REVENUE STABILIZATION AND TAX POLICY COMMITTEE

2013
INTERIM
FINAL REPORT

New Mexico Legislature
Legislative Council Service
411 State Capitol
Santa Fe, New Mexico 87501

REVENUE STABILIZATION AND TAX POLICY COMMITTEE
2013 INTERIM FINAL REPORT

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2013 INTERIM SUMMARY

REVENUE STABILIZATION AND TAX POLICY COMMITTEE
Senator Carlos R. Cisneros, Chair
Representative Edward C. Sandoval, Vice Chair
SUMMARY OF WORK COMPLETED
2013 Interim

The Revenue Stabilization and Tax Policy Committee held six meetings in 2013. Bill endorsements were completed on the second day of the December meeting, at which 13 of the 19 bills under consideration were endorsed.

This year, the committee discussed and studied a variety of issues, ranging from reform of the state's various tax programs, the effectiveness of existing tax incentives and tax issues facing local governments. The committee also heard presentations regarding the status and health of the state's funds.

One of the first issues explored during the interim was tax reform. Richard Anklam of the New Mexico Tax Research Institute and Helen Hecht of the Federation of Tax Administrators provided the committee with an overview of tax schemes of different states. A significant topic involved reform of the state's existing gross receipts tax system and the manner in which other states have reformed their consumption tax systems. In that context, the committee heard presentations about how other states are taxing internet sales, trends toward "market-based" sourcing for sales and increased focus on evaluation of state economic and tax incentives.

Early in the interim, the Taxation and Revenue Department presented an overview of the fiscal impacts anticipated with regard to the various portions of the New Mexico jobs package (HB 641) that passed during the last legislative session. HB 641 resulted in changes with respect to the corporate income tax rate, certain gross receipts tax deductions, the high-wage jobs tax credit, the film production tax credit, significant changes to "hold harmless" distributions and the authority for municipalities and counties to impose a hold harmless gross receipts tax.

The New Mexico Association of Counties and the New Mexico Municipal League made presentations on the consequences of changes to the hold harmless distributions, including that some municipalities and counties will get "windfalls" as a result of the hold harmless gross receipts tax authorization, while others will never receive an amount equal to the distribution they would have received before the enactment of HB 641.

The department presented its 2013 tax expenditure report in October. This year's report is more comprehensive than last year's, and staff is working to make next year's report even more comprehensive. The report also states that further discussion is needed on the merits of requiring additional information from taxpayers so that policymakers can make informed decisions regarding tax incentives.

2013 WORK PLAN AND MEETING SCHEDULE

2013 APPROVED
WORK PLAN AND MEETING SCHEDULE
for the
REVENUE STABILIZATION AND TAX POLICY COMMITTEE

Members

Sen. Carlos R. Cisneros, Chair
Rep. Edward C. Sandoval, Vice Chair
Sen. Sue Wilson Beffort
Rep. Anna M. Crook
Rep. Brian F. Egolf, Jr.
Sen. Timothy M. Keller
Rep. Rodolpho "Rudy" S. Martinez
Sen. Mark Moores
Rep. Henry Kiki Saavedra
Sen. Clemente Sanchez
Sen. William E. Sharer
Sen. John Arthur Smith
Rep. James R.J. Strickler
Rep. Thomas C. Taylor
Sen. Lisa A. Torraco
Rep. Jim R. Trujillo
Sen. Peter Wirth
Rep. Bob Wooley

Designees

Rep. Donald E. Bratton
Sen. William F. Burt
Sen. Jacob R. Candelaria
Rep. Ernest H. Chavez
Rep. Miguel P. Garcia
Sen. Phil A. Griego
Rep. Jason C. Harper
Rep. Sandra D. Jeff
Sen. Gay G. Kernan
Rep. Tim D. Lewis
Rep. Bill McCamley
Sen. George K. Munoz
Rep. Paul A. Pacheco
Rep. Dennis J. Roch
Rep. Debbie A. Rodella
Sen. Nancy Rodriguez
Sen. John M. Sapien
Rep. Carl Trujillo
Rep. Luciano "Lucky" Varela
Sen. Pat Woods

Work Plan

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

A. In the 2013 interim, the committee will:

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

(a) adequacy;
(b) efficiency;
(c) equity;
(d) simplicity; and

(e) accountability;

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

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

4. continue to examine exemptions, deductions and credits to determine the ability to report and track the effectiveness and value to the state of tax incentives;

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

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

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

(a) increasing the working families tax credit;

(b) achieving revenue adequacy for the State Road Fund;

(c) addressing the limitation on property tax valuations and resulting property tax lightning;

(d) responding to congressional action to allow state taxation of remote sellers and internet sales; and

(e) formalizing procedures to provide more accurate and timely fiscal impact reports that might also provide dynamic scoring;

8. evaluate recent tax and revenue-related legislation introduced in an effort to reduce ambiguity, mitigate unintended consequences and ameliorate deficiencies; and

9. review the revenue status of gaming within the state, including lottery gaming, Indian gaming and gaming conducted by racinos and fraternal and other organizations.

