 million. After including all of the action known as the "Solvency Package", plus reversions and transfers enacted during the 2009 regular legislative session, fiscal year 2009 total revenues are still $121.5 million short of restoring a 10 percent reserve, and fiscal year 2010 revenues are short an additional $427.7 million. Total general fund revenues are not expected to exceed the fiscal year 2008 peak level before fiscal year 2015, said Mr. Graeser.

Secretary Homans led the committee through a detailed analysis of the revenue forecast, which has worsened since the February forecast. That estimate forecasted slow growth in all sectors, but growth in the broad-based taxes has actually turned negative. Gross receipts and compensating taxes are the largest sources of general fund revenues, but are expected to fall .7 percent for fiscal year 2009 and another 1.0 percent in fiscal year 2010. Revenue growth is expected the following three fiscal years, hovering near three percent each year.

After reviewing natural gas and oil price and volume predictions for the next few fiscal years, Secretary Homans reported that the consensus group expects an additional $31.9 million to the general fund for fiscal year 2009 and nearly the same forecast for fiscal year 2010.

Personal income tax estimates have fallen dramatically since the February forecast, due to lower personal income levels and reductions in capital income gains. Total combined reductions for fiscal years 2009 and 2010 are nearly $200 million lower than the February estimate. The combined reductions from corporate income taxes for those two years amount to a similarly large drop of $164 million. Selective excise taxes are expected to be $5 million higher than predicted in February, and an additional nonrecurring amount of $40.2 million in reversions and higher-than-expected federal forest reserve account accumulations have been reported.

In conclusion, Secretary Homans said that there is still much work to be done to remedy an approximate $433 million budget deficit for fiscal year 2010 and build an adequate budget for fiscal year 2011.

Mr. Clifford next reported to the committee, giving the viewpoint of the LFC, which mostly concurred with the executive branch estimate. He pointed out that the total loss in revenues from fiscal year 2009 to 2010, excluding the solvency package, amounts to $1 billion, or 17 percent of the general fund budget. Without making any changes, the general fund balance at the end of the current fiscal year will be -$34 million, down $675 million from previous estimates. Mr. Clifford said that the lack of timely and accurate revenue reports has become a serious risk to the revenue forecast.

Mr. Clifford presented recurring general fund revenue trends since 2003. Although revenues to the fund grew a total of 50 percent from 2003 to 2008, one-half of that growth was lost the next two fiscal years (including projections for the current fiscal year). Growth is expected to resume beginning in fiscal year 2011, and current projections are that fiscal year 2011 collections will be $346 million more than fiscal year 2010. Energy-related revenues accruing to the general fund have dropped significantly, from fiscal year 2006 and 2008 levels above 20 percent, to an expected fiscal year 2010 level of 13 percent of the general fund, said Mr. Clifford.

Mr. Clifford pointed out that food and medical deductions from gross receipts are approaching $4 billion annually, and are now in well in excess of levels originally forecast. The result is a net decrease in general fund GRT distributions of approximately $90 million in fiscal year 2010.

A committee member asked what the fiscal year 2009 shortfall is. Mr. Clifford said that the LFC estimate is $133 million, and the DFA estimate is $121 million. The difference in figures is because the DFA is using some nonrecurring dollars to fill in gaps in recurring revenue. The committee member said he has heard the cumulative impacts of the 2003 income tax cuts and GRT deductions are about $1 billion. Mr. Clifford said he estimates the cost to the general fund to actually total $650 million. Mr. Graeser said that previously, he had validated the $1 billion estimate.

Mr. Graeser, responding to a question from a committee member, said that the secretary of finance and administration wants to shift balances in accounts to bring fiscal year 2009 final balances to a 10 percent general fund reserve level. Looking to fix the current 2010 budget, he said that the governor has asked all agencies to trim three percent from their budgets. Some tax incentives can be looked at for elimination, but he said he has heard that the governor has said that film tax credits and personal income tax increases are not on the table for negotiation. The committee member responded by saying that everything should be on the table, and that social service programs, especially Medicaid, should not be cut. If the state cuts Medicaid funding, it will lose a large amount of proportionate federal funding, which will hurt the state's population even more.

A committee member asked why emergency school tax collections were increasing, compared to the February forecast. Mr. Graeser said that tax is a source of revenue to the general fund. Oil prices and volumes are holding steady, and natural gas prices are expected to increase soon.

A committee member asked what the economic impacts of film industry tax incentives are. Secretary Homans said he would send the member copies of recent economic analyses of the film industry and the tax credits. He said that any capping of the total tax credits allowed would send a negative message to the industry.

A committee member asked why the fiscal impact to the state from the food deductions is so large. Mr. Clifford said that when he did the fiscal analysis for the original food deduction legislation, he did not have accurate data. The removal of a GRT credit for municipalities was supposed to offset the food deduction, but it did not do so.

The committee requested information about the impacts that combined reporting of tax returns has on the state.

A committee member said the revenue projections presented seem too optimistic. He thinks New Mexico will have a difficult time recovering from the recession, citing as evidence the still-sluggish construction industry. He asked if the governor still supports a one-year surtax on personal income for people earning over $250,000. Secretary Homans said he cannot represent any proposal that the governor will support.

A committee member stressed that the film industry, although receiving a 25 percent credit on expenditures, has also spent more than $320 million last year in the state. He also suggested revisiting the definition of "food" for GRT purposes.

A committee member asked whether the Tobacco Settlement Permanent Fund will be receiving more distributions, since it is complying with manufacturers' demands that it perform "due diligence" in enforcing the Master Settlement Agreement. Mr. Graeser said that issue is now undergoing national mediation, and any resolution will not have any immediate fiscal impact.

A committee member asked whether the $433 million budget shortfall for fiscal year 2010 could go even higher in the next consensus revenue forecast. Mr. Graeser said that the uncertainty in the current forecast is probably higher than in previous forecasts. Mr. Clifford said that he is concerned about the natural gas price projections of $5.60 per thousand cubic feet (MCF) next fiscal year. The current price New Mexico producers are receiving is $2.80. Most national indicators predict gas prices will rise to $4.30 per MCF by the end of this fiscal year. He also said that he is concerned that GRT collections will not rebound as predicted.

Residential Property Tax Limitation - Litigation Update

Karen Montoya, Bernalillo County assessor, provided the committee with an update of the Dzur case, in which residential property owners successfully sued the assessor's office in district court, claiming that statutes establishing how properties are valued for taxation violate the Constitution of New Mexico. The court ruled that valuation provisions of Section 7-36-21.2 NMSA 1978, in which a procedure is set up to limit property valuations until a property is sold, violates Article 8, Section 1 of the constitution, which allows for limitation of valuation of residential property, but only in regard to owner-occupancy, age or income. The court ruled that Section 7-36-21.2 NMSA 1978 set up a fourth class of property owners to which valuation limitations could be applied, which unfairly hurt new homeowners, since they have to bear a heavier burden than similar homeowners who have not recently purchased their property.

Ms. Montoya said that the county assessor's office argued that the Dzur's property valuation should be upheld, and presented four arguments, each of which was rejected by the court. The first argument was that the appeal to the court did not name the county assessor as a defendant, and thus violated clearly established procedures. The court held that although the wrong defendant was named (the valuation protest board instead of the county assessor), no harm was done, and minor technical deficiencies should not stand in the way of the appeal.

The second issue revolved around the protest board's ability to make constitutional determinations. The court did not determine whether the board had that ability, but merely determined that the court did have that authority.

The third, and perhaps most important issue, centered on the constitutionality of Section 7-36-21.2 NMSA 1978. The assessor argued that the constitutional language of "the limitation may be applied to classes of residential property taxpayers based on owner-occupancy, age or income" implied that the legislature can set up other classes in which to limit valuations. The court rejected that argument and held that those classes are the only permissible ones in which valuations can be limited.

The final issue argued by the assessor was that if the statute in question is held unconstitutional, then all residential property owners would be harmed, since all properties would have to be valued at their current and correct values. The court, according to Ms. Montoya, carving with a very sharp knife, skirted this potential effect and only ruled that Subsections A, B and E of that section violated the constitution. The impact of that narrow decision is that pre-existing homes that are sold would not be deemed to be a change in ownership, and, thus, the previous cap on valuation would remain in effect for the new homeowner.

A committee member asked whether the ruling will be appealed, and what impact the ruling will have. Ms. Montoya said that she will decide by September 1 whether to appeal. She said that currently, the decision only applies to one residential property and does not apply to other properties.

Committee members commented that the case is not a class action lawsuit, and the case only applies to one property. The case will also not set a precedent, and another judge may rule differently in another case. Another committee member clarified that the case did not involve a federal constitution equal protection claim, but was rather a limited New Mexico constitutional issue.

Mr. Graeser said that if the ruling in the case were to be applied statewide, local government finances will not be affected very much, but that state general obligation bonding capacity will be significantly reduced.

Weight Distance Tax Update

Secretary Homans and Colonel Forest Smith, director, Motor Transportation Division (MTD), Department of Public Safety (DPS), discussed issues involving New Mexico's weight distance tax. Secretary Homans described New Mexico's trucking industry, which employs about 46,000 people in the state, with a yearly payroll of $1.6 billion. Approximately $488 million in federal and New Mexico road taxes are paid each year by the industry. A long-term issue that the state is facing is declining revenues to the State Road Fund. Gasoline tax revenues are flat, weight distance tax and special fuel excise tax revenues are declining and trip tax revenues are slightly up. Considering ever-increasing costs for road maintenance and construction, the State Road Fund faces serious long-term shortfalls.

New Mexico is only one of four states that administers a weight distance tax. Other states apply a much higher registration fee on commercial vehicles. The weight distance tax and the alternative trip tax generate about $88 million per year, all of which is directed to the State Road Fund. The weight distance tax is imposed based on miles traveled and the weight of vehicles and is paid quarterly by registered companies. If a commercial vehicle is not registered, it is instead levied a trip tax at New Mexico ports of entry that is imposed at an amount approximately 10 times greater than the weight distance tax.

With commercial truck traffic down 20 to 25 percent from last year, Secretary Homans said that revenues to the road fund are declining significantly.

He discussed a new initiative to better collect weight distance and trip taxes. The initiative involves collaboration among the TRD, the MTD and the Department of Transportation (DOT). Part of the initiative involves installation of electronic license plate readers to better track vehicle traffic and more auditing of tax returns to enforce compliance with the tax. The initiative is self-funded and expects to generate an extra $3.2 million in fiscal year 2010 and $6 million in fiscal year 2011.

Colonel Smith described enforcement operations in which the MTD is involved, including citing hundreds of weight distance tax nonfilers and nearly 1,400 filers that claimed no miles traveled. In addition, the division performs thousands of safety inspections and has seized eight caches of drugs this year. He said that the new electronic license plate readers will help officers enforce compliance with the weight distance tax. Colonel Smith also described a recent eight-day enforcement "blitz" in which hundreds of citations were issued. He said that due to a lack of officers, only 45 percent of vehicles that were identified as being out of compliance were actually stopped.

A committee member said that there seems to be unfair treatment of DPS employees who work at weigh stations. He said they are paid very little and often face dangerous situations. In addition, at the Gallup weigh station, employees have no safe place to store cash collected from truck drivers paying trip taxes. Colonel Smith agreed about the wage issue, and said that he has been trying to get better pay and classification for transportation inspectors for three years. The current entry wage for transportation inspectors is $10.88 per hour, he said. Another committee member said that vehicle inspectors face some of the same dangers that MTD officers face, but that they do not have access to safety gear such as protective vests.

A committee member asked what the impact would be if New Mexico raised commercial vehicle registration fees. Secretary Homans said that although New Mexico has one of the lowest registration fees in the country, it also has a significant weight distance tax, which most other states do not have. He said that if registration fees were raised, the fee structure would have to be adjusted to take into account the seasonal nature of agricultural vehicles.

A committee member said that there are competing missions between the MTD and the New Mexico State Police (NMSP), and that MTD officers frequently are called to assist the state police. Colonel Smith said that MTD officers are sometimes called for backup in domestic violence calls. He said that the NMSP and the MTD have high officer vacancy rates. The committee member said that perhaps the entrance requirements to attend the New Mexico Police Academy are too stringent.

Taxation and Revenue Department Legislative Proposals

Secretary Homans and Jim Nunns, tax policy director, TRD, presented three legislative proposals for the committee's consideration. All three bills are substantially similar to bills endorsed by the committee in 2008, said Secretary Homans. He said the governor has not yet endorsed any of the proposals this year. The first proposal involves changes to withholding provisions for oil and gas proceeds and pass-through entities; clarification of definitions and rules for withholding; tightening of rules that allowed nonresidents to avoid New Mexico income tax; and making pass-through entity withholding due quarterly. This legislation is similar to 2009 legislation introduced by Speaker Lujan, but with some important changes made to address concerns of the oil and gas industry and of accountants. In particular, the current proposal does not apply to New Mexico residents.

The second bill draft discussed involves changes to tax increment development district (TIDD) legislation. The TRD proposes to amend the GRT increment calculations to correct an omission regarding food or medical deductions to more closely conform to tax reporting and to specify how certain estimates used in the calculations are made. The bill also amends the list of municipal and county GRTs that can be dedicated to a TIDD to remove obsolete local option taxes and to add others that are not currently listed. Finally, the bill would add a funding mechanism for necessary TRD staff work related to TIDDs.

The third bill being proposed by the TRD makes several changes to tax administration laws. Changes include:

- simplification and improvement of the protest and hearing process for taxpayers who have disagreements with the TRD;

- the ability to award administrative and litigation costs related to credits;

- increasing the threshold for required monthly filing of combined reporting system taxes from the 1991 level of $200 to an inflation-adjusted level of $300;

- giving the secretary of taxation and revenue limited authority to delay accrual of interest for persons affected by disasters or by military or terrorist actions;

- correction of an oversight in the 2007 change to the tax rate for food and medical hold harmless distributions to large municipalities and counties; and

- changes to help the TRD administer tax laws more effectively.

Public Improvement Districts

Robin Blair, county attorney for Colfax County, discussed briefly with the committee public improvement districts (PIDs), including the creation of one in Angel Fire in 2008. Mr. Blair said that he became aware of PIDs in 2008 upon the filing by the Angel Fire PID of a special levy for the district, which the county is obligated to administer. Soon thereafter, several residents filed lawsuits objecting to the special levy. According to the authorizing statutes (Chapter 5, Article 11 NMSA 1978), PIDs can be initiated on a petition of 25 percent of the ownership of the proposed district. Then, the appropriate local government holds public hearings and decides whether to hold a formation election. Property owners are allowed to vote in proportion to the number of acres they own, and residents of the district are also allowed to vote. A special levy is allowed to be voted on at the formation or other election, which can assess a certain dollar amount per property, as opposed to a mill levy, which is assessed at a certain percentage of property valuation. Mr. Blair said that one potential problem with the Angel Fire PID is that it is created within the municipality of Angel Fire, but Colfax County is obligated to collect the levy. Another issue that could be raised is that PIDs can issue levies based on indirect benefits, rather than direct benefits. Improvement districts, which also have the ability to issue assessments against property, are limited to direct benefits, and property owners have an easier way of protesting that assessment. It could be argued that PIDs, when levying assessments for indirect benefits, violate equal protection provisions of the U.S. Constitution, since property owners have a greater say than residents in assessment elections, said Mr. Blair.

A committee member said that bonds have already been issued by the New Mexico Finance Authority for the Angel Fire PID, but the bond proceeds are unable to be released due to the litigation. Another committee member suggested that the legislature gave too much authority in the enactment of PID legislation.

A committee member asked if PID special levies have priority over mortgages. Mr. Blair said that special levies are treated co-equal with other property taxes and will trump a mortgage.

The minutes from the July 14-15 meeting of the committee were adopted, without changes. The committee recessed at 4:25 p.m.

Friday, August 28

The committee reconvened on Friday, August 28, at 9:04 a.m. Scott Weese, president of the Raton Chamber of Commerce, welcomed the committee to Raton and encouraged committee members to visit local assets, including Sugarite Canyon State Park and the National Rifle Association's Whittington Center.

Archie Vigil, mayor, Village of Chama, spoke to the committee about the need to keep "hold harmless" provisions designed to protect local governments in place. He said that Chama cannot afford to absorb any reductions in tax revenue that the legislature may be contemplating. Mayor Vigil then described activities in Chama, including that the Cumbres and Toltec Scenic Railroad has seen declining use. He said that village residents recently adopted a new one-fourth percent GRT increase. A committee member asked about the wastewater system upgrade. Mayor Vigil said that the wastewater system is more than 30 years old, and that renovations are more than 10 years overdue. With community development block grant funding, the village finally received enough funding to complete upgrades.

Hold Harmless Tax Provisions — Revenue Impact on State and Local Governments

Mr. Nunns and Bill Fulginiti, executive director of the New Mexico Municipal League, discussed with the committee the fiscal impacts on hold harmless provisions enacted into tax law, designed to offset local government revenue impacts from the creation of new credits, deductions or distribution formulas. The benefits provided to local governments by hold harmless provisions usually reduce state general fund revenues, said Mr. Nunns. Many of the provisions have been enacted recently, including enacting new distributions to municipalities and counties to offset the deductions for food and health care practitioner services; the allowance of some credits against the state portion of GRT due; and changes in distribution formulas that reduce the amount distributed to the general fund but not the amount distributed to local governments.

When the food and medical deductions were enacted in 2004, they were accompanied by hold harmless distributions to municipalities and counties, which generally fully offset the loss of revenue that local governments would otherwise have incurred as a result of those deductions. The total cost to the state general fund in fiscal year 2009 as a result of the hold harmless distributions was $121 million, consisting of $93.4 million for food and $27.5 million for medical services. The legislature in 2004 also repealed the .5 percent credit for municipal GRT rates against the state rate, which was supposed to make the food and medical deductions revenue neutral to the state.

However, the food deduction turned out to be much more costly than was estimated in 2004. Taking into account the state share of deductions and the local government offsets against the municipal GRT credit repeal, the state lost $95.9 million in general fund revenues compared to what would have accrued if the legislation were not in effect.

Another type of hold harmless provision is the allowance of certain credits only against the state portion of the GRT. The investment credit, the technology jobs tax credit and the affordable housing tax credit do not allow claimants to take the credit against local government GRT liabilities.

The third type of hold harmless provision is created when distribution formulas are amended such that local governments are not harmed by redistributions. For example, when modifying the distribution to the State Aviation Fund, the legislature included language that specified the distribution would be "from the net receipts attributable to the gross receipts tax distributable to the general fund". The effect of this language was to keep the same distribution amount to local governments.

Finally, Mr. Nunns discussed several administrative concerns regarding hold harmless provisions, including that taxpayers often incur significant additional costs to comply with hold harmless provisions; there are often reporting errors associated with the food and medical deduction; the TRD often needs to spend a considerable amount of time working with taxpayers who have difficulty complying with a new hold harmless provision; and TRD resources were especially taxed when the food and medical provisions were enacted. Policy considerations for future hold harmless legislation include whether local governments are more willing to accept changes to the tax system with a hold harmless provision that would otherwise not be in their best interests; and whether the benefits of hold harmless provisions are fairly allocated among local governments.

Mr. Fulginiti then presented the point of view of municipalities, which see hold harmless provisions as critical to municipal budgetary stability. The chief reason is that municipalities derive 75 percent of their revenue from the GRT. Whenever the legislature narrows the GRT base by enacting a credit or deduction, it disproportionately affects municipalities without a hold harmless provision. Mr. Fulginiti repeated advice given by Franklin Jones: keep the tax base broad and keep rates lower.

Mr. Fulginiti discussed how certain rural municipalities would have fared had the food deduction hold harmless provisions not been enacted. In Ruidoso

Downs, for example, food expenditures account for 40 percent of gross receipts. If the village was not able to recoup from the state the amount of deductions from gross receipts, it would have had a budgetary crisis. In Albuquerque, however, of which approximately eight percent of gross receipts are attributable to food sales, the impact would not have been as severe.

State Road Fund and Transportation Infrastructure Revenue Needs

Gary Giron, secretary of transportation, discussed with the committee State Road Fund revenue trends. The DOT is funded by various highway taxes and fees; not by the general fund. The current recession has had a large negative impact on revenues accumulating to the department, which department economists began noticing in February 2009. Freight traffic from California ports dropped, which reduced the resulting taxes New Mexico received from weight distance and trip taxes, oversize/overweight permits and special fuel excise taxes. Freight taxes make up about 50 percent of distributions to the State Road Fund, and those collections are down 20 percent from last year, which amounts to about $40 million less revenue.

Gasoline tax collections, however, have not declined, even though gasoline prices reached record levels last year. Vehicle registrations, which make up another large part of distributions to the fund, have declined slightly over the last year. In summary, while fiscal year 2009 distributions to the State Road Fund were about $400 million, the fund is expected to only receive $360 million in fiscal year 2010. In addition, interest rates the DOT received from its various fund investments began to decline in October 2008 and have not yet rebounded. Secretary Giron estimated that revenues to the fund will not reach fiscal year 2007 levels until fiscal year 2014.

Secretary Giron then discussed the impact of revenue reductions on the DOT's capital program and operations budget. To date, there still exist $368 million in GRIP projects that do not have funding, and an additional $235 million in projects have been delayed from road fund shortfalls. However, federal stimulus funding will make up about $163 million of that shortfall. In addition, the DOT will be submitting applications for funding projects, including the Interstate 10/Interstate 25 interchange in Las Cruces, the Mesa del Sol interchange in Albuquerque, the Paseo del Norte interchange in Albuquerque, the U.S. Highway 64/87 project and the U.S. Highway 491 project on the Navajo Nation. Other projects are still under discussion, he said.

The future of GRIP funding is uncertain, as remaining bonds and severance tax bond proceeds are committed and federal highway funding is not determined. The DOT is assuming relatively flat funding around $300 million from the federal government's statewide transportation improvement program (STIP). That money is allocated by formula after current debt service payments are made of approximately $100 million. The remaining money distributed to each state transportation district would only cover the cost of one large project, said Secretary Giron.

The current shortfall to the federal Highway Trust Fund has been fixed, temporarily, with Congress approving $7 billion to the fund. However, revenue increases will still be needed at the federal level to sustain current funding levels.

The operational budget impacts on the DOT from revenue reductions have been significant. The DOT reduced road-fund-supported activities by almost $50 million in fiscal year 2009, and the department is planning $40 million in cuts from the current budget year. For fiscal year 2011, the DOT will be submitting a flat budget of about $360 million. Because of existing commitments to meet federal highway matches, the majority of reductions will be in the department's operations, including reductions in contract maintenance, heavy equipment replacement, field supplies and no requests for wholly state-funded construction projects. Finally, Secretary Giron discussed ongoing funding gaps for maintenance of current infrastructure, including $200 million annually in road and bridge maintenance and $50 million annually for bridge replacement.

Questions and comments from committee members included:

- state road maintenance is a critical issue;
- a lawsuit is holding up $33 million in funding for an Interstate 10 project;
- some penalty assessments should be distributed to the State Road Fund; and
- the use of prevailing wages in highway projects increases costs.

Raton Racetrack and Casino Update

David Norvell, chair, Gaming Control Board (GCB), and Michael Moldenhauer, representing the Raton racetrack and casino, discussed with the committee the status of the Raton facility. Mr. Norvell described the process the GCB went through to determine that the Raton casino application met statutory requirements. Since the approval, however, the GCB has been concerned that there has been little physical progress on the facility; there are no buildings under construction and the track is not progressing. The casino license was granted conditionally, based on the applicant meeting certain benchmarks, including having 60 race days in 2010, beginning on Memorial Day.

Mr. Moldenhauer said that the casino is scheduled to open in late 2009 or early 2010, and that the first race meet is scheduled for the Memorial Day weekend in 2010. Race purses will be generated by casino operations initially, he said. He said that the development of the racetrack and casino will spur much more economic development in the area. A master plan is being developed with Raton to build new hotels and restaurants. New development will strengthen the local economy.

A committee member said that horse owners want assurance that there will be adequate infrastructure for their horses before races begin next year. Mr. Moldenhauer said that bricks and mortar are just a small part of the entire project, and that construction will begin soon. The size of the racetrack/casino will be approximately 50,000 square feet, with 600 slot machines. The total cost for the project will be around $40 million, he said. The racetrack and barns for the 2010 season will be temporary buildings, and permanent buildings will be constructed next year. The total investment in the Raton area could reach as high as $100 million.

Committee members asked about many details of the construction, temporary structures, security, employment and training and financing of the racetrack/casino. Additional committee comments focused on ways to keep the horse racing industry viable and discussion of expected tourism to the area as a result of the new facility.

There being no further business, the committee adjourned at 12:44 p.m.

REVENUE STABILIZATION AND
TAX POLICY COMMITTEE

Section 6

September 2009
Agenda
Minutes

Revised: September 10, 2009

TENTATIVE AGENDA
for the
FOURTH
MEETING IN 2009
of the
REVENUE STABILIZATION AND TAX POLICY COMMITTEE

September 14-15, 2009
Cloudcroft, New Mexico
The Lodge Resort at Cloudcroft

Monday, September 14

9:00 a.m. **Call to Order**
—Senator John Arthur Smith, Chair

9:05 a.m. **Welcome — Local Issues**
—David Venable, Mayor, Cloudcroft

9:45 a.m. **Taxation and Revenue Department Legislative Proposals**
—Rick Homans, Secretary of Taxation and Revenue
—Jim Nunns, Tax Policy Director, Taxation and Revenue Department (TRD)

10:45 a.m. **Fair Share Program Update**
—Rick Homans, Secretary of Taxation and Revenue
—Philip J. Salazar, Director, Audit and Compliance Division, TRD

11:30 a.m. **Statewide Municipal and County Legislative Priorities**
—Bill Fulginiti, Executive Director, New Mexico Municipal League
—Tony Atkinson, President, New Mexico Association of Counties (NMAC)
—Paul Gutierrez, Executive Director, NMAC

12:30 p.m. **Lunch**

1:45 p.m. **Continue Research and Development Tax Credit**
—Matthew Woodlee, Director, Office of International Trade, Economic Development Department (EDD)

2:35 p.m. **Film Production Tax Credit Legislative Proposal**
—Lisa Strout, Director, New Mexico Film Office, EDD

3:25 p.m. **Pyramiding and Other Gross Receipts Issues**
—Jim Nunns, Tax Policy Director, TRD

4:15 pm. **Update of Legislative Finance Committee Review of Film Credit Studies**
—Tom Clifford, Chief Economist, Legislative Finance Committee (LFC)

5:00 p.m. **Recess**

Tuesday, September 15

9:00 a.m. **Corporate Income and Franchise Tax Review and Alternatives**
—Richard Anklam, Executive Director, New Mexico Tax Research Institute
—Jim Nunns, Tax Policy Director, TRD

10:00 a.m. **Uses of Fire Protection and Emergency Medical Services Funds**
—Mike Miller, City Councilor, Portales

11:00 a.m. **Solvency Discussion Update**
—David Abbey, Director, LFC

12:00 noon **Adjourn**

MINUTES
of the
FOURTH MEETING IN 2009
of the
REVENUE STABILIZATION AND TAX POLICY COMMITTEE

September 14-15, 2009
The Lodge Resort at Cloudcroft
Cloudcroft, New Mexico

The fourth meeting of the Revenue Stabilization and Tax Policy Committee (RSTP) for 2009 was called to order by Senator John Arthur Smith, chair, at 9:12 a.m. in the Lodge Resort in Cloudcroft, New Mexico.

Present	**Absent**
Sen. John Arthur Smith, Chair	
Rep. Edward C. Sandoval, Vice Chair	
Sen. Carlos R. Cisneros	
Rep. Nathan P. Cote	
Rep. Anna M. Crook	
Sen. Dianna J. Duran	
Sen. Tim Eichenberg	
Rep. Keith J. Gardner	
Sen. Timothy Z. Jennings	
Sen. Timothy M. Keller	
Sen. Gay G. Kernan	
Rep. Ben Lujan	
Rep. Rodolpho "Rudy" S. Martinez (September 14)	
Sen. Howie C. Morales (September 14)	
Rep. Henry Kiki Saavedra	
Sen. William E. Sharer	
Rep. Thomas C. Taylor	
Rep. Jim R. Trujillo	
Designees	
Sen. Peter Wirth	Sen. Mark Boitano
	Rep. Donald E. Bratton
	Rep. Zachary J. Cook
	Sen. Kent L. Cravens
	Rep. Miguel P. Garcia
	Sen. Clinton D. Harden, Jr.
	Rep. Sandra D. Jeff
	Sen. Carroll H. Leavell
	Rep. Antonio "Moe" Maestas
	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

Other Legislators Attending
Rep. Dennis J. Kintigh
Sen. Mary Kay Papen (September 14)

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

Staff
Pam Ray, Staff Attorney, Legislative Council Service (LCS)
Doris Faust, Staff Attorney, LCS
Ric Gaudet, LCS

Monday, September 14

Welcome — Local Issues

David Venable, mayor of the Village of Cloudcroft, welcomed the committee to Cloudcroft and suggested renaming the committee the "Missing Revenue and Hold Harmless Tax Policy Committee". He reported on the state of Cloudcroft's economy and government budget and said that the village has already cut spending this fiscal year by 10 percent. Voters recently adopted a one-fourth percent gross receipts tax (GRT) increment, which has helped the village. As a small measure, village officials are also paying their own expenses for any out-of-town trips. Mayor Venable expressed frustration at some of the regulatory and paperwork burdens erected in order to qualify for federal stimulus grant funding, citing the thousands of pages of federal guidance that his secretary has had to sort through in addition to her other regular duties. He mentioned a nearly completed project funded by federal stimulus grants, the rebuilding of the Mexican Canyon Trestle, a historic landmark. That project was granted $249,000, and Mayor Venable said that the project was expected to be finished within the week.

Questions from committee members included:

- Not including the recent tax increase, how much are GRT collections reduced? (Gross receipts in the village are down 12 percent to 13 percent from last year; occupancy tax collections are also down by the same percentage. Cloudcroft has not bonded against any GRT, however.)

- Has Cloudcroft applied for other stimulus funds? (The village has applied for five grants and has also applied with the state for colonias funding.)

- Has Cloudcroft imposed any mill levy taxes? (Yes, to a limited extent. The village council views increasing property taxes as a last resort because local schools already have imposed high mill levies.)

- What is the size of the police force and other village offices? (Cloudcroft has a three-member police department, and the village has a total of 17 staff members.)

- Is there any lumber activity in the area? (Only a few small companies operate in the area, mostly involving U.S. Forest Service clearing projects; the Mescalero Apache Tribe has some lumber operations.)

Taxation and Revenue Department Legislative Proposals

Rick Homans, secretary of taxation and revenue, Jim Nunns, tax policy director, Taxation and Revenue Department (TRD), and Michael Sandoval, director, Motor Vehicle Division (MVD), TRD, presented to the committee eight legislative proposals for its consideration. The proposals include one tax bill and seven motor vehicle-related bills:

- <u>Simplification of Personal Income Tax (PIT).</u> The bill would simplify the PIT, making it easier for taxpayers to file their returns; make the PIT fairer by ensuring that people are not taxed unfairly by inflation; remove obsolete language and clarify definitions; and maintain fiscal responsibility by designing the tax changes to be revenue neutral. The bill is similar to legislation endorsed by the committee in 2008.

- <u>Recompilation of the Motor Vehicle Code and Technical Changes.</u> The New Mexico Compilation Commission has agreed to recompile the Motor Vehicle Code as requested by the TRD without requiring the introduction of legislation. The proposed bill will make dozens of technical and cleanup changes to the code, without attempting to delve into substantive issues. Substantive changes to the code will be proposed for the 2011 legislative session.

- <u>Allow Driver's Licenses and Identification Cards To Be Renewed Via the Internet or by Mail.</u> This bill will reduce significantly wait times in MVD offices. The bill also eliminates the requirement that a person take a vision test every time the person renews a license. Persons over the age of 75 still are required to take an annual vision test.

- <u>Clarify Expiration Dates for Driver's Licenses of Individuals under Age 21.</u> Currently, a driver's license is issued in a vertical format to a person under age 21, which format signifies that the person is not allowed to purchase alcohol. When a four-year license expires for a person who is still under 21 years of age, a new license is issued in the vertical format, which often causes inconveniences for those people once they turn 21. The proposed legislation provides that certain vertical format licenses would be extended to expire 30 days after the person's twenty-first birthday, which would allow issuance of a regular horizontal-format license. In addition, people who turn 21 but still have several years remaining on their license tenure may get a replacement horizontal-format license issued for a minimal charge.

- Require a New Mexico Driver's License To Be Obtained Within 30 Days of Establishing Residency. Many new residents who have past DWI offenses in other states, once they learn of New Mexico's ignition interlock laws, defer applying for a driver's license for several years. The proposed law would require all new residents to apply for a New Mexico driver's license within 30 days of establishing residency, which would increase compliance with the ignition interlock statutes. The legislation would include exemptions for college students, military personnel and others.

- Cancel Ignition Interlock Driver's License for Noncompliance. The legislation would give the MVD authority to cancel the ignition interlock driver's license of a person who, after installing an ignition interlock device in order to receive the limited driver's license, removes the device before the required period of time has passed.

- Reform the "Drive Insured" Program. Several changes are proposed, including directing law enforcement officers at traffic stops to verify through an electronic database whether a vehicle is insured and prohibiting an officer from citing a person for failure to carry proof of insurance if the database confirms that the vehicle is insured; giving law enforcement officers the discretion to remove a vehicle's license plate for a violation of driving without proper liability insurance; clarifying that the issuance of a temporary operation sticker given to drivers who have been cited for not maintaining proper insurance does not create any liability for the state or the local government involved in the citation; allowing a person cited for lack of insurance to pay a penalty assessment fine of $75.00 rather than requiring the person to appear in court; and increasing the registration reinstatement fee after a violation of the Mandatory Financial Responsibility Act from $25.00 to $100, with indigency waivers and 50-day notice requirements before a registration is canceled.

- Update and Clarify Rules for Off-site Sales of Vehicles and Recreational Vehicles. The legislation would clarify the statutory language that regulates the program of off-site vehicle sales. The TRD is working closely with motor vehicle dealers to draft the legislation and will report its results to the committee in November.

Questions and comments from committee members included the following the following:

- How can the TRD ensure the security of internet driver's license renewals? Secretary Homans said that the department is working with an interstate trade group to resolve security issues. Key issues involve facial recognition software and password protections. If the legislation is enacted, the department will be using current best practices available to the industry.

- The state should look into insurance and licensing requirements for boat operators.

- How does the bill clarifying expiration dates of driver's licenses for under-21 drivers mesh with provisional driver's licenses for first-time young licensees? Secretary Homans said that the department will research that issue to ensure there are no conflicts.

- Do drivers over 75 years of age have to demonstrate their ability to drive safely in order to be issued a license? Mr. Sandoval said that the only requirement for drivers over 75 is a yearly vision test. A person who is concerned about somebody's ability to drive can send a letter to the MVD, which can then contact that person. Without such a letter, the MVD is prohibited from asking a person about physical conditions other than eyesight.

- Perhaps the state should require everyone to get a new driver's license within 30 days of turning 21 as a simpler method of fixing the expiration date problem.

- Giving police officers discretion to remove a license plate for noncompliance with insurance requirements may lead to unfair treatment of certain population groups. Secretary Homans said that language may need to be clarified.

- Many municipal MVD offices have a hard time providing good service to customers, mostly because they lack high-speed internet services. Secretary Homans agreed and said that the TRD is working to provide high-speed internet access to the 12 municipalities that are still using dial-up connections for MVD services.

- The TRD should not sell driver information to the private sector.

- The newly enacted laws regulating all-terrain vehicles are too strict.

- Some municipalities are financially burdened by having MVD services. Secretary Homans agreed and said that the state could take over some of those operations if so requested. He said that municipalities typically recoup $6.00 to $7.00 per transaction, but the private MVD Express charges about $20.00 per transaction.

- Any MVD legislative proposals need to be revenue neutral because the state is facing large budget shortfalls.

Fair Share Program Update

Secretary Homans and Phillip Salazar, director, Audit and Compliance Division (ACD), TRD, briefed the committee on the division's Fair Share Enhanced Delinquent Tax Collections program, which attempts to collect some of the tax obligations owed the state. New Mexico, which has a voluntary system of tax compliance, has a "tax gap" estimated to be $818 million annually. A tax gap is the difference between the amount of taxes owed and what is voluntarily paid. The division since 2003 has directed additional state resources toward collecting more tax obligations, focusing primarily on measures that bring in much more tax revenue than they cost to implement. Some of those measures include the creation of a call center to increase tax collection efforts; the creation of a desk audit unit for credit reviews; the expansion of audit coverage to smaller tax programs; the increase in the overall number of auditors and collectors; the posting of a delinquent taxpayer list on the TRD web site; the use of private collection agencies; the expansion of combined reporting system (CRS) workshops; the implementation of the treasury offset program, which offsets federal income tax refunds to state income tax debt; the expansion of the bankruptcy unit; and the implementation of a data warehouse to enhance audits and collections.

In 2009, the legislature enacted legislation that funded the Fair Share program to allocate more resources to collect tax obligations. With a recurring cost of $5.1 million, the program is expected to bring in an additional $29.2 million in fiscal year 2010 and $44.4 million in fiscal year 2011. The increased appropriations funded 82 new staff positions, including auditors, collections agents, refund and credit reviewers and information technology staff to manage the data warehouse.

Mr. Salazar described some of the enhanced programs funded in the Fair Share program. In the auditing program, the data warehouse is being used to score candidates for auditing, which will result in better collections; desk audits are being implemented to match other tax-related documents with collection information; the department is promoting managed audits; the department can pursue leads from the Multistate Tax Commission about unregistered businesses in New Mexico; the department can pursue taxpayers who over-claim deductions for tangible property on projects funded by industrial revenue bonds; and the department can pursue taxpayers who use the incorrect tax rate code to avoid paying local option taxes.

In the collection program, improvements in the data warehouse will allow collectors to use income documents to identify taxpayers that owe personal income tax and to identify different levy sources of delinquent taxpayers. In addition, collectors can now access all debt information associated with a taxpayer and implement payment plans across tax programs.

In the refund and credit program, the department has expanded auditing capacity to review tax credits associated with the film industry and for high-wage and advanced energy tax credits. The ACD is also working with the Revenue Processing Division of the department to expand the number of credit claims that will be reviewed. Finally, the division is working to get credit information filed electronically in order to prevent duplicate credits from being allowed.

Secretary Homans then described the managed audit program, which is designed to promote compliance and to benefit taxpayers who discover a past filing obligation and liability and wish to correct it. If a taxpayer under the managed audit program discovers taxes that are owed, the taxes can be paid without penalty or interest if the entire amount is paid within 180 days of the assessment. Taxpayers that wish to enter a managed audit must apply with the department and meet eligibility requirements, including that they have not already been selected for audit, that they are not currently being pursued for collections, that they demonstrate a willingness and ability to comply with New Mexico tax laws and that they have not been the subject of a criminal investigation or are in a legal dispute with the department.

Questions and comments from committee members included the following:

- Does New Mexico have the ability, similar to the authority the Internal Revenue Service (IRS) has, to negotiate the amount of tax liability owed the state? Mr. Salazar said that the department cannot compromise on a tax liability except when there is a dispute over how much is actually owed.

- How much of the estimated $600 million per year that is deemed uncollectible could be recouped by the state if it had the authority to negotiate tax liabilities? Mr. Salazar said that there are too many variables to give an accurate projection, and he said that the $600 million figure is an IRS estimate.

- Perhaps the TRD should establish an independent arbitration process to settle tax disputes rather than using the current practice of appointing hearing officers who are also TRD employees. Secretary Homans said that the TRD gives complete independence to its hearing officers, but he also acknowledged that there is still an appearance of a conflict of interest in the system.

- What types of businesses are having difficulty paying taxes during the current economic recession? Mr. Salazar said that businesses across the spectrum are having trouble meeting their tax liabilities.

Statewide Municipal and County Legislative Priorities

Paul Gutierrez, executive director, New Mexico Association of Counties (NMAC), and Bill Fulginiti, executive director, New Mexico Municipal League (NMML), discussed with the committee their organizations' legislative priorities. Mr. Gutierrez began with a list of potential legislative changes, including:

- the expansion of the definition of felony offender to include county inmates awaiting transport to prison, in order to reimburse counties for the cost of housing state inmates;

- an increase in the amount of retirement distributions made on behalf of volunteer firefighters;

- an increase in the term limits of elected county officials from two terms to three;

- resolving the discrepancies throughout the state involving payments to county officers;

- allowing an increase in the county correctional facility GRT;

- the establishment of a statewide system for hazardous material route designations;

- requiring that county sheriffs also be certified peace officers;

- fixing the issues surrounding residential property tax valuations; and

- resolving problems counties have with voting machine maintenance contracts.