B. The committee will coordinate, as needed, with other committees regarding presentation of subject matter of common concern, particularly regarding sources of revenue that can be used to support transportation needs in New Mexico. The committee will hear a final report from the Transportation Infrastructure Revenue Subcommittee regarding its recommendations and proposed action.

Revenue Stabilization and Tax Policy Committee
2013 Approved Meeting Schedule

Date	Location
May 14	Santa Fe, State Capitol, Room 307
July 15-16	Santa Fe, State Capitol, Room 307
August 19-20	Albuquerque
September 23-24	Santa Fe, State Capitol, Room 307
October 21-22	Santa Fe, State Capitol, Room 307
December 17-18	Santa Fe, State Capitol, Room 307

AGENDAS

Revised: May 14, 2013

TENTATIVE AGENDA
for the
FIRST MEETING IN 2013
of the
REVENUE STABILIZATION AND TAX POLICY COMMITTEE

May 14, 2013
State Capitol, Room 307
Santa Fe

Tuesday, May 14

10:00 a.m. (1) **Call to Order**
—Senator Carlos R. Cisneros, Chair

10:05 a.m. (2) **Interim Committee Procedures**
—Raúl E. Burciaga, Director, Legislative Council Service (LCS)

10:25 a.m. (3) **Post-Session Fiscal Report**
—David Abbey, Director, Legislative Finance Committee

11:15 a.m. (4) **Organizational Business — Work Plan and Meeting Schedule**
—Damian Lara, Staff Attorney, LCS
—Pam Stokes, Staff Attorney, LCS
—Tessa Ryan, Staff Attorney, LCS

12:00 noon **Lunch**

1:00 p.m. (5) **2013 Tax Legislation: Impacts and Implementation**
—Demesia Padilla, Secretary, Taxation and Revenue Department

1:45 p.m. (6) **2013 Tax Legislation: New Mexico Jobs Package**
—Tom Clifford, Secretary, Department of Finance and Administration

2:30 p.m. (7) **Taxation of Internet Sales/Remote Sellers**
—Richard Anklam, President and Executive Director, New Mexico Tax Research Institute

3:15 p.m. **Adjourn**

Revised: July 12, 2013

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

July 15-16, 2013
Room 307, State Capitol
Santa Fe, New Mexico

Monday, July 15

10:00 a.m. **Call to Order**
—Senator Carlos R. Cisneros, Chair

10:05 a.m. (1) **Review and Explanation of the New Mexico Jobs Package — HB 641 (2013)**
—Demesia Padilla, Secretary, Taxation and Revenue Department (TRD)
—John Tysseling, Chief Economist, TRD

11:00 a.m. (2) **Comparing New Mexico's Tax Structure to Other States — An Overview**
—Richard Anklam, President and Executive Director, New Mexico Tax Research Institute

12:00 noon **Lunch**

1:00 p.m. (3) **Cultural Affairs Department: Selected Capital Outlay Projects**
—Jeff Canney, Program Evaluator, Legislative Finance Committee

2:00 p.m. (4) **Telecommunications Access Fund — Status and Concerns**
—Lisa Dignan, Acting Executive Director, Commission for Deaf and Hard-of-Hearing Persons (CDHHP)
—Shannon Smith, Relay Administrator, CDHHP

3:00 p.m. (5) **Update on Selected Tax Expenditures**
—Demesia Padilla, Secretary, TRD
—John Tysseling, Chief Economist, TRD

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

Tuesday, July 16

9:00 a.m.		**Reconvene** —Senator Carlos R. Cisneros, Chair
9:05 a.m.	(6)	**Trends in Tax Policy Issues Relevant to New Mexico** —Helen Hecht, Tax Counsel, Federation of Tax Administrators
10:00 a.m.	(7)	**Current County Tax Issues** —Paul Gutierrez, Executive Director, New Mexico Association of Counties
10:30 a.m.	(8)	**Gross Receipts Tax (GRT) Take-Backs — Local Government Perspective** —Bill Fulginiti, Executive Director, New Mexico Municipal League
11:30 a.m.	(9)	**GRT Take-Backs — Update from the TRD** —Demesia Padilla, Secretary, TRD —Nelson Goodin, Chief Legal Counsel, TRD
12:00 noon		**Adjourn**

Revised: August 9, 2013

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

August 19-20, 2013
Salon Ortega
National Hispanic Cultural Center
Albuquerque, New Mexico