Mr. Fulginiti presented a preliminary list of legislative proposals and general principles that he anticipated would be adopted by the NMML at its October meeting. The first principle is that the league opposes federal and state legislation that preempts local authority, and the second principle is that the NMML endorses the protection of municipal revenues due to any changes in tax structure. Three specific legislative proposals are also expected to be endorsed, including:

- establishing a uniform system of assessing franchise fees on utility companies;

- the removal of the restriction that municipalities must enact all other GRT increments before they can enact a municipal capital outlay GRT;

- allowing all municipalities to impose the municipal environmental services GRT at a rate of one-half of one percent of gross receipts; and

- the passage of a general obligation bond bill for $18 million for libraries, for approval by the voters at the 2010 general election.

Questions and comments from committee members included:

- Will increased franchise fees that energy companies may pay to the counties result in an increase in customer bills? Mr. Gutierrez said that fees will probably be passed on to their customers. He said the NMAC wants to have one statewide rate for franchise fees rather than the current practice of each county negotiating franchise fees with energy companies. John Gillis of the New Mexico Gas Company said that while municipalities can collect a franchise fee from energy companies based on a percentage of the sales in the municipality, counties are restricted to receiving only "reasonable expenses". He said that his company supports the proposed change.

- What problems are counties facing with their correctional centers? Mr. Gutierrez said that counties are required by law to house inmates, yet they are not adequately compensated by the state or municipalities to cover their expenses. Some counties are spending 40 percent of their annual budgets on correctional centers.

- Volunteer firefighters should be compensated for some of their training activities. The NMAC needs to work with the Public Employees Retirement Association (PERA) to ensure that volunteer firefighters are properly credited for their service.

- What is the reason behind increasing the term limits for county officers? Mr. Gutierrez said that an extra term would provide more stability for county governments because more time in office would be helpful to develop the skills of elected officials.

- Is Santa Fe County allowed to remove the sole community provider designation of Christus St. Vincent Medical Center since voters have already enacted a one-eighth percent GRT increment for that purpose? Mr. Gutierrez said he will research that question for the committee.

- Some counties are over-bonding GRT revenues and are laying off employees at the same time they are creating new costly initiatives.

Continue Research and Development Tax Credit

Matthew Woodlee, director, Division of International Trade, Economic Development Department (EDD), discussed a legislative proposal to extend the research and development small business tax credit until 2014. He said that the bill has been introduced in the legislature the past two years and has not received any opposition, yet it was unable to make it through the legislature either year. He said that five to seven companies each year have received the credit, and it has a fiscal impact of about $140,000 per year. Although the credit is relatively small, it has attracted research and development companies to the state, said Mr. Woodlee.

Questions and comments from committee members included the following:

- Why has the research and development small business tax credit not been used very much? Mr. Woodlee said that the credit was specifically designed to benefit research and development companies that may sell a few items but have not yet begun full production.

- Which companies have benefited from the credit and for how much? Mr. Nunns said that the TRD is only allowed to disclose the names of taxpayers if a credit is granted for $10,000 or more.

- The committee requested a list of companies receiving the credit along with a list of all other credits and investment benefits those companies are receiving from the state.

Film Production Tax Credit Legislative Proposal

Lisa Strout, director, New Mexico Film Office, EDD, presented proposed legislation to the committee to change and clarify certain provisions of the film production tax credit. The bill gives the division more flexibility to determine whether all creditor claims have been satisfied before approving the credit for the company, provides for withholding of income taxes by pass-through entities acting as film performing artist entities and provides a corresponding exemption from the GRT for those entities.

Questions and comments from committee members included the following:

- Changing the requirement for satisfying creditor claims from a specific date to a date that is at the discretion of the division may open up the state to uncertainties in how it approves the tax credit. Ms. Strout said that the language change was an attempt to give the division some flexibility rather than having a fixed date at which all creditor claims must be satisfied. The change is also attempting to strengthen protections of employees and vendors against unscrupulous film production companies.

- Perhaps the division should put some of these proposed changes into rule rather than statute.

- A recent listing of film production companies receiving the tax credit revealed that one-third of those companies are not registered with the Public Regulation Commission. Ms. Strout said that a company is not required to be a New Mexico company in order to receive the credit.

- Expenditures by film production companies need to be disclosed. Ms. Strout said that some information is confidential. The division is now requiring companies to disclose amounts spent by expense category.

- Have other states increased their film production tax credits recently? Ms. Strout said that the credit percentage is 42 percent in Michigan, 44 percent in Alaska and 50 percent in Iowa, compared to New Mexico's 25 percent.

- Why does the proposed legislation exempt the GRT for film performing artist entities? Ms. Strout said that imposing the GRT on those entities, when they are already paying income tax, would lead to tax pyramiding. Mr. Nunns said that there would be no net fiscal impact, except for a one-time speed up of income tax collections.

Pyramiding and Other Gross Receipts Issues

Mr. Nunns gave a presentation to the committee about pyramiding issues within the GRT. Pyramiding occurs whenever a business' receipts are subject to the GRT and some of the business' purchases from other businesses are also subject to the GRT or the compensating tax. Examples of pyramiding include most services, utilities and equipment sold to businesses. Some of the pyramiding is offset by certain targeted credits, like the investment tax credit, and many transactions are not subject to the tax because of existing exemptions, deductions or credits. Pyramiding is a problem because it causes economic distortions that reduce business activity in New Mexico. Small businesses can be especially affected by pyramiding, because they often need to purchase many services, which are taxed, while large companies can often provide that same service in-house. Another problem with pyramiding is that businesses that purchase from other businesses have an incentive to purchase out of state.

Tax pyramiding can be addressed in several ways, including allowing a general deduction or credit for sales to other businesses or allowing purchasing businesses a general deduction or credit for taxed purchases. Pyramiding represents a large portion of the GRT base, so addressing it comprehensively would require substantial replacement revenues. Some estimates place pyramiding as high as one-third of the entire GRT base, said Mr. Nunns.

Exemptions from the GRT have been enacted in order to reduce pyramiding. Some exemptions are general exemptions, such as wages, because virtually all business sales require the use of some employees. Other exemptions and deductions are targeted to remove from the GRT base items that in principle "should" be taxed, but that are subject to other taxes or are exempted for specific policy goals. For example, motor fuels are exempt from gross receipts taxation because they are already taxed. Deductions from gross receipts for food are allowed to reduce the regressivity of the GRT. The medical deduction can be considered a way of avoiding pyramiding because medical services that can be deducted are also subject to the premium tax.

Another issue that has developed within the GRT system is that rate differentials exist between municipalities and counties and between in-state sales and out-of-state sales. GRT rate differentials between municipalities and the remainder of county areas average one percent but are as high as 2.4 percent, which could lead to businesses locating outside municipalities to avoid higher taxation. When comparing in-state purchases to purchases from out of state, the rate differentials are even larger. An out-of-state purchase from a seller without a nexus in New Mexico is subject only to the compensating tax of five percent, which automatically gives out-of-state sellers a competitive advantage of between one and two percent for all sales. However, due to a loophole in the compensating tax structure, if a New Mexico business makes a purchase from a seller without a nexus in New Mexico, and takes delivery of the items in New Mexico, no tax is due on that purchase. This can result in a differential as much as 8.5 percent, which can lead to significantly reduced business activity in the state. It should be noted, however, said Mr. Nunn, that taxing those out-of-state purchases, although making the tax system more equitable for in-state businesses, will also further compound the tax pyramiding problem.

Rate differentials between the GRT and other taxes also exist. For example, the motor vehicle excise tax is imposed at three percent, compared to an average 6.7 percent GRT rate. In principal, all goods and services purchased by households should be taxed at the same rate, unless a rate differential helps achieve some other policy goal, said Mr. Nunns.

Committee members discussed medical service deductions and made several comments, including that:

- giving a GRT deduction for medical services under contract with an insurance plan but taxing individuals who purchase the same services is not fair;

- medical providers, and not patients, are forced to pay the GRT for insurance co-payments, which are subject to the GRT; and

- enactment of medical services deductions has increased the number of providers in rural areas.

Update of Legislative Finance Committee Review of Film Credit Studies

Tom Clifford, chief economist, Legislative Finance Committee (LFC), gave the committee an update on the LFC's evaluation of film production tax credit policy. The amount of credit paid by the state since the increase of the credit allowed in 2005 has risen from just a few million dollars in fiscal year 2005 to $80 million in fiscal year 2009. However, fiscal impact reports presented to the legislature anticipated far less of an impact than was actually realized. Mr. Clifford said that with such a large fiscal impact, it is important to re-evaluate that particular incentive. The net impact of the film production tax credit has been previously studied and reported to the RSTP, and Mr. Clifford reviewed findings of New Mexico State University's Arrowhead Center and Ernst and Young (E & Y), which reached different conclusions. While the Arrowhead study found that the return on investment (ROI) of state tax expenditures for the film credit was 14 cents return to the state for every dollar spent, the E & Y study concluded that the state had an ROI of 96 cents, plus an additional 56 cents realized in local tax revenue. As previously reported, the LFC had several concerns with the E & Y study, including that the study included unusually high incomes for New Mexico employees; the study included a very large one-time capital expenditure related to the construction of Albuquerque Studios; and the study extrapolated tourism-related effects from a small number of survey responses. Without getting too far into the details of either study, Mr. Clifford concluded that the actual ROI of the tax credit is probably less than 50 cents.

The LFC had additional concerns with the E & Y study, since not all state and local subsidies were included in the study. For example, the State Investment Council made $229 million in no-interest loans to film production companies during that period, but those loans were not included in the study. Also not included were $27 million in direct capital expenditures, $9 million in job training partnership funds and an undetermined amount of GRT deductions. Mr. Clifford estimated that those subsidies would add a cumulative $10 million to $20 million annually to the amount of the state subsidy for the film industry.

Mr. Clifford said that the opportunity cost of the film production tax credit needs to be evaluated. The state is required to offset tax credits and other subsidies in its budgeting process, and reduced spending by the state has indirect effects on jobs, incomes, etc., similar to the increase in economic activity resulting from the film industry's increased presence. One way of evaluating the opportunity cost is to calculate the cost per job of film industry subsidies and compare that to other industry subsidies. Taking 2008 figures, Mr. Clifford estimated that each job created by the film industry tax credits costs $30,000 per year to the state. The investment credit costs the state between $25,000 and $50,000 per job, but that is a one-time expense. Another way of looking at the benefits of the tax credits is to calculate what could be done using that lost revenue to the state in other programs. For example, using the revenue to support the Medicaid program would generate three times as much money from the federal government as was spent, in addition to the benefits of providing more health coverage to New Mexicans. Other questions that need to be asked in evaluating a subsidy include "Why this particular industry?"; "What are the specific goals: i.e., if the policy goal is to create new jobs, should that be a requirement prior to receiving the credit?"; and "How much of a subsidy is appropriate, and for how long?". In conclusion, Mr. Clifford said that analysis of the current film production tax credits shows that the credits do not generate enough economic activity to offset their fiscal impact.

Mr. Clifford then briefly reviewed a summary of revenue impacts from changes in tax law since 2003. In summary, revenue-increasing changes are expected to add $385 million to the state revenues in fiscal year 2011, while revenue-decreasing measures will reduce state coffers by $913 million, for a net fiscal year 2011 loss of $528 million. Mr. Clifford categorized tax law decreases into five broad categories: low-income tax relief ($268 million), medical services ($108 million), economic development ($508 million), renewable energy incentives ($11 million) and other incentives ($18 million). Tax increases included transportation funding tax changes ($68 million), premium tax changes ($52 million), income tax withholding changes for oil and gas distributions ($30 million), GRT credit changes ($184 million) and other tax increases ($51 million).

Questions and comments from committee members included the following:

- Mr. Nunns was asked if he concurred with the conclusions made by Mr. Clifford. Mr. Nunns said that economic impact studies are always difficult to perform, and they have many variables that can be adjusted, depending on one's assumptions.

- Why was there such a large increase in oil and gas withholding? Mr. Clifford said that when the increased requirements took effect, a large number of tax obligors began withholding taxes for the first time. The TRD did not expect such a large increase, he said.

- In order to present an accurate picture of net revenue changes, fee changes need to be presented, as do tax law changes.

- The impact of what would happen to the film industry in New Mexico if the film production tax credit were repealed needs to be studied. Rather than studying opportunity costs, a bottom-up supply-side analysis needs to be performed.

- Are there any other economic development subsidies that are as large as those given to the film industry? Mr. Clifford said that industrial revenue bonds account for a large amount of tax expenditures for local governments.

- Is the tax credit refundable? Mr. Clifford said that it is, regardless of whether a tax liability exists. Mr. Nunns said that refunding credits is the most efficient method of administering a credit.

- The total amount of film production tax credit should be capped each year.

The committee recessed at 4:55 p.m.

Tuesday, September 15

The committee reconvened at 9:08 a.m. on Tuesday, September 15, 2009, at the Lodge Resort in Cloudcroft.

Corporate Income and Franchise Tax Review and Alternatives

Richard Anklam, director, New Mexico Tax Research Institute (NMTRI), and Mr. Nunns presented reviews of the corporate income tax system in New Mexico and alternatives to the current system. Mr. Anklam began by describing the basic tenets of the corporate income tax. The corporate income tax is a tax on profits that is paid by the corporation. Profits are also taxed at the individual level. Most small- to medium-sized businesses have converted to limited liability companies or a similar structure and are not subject to double taxation, said Mr. Anklam. Using four principles of good tax policy — adequacy and stability, equitable treatment, ease of administration and compliance and impact on economic development — Mr. Anklam evaluated the corporate income tax generally and a proposal to require combined filing of tax returns.

Adequacy and Stability of Revenue Source

Generally, the corporate income tax in New Mexico provides about five percent of state revenues, but the tax is also the most unstable revenue source because the tax is only collected when corporations earn a profit. More specifically, if corporations are required to use combined filing of their tax returns, although the requirement has been predicted to bring in additional revenue to the state, during a recession, the state may actually lose more money because corporations will be pulling in losses from out of state. Requiring combined reporting will not significantly affect the stability of corporate tax revenues.

Equitable Treatment of Similarly Situated Taxpayers

Because small- to medium-sized businesses can avoid corporate income tax, the tax is more likely to burden larger multistate businesses. Although policy reasons for this different treatment may have existed in the past, those reasons are no longer clear. Regarding mandatory combined filing, while requiring all taxpayers to use one method of filing would create more uniformity, it would not necessarily be equitable. Allowing filing options is a benefit for taxpayers in that it lets them choose the best method for their circumstances and may to some extent offset New Mexico's uncompetitive tax rate.

Ease of Administration and Compliance

State corporate income tax is very complex to administer and comply with. Compared to the revenue generated, this complexity is relatively significant. Requiring combined filing will only add to the complexity of the tax. Mr. Anklam said that there have been a few corporations that have abused the separate filing method as a means of avoiding corporate tax in the state. However, those abuses have been dealt with in court, and dozens of companies have since settled tax disputes with the TRD. Mr. Anklam suggested that the problems associated with the separate filing method have already been resolved, and there is no need to require combined filing.

Impact on Economic Activity and Development

Because the corporate income tax generally falls on larger, multistate companies, the impact of a particular state's corporate income tax may affect the amount of activity or investment a corporation makes in that state. The separate filing method currently allowed in New Mexico is a significant incentive for multistate, profitable companies to expand into or make investments in New Mexico if those investments are not expected to be initially profitable.

Next, Mr. Anklam discussed the apportionment method used to tax multistate companies that have elected to use combined filing. The traditional formula of apportionment uses a company's property, payroll and sales in all locations and in the state to come up with a percentage that is applied to taxable income. New Mexico uses the traditional three-factor formula in even portions. As a result, when a company makes investments or creates jobs in New Mexico, its tax increases in New Mexico. Some states have adopted apportionment formulas that reduce the emphasis on property and payroll and increase the emphasis on sales, making it more advantageous for companies to create "economic base jobs" in the state. Arizona, Colorado, Utah and Texas have adopted such formulas. He cautioned that a change in New Mexico's apportionment method to attract investment would likely reduce the state's total corporate income tax revenue.

Mr. Nunns then provided the committee with a review of policy considerations regarding the corporate income tax. The double tax design of the corporate income tax creates significant economic distortions for three principal reasons. First, because noncorporate forms of business are only taxed at the individual level, the corporate income tax provides a disincentive from forming a corporation. Second, because undistributed corporate income is taxed at a lower rate than distributed income, corporations have an incentive to retain income rather than distributing it. Finally, because corporate income is generally taxed at a higher rate than interest on loans, corporations have an incentive to finance with loans rather than finance with equity. There are additional distortions created by the current structure of the federal corporate income tax, including provisions that result in mistiming of deductions and income, which generally result in an understatement of net income. The most significant are those provisions that allow accelerated forms of cost recovery for investments. Another economic distortion in the current federal income tax is the deduction for domestic production activities, which distorts business decisions.

The New Mexico corporate income tax largely incorporates the economic distortions found in the federal tax. However, the issue of double taxation typically differs between large and small corporations at the state level. Large multistate corporations operating in New Mexico tend to have their income taxed at just the corporate level because most of their shareholders tend to live out of the state. Small New Mexico corporations, however, are more likely to have their shareholders living in the state, which results in income from that corporation being taxed twice by the state. New Mexico can design its tax system to mitigate the double tax issue of small corporations, said Mr. Nunns.

Other distortions arise in the New Mexico corporate income tax due to the complex methods of determining the appropriate amount of tax to impose on the income of multistate businesses. These companies are typically part of a large number of related entities that may have multiple transactions between themselves, including sales, asset transfers, cost-sharing arrangements, charges for services and royalties. These transactions make the determination of income attributable to New Mexico very difficult. In an attempt to match the income and expenses of multistate corporations properly, many states, including New Mexico, have introduced legislation to require combined reporting; to reallocate income, deductions and other items between entities; to tax passive investment companies that have been created to avoid taxes; to establish minimum taxes; or to enact significant franchise taxes. All of these attempts to catch taxes owed a state are complex, requiring significant state and corporate resources, and have also generated litigation.

Mr. Nunns discussed possible revenue effects to New Mexico if it adopts mandatory combined reporting for multistate corporations. Corporate income tax revenue is the most volatile taxation revenue source for the state, and requiring combined reporting will not change that volatility. Revenue estimates for the effect of mandatory combined reporting are difficult to make in New Mexico because it is uncertain how corporations will react to such legislation. Other states' experiences have previously indicated that New Mexico's corporate income tax revenues would increase by 20 percent if mandatory combined reporting was adopted. However, Mr. Nunns cited three recent studies suggesting that the 20 percent figure is unrealistically high. Some conclusions of the studies included that:

- combined reporting has uncertain effects on a state's revenues;

- switching from separate filing to combined reporting may have a negative impact on a state's economy;

- no evidence from statistical analysis of actual state revenues exists that combined reporting has affected state revenues; and

- combined reporting is not significantly associated with state corporate income tax revenues.

Given the revenue uncertainties and possible economic competitiveness issues surrounding mandatory combined reporting, Mr. Nunns said that other alternatives to tax multistate corporations effectively are worth serious consideration. One promising alternative is the new franchise tax proposal introduced in the 2009 regular legislative session by Senator Wirth. The new franchise tax amount would be based on a corporation's property, payroll and sales in New Mexico in excess of certain threshold amounts. Under the proposed legislation, the new tax would only affect the largest seven percent of corporations in New Mexico and would be offset by the amount of corporate income tax the business owes. This new tax would ensure that all large corporations pay some income or franchise tax related to their presence in New Mexico and the benefits they derive from that presence. In addition, the new tax would be a fairly reliable source of revenue because property, payroll and sales are more stable than a company's profits.

Questions and comments from committee members included the following:

- Why are there regional differences in the requirement of combined reporting? Mr. Anklam said that historically, eastern states developed their tax policy much earlier than western states. Also, western states tend to be signatories to multistate tax compacts.

- What is the best solution to the problem of taxing multistate corporations? Mr. Nunns said that mandatory combined reporting would help some, but that the franchise tax proposal would better match tax payments with services being provided by the state. Senator Wirth said that he sponsored the legislation because New Mexico-based companies were not being treated equitably compared to their multistate counterparts. New Mexico corporations are being taxed generally at 7.6 percent of net income, while some multistate corporations do not pay any state corporate income tax. This disparity is especially large in the tax treatment between local banks and multistate banks.

- If the franchise tax legislation included a manufacturing carveout to protect that industry, would the Richardson administration support the bill? Mr. Nunns said he is not sure if the governor would support that bill. Mr. Anklam said that if certain identifiable economic development sectors were protected, the NMTRI could support the bill.

- Is the film industry shifting profits from New Mexico to avoid corporate income tax? Mr. Nunns said that in general, he believes that is not happening, but he will confirm that information.

- Is the TRD actively pursuing corporations that are abusing the separate filing method to avoid paying the corporate income tax? Mr. Nunns said there are some current cases being pursued, which takes up a large part of the department legal staff's time.

- Multistate corporations are getting benefits from New Mexico but are not paying for those benefits.

- Does New Mexico allow carryforward losses on corporate income? Mr. Nunns said that carryforward deductions are allowed, but the period is shorter than what the federal government allows. Carryback loss deductions are not allowed in New Mexico.

- Are internet sales treated the same as catalog sales for tax purposes? Mr. Nunns said if a business has a nexus in New Mexico, then it is required to pay the GRT on sales in New Mexico. The real issue with taxing out-of-state sales for businesses without a nexus is whether the federal government will allow collection of those taxes.

- Bringing the property factor into a franchise tax could affect some companies' ability to pay their taxes, because property is not easily convertible into cash.

- Would "add back" provisions address the issue of multistate tax liability? Mr. Anklam said that most states that have separate filing for corporations also have such provisions to tax some of the profits that have been reported out of the state. The best solution, he said, is to go after companies that are actually abusing the tax laws rather than try to tax an entire class of law-abiding corporations. Mr. Nunns said that "add-back" laws could bring in more revenue to the state, but they would also use significant department resources to administer.

- Could the TRD reallocate multistate profits to the state, like many other states do? Mr. Nunns said that reallocation rules prevent companies from shifting profits to other states by underselling and other accounting practices. Although many states have such laws, they are difficult to enforce.

- Mr. Anklam was asked to provide the committee with data from other states on the enforcement of "add-back" laws.

Use of Fire Protection and Emergency Medical Services Funds

The committee heard a presentation about New Mexico's emergency medical services (EMS) and trauma system and a legislative proposal to fund the system. Leading the discussion was Mike Miller, city councilor, Portales. He was joined by Don McNutt, chair, Statewide Emergency Medical Services Advisory Committee, Jan Eliott, executive director, EMS Region III, Dr. Dale Kester, chair, Trauma System Fund Authority, Jim Stover, EMS director, Lincoln County, James Marshall, mayor, Silver City, and Mr. Fulginiti from the NMMI. Mr. Miller said that a task force has met for the past nine months to address funding for the statewide EMS and trauma system. In 1987, legislation was adopted, nicknamed "$1.00 for life", that assessed a $1.00 fee on motor vehicle registrations to fund the EMS system. Since 1992, money for the EMS system has been funded only from the general fund as part of the annual budget. The task force devised a plan to fund the EMS and trauma system permanently that includes imposing an additional one percent premium tax on home, rental and auto insurance policies. The increase in the tax would provide an additional $17 million annually to ensure the viability of the EMS and trauma system in the state. The legislation would also free up nearly $9 million in recurring general fund money, which can be used for other purposes. The premium tax would increase one-fourth percent every three years, up to a total increase of three percent in 2034, with the additional revenue being dedicated toward the EMS and trauma system.

Mr. Fulginiti said that most municipalities in New Mexico do not have adequate EMS systems, and most EMS volunteers fund their own training.

Questions and comments from the committee included the following:

- How are trauma centers in the state designated? Dr. Kester said that the trauma system in New Mexico follows national guidelines. Each state can have one Level I trauma center, which provides the highest level of care and research. Level II centers have the same medical care as Level I centers but without the research and education abilities. Level III centers have a moderate amount of trauma care abilities, and Level IV centers can provide basic stabilization of trauma patients before transport. Most trauma centers in the state are Level IV centers. Since the advent of New Mexico's trauma system, there has been a decrease in the amount of out-of-state transfers.

- Will the increase in the premium tax fund new trauma centers? Dr. Kester said that it will. Hospitals have contributed to trauma centers, but the state contribution has been flat. The increased funding will further encourage more contributions from private hospitals toward the system.

- Recent funding changes made by the governor that took $1 million from services to children with developmental disabilities and directed it toward the trauma system were not fair.

- A one percent increase in the premium tax is a large increase. Perhaps starting with a one-fourth percent increase instead would be a better idea.

- Are local governments contributing to the EMS and trauma system from local option GRT enactments? Mr. Miller said that most municipalities have enacted EMS taxes, but he was not sure about counties.

- Does combining 911 dispatch centers create problems? Mayor Marshall said that problems can arise when not all areas of an EMS area are known to dispatch employees, especially in larger counties.

Solvency Discussion Update

David Abbey, director, LFC, gave an update to the committee on the current status of fiscal year 2010 revenues and budget projections. The August 2009 consensus forecast, prepared by career economists at the Department of Finance and Administration, the Department of Transportation, the TRD and the LFC, estimates that fiscal year 2009 shortfalls would amount to $114 million and that fiscal year 2010 is currently projected to be $542 million short, for a total deficit amount of $656 million. Current reserves can cover some of the appropriation shortfall, but for the state to maintain a modest seven percent reserve level, $384 million needs to be found in nonrecurring savings, said Mr. Abbey.

Fiscal year 2009 shortfalls can be easily covered by legislation transferring money from the general fund reserves, but covering the expected fiscal year 2010 deficit will probably require significant reductions in budgets. A preliminary executive proposal for fiscal year 2010 budget reductions recommended cutting $454 million, but the LFC has advised the need for cutting $512 million. Revenue estimates in October will probably be even worse than the August estimate, which may necessitate further cuts. While the executive proposal cuts $100 million from state budgets, it leaves education alone. Other executive proposals include using $91 million in education stimulus funding; issuing $135 million in short-term severance tax bonds to be used for operational purposes; de-authorizing $68 million in capital outlay projects; suspending the increased state contribution to the Educational Retirement Fund for two years; and transferring $40 million from other state funds. The LFC recommends cutting all budgets, including educational budgets, by 3.5 percent, for $181 million in savings; using $75 million in executive and educational stimulus funding; swapping $10 million in general fund capital outlay appropriations for severance tax bonds; de-authorizing $80 million in unused capital outlay appropriations; and transferring $145 million from various state funds.

LFC staff members believe that the proposal to issue severance tax bonds for operating purposes may violate constitutional provisions specifying how severance tax revenues may be spent, said Mr. Abbey. Although the Public School Capital Outlay Council has the authority to issue short-term severance tax bonds for school projects and uses a portion of that money for operating expenses, he thinks that the executive proposal goes too far.

Questions and comments from committee members included the following:

- Revenue enhancements, including taxes, need to be considered in addition to cutting budgets. Mr. Abbey said that revenue enhancements enacted may not have much of an effect on fiscal year 2010 revenues. Revenue enhancements could play a large role in crafting the fiscal year 2011 budget, however.

- The legislature and executive need to be careful not to take money away from viable capital outlay projects.

- Can the executive transfer money to cover the budget shortfall without legislative action? Mr. Abbey said that only the legislature can authorize the transfer of funds.

- The executive hiring freeze ordered by the governor did not actually happen. The state will be in even worse shape in fiscal year 2011. The legislature needs to cut $500 million in recurring funding this fiscal year rather than trying to fill the budget void with transfers.

- Did state employees receive a pay increase in the fiscal year 2009 or 2010 budget? Mr. Abbey said that state employees actually had their effective salaries cut, since the state contribution to the PERA was reduced this year.

- The legislature has cut taxes over the past several years, and some estimates are that the state has foregone more than $2 billion in revenue during that period. Education funding should not be cut.

- A three percent cut in state agency budgets could result in employee layoffs, which could compound the economic downturn. Mr. Abbey said that both the executive and LFC scenarios do not contemplate layoffs.

The minutes of the August 27-28 minutes of the committee were adopted without changes.

There being no further business, the committee adjourned at 12:58 p.m.

REVENUE STABILIZATION AND
TAX POLICY COMMITTEE

Section 7

October 2009
Agenda
Meeting Canceled
No Minutes

Revised: October 1, 2009

TENTATIVE AGENDA
for the
FIFTH MEETING IN 2009
of the
REVENUE STABILIZATION AND TAX POLICY COMMITTEE

October 14, 2009
State Capitol, Room 307

October 15, 2009
State Capitol, Room 322

<u>Wednesday, October 14</u>

9:00 a.m. Call to Order
—Senator John Arthur Smith, Chair

9:05 a.m. **The Economy's Impact on Business in New Mexico**
—Beverlee J. McClure, Executive Director, Association of Commerce and Industry
—TBA, Business Owner
—TBA, Business Owner
—TBA, Business Owner
—TBA, Business Owner

10:00 a.m. **Governor's Solvency Proposal**
—Katherine B. Miller, Secretary of Finance and Administration

11:15 a.m. **Legislative Proposals — Taxation and Revenue Department (TRD)**
—Rick Homans, Secretary of Taxation and Revenue
—Jim Nunns, Tax Policy Director, TRD

12:10 p.m. **Lunch**

1:30 p.m. **Economic Forecast**
—Katherine B. Miller, Secretary of Finance and Administration
—Rick Homans, Secretary of Taxation and Revenue
—Tom Clifford, Chief Economist, Legislative Finance Committee

2:45 p.m. **Approval of September 14-15, 2009 Minutes**

2:50 p.m. **Property Tax Delinquencies — Need to Reform Process**
—Pete Rael, Chair, Valencia County Board of County Commissioners

3:50 p.m. **TBA**

4:45 p.m. **Recess**

Thursday, October 15

9:00 a.m.	**Streamlined Sales Tax — New Mexico's Options** —Thomas Pogue, Economist and Professor Emeritus, University of Iowa
10:30 a.m.	**Gross Receipts Tax Exemptions — Purpose, Necessity and Creation of Transparency** —Robert Desiderio, Attorney and Professor of Law
12:00 noon	**Adjourn**

REVENUE STABILIZATION AND
TAX POLICY COMMITTEE

Section 8

November 2009
Agenda
Minutes

Revised: November 20, 2009

TENTATIVE AGENDA
for the
FIFTH MEETING IN 2009
of the
REVENUE STABILIZATION AND TAX POLICY COMMITTEE

November 23-25, 2009
State Capitol, Room 322

<u>Monday, November 23</u>

9:00 a.m. **Call to Order**
—Senator John Arthur Smith, Chair

9:05 a.m. **Streamlined Sales Tax — New Mexico's Options**
—Thomas Pogue, Economist and Professor Emeritus, University of
Iowa

10:30 a.m. **Gross Receipts Tax Exemptions — Purpose, Necessity and**
Creation

of Transparency
—Robert Desiderio, Attorney

11:40 a.m. **Film Tax Credit and Other Business Incentive Credits —**
Update
—Jim Nunns, Tax Policy Director, Taxation and Revenue
Department
(TRD)

12:30 p.m. **Lunch**

1:45 p.m. **Legislative Proposals — TRD**
—Rick Homans, Secretary of Taxation and Revenue
—Jim Nunns, Tax Policy Director, TRD
—Michael Sandoval, Director, Motor Vehicle Division, TRD

2:45 p.m. **The Economy's Impact on Business in New Mexico**
—Beverlee J. McClure, President and Chief Executive Officer,
Association of Commerce and Industry (ACI)
—David Doyle, President and Owner, Enterprise Builders,
Albuquerque
—JoLou Trujillo-Ottino, Owner, MediaWorks, Albuquerque
—Luis Reyes, CEO, Kit Carson Electric Coop, Taos

—Lee Malloy, President, Honetreat Company, Clovis

4:00 p.m.	**Meal Tax for Tourism Marketing** —Michael Cerletti, Secretary of Tourism
5:00 p.m.	**Recess**

<u>Tuesday, November 24</u>

9:00 a.m.	**Energy, Minerals and Natural Resources Department (EMNRD) Bills** —Craig O'Hare, Special Assistant for Clean Energy, EMNRD
10:00 a.m.	**Property Tax Task Force Update** —New Mexico Association of Counties
10:40 a.m.	**Property Tax Litigation Update** —Karen Montoya, Assessor, Bernalillo County
11:00 a.m.	**Property Tax Proposals** —Senator Mark Boitano —Senator Steven P. Neville
12:00 noon	**Lunch**
1:15 p.m.	**Tax Expenditure Budget Legislative Proposal** —Senator Timothy M. Keller
2:00 p.m.	**Nonprofit Taxation** —Richard Anklam, Executive Director and President, New Mexico Tax Research Institute (NMTRI)
2:45 p.m.	**Revenue Forecast** —Tom Clifford, Chief Economist, Legislative Finance Committee (LFC) —Brian McDonald, Economist —Larry Waldman, Senior Economist, Bureau of Business and Economic Research, University of New Mexico (UNM) —Chris Erickson, Professor of Economics, New Mexico State University
3:30 p.m.	**Goals and Principles** —Pam Ray, Staff Attorney, Legislative Council Service —Tom Clifford, Chief Economist, LFC
4:45 p.m.	**Recess**

Wednesday, November 25

9:00 a.m.	**Reconvene** —Senator John Arthur Smith, Chair
9:15 a.m.	**Income Tax** —Tom Clifford, Chief Economist, LFC —Brian McDonald, Economist —Robert Desiderio, Attorney (Invited) —Timothy VanValen, Chair, Tax Policy Committee, ACI
10:45 a.m.	**Corporate Income Tax** —Tom Clifford, Chief Economist, LFC —Dick Minzner, Attorney —Robert Desiderio, Attorney (Invited) —Timothy VanValen, Chair, Tax Policy Committee, ACI
12:15 p.m.	**Lunch**
1:30 p.m.	**Budget Balancing Task Force Report** —Jim Nunns, Tax Policy Director, TRD
2:30 p.m.	**Gross Receipts Tax** —Tom Clifford, Chief Economist, LFC —Richard Anklam, Executive Director, NMTRI —Bill Fulginiti, Executive Director, New Mexico Municipal League —Lee Reynis, Director, Bureau of Business and Economic Research, UNM —Timothy VanValen, Chair, Tax Policty Committee, ACI
4:00 p.m.	**Adjourn**

MINUTES
of the
FIFTH MEETING IN 2009
of the
REVENUE STABILIZATION AND TAX POLICY COMMITTEE

November 23-25, 2009
Room 322, State Capitol
Santa Fe

The fifth meeting of the Revenue Stabilization and Tax Policy Committee (RSTP) for 2009 was called to order by Senator John Arthur Smith, chair, at 9:18 a.m. on November 23, 2009 in room 322 of the State Capitol in Santa Fe.

Present
Sen. John Arthur Smith, Chair
Rep. Edward C. Sandoval, Vice Chair
Sen. Carlos R. Cisneros
Rep. Nathan P. Cote (November 24)
Rep. Anna M. Crook
Sen. Tim Eichenberg (November 24)
Rep. Keith J. Gardner (November 25)
Sen. Timothy Z. Jennings (November 23-24)
Sen. Timothy M. Keller
Sen. Gay G. Kernan
Rep. Rodolpho "Rudy" S. Martinez
Sen. Howie C. Morales
Rep. Henry Kiki Saavedra (November 23-24)
Rep. Thomas C. Taylor
Rep. Jim R. Trujillo

Absent
Sen. Dianna J. Duran
Rep. Ben Lujan, Speaker of the House
Sen. William E. Sharer

Designees
Sen. Mark Boitano
Sen. Clinton D. Harden, Jr. (November 23)
Rep. Antonio "Moe" Maestas (November 25)
Sen. Nancy Rodriguez (November 25)
Rep. Luciano "Lucky" Varela
Sen. Peter Wirth (November 25)

Rep. Ray Begaye
Rep. Donald E. Bratton
Rep. Zachary J. Cook
Sen. Kent L. Cravens
Rep. Miguel P. Garcia
Rep. Sandra D. Jeff
Sen. Carroll H. Leavell
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

Other Legislators Attending
Sen. Stuart Ingle (November 24)

Rep. Danice Picraux (November 23-24)
Sen. Mary Kay Papen (November 23-24)

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

Staff
Pam Ray, Staff Attorney, Legislative Council Service (LCS)
Doris Faust, Staff Attorney, LCS
Kate Ferlic, Staff Attorney, LCS
Ric Gaudet, LCS

<u>Monday, November 23</u>

Streamlined Sales Tax — New Mexico's Options

Thomas Pogue, economist and professor emeritus, University of Iowa, gave a presentation to the committee about the Streamlined Sales Tax Project (SSTP), in which New Mexico participates as an advisory member. The project is a cooperative effort by 44 states and the District of Columbia to simplify and modernize sales and use tax administration and to provide even-handed treatment of in-state and out-of-state sellers. States that are full members are able to receive additional revenue in sales and use taxes from sellers located in states that are also participating in the SSTP. Other advantages include simplified compliance for taxpayers, reduction over time in the state's administrative costs, reduction of the tax advantage that out-of-state sellers enjoy over in-state sellers and lower litigation costs. Although the SSTP would be an improvement for the state over the current situation, federal legislation requiring out-of-state sellers to collect tax on sales into a state is still needed to fully realize the potential of taxing remote sales into New Mexico. Joining the SSTP carries some disadvantages, including the loss of some state sovereignty and flexibility in taxation.

For New Mexico to become a full member of the SSTP, New Mexico needs to comply with some key components of the project, including the following:

- State and local governments must use the same tax base.

- Adjustments would have to be made to the compensating tax, which does not currently apply to the same base as the gross receipts tax (GRT).

- Definitions of taxed products and services must comply with SSTP guidelines, including that items in certain categories of consumer goods should all be either taxed or tax exempt.

- Online registration and shared registration procedures need to be developed.

- An electronic taxability matrix needs to be developed that shows all products and services subject to tax. A rates and boundaries database would be required, which would show the boundaries of local jurisdictions and the corresponding tax rates for each locality.

- Multiple rates for the same product or service are not allowed by the SSTP, which means that New Mexico would have to abolish all partial deductions, caps and thresholds.

Other administrative procedures would need to be brought into alignment with the SSTP, including adjusting rules governing administration of exemptions; adoption of uniform tax returns and rules for remittances; making adjustments to comply with rules for recovery of bad debt; making monetary allowances to partially offset taxpayers' compliance costs; and granting tax amnesty to certain out-of-state taxpayers who subsequently become registered in New Mexico.

New Mexico would face some one-time costs to comply with the SSTP, mostly involving the development of the databases, acquiring data processing equipment, contracting with certified service providers and certified automated systems and modifying forms and procedures used in tax administration. During the transition, taxpayers would incur additional compliance costs; but after transition, compliance would be simplified for taxpayers. However, remote sellers that begin remitting taxes would incur higher compliance costs over the long term.

Questions and comments from committee members included the following:

- Can New Mexico continue to grant a deduction from gross receipts on food? Mr. Pogue said that it can, but the definition of food needs to be aligned with SSTP definitions, and the state cannot allow partial deductions. Jim Nunns, tax policy director, Taxation and Revenue Department (TRD), said that the SSTP has more flexibility in defining and taxing food than it has with other products.

- Would remote internet sales be taxed if New Mexico joined the SSTP? Mr. Pogue said that until federal legislation is enacted, internet sales will not be fully taxed. Only businesses operating in states that have joined the SSTP will be required to collect taxes on those sales. The SSTP is a step in the right direction in collecting tax on internet sales. Mr. Nunns said that New Mexico has a compensating tax on the use of products brought into the state, but it is currently estopped by statute from collecting the tax on individuals. Another problem is that the compensating tax is set at a much lower rate than the GRT, and it does not apply at all when the product is purchased out of state and delivered in New Mexico. On the other hand, if a company has nexus in New Mexico, then it must collect the GRT on sales in New Mexico. However, he cited a recent case in which the bookseller Borders was able to successfully separate its internet sales under a different company from its store sales and thus avoid collecting the GRT.

- Have other states had problems complying with the SSTP? Mr. Pogue said that Wisconsin is the most recent state to join the project, and its process was fairly smooth. Other states have not been happy with the process, mostly because it has been difficult to comply with the former requirement that sales taxes be destination-based, rather than origin-based. Mr. Nunns pointed out that the SSTP changed a rule in 2008 to allow states to have origin-based tax on sales inside the state, but it still required out-of-state sales to be destination-based. He also said that the two largest states, New York and California, have not yet become full member states.

- Why did Colorado choose not to participate in the SSTP? Staff was directed to research that question.

- What changes are needed in New Mexico's compensating tax? Mr. Pogue said that if all states joined the SSTP, then the compensating tax would no longer be necessary. In the interim, the compensating tax base needs to be made the same as that of the GRT.

- Will New Mexico still be able to tax services if it joins the SSTP? Mr. Pogue said that the SSTP does not restrict what can be taxed. It does require that definitions of products and services be the same as other states.

- Will taxes on motor vehicles be affected by joining the SSTP? Mr. Nunns said that the motor vehicle excise tax is imposed on vehicles at the time of registration and would not be affected by the SSTP.