Monday, August 19

10:00 a.m.		**Call to Order** —Senator Carlos R. Cisneros, Chair
10:05 a.m.	(1)	**Premium Tax Update** —John Franchini, Superintendent of Insurance
11:00 a.m.	(2)	**New Mexico Film — Update and Film Production Tax Credit Annual Report** —Nick Maniatis, Director, New Mexico Film Office (NMFO)
12:00 noon		**Lunch**
1:00 p.m.	(3)	**State Land Office Annual Status and Revenue Update** —Ray Powell, Commissioner of Public Lands
2:00 p.m.	(4)	**Severance Tax Bonding Overview** —Stephanie Schardin Clarke, Director, State Board of Finance
3:00 p.m.	(5)	**Investment Performance for Fiscal Year 2013; Impact of Contributions and Distributions on the Permanent Fund; New Mexico Private Equity Overview** —Steven K. Moise, State Investment Officer, State Investment Council —Vince Smith, Deputy State Investment Officer, State Investment Council
4:30 p.m.		**Recess**

Tuesday, August 20

9:00 a.m.		**Reconvene** —Senator Carlos R. Cisneros, Chair
9:05 a.m.	(6)	**Gaming — Revenue, Trends and Tribal-State Revenue Sharing** —Jeffrey S. Landers, Chair, Gaming Control Board (GCB) (*invited*) —Paulette Becker, Board Member, GCB —Frank A. Baca, General Counsel and Acting Executive Director, GCB
10:15 a.m.	(7)	**New Mexico (NM) Lottery Revenue Update and Legislative Lottery Scholarship Fund Status** —Tom Romero, Chief Executive Officer, NM Lottery —José Z. Garcia, Ed.D., Cabinet Secretary, Higher Education Department (HED) —Glenn Walters, Deputy Secretary, HED
11:30 a.m.		**Adjourn**

Revised: September 11, 2013

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

September 23-24, 2013
Room 307, State Capitol
Santa Fe, New Mexico

Monday, September 23

10:00 a.m.		**Call to Order** —Senator Carlos R. Cisneros, Chair
10:05 a.m.	(1)	**Revenue Forecast** —Elisa Walker-Moran, Chief Economist, Taxation and Revenue Department —Peter van Moorsel, Economist, Legislative Finance Committee (LFC) —Leila Burrows, Chief Economist, Department of Finance and Administration (DFA)
12:00 noon		**Lunch**
1:00 p.m.	(2)	**State Road Fund Update** —Tom Church, Secretary-Designate, Department of Transportation (DOT) —Clinton Turner, Chief Economist, DOT
2:00 p.m.	(3)	**Laboratory Partnership with Small Business Tax Credit Annual Report** —Belinda Snyder, Economic Development Program Manager, Los Alamos National Laboratory —Genaro Montoya, New Mexico Small Business Assistance Program Manager, Sandia National Laboratories
3:00 p.m.	(4)	**Reforming the Gross Receipts Tax** —Helen Hecht, Tax Counsel, Federation of Tax Administrators —Richard Anklam, President and Executive Director, New Mexico Tax Research Institute
4:00 p.m.		**Recess**

Tuesday, September 24

9:30 a.m.		**Reconvene** —Senator Carlos R. Cisneros, Chair
9:35 a.m.	(5)	**Tax Expenditure Oversight and Replacing the Gross Receipts Tax with a Sales Tax** —Representative Jason C. Harper —Representative Bill McCamley
11:30 a.m.	(6)	**Gross Receipts Deduction for Durable Medical Equipment and Medical Supplies** —Richard Minzner, Lobbyist
12:00 noon		**Adjourn**

Revised: January 14, 2014

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

October 21-22, 2013
Room 307, State Capitol
Santa Fe, New Mexico

Monday, October 21

10:00 a.m.		**Call to Order** —Senator Carlos R. Cisneros, Chair
10:05 a.m.	(1)	**Tax Expenditure Report** —Demesia Padilla, Secretary, Taxation and Revenue Department (TRD) —Elisa Walker-Moran, Chief Economist, TRD
12:00 noon	(2)	**Effect of *Gillette* Litigation on New Mexico** —Nelson Goodin, Chief Legal Counsel, TRD
12:30 p.m.		**Lunch**
1:30 p.m.	(3)	**Evidence Counts: Evaluating Tax Incentives for Jobs and Growth** —Robert Zahradnik, Director, State Policy, State Fiscal Health and Economic Growth, The Pew Charitable Trusts
2:30 p.m.	(4)	**Capital Outlay Process: Concerns and Options for Improvement** —Linda Kehoe, Principal Analyst, Legislative Finance Committee (LFC) —Ryan Gleason, Tax Policy and Research Director, TRD
4:00 p.m.	(5)	**Heritage Series License Plates, HB 625 (2013)** —Representative Tim D. Lewis
5:00 p.m.		**Recess**