Gross Receipts Tax Exemptions — Purpose, Necessity and Creation of Transparency

Robert Desiderio, attorney and former dean of the University of New Mexico School of Law, reviewed for the committee the role of GRT exemptions. New Mexico has a comprehensive base for gross receipts taxation, which captures too many goods and services that should not be taxed. There are many transactions that are prohibited from taxation by federal law or on constitutional grounds, including exemptions for the federal government, foreign governments and

Indian nations; services performed out of state; food stamps; and railroad equipment and aircraft used in transportation. Many activities are exempt from gross receipts taxation for normative reasons, including exemptions for the state and its political subdivisions; wages; dividends and interest; personal effects; homeowners' association assessments; occasional transfers; and social organization dues. Many exemptions have been enacted to avoid multiple taxation, including exemptions from the stadium surcharge and the event center surcharge and from sales of vehicles, boats, insurance, fuel and natural resources, all of which are taxed elsewhere. Specific taxpayers have also been exempted from taxation, including the use of property by and sales to federally recognized tax-exempt nonprofit organizations; sales to students at on-campus bookstores; receipts of nonprofit organizations operating facilities for retired or elderly persons; religious activities of ministers; and receipts of disabled street vendors. Finally, some industry-specific exemptions have been enacted, including receipts from the sale of livestock agricultural products, livestock feeding, fuel for space ships and race purses at New Mexico racetracks.

Mr. Desiderio discussed the transparency of exemptions, which are not reported to the state. Many of the exemptions are known to the state, since those transactions are reported elsewhere (for example, wages are reported via tax withholding). It would not be possible for the state to require reporting of transactions by the federal government or of out-of-state sellers. Requiring tax-exempt organizations to report their exemptions could be done, but would require significant expense to the state to enforce compliance and to organize the reported data. Finally, although converting some exemptions into deductions would bring some transparency to certain transactions, Mr. Desiderio said that most deductions are reported in the aggregate, which would not improve the transparency issue very much.

The committee discussed at length issues surrounding the tax exemptions granted to nonprofit organizations, including the high salaries that some organizations pay to their employees. Many committee members said that the tax exemptions given to nonprofits need to be reviewed and that nonprofit organizations need more scrutiny. Other questions and comments from the committee included the following:

- How much revenue is the state forgoing through exemptions? Mr. Desiderio said that many exemption amounts are known, but not all. The state does not have any revenue data on tax-exempt organizations.

- What is the difference between a sales tax and a gross receipts tax? Mr. Desiderio said that a sales tax puts the tax burden on the buyer, and New Mexico's GRT puts the burden on the seller. This distinction allows contractors that are providing services or products to the federal government to collect the taxes for those services or products.

- How the state issues nontaxable transaction certificates needs to be reformed. The current system raises many equity issues.

Film Tax Credits and Other Business Incentive Credits — Update

Mr. Nunns reviewed for the committee film and other business incentive tax credits existing in New Mexico. He began by stating that business incentive tax credits are intended to promote economic development, encourage development and use of alternative energy sources or meet some other policy goal. As such, these credits are really "tax expenditures" and need to be evaluated by expenditure principles and not by tax policy principles. Evaluating business incentive tax credits against the four basic tax policy principles of adequacy, efficiency, equity and simplicity shows that they tend to violate all four principles. Tax credits do need to be evaluated, but by using other expenditure principles. Credits can be evaluated using quantitative analyses such as return on investment (ROI) studies, but those studies require an investment of state resources.

Mr. Nunns presented a chart describing the 27 business incentive tax credits in New Mexico currently in effect and the three that have expired. There is a fair amount of variation in the key features of these credits, including against which types of taxes the credits can be claimed. Some credits specify a particular tax that can be reduced, while others allow credits against several taxes. Some credits can be carried forward against tax liabilities for a period of years, and others, like the film production tax credit, are completely refundable.

Mr. Nunns then described the fiscal impact to state revenues from the various tax credits. He pointed out that the rapid growth in the number and amount of claims is due in part to the relatively recent adoption of most credits. Increases in the film production, high-wage jobs, renewable energy production and rural health care practitioner tax credits account for most of the growth in the amounts claimed in the past several years. Finally, Mr. Nunns presented data on the film production tax credit for the current fiscal year. Through the first quarter of fiscal year 2010, 23 credits have been approved for $13.6 million, compared to 26 credits amounting to $27 million in the first quarter of fiscal year 2009.

Questions and comments from committee members included the following:

- What is the ROI of the film production tax credit? Mr. Nunns said that two studies were performed, with conflicting results. Ernst & Young did a study that showed an ROI of more than $1.50 returned to state and local governments for every dollar of credit granted, while the Arrowhead Center at New Mexico State University did a study that showed an ROI to the state government of 14 cents.

- The film production tax credit needs to be tightened up and perhaps capped, and its effectiveness needs to be reviewed periodically. Lisa Strout, director, New Mexico Film Division, Economic Development Department (EDD), said that her division is now requiring reporting on 12 different categories of film expenditures.

- An analysis of loans made to the film industry needs to be performed.

- The state should study whether the film production tax credit is creating a sustainable industry, and whether this credit needs to be in place in perpetuity. Once an industry is firmly in place, the credit granted to attract that industry should be phased out or capped.

- The committee requested more information from the TRD and EDD about how much the state is benefiting from the film production tax credit in terms of the number of jobs created and other criteria.

Taxation and Revenue Department Legislative Proposals

Rick Homans, secretary of taxation and revenue, Mr. Nunns and Michael Sandoval, director, Motor Vehicle Division, TRD, presented to the committee fiscal impact reports (FIRs) on six tax and four MVD legislative proposals. All of the bill drafts have been drafted by the LCS, and some had been presented to the committee at its meetings in Raton and Cloudcroft.

- <u>Withholding on Oil and Gas Proceeds and Pass-Through Entities</u>. The bill would combine the provisions for withholding on pass-through entities with the oil and gas proceeds withholding provisions; add clarifying definitions and rules; tighten rules that allowed nonresidents to avoid New Mexico income tax; and make pass-through entity withholding due quarterly. The FIR indicates a positive fiscal impact to the state of $15 million for fiscal year 2011, and about $10 million in subsequent fiscal years.

- <u>Tax Increment Development Districts (TIDDs)</u>. The bill would make two important technical changes to TIDD rules. The first change amends the GRT increment calculations to correct an omission, more closely conform to tax reporting and specify how certain estimates in the calculations are made. The second change amends the list of municipal and county gross receipts taxes that can be dedicated to a TIDD. The FIR does not indicate an actual fiscal impact, since that will depend on future state and local government decisions regarding particular tax increment dedications.

- Tax Administration. The bill would make a number of needed improvements to tax administration rules, including simplifying the protest and hearing process for taxpayers who have disagreements with the TRD; allowing the award of administrative and litigation costs related to credits; increasing the threshold for required monthly filing of combined reporting system (CRS) taxes from its 1991 level of $200 to an inflation-adjusted level of $300; authorizing the secretary of taxation and revenue to delay accrual of interest for persons affected by disasters or by military or terrorist actions; and correcting an oversight in the 2007 change to the tax rate for food and medical hold harmless distributions to large municipalities and counties. The FIR estimates a positive impact of approximately $7 million per fiscal year.

- Personal Income Tax (PIT) Simplification. The bill would simplify the PIT, making it easier for residents to file their tax returns; ensure that taxpayers are not unfairly taxed by inflation; and remove obsolete language and clarify definitions in the Income Tax Act. The FIR indicates that there would be no net fiscal impact.

- Require GRT Surety Bonds for In-State Contractors. The bill would require in-state contractors who enter into a prime construction contract for work in New Mexico to post a surety bond with the TRD to secure payment of the GRT. Under current law, the surety bond requirement only applies to out-of-state contractors. The FIR indicates a positive impact between $17 million and $20 million each fiscal year.

- Increase the TRD Administrative Fee by One-Fourth Percent. The bill would make permanent the increase in the administrative fee made in the General Appropriation Act of 2009. Revenue from the increase will be used by the department to fund a portion of the Fair Share Initiative, which is an effort to collect more taxes owed the state and local governments. The FIR indicates a negative impact to the general fund of approximately $1.7 million per year but does not reflect the expected gain to the state from increased compliance of taxpayers from the initiative.

- Allow Driver's Licenses and Identification Cards to be Renewed via the Internet or Mail. The bill will eliminate the requirement that a person take a vision test every time the person applies for a license, which will allow most renewals to be performed remotely. The FIR indicates no net impact.

- Clarify Expiration Dates for Driver's Licenses of Individuals Under 21. The bill would allow, depending on how old the person is upon initial licensing, either the expiration of a driver's license within 30 days of an individual's twenty-first birthday or the issuance of a replacement horizontal format license for a minimal fee upon an individual's twenty-first birthday. The FIR indicates no net fiscal impact.

- Require a New Mexico Driver's License to be Obtained within 30 Days of Establishing Residency. Since many new residents with DWI convictions in other states decline to get a New Mexico driver's license when they learn of the state's ignition interlock license requirements, the bill would eliminate that loophole by requiring most new residents to obtain a New Mexico driver's license within 30 days of establishing residency. The FIR indicates no net fiscal impact.

- Cancel Ignition Interlock Driver's License for Noncompliance. The bill would give the MVD the authority to cancel a current ignition interlock license when it receives notification from an ignition interlock device vendor that the device has been improperly or prematurely removed from a vehicle. This will eliminate a loophole in the law that currently provides no sanction for a person who installs an ignition interlock device in order to receive a driver's license and who then immediately removes the device after becoming licensed. The FIR indicates no net fiscal impact.

Questions and comments from committee members included the following:

- How would the MVD define residency, and how would the division inform new residents of the requirement to obtain a driver's license with 30 days? Mr. Sandoval said that the division would define residency by rule. The MVD would need to do some public outreach, including using existing programs aimed at new residents.

- The licensing system for commercial drivers needs to be reformed and made easier. Some seasonal workers in New Mexico are unable to receive a commercial driver's license for several months.

- How will the 30-day license requirement be enforced? Mr. Sandoval said that the requirement will be very difficult to enforce, similar to the difficulty of enforcing the existing requirement that vehicles be registered upon establishment of residency.

- What is the state preparing to do in anticipation of the December 1, 2009 deadline of the federal REAL ID Act of 2005 for states to conform to that law? Secretary Homans said that most states have resisted complying with the act, and he expects a waiver or deferral of the federal requirements. Otherwise, New Mexico driver's licenses will no longer be a valid form of identification for air travel.

- How can MVD service be improved in rural areas? Secretary Homans said that several local-government-operated MVD offices are still using dial-up internet connections, making processing MVD transactions very slow. The TRD is interested in helping these offices upgrade to high-speed internet connections, but there is not enough money in the TRD budget to do so. He told the committee that TRD legal counsel had recently confirmed the possibility of local MVD offices increasing their fees slightly in order to provide better service.

- Does the cost to install ignition interlock devices unduly affect poor people? Mr. Sandoval said that the average cost for a device is about $80.00 per month plus installation expenses. If a person is determined by the court to be indigent, much of the cost for the device is paid out of a designated fund.

- The ignition interlock requirement is a burden on people who do not own cars but need to be licensed in order to work.

The Economy's Impact on Business in New Mexico

Beverlee McClure, president of the Association of Commerce and Industry (ACI), introduced a panel of business owners and consultants, which discussed the current economic recession and its impact on businesses in New Mexico. She said that it appears New Mexico has lost 41,000 jobs since 2008 and that 2010 does not look very promising for the private sector.

Doug Clark of the Jaynes Corporation said that his company has been in operation since 1946 and has never laid off employees until this year. In 2008, the construction company had 528 regular employees, but it now employs only 417, with more layoffs expected soon. He presented a report from the Associated General Contractors that estimated that New Mexico lost 8,700 construction jobs since September 2008, 1,200 of them in Santa Fe. The Jaynes Corporation has realized a 40 percent decline in revenue compared to 2008. The construction industry is experiencing a 15 percent decline statewide, including the usually recession-immune Farmington area. Finally, Mr. Clark said that he expects construction unemployment in New Mexico to reach 18 percent in 2010 and that the industry will not begin recovery until 2011.

Christopher Madrid of Impact New Mexico, which works with small rural businesses, described the recession's impact on many small businesses for which he consults. Many small businesses have been able to survive the economic downturn by cutting costs, but they are now facing bankruptcy because they are unable to cut costs anymore and are unable to access capital markets. He said that any new taxes imposed on businesses will force many of them to close.

JoLou Trujillo, owner of Media Works, an Albuquerque advertising company, described the situation her company is facing. Media Works exclusively sells advertising services to other businesses and, until recently, has not had any layoffs in its 22 years in existence. However, since late 2008, she has laid off one-half of her staff, because most of her business clients have slashed their advertising budgets. She also said that health insurance premiums have doubled in the past seven years and that insurance premiums for a family of four have topped $1,700 per month. She said that private-sector employees are no less important than state employees and should not be forced to bear all of the burden of the economic downturn. The state needs to cut services before it raises taxes, said Ms. Trujillo.

Mark Cohen, owner of Made in New Mexico, a Taos-based company that features products made in New Mexico by over 300 different small vendors, described his company's current status. He said that about 10 percent of his suppliers have gone out of business in the past year. That loss of family-run businesses does not show up in state unemployment figures. He estimated that his customers are spending 15 percent less this year than in 2008. Key credit lines vital to businesses have been cut; interest rates have doubled; business insurance rates have increased 10 percent; health insurance premiums have increased 15 percent; and unemployment insurance will increase dramatically soon. He said that small businesses cannot afford any new fee or tax increase the state may be contemplating.

Ms. McClure concluded, saying that although the federal stimulus money has been spent for New Mexico projects, much of that spending has gone to out-of-state contractors, since companies nationwide are desperate for projects. She said that many engineering and architectural firms have no projects booked for 2010.

Questions and comments from committee members included the following:

- The accuracy of Ms. McClure's statement about federal stimulus money not benefiting New Mexicans was questioned. Although out-of-state contractors may have been hired, those firms still hire mostly local workers, said a committee member. Mr. Clark said that the projects at Cannon Air Force Base are controlled by federal procurement processes but that the result is still competitive. He agreed that out-of-state companies do hire local contractors for much of the construction work.

- Ms. Trujillo was asked if she was implying that state workers should be laid off. Ms. Trujillo said that she would prefer no layoffs and that her company has been cutting costs for 18 months. She said the state has not gone through much cost-cutting, compared to the private sector.

- How does the state procurement preference for in-state contracts affect the Jaynes Corporation? Mr. Clark said that his company is based in New Mexico and does receive a five percent advantage for "hard bid" procurement. Other venues, including qualifications-based procurement, do not always provide for in-state preference.

- Are nonprofit organizations competing with the private sector? Mr. Cohen said that many nonprofit organizations are competing with his business, including some state agencies. Mr. Madrid said that many nonprofit organizations are trying to help small businesses and are not competing with them.

- Are there any negative effects of state regulation of the private sector? Ms. McClure said that the ACI will provide a report to the committee that quantifies the job impacts of recent Department of Environment regulations. Mr. Madrid said that many relocating businesses have difficulty getting licenses in New Mexico. Especially troubling is the 190-day average to receive a simple beer and wine license for a restaurant, compared to 20 days in many other states. A committee member said that he has been attempting to get the Regulation and Licensing Department to become more efficient for years.

- What could the state do to assist businesses in New Mexico? Ms. Trujillo said that not imposing any new burdens on businesses would be helpful. Mr. Cohen said that the state needs to encourage small businesses, which are the real drivers of economies. He suggested reducing the GRT on locally produced products.

- The state has a good opportunity to reorganize the state budget, and it needs to get more efficient before any taxes are raised. The Farmington business incubator's budget was recently cut by 78 percent. The incubator has benefited the economy at a cost of $150 per job created, compared to the film industry credits that cost $30,000 per job created.

Meal Tax for Tourism Marketing

Michael Cerletti, secretary of tourism, presented to the committee a proposal to enact a dedicated revenue stream for tourism advertising. Presenting with him were Jennifer Hobson, deputy secretary, Richard Eaves and Martin Leger. The proposal involves the imposition of a one-fourth percent tax on restaurant sales, which would be earmarked for Tourism Department (TD) advertising. The funding stream would replace current general fund yearly appropriations, and effectively double the current advertising budget of the department to approximately $6.5 million annually.

Secretary Cerletti said the tax would cost only 12.5 cents for a $50.00 meal, and that the average family that spends $50.00 per week dining out would spend an additional $6.50 per year. The money generated will be used by the department to further stimulate economic development in New Mexico, said Secretary Cerletti, citing data that show an ROI of tourism advertising of $40.00 for every dollar spent. He estimated that the additional advertising will generate $260 million in additional visitor spending each year.

Questions and comments from committee members included the following:

- How much of the TD's advertising budget was cut after the October special session of the legislature? Mr. Leger said that $91,000 was recently cut from the budget.

- How have restaurants reacted to the meal tax proposal? Secretary Cerletti said that the New Mexico Restaurant Association and the New Mexico Lodging Association have endorsed the idea, so long as the revenue is spent on tourism advertising.

- The $6.5 million estimate the tax will generate may be unrealistically high, given the dismal state of the economy. Secretary Cerletti said that the revenue estimate is based on 2008 figures and that the tax will provide a stable revenue source for tourism advertising.

- Is the TD using newer media forms to advertise? Secretary Cerletti said that traditional forms of advertising, such as print media and television, are still used, but that the department is also focusing on internet social media outlets. He said that many small business owners who visit the state are sufficiently impressed that they subsequently relocate their businesses to New Mexico. Deputy Secretary Hobson said that she is working with the EDD to target people who work remotely via the internet to move to the state.

- The governor wants a decrease in the gaming tax to increase tourism, but the TD wants a new tax on meals to increase tourism.

- Small restaurants may not benefit from increased tourism generated by the new tax. Deputy Secretary Hobson said that a recent TD campaign to highlight the green chile cheeseburger trail around the state has been a huge success for small, independent restaurants. She also said that agritourism is increasing in New Mexico.

The committee recessed at 5:17 p.m.

Tuesday, November 24

The committee was reconvened by Senator Smith on Tuesday, November 24, 2009, at 9:10 a.m.

Energy, Minerals and Natural Resources Department (EMNRD) Bills

Craig O'Hare, special assistant for clean energy, EMNRD, presented two legislative proposals for the committee's consideration. The first bill proposes to grant a credit of $5.00 per wet ton of dairy biomass that is transported to an energy facility for electricity production. The credit is capped at one million tons per year, or $5 million. The $5.00 credit is intended to cover the cost of dairy producers to transport dairy biomass to the energy facility. The proposed bill is similar to the credit proposed by 2009 House Bill 405, except that the credit is granted to the dairy producer, rather than the energy facility.

The next bill proposed by the EMNRD expands the renewable energy production tax credit cap from 500,000 megawatt-hours (MWH) to 1,000,000 MWH. The state needs to increase the amount of tax credit available to solar energy facilities to continue to establish New Mexico's solar industry economic cluster, said Mr. O'Hare. He described two announced solar projects: a 92 MW solar thermal project in Santa Teresa, and a 30 MW photovoltaic project in Colfax County. The Santa Teresa project will be the state's first solar thermal plant, which can also be used to store solar energy for conversion to electricity upon demand.

Questions and comments from committee members included the following:

- The state enacted a biomass credit a few years ago, but the dairy industry indicated that an energy facility would need to be located within 100 miles of a dairy for the energy production to be economically feasible. Mr. O'Hare said the $5.00 per ton credit is intended to cover transportation costs.

- How long will the new solar energy plants take to become operational, and how many jobs will be created? Mr. O'Hare said the photovoltaic plant will be finished in one year, and after the construction phase, only a few permanent jobs will be created. The solar thermal facility will be more complicated to construct, but it will hire more operations and maintenance personnel on a long-term basis. Since photovoltaic electricity systems have no moving parts, they require significantly fewer maintenance personnel.

- The size and location of the proposed Pecos Valley biomass energy facility was discussed. Mr. O'Hare said that the plant will be located in the Roswell-Hagerman area. Other facilities could be constructed in the Las Cruces and Clovis areas if the first plant is successful.

- The dairy biomass credit might be used more if it were granted per mile of transport, rather than per ton.

- How many cows are needed to support the Pecos Valley biomass plant? Mr. O'Hare said that waste from about 50,000 cows will be used to supply the plant.

- The proposed credits may be useful to initiate industries, but they should not be extended in perpetuity.

Property Tax Education and Study Committee Update

Karen Montoya, Bernalillo County assessor, updated the committee on the activities of the New Mexico Association of Counties (NMAC) Property Tax Education and Study Committee (PTESC). She said the committee focused on implementing and educating the public on the recently enacted property tax disclosure legislation (Section 47-13-4 NMSA 1978).

Clyde Ward, San Juan County deputy assessor, said that any contemplated changes in tax law need to be time sensitive, since there are many different dates that need to be met in property tax law. Many counties have already reached their maximum mill rates, and counties will not be able to roll back tax values. Eighteen counties do not yet have computer-aided mass appraisal (CAMA) systems, which means they do not have the tools necessary to make quick and accurate changes to valuations. The PTESC recently sent out a survey to counties to learn about local concerns regarding property tax issues.

Questions and comments from committee members included the following:

- Would it be possible for multiple counties to use one centralized CAMA system, since many counties cannot afford the expense? Ms. Montoya said there have been recent discussions about that possibility. Paul Baca, Lincoln County assessor, described some of the problems faced by counties that do not have a CAMA system. A CAMA system can generate reports on any data within the system, making quality checks of data easier and allowing tracking of data on a mass basis.

- How does the Property Tax Division (PTD) of the TRD regard the possibility of one statewide CAMA system? Rick Silva, director, PTD, said that, currently, many counties use different methodologies to appraise properties, and requiring all the counties to use a uniform system would be a challenge.

- Is the PTESC studying the issue of property tax "lightning", in which valuations are dramatically increased after a change in ownership? Mr. Ward said that in San Juan County, many people questioned their valuations, but assessor staff were able to educate homeowners about how valuations are performed satisfactorily. He said that many states are trying to eliminate their property valuation caps because the caps always create inequities.

- Can the issues raised by the *Dzur* case, in which a district judge ruled that certain valuation provisions of Section 7-36-21.2 NMSA 1978 were unconstitutional, be addressed administratively, or does the legislature need to solve the problem? Ms. Montoya said the *Dzur* case only applies to Bernalillo County. Mr. Ward said that he would not be able to roll back property tax valuations, as was done in Bernalillo County. He said that a roll back would create even more inequities. Mr. Silva said that if a county other than Bernalillo County were to roll back valuations, it would probably be violating the law, which is still valid in the 32 other counties.

- Will the PTESC recommend legislation to remedy the issues raised by the *Dzur* case? Ms. Montoya said there probably is not enough time to design a solution before the next legislative session.

- Has the ratio of residential to commercial total valuation changed recently? Jim O'Neill, tax consultant to the NMAC, said that in the past 15-20 years, the proportion of property tax revenue from residential valuations has risen, compared to commercial properties.

- The property tax system was probably more fair before attempts were made to restrict increases in valuations for certain segments of the population.

- The PTD was asked to provide the committee with data on statewide assessed valuations for 2008 and 2009.

Property Tax Litigation Update

Ms. Montoya briefed the committee on property tax litigation since the last report to the committee in August. She said that one more district judge in Bernalillo County has concurred with the decision in the *Dzur* case, ruling that portions of Section 7-36-21.2 NMSA 1978 are unconstitutional.

Questions and comments from committee members included the following:

- Was the decision by the Bernalillo County assessor to roll back property tax valuations to 2007 values for all protestants legal? Mr. Silva said that Ms. Montoya "did what she had to do, to avoid a bigger mess. She is following the guidance of the court."

Tax Expenditure Budget Legislative Proposal

Senator Keller presented proposed legislation to the committee that would require the TRD to develop a tax expenditure budget and report. The report would include an analysis of foregone revenue from tax expenditures, including a projection of the costs of tax expenditures for all significant general fund revenue sources; for each tax expenditure, its statutory basis, purpose, year of enactment and date of repeal; the quantification of the revenue lost to the state from each tax expenditure; the identity to the extent possible of the beneficiaries of each tax expenditure; the unintended consequences of each tax expenditure; and the total cost in each fiscal year for all tax expenditures. Senator Keller noted that New Mexico is one of only nine states that does not require a tax expenditure budget. The bill he is proposing is nearly identical to a bill that was carried by former Representative Brian K. Moore but vetoed by the governor.

Questions and comments from committee members included the following:

- What is the fiscal impact of the bill? Senator Keller said that the previous bill's FIR indicated a cost of $100,000. However, he said that this is something the TRD should be doing in-house anyway, and said that he does not expect the tax expenditure budget to cost very much to prepare.

Nonprofit Taxation

Richard Anklam, executive director, New Mexico Tax Research Institute (NMTRI), gave a presentation to the committee about New Mexico's tax treatment of nonprofit organizations. The presentation focused on federally designated organizations that have been granted tax-exempt status, commonly called "501(c)(3)" organizations. Although many states rely on the federal 501(c)(3) designation, some impose additional restrictive criteria for tax benefits. He noted that concerns tend to arise in those situations when there seems to be unfair competition with the private sector, especially prominent in the health care and education sectors. Other high profile examples concerning taxation of nonprofit organizations include church facilities for hire, Girl Scout cookie sales, the Santa Fe Opera and the Los Alamos National Laboratory (LANL) before it became part of a private-sector company.

Organizations receiving the 501(c)(3) designation from the federal government are exempt from federal income taxation and the federal unemployment tax. They are required to file federal Form 990, which is an informational return and is subject to public inspection. New Mexico exempts these organizations from state income tax but not from state unemployment or workers' compensation insurance.

Receipts of 501(c)(3) organizations are exempt from the GRT, except for receipts derived from an unrelated trade or business. Purchases made by those organizations are exempt from the compensating tax, and receipts made by vendors for tangible personal property can be deducted from gross receipts, except for the sale of construction materials. Mr. Anklam noted that construction material sales to tax-exempt entities, including to governments, is a significant audit area for the TRD. Finally, since Section 7-9-48 NMSA 1978 requires the next sale of services be subject to the GRT, first-tier subcontractors of 501(c)(3) organizations must pay the GRT for services provided, because the organization's sales are tax exempt by another statute. This situation existed most prominently when LANL was a 501(c)(3) organization.

The Constitution of New Mexico exempts from property taxation any property used for charitable purposes, all church property not used for commercial purposes and all property used for educational purposes. The legislature later clarified these exemptions in statute, specifically including exemptions for charitable nursing, retirement and long-term care organization property, so long as certain criteria are met by the organizations. Property tax exemptions for nonprofit organizations must meet a stricter standard than merely qualifying as 501(c)(3) organizations, said Mr. Anklam.

Questions and comments from committee members included the following:

- The educational purposes of an organization often cross the line into political purposes. Mr. Anklam said that current New Mexico law ties tax-exempt status to 501(c)(3) status, so the state has no say in the matter.

- Are board member salaries of tax-exempt organizations subject to taxation? Mr. Anklam said that payments to board members are subject to the GRT, and they are subject to income taxation as well.

- Do some 501(c)(3) organizations exist merely to avoid taxation? Mr. Anklam said that probably does happen sometimes. He said that the state is not bound to provide any tax exemption to charitable organizations, except for those property tax exemptions specified in the state constitution.

- A 501(c)(3) organization that competes with the private sector, such as a hospital or child-care provider, should not be given special treatment through its tax-exempt status.

Revenue Forecast

Tom Clifford, chief economist, Legislative Finance Committee (LFC), introduced a panel of economists who discussed the state's revenue forecast. The panel members included Laird Graeser, chief economist, Department of Finance and Administration; Brian McDonald, economist; Larry Waldman, senior economist, Bureau of Business and Economic Research (BBER), University of New Mexico; and Chris Erickson, professor of economics, New Mexico State University.

Mr. Graeser began by saying that the economic decline the country is experiencing is virtually unprecedented, and the depth of the recession could not have been predicted. He opined that New Mexico has reached the bottom of the recession on a consumption basis, although not on an employment basis. He discussed the October 17, 2009 update to the revenue forecast, saying that the biggest change from the August to October estimates is a steep decline in income taxes.

Mr. Clifford next summarized the October 2009 consensus general fund revenue estimate. New Mexico's labor market weakened dramatically at the beginning of 2009, with total job losses in excess of 40,000, almost entirely in the private sector. The formerly broad-based revenue growth turned negative at the end of 2008, and Mr. Clifford said that all business sectors show a decline in taxable gross receipts this fiscal year. In terms of revenues to the state, the October forecast reduced the fiscal year 2009 estimate by $98 million and the fiscal year 2010 estimate by $219 million, bringing the cumulative fiscal year 2008 to 2010 decrease in revenues to $1.2 billion. Revenue growth is predicted to resume in fiscal year 2011, but the high fiscal year 2008 levels will not be reached again until fiscal year 2015.

During the Richardson administration, revenue growth has totaled 24 percent, but expenditures have grown in that same period by 39 percent, an annual shortfall of $585 million, said Mr. Clifford. Five hundred million dollars in spending cuts or revenue increases are needed to maintain flat budgets in fiscal year 2011, and that would still leave the state's reserves well below prudent levels.

Mr. McDonald discussed the state of the national economy, saying that New Mexico's economy has been hit just as hard as the rest of the nation. He said the national economy is beginning to recover from the recession, and economists expect a gross domestic product (GDP) growth of 2.8 percent for 2010. However, unemployment is still growing and currently stands at 10.2 percent. At the same time that unemployment was rising, so was productivity, which shows that businesses have been able to do more with fewer employees. Corporate profits have rebounded, but companies are still not yet hiring. Finally, Mr. McDonald said that the commercial real estate market is in serious decline, which could jeopardize the modest gains the economy has seen.

Mr. Erickson said that he agreed with his colleagues' analyses and he believed the recession ended in September. Although typical recessions last 10 months, the current recession, precipitated by a financial crisis, has lasted 20 months. He presented forecasts from several national economic organizations that predict overall GDP growth in 2009 to be approximately negative one percent but GDP to rebound in 2010 with 1.5 percent growth expected.

Mr. Erickson then discussed expected oil and gas prices, which many estimates peg to increase next year. He cautioned that he did not think that the price of gas would increase as much as the consensus revenue group estimated. After many years of trying to predict gas prices, he said the most reliable method is to use the current price, which has less of an error rate than other estimating methods. Finally, Mr. Erickson discussed the problem that businesses are having gaining access to capital. The Federal Deposit Insurance Corporation (FDIC) is putting pressure on local banks to curtail lending, precisely the type of banks small businesses tend to borrow money from. This lack of capital has meant that small businesses, the sector that creates most of the jobs in the nation, are not hiring right now.

Mr. Waldman said that he believes the recession is even deeper than most economic indicators show. From an employment viewpoint, New Mexico entered a recession in the third quarter of 2008. Citing data from the Workforce Solutions Department, he said that this recession looks like the worst loss of employment since the Great Depression. He said that job recovery is not expected to resume until the second quarter of 2010, with a moderate to strong recovery in subsequent quarters.

Questions and comments from committee members included the following:

- The FDIC lending standards seem to be in conflict with economic goals. Mr. Erickson said this topic has been the subject of much discussion in Washington, D.C. He said the new lending standards, adopted to avoid another round of bank foreclosures, do not apply as much to the larger national banks.

- Are the seven percent revenue growth predictions the consensus revenue group made realistic? Mr. Graeser said that economic feedback studies are never very reliable. He said that he does not see much of an economic difference between cutting expenditures and raising taxes. Mr. McDonald agreed, and said that because of the way federal income tax deductions are structured, about one-third of the 2004 New Mexico PIT cuts actually ended up in the federal treasury.

- New Mexico needs a better system of estimating gas prices, since most of the natural gas comes from the San Juan Basin, which is always significantly different than the Henry Hub or New York Mercantile Exchange prices. In the past two years, consensus revenue estimates have been much higher than the actual prices, which only deepens the economic hole the state is in.

- Raising taxes or cutting expenditures hurts different population segments. It would be better to fund Medicaid, which will keep people healthy, who will subsequently pay taxes. Mr. Graeser said that some studies have shown that funding education helps the economy in the long-run but that spending on welfare programs does not help the economy grow. Mr. Waldman said that there are no solid economic studies that indicate one route over the other. Mr. Erickson agreed and said the decision is really a political decision, rather than an economic one.

- Although private sector job losses have topped 40,000 since last year, the public sector has actually seen employment growth. Mr. Waldman said that although official unemployment statistics show New Mexico with eight percent unemployment, he believes the figure is actually 10 percent.

- Recent consumer spending has been financed to a large extent by second mortgages, which probably means that consumer spending will not rebound soon. Mr. Erickson said that recessions caused by financial crises tend to last longer than other recessions.

- What is the job growth in the oil and gas industry? Mr. Waldman said that the state has lost 20 percent of its oil and gas jobs in the past year.

- Have the recent "pit" rules affected the oil and gas industry negatively? Mr. Graeser said that he has studied this issue and has concluded that only a small portion of the downturn in oil and gas rig activity in New Mexico can be ascribed to new environmental rules. Most of the shift is due to the recent Texas oil shale boom, which has shifted drilling activity temporarily away from the state. New Mexico has some shale properties, but they have not yet been exploited.

- The residents of the state need to understand that it will take New Mexico three to four years to recover from the current recession.

Goals and Principles

Pam Ray, staff attorney, LCS, told the committee that the subsequent meeting day would be devoted to exploring possible revenue enhancements for the state. Mr. Clifford then gave a presentation on the background of possible revenue options. After the October 2009 revisions, the consensus revenue group estimated the compound growth rate of general fund revenues per year from 1989 to 2010 at 5.4 percent, with personal income growth at 5.6 percent for the same period. While annual revenue growth between fiscal years 2003 and 2011 was 3.2 percent, expenditure growth for fiscal years 2003 to 2010 was 4.2 percent. This gap means the state will need to find $508 million in new money or cut expenditures just to keep the fiscal year 2011 budget flat.

Mr. Clifford reviewed net revenue changes since 2003. The cumulative annual impact to the general fund from tax law changes is a loss to the general fund of more than $600 million. Much of the loss comes from the 2003 PIT cuts, but other major revenue-reducing changes include the food and medical deductions from gross receipts, film production tax credits and low-income tax credits and exemptions.

Mr. Clifford next discussed the LFC's good tax policy principles, which include adequacy, efficiency, equity, simplicity and accountability. In general, the best tax policy is to have a broad tax base and low rate. From an efficiency standpoint, in theory, if a state imposes above-average taxes, investment may migrate to other states, reducing growth and shifting the tax burden to those who remain. This mobility argument applies to skilled labor as well, which is an argument against a highly progressive rate structure. However, Mr. Clifford said that empirical studies of this phenomenon provide mixed evidence to support this argument; the majority of the studies show a small negative impact of state and local taxes on economic growth. Mr. Clifford presented data that show that residents of Albuquerque have on average a higher total tax burden than residents of other western cities, but that taxes on businesses in New Mexico are about average compared to other western states.

Questions and comments from committee members included the following:

- If one compares actual tax rates instead of tax burden as a percentage of personal income, different results are obtained. Mr. Clifford was asked to present the same study, but using the actual tax rate.

The minutes of the September 14-15 meeting of the committee were adopted without changes.

The committee recessed at 4:37 p.m.

Wednesday, November 25

The committee was reconvened by Senator Smith on Wednesday, November 25, 2009, at 9:12 a.m.

Income Tax

The committee heard from a panel that discussed revenue options of the PIT. Panelists included Mr. Clifford, Mr. McDonald, Mr. Desiderio and Timothy VanValen, chair, Tax Policy Committee, ACI. Mr. Clifford began by discussing different PIT revenue trends. New Mexico piggybacks on the federal income tax structure. PIT revenues have grown significantly over the last 10 years, even with the 2003 reductions. As a percentage of general fund revenues, the PIT percentage has been reduced from 24 percent in fiscal year 2003 to 20 percent in fiscal year 2010. He provided a comparison of New Mexico PIT rates with other western states, noting that New Mexico is in the low to middle sector of states that have an income tax, with a top rate of 4.9 percent.

Mr. Clifford presented a few PIT revenue options, including increasing the top rate on various income brackets, adding back the income tax deduction for state and local taxes and reducing the deduction on capital gains.

Mr. McDonald said that in addition to investigating PIT rate increases, the legislature should consider broadening the PIT base. About 30 percent of personal income in New Mexico is not subject to the PIT, primarily due to deductions and exemptions. For a married couple with two children, their first $34,000 in income is not taxed by the state. When that same couple's personal income reaches $58,000, they reach the top tax rate for the PIT. Prior to 2003, New Mexico had a much more progressive PIT system. He suggested that the effort to raise revenue for the state should involve a review of the entire state taxation system to ensure an overall system that is not regressive.

Mr. VanValen said that he was representing the interests of the business community. He said that the legislature should look at all options, including cutting expenditures. He said that one-third of PIT filers pay no income tax at all. The majority of businesses in New Mexico pay the PIT rather than corporate taxes, so any PIT tax changes need to consider the impact on businesses. Mr. Clifford said that approximately 80,000 of the 100,000 businesses in New Mexico are PIT filers.

Mr. Desiderio reminded the committee that any increase in the PIT rate will be partially offset by a reduction in federal taxes, because of the deduction allowed against state taxes. He cautioned against expanding the PIT base too much, because that may increase the regressivity of the state's tax system. People who can least afford reductions in state services will suffer the most if dramatic expenditure cuts are made instead of tax increases.

Questions and comments from committee members included the following:

- Did the 2003 tax reductions result in more high-income jobs in New Mexico? Mr. Clifford said these types of analyses are very difficult to do, because many jobs would have been created without the tax reductions. He said that economic theory would support that thesis, but there is no hard data to show if it occurred.

- The PIT is now mostly a flat tax.

- A complete economic modeling study needs to be performed for any changes to the tax code. Although it is often claimed that businesses may leave the state if the PIT is raised, it is equally valid to claim that many businesses have not moved to New Mexico because of serious deficiencies in the state's educational system and health care infrastructure.

- Most of the tax burden in the state is paid by the wealthiest residents, which also have the most sophisticated means of avoiding paying taxes. In addition, many high-income people will be carrying forward losses for the next few years, reducing the amount that the state will realize in revenue.

- Counter to recent "trickle down" economic theory, money seems instead to "trickle up" from the poor to the wealthy.

Corporate Income Tax

Mr. Clifford, Mr. Desiderio, Mr. VanValen and Dick Minzner, attorney, discussed options relating to changes in the Corporate Income Tax (CIT). Mr. Clifford began by giving some background information on the CIT. New Mexico has a graduated CIT rate structure, from 4.8 percent to 7.6 percent. Corporations in New Mexico generally have three methods of filing: separate, combined or federal consolidated. Income is apportioned using an equally weighted three-factor formula of payroll, property and sales, except that manufacturing businesses may use a double-weighted sales factor to apportion their income.

The New Mexico CIT base grew strongly in the 1990s due to a boom in manufacturing, and the oil and gas industry created another spurt in the 2000s. Even after the precipitous drop in CIT collections this past year, CIT revenue is still above the 2002 level. Another factor in CIT revenue reduction has been the increase in film production tax credits in recent years. Net CIT revenue for fiscal year 2010 is expected to fall to $130 million, compared to an historic high of $407 million in fiscal year 2007. Compared to other western states, New Mexico has the second highest CIT rate, but is only one of three states that does not require combined reporting.

Mr. Clifford presented some possible changes to corporate income taxation, including requiring combined reporting, increasing the franchise tax from $50.00 to $250 per year and reducing the film production tax credit from 25 percent of qualified expenditures to 15 percent.

Mr. Minzner began his presentation by stating that one consideration corporate executives use in locating new investment is a state's tax climate. Although he agreed that the administration overstated the impact on executives when arguing for the 2003 PIT cuts, Mr. Minzner said that CIT rates are quite important for corporations in deciding whether to relocate to the state. He stated that of approximately 20,000 CIT filers, about 16,000 pay no CIT at all, 50 corporations pay three-fourths of the state's CIT collections and the next 200 corporations pay another 15 percent.

Mr. Minzner said that mandating combined reporting will hurt corporations in New Mexico and discourage others from locating here. He said that combined reporting is principally concerned with subjecting to New Mexico tax some of the income earned by companies not doing business in New Mexico. Mandating combined reporting is essentially imposing a tax on establishing a business in New Mexico. Finally, he said that combined reporting would impose tax costs on increasing New Mexico payroll or investment and would provide tax reductions to companies that lay off employees in New Mexico.

Mr. Desiderio said that the trend nationally is for businesses to become limited liability companies rather than C corporations to avoid the double taxation issue. Smaller corporations tend to zero out profits through higher salaries of employees. For those larger corporations that do end up paying the CIT, a very inequitable situation exists between in-state corporations, which pay the CIT, and multistate corporations, which can avoid paying the New Mexico CIT. He said the current structure of assessing the CIT needs to be revisited to reduce the inequities.

Mr. VanValen said the CIT is a relatively small component of the state's revenues, and it is a very volatile source of revenue. He said that nobody really knows the fiscal impact of requiring combined reporting. In addition, the requirement would be very complex to administer, both for the state and for corporations, and would probably lead to an increase in litigation.

Questions and comments from committee members included the following:

- Mr. Minzner was asked to disclose whether he was representing companies that are opposed to mandatory combined reporting. Mr. Minzner acknowledged that he represents two multistate companies that would be adversely affected by mandatory combined reporting.

- Requiring mandatory combined reporting is not a radical idea. Local banks that are currently working at a competitive disadvantage to multistate banks support the idea, which will level the playing field in the banking industry. Mr. Minzner said the effect of combined reporting could be that multistate banks may move certain aspects of their operations out of the state, which would negatively affect jobs in New Mexico.

- Some multistate banks operating in New Mexico have set up holding companies in Nevada, which does not have a CIT, and are exchanging profits for stock.

- The 2009 FIR on Senator Wirth's bill that would capture a portion of a business's sales, payroll and wages in a franchise tax and offset against the amount owed on the company's CIT indicated about $20 million in additional revenues to the state. The bill would also ensure that all corporations operating in New Mexico pay some sort of CIT or franchise tax in relation to their presence in the state. Mr. Clifford said that some companies use federal consolidated returns, which is a much simpler filing method for those companies, and he suggested that New Mexico continue to allow that method of filing.

- Why is the CIT imposed on the three apportionment factors rather than income? Mr. Desiderio said that it is impossible to allocate profit on a geographical basis, so a system was designed to tax a corporation's profits based on that company's presence in the state.

- In-state companies probably support combined reporting, since they operate at a competitive disadvantage against multistate companies. ACI's membership is also probably divided on this issue.

Budget Balancing Task Force Report

Mr. Nunns gave a report to the committee on the work of the governor's Budget Balancing Task Force, which was convened to examine possible revenue enhancements to the state. The task force is charged with providing analysis on a variety of revenue options that improve the state's tax system, are consistent with good tax policy, maintain the competitiveness of New Mexico's economy and have the potential to address the state's long-term solvency. The task force is studying the GRT and compensating tax; taxes on tobacco, liquor, insurance premiums and motor vehicles; the PIT, CIT and withholding taxes; taxes on oil, natural gas and uranium; tax compliance and administrative rules; and rules defining business incentive tax credits.

The task force is composed of 42 members representing business, labor, local government, health care, religious, environmental, higher education, transportation and nonprofit groups and will complete its work by December 21, 2009. The task force will not make any policy recommendations to the governor, but it will discuss the pros and cons for each proposal. Revenue estimates have been completed for about one-half of the more than 50 proposals. All of the proposals and FIRs are available on the task force's web site, www.nmrevenueoptions.com. Mr. Nunns said that some of the proposals are best packaged together.

Questions and comments from committee members included the following:

- When the GRT was removed from food items, the FIRs were very far from being accurate.

- Why were no legislators appointed to the task force? Mr. Nunns said that all of the meetings are open to the public, and legislators are welcome to attend or provide input. There is much overlap between the task force's work and legislative committee work, he said.

- How will the task force evaluate proposals against "good tax policy"? Mr. Nunns said that the TRD's good tax policy principles are consistent with the LFC's similar tax policies. The committee member suggested that an independent body evaluate proposals to determine if they are consistent with tax policy principles.

- The task force should also make a report to the legislature. Standing taxation committees should start working on proposals before the legislative session begins. The governor needs to work with the legislature before the session begins.

- Is the task force considering imposing the GRT on gasoline and other fuels, in addition to the existing gasoline and special fuel excise taxes? Mr. Nunns said that the gasoline tax can be viewed as a "road use" tax, and imposing the GRT would be consistent with the idea of having a broad base for GRT taxation, without the pyramiding issue arising. He said that many states have such a tax structure, and New Mexico used to impose sales taxes and gasoline taxes on fuel.

- Can the state change the oil and gas emergency school tax rate retroactively, as one proposal recommends? Mr. Nunns said that the legislature can enact a new tax rate in the 2010 session with a January 1, 2010 effective date because the taxes are due 55 days after severance of the oil or gas. As long as the tax change becomes effective before the taxes are due, the change would not run afoul of retroactive legislation constitutional problems.

- Regardless of revenue impacts, would required combined reporting make the CIT more equitable and consistently applied? Mr. Nunns said that from a tax theory point of view, the CIT is the worst tax New Mexico has, because income is essentially taxed twice.

- The TRD should research what other states are doing to offset the recession's impact on state revenues.

Gross Receipts Tax

Mr. Clifford, Mr. Anklam, Mr. VanValen, Bill Fulginiti, executive director, New Mexico Municipal League (NMML), and Lee Reynis, director, BBER, discussed revenue options related to the GRT. Mr. Clifford began by presenting background information on the GRT, which is the largest general fund revenue source. Collections of GRT and compensating tax have grown at a compound annual rate of six percent per year since 1990, a rate slightly larger than personal income. The largest components of the GRT base include services, at 43 percent; retail, at 26 percent; and construction, at 15 percent. The combined average state and local sales tax rates place New Mexico fairly low compared to other western states; but expressed as a percentage of personal income, New Mexico has the second-highest GRT burden.

Mr. Clifford described recent changes to the GRT, which have a net negative annual cumulative impact on the general fund of $147 million. The largest impact has come from food and medical deductions, which are only partially offset by the repeal of the 0.5 percent credit in municipal areas. Mr. Clifford presented several possible changes to GRT statutes to increase revenue. The largest changes would be repealing the gross receipts deduction of food and increasing the statewide GRT rate by one-fourth percent.

Mr. Fulginiti said that 75 percent of municipal revenue is from the GRT. Less than 15 percent of municipal revenue is derived from property taxes. Many cities have seen dramatic decreases in reported gross receipts, averaging 18-20 percent this calendar year. He cautioned that any proposal to change the distribution formula of GRT revenue toward local governments would further compound the budget problem they are facing. He said the NMML opposed the food deduction, because it would make the GRT base too narrow.

Ms. Reynis said that the GRT is very important to municipalities and that food sales make up a large portion of retail sales. She said that she was very concerned about municipal revenues when the food deductions were enacted. She also said that her research has indicated that GRT revenues are very sensitive to construction activities and that housing booms and busts have driven overall GRT revenues over time.

Mr. Anklam repeated the NMTRI's tax mantra: broad base, low rates. He said that any increase in the GRT rate will increase pyramiding of taxes and will increase the regressivity of the GRT. Local governments are already too reliant on the GRT. Other revenue options should be pursued, he said.

Mr. VanValen said that the ACI also believes the best tax policy is to have a broad base and low rates. Pyramiding is a big concern for businesses. He said that the ACI opposed the food deduction because it narrowed the GRT base.

Questions and comments from committee members included the following:

- The piecemeal deductions and exemptions over the last 20 years have reduced the GRT base too much.

- The state needs to increase the general fund share of GRT revenues. Mr. Fulginiti said that the 1.225 percent distribution to municipalities is not a state tax just given to municipalities. Before the GRT was enacted, municipalities already had local sales taxes. Those taxes were rolled into the GRT, and administered by the state for administrative simplicity.

- What would members of the panel recommend to raise $200 million in state revenue? Mr. Fulginiti said revenue should be raised from multiple sources. Mr. VanValen said that was the wrong question to ask, suggesting that legislators need a range of options, but expenditure cuts need to be made before any tax increase is enacted. Mr. Anklam suggested enacting PIT add-back deductions, increases in "sin" taxes and motor vehicle excise tax increases. Ms. Reynis said that in the long term, the state needs to accomplish comprehensive reform of property taxation.

- Most medical providers cannot pass along the GRT for services, because they are contractually bound to only charge co-pays. This presents a seven to eight percent disadvantage compared to out-of-state providers. Ms. Reynis said that gross receipts taxation of medical services has been a problem for a long time. There is much inequitable tax treatment in the industry.

- Mr. Nunns was asked to provide a list of exemptions, deductions and credits associated with the GRT.

There being no further business, the committee adjourned at 3:51 p.m.

REVENUE STABILIZATION AND
TAX POLICY COMMITTEE

Section 9

December 2009
Agenda
Minutes

Revised: December 9, 2009

TENTATIVE AGENDA
for the
SEVENTH MEETING IN 2009
of the
REVENUE STABILIZATION AND TAX POLICY COMMITTEE

December 14-16, 2009
Room 307, State Capitol

Monday, December 14

9:00 a.m. **Call to Order**
—Senator John Arthur Smith, Chair

9:05 a.m. **Revenue Forecast**
—Katherine B. Miller, Secretary of Finance and Administration
—Rick Homans, Secretary, Taxation and Revenue Department
(TRD)
—David Abbey, Director, Legislative Finance Committee (LFC)

10:30 a.m. **FIRs on TRD and Motor Vehicle Division (MVD) Proposals**
—Rick Homans, Secretary, TRD
—Jim Nunns, Tax Policy Director, TRD
—Alicia Ortiz, Deputy Director, MVD

11:30 a.m. **Legislative Proposal — Biennial Budget Process**
—Senator Timothy M. Keller

12:15 p.m. **Lunch**

1:30 p.m. **Review of Excise and Other Taxes**
—Tom Clifford, Chief Economist, LFC

3:00 p.m. **Energy, Minerals and Natural Resources — Dairy Biomass for Fuel**
—Fernando Martinez, Director, Energy Conservation and Management
Division, Energy, Minerals and Natural Resources Department

4:00 p.m. **Recess**

Tuesday, December 15

9:00 a.m. **Property Tax Issues and Suggestions**
—Jim O'Neill, Consultant
—Lee Reynis, Director, Bureau of Business and Economic Research,
University of New Mexico
—Janice McCrary, Vice Chair, Greater Albuquerque Association of Realtors

10:30 a.m. **Overview of Governor's Budget Balancing Task Force**
—Jim Nunns, Tax Policy Director, TRD

12:00 noon **Lunch**

1:30 p.m. **Simulcast Dog Racing from Licensed Dog Racing Tracks**
—Don Cook, General Manager, The Downs at Albuquerque
—Ed Mahr, Lobbyist, The Downs at Albuquerque

2:15 p.m. **Tax Incentive Review**
—Tom Clifford, Chief Economist, LFC
—Thomas F. Pogue, Professor Emeritus of Economics, University of
Iowa
—Timothy R. Van Valen, Chair, Tax Policy Committee, Association of
Commerce and Industry
—Deirdre Firth, Senior Economic Developer, City of Albuquerque, Economic Development Department (EDD)
—Bob Walton, Vice President, Business Development, Albuquerque Economic Development, Inc. (AED)
—Deborah Inman, Vice President, Business Devolopment, AED

4:00 p.m. **Recess**

Wednesday, December 16

9:00 a.m. **Summary of Revenue Raising Options and Tax Principle Application**
—Tom Clifford, Chief Economist, LFC

10:30 a.m. **Legislative Proposal Endorsements**
—Staff

12:00 noon **Adjourn**

MINUTES
of the
SIXTH MEETING IN 2009
of the
REVENUE STABILIZATION AND TAX POLICY COMMITTEE

December 14-16, 2009
Room 307, State Capitol
Santa Fe

The sixth meeting of the Revenue Stabilization and Tax Policy Committee (RSTP) for 2009 was called to order by Senator John Arthur Smith, chair, at 9:11 a.m. in Room 307 of the State Capitol in Santa Fe.

Present
Sen. John Arthur Smith, Chair
Rep. Edward C. Sandoval, Vice Chair
Sen. Carlos R. Cisneros
Rep. Nathan P. Cote
Rep. Anna M. Crook
Sen. Dianna J. Duran
Rep. Keith J. Gardner
Sen. Timothy M. Keller
Sen. Gay G. Kernan
Rep. Ben Lujan, Speaker of the House
Sen. Howie C. Morales (12/14 and 12/16)
Rep. Henry Kiki Saavedra (12/14-12/15)
Sen. William E. Sharer
Rep. Thomas C. Taylor (12/14-12/15)
Rep. Jim R. Trujillo

Absent
Sen. Tim Eichenberg
Sen. Timothy Z. Jennings
Rep. Rodolpho "Rudy" S. Martinez

Designees
Sen. Mark Boitano (12/14-12/15)
Rep. Debbie A. Rodella
Sen. Nancy Rodriguez
Sen. Bernadette M. Sanchez (12/15)
Sen. John M. Sapien
Rep. Luciano "Lucky" Varela (12/15-12/16)
Rep. Ray Begaye
Rep. Donald E. Bratton
Rep. Zachary J. Cook
Sen. Kent L. Cravens
Rep. Miguel P. Garcia
Sen. Clinton D. Harden, Jr.
Rep. Sandra D. Jeff
Sen. Carroll H. Leavell
Rep. Antonio "Moe" Maestas
Sen. Steven P. Neville
Rep. James R.J. Strickler
Rep. Don L. Tripp
Sen. Peter Wirth

Other Legislators Attending
Sen Rod Adair (12/14)
Rep. Andrew J. Barreras (12/15-12/16)
Rep. Thomas A. Garcia (12/16)
Sen. Linda M. Lopez (12/14-12/15)
Sen. Richard C. Martinez (12/14-12/15)
Sen. George K. Munoz (12/15-12/16)
Sen. Mary Kay Papen (12/14-12/15)
Rep. Benjamin H. Rodefer (12/15-12/16)

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

Staff
Pam Ray, Staff Attorney, Legislative Council Service (LCS)
Doris Faust, Staff Attorney, LCS
Kate Ferlic, Staff Attorney, LCS
Ric Gaudet, LCS

Monday, December 14

Revenue Forecast

Secretary of Finance and Administration Katherine B. Miller, Secretary of Taxation and Revenue Rick Homans and Tom Clifford, chief economist, Legislative Finance Committee (LFC), presented the December general fund consensus revenue estimates. According to Global Insight, the national recession probably ended in June 2009. In New Mexico, the University of New Mexico's (UNM) Bureau of Business and Economic Research (BBER) predicts that job losses will continue through the second quarter of 2010. The depth and length of the recession means that state general fund revenues will take several years to achieve the peak levels of fiscal year 2008. The key factor in the current and other recent revenue estimates is not the often-volatile oil and gas revenues, but the steep declines in broad-based revenue sources, including the gross receipts tax (GRT), the corporate income tax (CIT), the personal income tax (PIT) and the motor vehicle excise tax.

The December forecast estimates $366 million more in total general fund revenues than the October estimate, mostly due to special session and executive order reductions. Recurring revenues dropped $10 million from the October estimate, which masks substantial weaknesses in the GRT. Offsetting this weakness somewhat is some strength in the CIT and federal mineral leasing receipts. GRT collections, which normally account for 30 percent of general fund revenues, fell 1.1 percent from fiscal year 2008 to 2009, with construction being the biggest drag on revenues. Fiscal year 2010 GRT revenues are expected to see the largest drop ever. Revenue levels from fiscal year 2008 are not expected to be surpassed until fiscal year 2012. Oil and gas revenues are expected to be $24 million higher than the October estimate. The percentage of general fund revenues from oil and gas, which reached a high of 25 percent in 2008, is expected to level out to the historic average of 15 percent in the next few fiscal years. The PIT, contributing about 20 percent of general fund revenues, fell 21 percent from fiscal year 2008 to 2009. PIT revenues are not expected to rebound for a few years. Corporate profits have seen modest gains this year, and the revenue estimate predicts an additional $30 million in general fund revenues.

One-time reversions and transfers to the general fund, mostly due to what is commonly called the "solvency package", have brought in an additional $376.6 million. All of that money was used to cover the expected shortfall in the fiscal year 2010 budget.

Overall, recurring general fund revenue from fiscal year 2009 to 2010 is expected to drop from $5.3 billion to $4.8 billion, a decline of more than nine percent. Fiscal years 2011 and 2012 should see revenue increases around six percent, followed by more modest gains near 3.5 percent the following two fiscal years. General fund revenues are not expected to reach the historic fiscal year 2008 level until fiscal year 2015. Mr. Clifford added that he believes the projected price for gas of $5.20 per thousand cubic feet (MCF) is too risky an estimate, given that current prices are around $4.00 per MCF.

Questions and comments from committee members included the following:

- How did the revenue estimate predict a 6.2 percent growth in fiscal year 2011? Mr. Clifford said that energy-related revenues make up the largest part of that growth. PIT revenues will increase, but that really represents a recovery from previous very low levels.

- Why is there an expected decline in oil production over time, when other states have been increasing production? Mr. Clifford said that historically, oil production has been declining one to two percent every year.

- New Mexico would not be in such a deep recession if it developed its natural resources. In San Juan County, wells are being capped much faster than they are being drilled. The revenue estimate predictions of higher gas volumes are not realistic.

- What is the status of the $150 million in frozen capital projects, and how has the freeze affected construction jobs? Secretary Miller said that the governor has frozen capital projects in order to identify projects that can be canceled in the upcoming legislative session. No projects have been canceled yet, and the intent of imposing the freeze was to identify projects that are not able to progress.

- The Department of Finance and Administration has delayed signing grant agreements, which has made some projects appear as if they are not progressing. The capital projects freeze hurts GRT revenues.

Taxation and Revenue Department (TRD) and Motor Vehicle Division (MVD) Proposals

Jim Nunns, tax policy advisor, TRD, and Alicia Ortiz, deputy director, MVD, presented several bills for which the department was seeking endorsement from the committee. Most of the bills had been presented at earlier committee meetings.

Tax Bills

- Withholding on oil and gas proceeds and pass-through entities (presented at the November meeting).

- Tax increment development districts (presented at the November meeting).

- Tax administration (presented at the November meeting). The bill includes two other bills presented to the committee in November. These require that surety bonds be posted with the TRD by in-state contractors and that the administrative fee withheld by the department be increased by one-fourth percent.

- PIT simplification (presented at the November meeting). The revised fiscal impact report (FIR) indicates a small net gain to the general fund every year.

MVD Bills

- Allow driver's licenses and identification cards to be renewed via the internet or mail (presented at the November meeting).

- Clarify expiration dates for driver's licenses of individuals under age 21 (presented at the November meeting).

- Require that a New Mexico driver's license be obtained within 30 days of establishing residency (presented at the November meeting).

- Cancel ignition interlock driver's license for noncompliance (presented at the November meeting).

- Mandatory auto insurance reform. The bill makes several changes to auto insurance statutes. Law enforcement officers will be directed to verify, through an electronic database, whether a vehicle at a traffic stop is insured; if the vehicle is insured, the officer would be prohibited from issuing a citation for failure to carry proof of insurance; if the vehicle is not insured, the officer may remove the license plate of the vehicle. The bill clarifies that the issuance of temporary operation stickers does not create a liability for the state or the local government issuing the sticker. The bill allows a driver who is not insured to pay a penalty assessment fine of $75.00 rather than the current practice of forcing the person to go to court. This provision should provide some relief to the state's overburdened courts. Finally, the bill increases the registration reinstatement fee for lack of insurance from $25.00 to $100. The FIR indicates a gain of $1 million annually.

- Require date of birth and driver's license to register a vehicle. This bill will make it easier for the TRD to create one account for each customer, which will track all driver and vehicle histories. The FIR indicates no fiscal impact.

- Lifetime driver's license revocation for vehicular homicide. The bill makes consistent the revocation period for DWI-related vehicular homicide, which is currently less stringent than convictions for DWI. After a conviction for vehicular homicide, a person would be able to apply for an ignition interlock license and could apply to the district court after 10 years for reinstatement of a regular driver's license. The FIR indicates no fiscal impact.

- Off-site vehicle sales provisions. The bill gives the MVD authority to provide intermediate sanctions for violation of provisions of the MVD program to allow off-site vehicle sales by dealers. Currently, the division may only revoke the dealer's license. The bill provides the opportunity to impose fines up to $10,000 per violation in addition to revoking a license. The FIR indicates no fiscal impact.

Questions and comments from committee members included the following:

- What is the justification for increasing the registration reinstatement fee for lack of insurance? Ms. Ortiz said that many people who are cited for lack of insurance buy insurance, pay the $25.00 reinstatement fine and then cancel their insurance policies. Increasing the fee to $100 would discourage people from gaming the system this way. The legislator said the fee should be deposited into the general fund rather than funding TRD's computer systems.

- Driver's license revocation for the rest of a person's life seems excessive as does the governor's idea of making the third DWI offense a felony.

- What is the status of the federal REAL ID Act of 2005? Ms. Ortiz said that Congress will not be able to address the problem until 2010. She said she expects the federal Department of Homeland Security to issue extensions for states to comply with the law.

- The use of social security numbers in renewing driver's licenses over the internet could pose a risk for that information to be misused.

- The current requirement that an ignition interlock device, which measures the alcohol content of a person, be installed in a vehicle if the person was convicted of driving under the influence of drugs, seems pointless.

- If New Mexico repealed the law that allows undocumented immigrants to obtain a driver's license, it would probably comply easily with the REAL ID Act of 2005. Ms. Ortiz said that other unfunded provisions of the act are still unresolved, such as the requirement that the MVD verify electronically the immigrant status of license applicants.

Legislative Proposal — Biennial Budget Process

Senator Keller presented a proposed bill for the committee's consideration that would establish a two-year budgeting process for the state. The budget for each biennium would be prepared and introduced in the legislature every odd-numbered year. During the even-numbered year, the legislature would only consider deficiency and supplemental appropriations as a supplement to the biennial budget. The two-year budgeting process would start in fiscal year 2012, which would allow state agencies sufficient time to prepare their first biennial budgets for the 2013 legislature. Senator Keller said this bill is similar to a bill the governor pocket vetoed a few years ago, but the governor has indicated he is open to the idea now.

Questions and comments from committee members included the following:

- Are there any constitutional issues that may prevent two-year budgeting? Senator Keller said that the LCS has indicated that there are none.

- Would the two-year budget process give more power to the executive branch, especially in the use of budget adjustment requests (BARs)? Senator Keller said the bill would not directly affect the balance of power between the executive and legislature, but he acknowledged that the process could be abused by agencies issuing multiple BARs over the biennium.

- Do other states have biennial budgets, and what has been their experience? Senator Keller said that Arizona and Kansas have biennial budgeting. A biennial budget would save money by significantly reducing printing costs and by reducing staff time in preparing budgets each year.

- If New Mexico had a biennial budget process in 2008, the state's finances would have been even more dismal than they currently are.

Review of Excise and Other Taxes

Mr. Clifford presented several excise tax revenue-raising options for the committee to consider. The first option he discussed was to raise the motor vehicle excise tax by one percent above the current three percent rate. A one percent increase would bring in $34 million in fiscal year 2011. The next option would be to increase the oil and gas emergency school tax by one percent. The current rates of this tax are 3.15 percent on oil and four percent on gas. Raising the tax on oil would bring in $40 million in fiscal year 2011, and raising the tax on gas would generate $53 million. However, comparing the combined oil and gas effective tax rates with those of surrounding states, New Mexico, which already has higher effective tax rates, could lose some production activity if the tax rates increased.

Another proposal studied is raising the liquor excise tax by an amount that would effectively add five cents to the cost of every alcoholic drink. Raising the tax on beer would generate an additional $25 million, on wine $4 million and on spirits $11 million. New Mexico has the highest tax rate on beer in the region and the second highest rate on spirits. Alcohol purchases are also subject to the GRT. It could be argued that additional taxes on alcohol would add to the regressivity of the state's tax structure.

The premium tax on health insurance, currently set at 4.003 percent, could be raised by one percent, which would generate an additional $22 million in fiscal year 2011 and double that in fiscal year 2012. The tax is imposed on a calendar-year basis, so the fiscal year 2011 impact would not be as great as the subsequent years. It could be argued that because insurance companies are exempt from all other taxes except the property tax, raising the premium tax would not pose a significant burden. However, it could also be expected that an increase in the premium tax would be passed on to customers in the form of higher premiums.

The cigarette tax could be raised by $1.00 per pack. Because tribal sales of cigarettes account for a large portion of the state's total sales, one option would be to tax all cigarette sales in the state and then give tribes an exemption from the tax. This option would raise $30 million. The state could also not give tribes an exemption and make a distribution to tribes based on the sales of cigarettes to their own tribal members, which would raise $47 million. In conjunction with an increase of the cigarette tax, the tobacco products tax would be raised to 40 percent of the wholesaler's purchase price, which would raise $3.5 million.

Mr. Clifford presented the fiscal impact of reducing several tax credits, which currently exceed $100 million on an annual basis. The largest reduction could come from reducing the film production tax credit from 25 percent to 15 percent of qualified expenditures, which would generate $26 million. The main problem with tax credits is the lack of accountability, said Mr. Clifford. The opportunity cost of credits should be studied to gain a better understanding of their impact. As an example, rather than granting medical subsidies, that money could be used to match federal funds in Medicaid, which would increase the amount of medical services people use because new people would become eligible to receive health care. That would in turn create more revenue for the health care industry, offsetting the tax breaks it had previously received.

Questions and comments from committee members included the following:

- Does increasing the cigarette tax rate reduce the incidence of smoking? Mr. Clifford said that the last time New Mexico increased the cigarette tax, there was a modest decrease in smoking, but the major impact was the shifting to tax-exempt sales on tribal lands.

- What would be the net impact of eliminating the deduction from gross receipts on food? Mr. Clifford said that the state could raise $100 million per year.

- New Mexico needs to develop a mechanism for allowing medical providers to pass along the GRT to patients, which they currently cannot do under certain insurance plans.

- The increase in the liquor excise tax could be imposed at the retail level as a surtax. Mr. Clifford said that could be done, but it would increase significantly the complexity of the tax. Increasing the liquor excise tax using the existing system would be much simpler.

- How would reducing the film production tax credit to 15 percent affect the presence of the film industry in the state? Mr. Clifford said he will study that issue. He said many states are currently revisiting their film industry incentives.

- The legislature should consider taxing junk food rather than all food.

- The state has relinquished much of its revenue from the GRT by distributing it to municipalities and counties. Maybe the GRT should be increased by one-fourth percent. Mr. Clifford said that would raise $140 million per year.

- Will changes to the national health care system affect New Mexico's premium tax? Mr. Clifford said that revenues collected from the premium tax probably will be affected, but the tax itself will not be.

Energy, Minerals and Natural Resources Department (EMNRD) — Dairy Biomass for Fuel

Fernando Martinez, director, Energy Conservation and Management Division, EMNRD, presented to the committee a bill draft granting a tax credit to dairies and feedlots of $5.00 per wet ton for transport to a facility that processes the waste into fuels or electricity. The credit will be phased out in 2020. The credit is capped at $5 million per year. Mr. Martinez also briefly discussed renewable solar energy tax credit legislation being proposed, which was presented at the committee's November meeting.

Questions and comments from committee members included the following:

- The state should consider establishing a grant program to help the renewable energy industry rather than providing a tax credit. Does the governor support the bill? Mr. Martinez said that he has not yet heard from the governor's office whether this bill will be supported.

- It needs to be determined whether the proposed energy production facility near Roswell will be efficient enough to be cost-effective. The department was asked to provide operational figures before the legislature considers the bill. T.J. Trujillo, lobbyist for the Dairy Producers of New Mexico, said that the Pecos Valley facility is still in the development phase. Although the developers originally wanted to produce electricity, with new developments in algae gas production, producing gas from feedlot waste now seems feasible.

The minutes of the November 23-25, 2009 meeting of the committee were adopted without changes.

The committee recessed at 3:36 p.m.

Tuesday, December 15

Property Tax Issues and Suggestions

Jim O'Neill, consultant, Lee Reynis, director, BBER, UNM, and Janice McCrary, vice chair, Greater Albuquerque Association of Realtors, discussed with the committee issues surrounding the property tax. Mr. O'Neill began by stating that the recent lawsuits in the second judicial district have left New Mexico with two separate property tax codes: one for that district, and one for the rest of the state. Two judges have ruled that significant portions of Section 7-36-21.2 NMSA 1978 are unconstitutional. That section limits increases in the valuation of property except when new construction occurs or there is a change of ownership. There is reason to believe that the unconstitutionality of that section will be upheld by higher state courts, and there is no current remedy in statute to solve the problem.

Mr. O'Neill suggested some options, the first being to repeal Section 7-36-21.2 NMSA 1978. If the legislature repealed that section, other property valuation limitations in other sections would remain, such as for elderly and disabled residents. However, just repealing that section would have serious political consequences, because nearly everybody's tax liability would increase, subject to the yield control limitations in place. Another option would be to create a new general valuation limitation that meets the requirements of Article 8, Section 1 of the Constitution of New Mexico. The new valuation limitation could change how much the increase is limited to, and it could also set up different classes of residential property taxpayers. Other options to be considered include changing the tax ratios between residential and commercial properties and increasing the head of family exemption, which can be tailored to fit exactly the set of properties where relief is desired.

Ms. Reynis then gave an overview of the property tax system in New Mexico. The state stopped receiving operating money from property taxes after it relinquished the 20-mill levy to municipalities and counties in the 1980s. The statewide property tax is only used for debt service on state general obligation bonds. The state does take credit for the one-half mill levy imposed by school districts but distributes that money through the state equalization distribution. The total taxable value of residential property in New Mexico in 2008 was $27.8 billion, and nonresidential property was valued at $22.7 billion. Residential valuations have risen more quickly than nonresidential valuations in the past 10 years.

Ms. Reynis presented several proposals to reform the property tax system, the first being the reinstatement of a statewide one-mill levy to fund public schools, which would raise $50 million annually. County assessors need to be allowed to bring all properties to their current and correct values, and they need to have the tools to do their jobs. She suggested effective safeguards to protect low-income homeowners and protections for those who may have high-valued land but little ability to pay high property taxes. One idea would be to defer payment of a certain portion of property taxes until the sale of the property.

Ms. McCrary gave a presentation on how the property tax lightning issue has become progressively worse each year since the enactment of valuation limitation legislation in 2000. While property values increased at an average of two to five percent per year, there was not much of a valuation difference between newly purchased homes and their adjacent homes. However, the last several years have seen a rapid increase in actual property values, but assessors are limited to increasing the valuations of owner-occupied houses to three percent per year. When a house was sold, it was assessed at its current and correct value, which sometimes resulted in property taxes on a newly purchased home being more than twice as high as a similar adjacent house.

Questions and comments from committee members included the following:

- Property valuations should be at their current and correct levels, but that would cause much unrest in certain segments of the population. Mr. O'Neill said that one of the problems with the property tax is that the level of taxation is not related to the income level of the property owner.

- Was the decision by Bernalillo County Assessor Karen Montoya to reduce the valuations of all property tax protestors legal? Mr. O'Neill said that she merely followed the direction of the court.

- The tax lightning problem seems to be limited to only a few counties in the state. The legislature should investigate a local option for those areas in which the problem exists.

- Why did county assessors not value properties at their current and correct values, as required by law? Mr. O'Neill said that they tried to, but that they were also constrained by the three percent valuation limitation, which makes it impossible to comply with the current and correct provisions. He said that the legislature could remove the three percent cap for one year to allow valuations to adjust and then apply the cap again.

- Most residents who have lived in their houses for several years are content with the three percent valuation limitation. The only people who seem to be complaining about the limitation are the Realtors, who need to share some of the blame for the problem because they have been hesitant to disclose the true property tax obligations of newly purchased homes.

- Many lenders outside the Albuquerque metropolitan area did not make bad mortgage loans, and the housing bubble did not exist in rural areas.

Overview of the Governor's Budget Balancing Task Force

Mr. Nunns gave an update on the work of the Budget Balancing Task Force, which was scheduled to hold its final meeting and issue a final report on December 17. The task force would not be making any recommendations, but it will be providing FIRs and analyses of more than 50 revenue-raising options.

Questions and comments from committee members included the following:

- If the GRT is imposed on sales of vehicle fuel, a portion of that revenue should be distributed to the State Road Fund.

- How long does a person need to work in New Mexico to be subject to the PIT? Mr. Nunns said that if a person works 15 days in the state, that person is typically subject to the PIT. Some states are looking at lengthening that period to 30 days to reduce administrative hassles for itinerant workers. Income tax would still be paid in the person's home state.

- The task force was formed to balance the budget, but expenditure cuts are not being considered by the group. Mr. Nunns said that former Governor Garrey Carruthers was heading up a government "streamlining" group to identify potential cost savings in state government.

- Do the models that generate the FIRs use current economic data? Mr. Nunns said that the most recent data available from actual tax returns are used to predict the revenue impact of the various tax proposals.

- If the state income tax rates increase, will corresponding federal taxation decrease? Mr. Nunns said that because state income tax can be deducted from income for federal taxation purposes, for every one percent increase in the state PIT, an individual will actually pay on average only 0.6 percent more because of the federal deduction.

- Would it be possible to impose the GRT on bottled water in addition to junk food? Mr. Nunns said that would be possible, but the task force wanted to keep all of its proposals consistent with Streamlined Sales Tax Agreement definitions.

- Did the task force discuss tax expenditures? Mr. Nunns said the task force did not have a thorough discussion of tax credits and other tax expenditures.

Simulcast Dog Racing from Licensed Dog Racing Tracks

Ed Mahr, lobbyist, and Don Cook, general manager, The Downs at Albuquerque, presented a proposed bill to the committee to allow parimutuel wagering on simulcast dog racing. Mr. Cook clarified that this bill does not contemplate an expansion of gaming activities at the state's racinos, it only expands parimutuel betting at those facilities. Mr. Cook said that many of the Downs' patrons have asked for years to be allowed to bet on dog races in addition to horse races. He stressed that the simulcasts would only be from licensed dog racetracks from other states. Mr. Mahr said that there is now a successful adoption program for retired greyhounds and that former racers are no longer euthanized.

Questions and comments from committee members included the following:

- The Pueblo of Pojoaque currently simulcasts dog races, and the state does not realize any money from that activity. Does the legislation allow for advanced deposit wagering? Mr. Mahr said that it does not, and the intent is to mirror the existing parimutuel wagering system in place for horse racing.

Tax Incentive Review

Mr. Clifford introduced a panel to discuss business tax incentives. The panel included Thomas Pogue, professor emeritus of economics, University of Iowa, Timothy Van Valen, chair, Tax Policy Committee, Association of Commerce and Industry, Deirdre Firth, senior economic developer, City of Albuquerque, Bob Walton, vice president, business development, Albuquerque Economic Development (AED), and Deborah Inman, vice president, business development, AED.

Mr. Pogue began by giving an overview of New Mexico's business tax credits. Until about 30 years ago, no business tax credits were in existence, and as of 2009, there are nearly 30. Most of the tax credits have been enacted in the current decade. Credit claims have also grown significantly from $4 million in 2003 to more than $111 million in fiscal year 2009. While New Mexico has followed the nationwide trend of encouraging economic development by enacting credits and other business incentives, very little study of the effectiveness of those incentives has been performed. There is a need to establish a framework to evaluate business incentives. Some of the criteria to evaluate incentives should include whether the incentive actually increases tax revenue to the state and what the actual economic impact of the incentive is. Both of those questions are difficult to evaluate, said Mr. Pogue.

Ms. Firth described to the committee how the City of Albuquerque administers its industrial revenue bond (IRB) program. IRBs are essentially an abatement of property tax liabilities on real and personal property involved in qualified projects. Both new and expanding businesses use the IRB process, which requires a significant application and review process. Accountability is a crucial component of the IRB system. The program requires detailed annual reports, and the city is authorized to recoup taxes if a company does not perform according to what was promised in the IRB contract. However, there is flexibility to allow for companies that are not able to meet their performance goals due to circumstances beyond their control.

Mr. Walton and Ms. Inman discussed the activities of AED, which is a private, nonprofit organization that focuses on the recruitment and expansion of industries in the Albuquerque area. The organization was founded in 1960 and provides assistance to companies considering locating in the metropolitan area. The AED also works with local companies and since 2002 has assisted more than 500 local businesses. One of the main programs AED uses is the job-training incentive program (JTIP), which is a state-funded program to provide training for new employees. The program provides partial wage reimbursement for training new positions in economic-based companies.

Mr. Walton introduced John Spruce, chief executive officer of Mechtronics Solutions, Inc., an engineering company. Taking advantage of JTIP incentives, Mechtronics has been able to grow from a company with 13 employees in 2003 to 57 employees in 2009. Ms. Inman said that the JTIP program is currently out of money, and the Economic Development Department (EDD) will ask for $2.5 million in emergency funding for the program in the upcoming session.

Mr. Van Valen said that business incentives are especially important now. Incentives are often used by businesses in obtaining financing. The development community does not see incentives as lost revenue to the state because if a project does not move forward, a credit is not issued. He said that accountability is important as long as the rules are not draconian.

Questions and comments from committee members included the following:

- If a company goes bankrupt, can revenue be recouped from an IRB? Ms. Firth said that revenue cannot be collected.

- There are many different reporting requirements for the state's business incentive credits. What would be the best practice to administer them? Mr. Pogue said the state should centralize the oversight of incentives and provide for standardized evaluations. Therese Varela, JTIP program manager, EDD, said that a recent study showed a 34 percent long-term retention of employees in companies receiving JTIP assistance. Many employees move on to other companies, which accounts for much of the low figure, she said. She also cited a study of the wages of 900 JTIP trainees, which showed much higher wages after their training.

- Utah has a very good incentive program with very strict accountability.

- Many credits have diminishing returns, and it is difficult to quantify the effects of credits.

The committee recessed at 4:07 p.m.

<u>Wednesday, December 16</u>

The committee reconvened at 9:13 a.m.

Summary of Revenue-Raising Options and Tax Principle Application

Mr. Clifford discussed tax policy principles in relation to possible tax increases. Recent tax law changes have resulted in a net $600 million reduction in state revenues, and the state faces a $900 million gap between revenues and expenditures in fiscal year 2010. He cited some studies that put New Mexico's tax burden on households above the average among surrounding states. Mr. Clifford said that many surrounding states are considering tax increases to deal with budget shortfalls.

Mr. Clifford said that raising taxes on high-income taxpayers would improve vertical equity but could create a narrower tax base, thus impairing efficiency. Currently, 60 percent of taxes are paid by nine percent of households, and increasing taxes too high on higher income persons will exacerbate this situation. However, any PIT increase will be partially offset by increased federal deductions. Mr. Clifford said that the state could either reduce the capital gains deduction or could allow the large deduction for investment in New Mexico.

Mr. Clifford said that the CIT is a highly concentrated tax that applies to a small minority of businesses in New Mexico. The top 250 corporations pay 90 percent of the CIT, and New Mexico has one of the highest rates in the region. He then discussed the GRT and said that the tax is largely a tax on services. He estimated that 70 percent of household purchases are exempt or deductible and that raising the tax rate will increase pyramiding. Eliminating the food deduction will broaden the GRT base and improve efficiency. He said that the food deduction is poorly targeted because most of the benefit goes to non-poor households.

New Mexico can increase excise taxes, and Mr. Clifford discussed some implications of various proposals. New Mexico excise taxes are relatively high in comparison with other states, with the exception of the motor vehicle excise tax. Revenue generated from an increase in the cigarette tax will be limited due to the tribal exemption. Increasing the liquor excise tax or the cigarette tax probably is also regressive, and significant rate increases could lead to the increased use of untaxed internet purchases.

Questions and comments from committee members included the following:

- Taxing food would instantly raise the price of food by an average of seven percent, which will hurt low- and moderate-income people. Mr. Clifford said that food stamps have always been exempt from the GRT. He said that the LICTR was originally designed to reduce the regressivity of the GRT, which probably should be increased if food is taxed again.

- How risky are the revenue estimates? Mr. Clifford said that he thinks the expected rise in the price of gas by 25 percent is not realistic but that the other estimates made by the consensus revenue group seem to be much safer.

- How much money would be generated by imposing the GRT on food and by increasing the GRT by one-fourth percent? Mr. Clifford estimated that the state would raise about $350 million annually.

- The legislature needs to address the problem that medical service providers have in not being able to pass along the GRT to many of their patients.

- What has been the major factor in the increase in state spending? Mr. Clifford said that health spending has accounted for at least one-third of state government growth.

- Would mandatory combined reporting broaden the CIT base? Mr. Clifford said that it would, somewhat.

- Food stamps do not always cover all the food expenses of a household, so many low-income households would suffer if food were taxed. In addition, only about three-fourths of the people who qualify for food stamps are enrolled in the program.

- Although it is politically difficult to raise taxes, it is very important that New Mexico not lose any ground it has gained in recent years in education and health care.

- The impact of local governments using operation property tax levies needs to be studied.

- Would it be a good idea to provide another tax amnesty period, which would allow delinquent taxpayers to pay their taxes without interest or penalties? Mr. Nunns said that the state allows managed audits, which are similar to an amnesty.

Legislative Proposal Endorsements

The committee did not endorse any legislation.

There being no further business, the committee adjourned at 11:15 a.m.

REVENUE STABILIZATION AND
TAX POLICY COMMITTEE

Section 10

2009
Legislation Reviewed

No Committee Endorsements