Tuesday, October 22

9:00 a.m.		**Reconvene** —Senator Carlos R. Cisneros, Chair

9:05 a.m. (6) **Local Government Legislative Priorities**
—Bill Fulginiti, Executive Director, New Mexico Municipal League (NMML)
—Paul Gutierrez, Executive Director, New Mexico Association of Counties (NMAC)

10:00 a.m. (7) **Hold Harmless Changes**
—Bill Fulginiti, Executive Director, NMML
—Paul Gutierrez, Executive Director, NMAC
—Peter VanMoorsel, Chief Economist, LFC

11:00 a.m. (8) **Compensating and Gross Receipts Tax Deduction — Equipment Used in the Production and Processing of Chile**
—Charlie Marquez, Lobbyist

11:30 a.m. **Adjourn**

Revised: December 16, 2013

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

December 17-18, 2013
Room 307, State Capitol
Santa Fe, New Mexico

Tuesday, December 17

10:00 a.m.		**Call to Order** —Senator Carlos R. Cisneros, Chair
10:05 a.m.	(1)	**Revenue Forecast** —Demesia Padilla, Secretary, Taxation and Revenue Department (TRD) —Elisa Walker-Moran, Chief Economist, TRD —Leila Burrows, Chief Economist, Department of Finance and Administration —Peter van Moorsel, Chief Economist, Legislative Finance Committee (LFC)
12:00 noon		**Lunch**
1:15 p.m.	(2)	**Attorney General Opinion No. 13-03: May the Governor Unilaterally Withhold a Capital Outlay Appropriation Made to an Agency by the Legislature?** —TBD, Attorney General's Office
2:00 p.m.	(3)	**Retiree Program Solvency Report** —Wayne Propst, Executive Director, Public Employees Retirement Association
3:00 p.m.	(4)	**How Tax Policy Can Be Used to Improve Child Well-Being** —Bill Jordan, Senior Policy Advisor, Governmental Relations, New Mexico Voices for Children
3:30 p.m.	(5)	**Status Report of the Proposed Navajo Compact** —Ben Shelley, President, Navajo Nation —LoRenzo Bates, Delegate, Navajo Nation Council
4:30 p.m.		**Recess**

Wednesday, December 18

9:00 a.m.		**Reconvene** —Senator Carlos R. Cisneros, Chair
9:05 a.m.	(6)	**Tax Reform Study** —Senator William E. Sharer —Representative Thomas C. Taylor
9:30 a.m.	(7)	**Hold Harmless Gross Receipts Tax and Distribution Changes** —Representative Jason C. Harper —Bill Fulginiti, Executive Director, New Mexico Municipal League —Tasia Young, Legislation Liaison, New Mexico Association of Counties (NMAC)
10:30 a.m.	(8)	**Separate Reporting of Certain Gross Receipts and Compensating Tax Deductions and Exemptions** —Representative Jason C. Harper —Representative Bill McCamley —Senator Timothy M. Keller
11:00 a.m.	(9)	**Legislative Proposals: Reporting Requirements; Changes to Working Families Tax Credit and Capital Gains Deduction; and State Graduate Employment Tax Credit** —Senator Timothy M. Keller
11:30 a.m.	(10)	**County Government Legislative Proposals** —Tasia Young, Legislation Liaison, NMAC
12:00 noon	(11)	**Capital Outlay Planning and Monitoring Act** —Linda Kehoe, Principal Analyst, LFC
12:30 p.m.	(12)	**Other Legislative Proposals** —Pam Stokes, Staff Attorney, Legislative Council Service
1:00 p.m.		**Adjourn**

MINUTES

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

May 14, 2013
Room 307, State Capitol
Santa Fe

The first meeting in 2013 of the Revenue Stabilization and Tax Policy Committee (RSTP) was called to order by Senator Carlos R. Cisneros, chair, on Tuesday, May 14, 2013, at 10:06 a.m. in Room 307 of the State Capitol in Santa Fe.

Present
Sen. Carlos R. Cisneros, Chair
Rep. Edward C. Sandoval, Vice Chair
Sen. Sue Wilson Beffort
Rep. Anna M. Crook
Rep. Brian F. Egolf, Jr.
Sen. Timothy M. Keller
Rep. Rodolpho "Rudy" S. Martinez
Sen. Mark Moores
Sen. Clemente Sanchez
Sen. William E. Sharer
Sen. John Arthur Smith
Rep. James R.J. Strickler
Rep. Thomas C. Taylor
Rep. Jim R. Trujillo

Absent
Rep. Henry Kiki Saavedra
Sen. Lisa A. Torraco
Sen. Peter Wirth
Rep. Bob Wooley

Designees
Rep. Ernest H. Chavez
Rep. Dennis J. Roch
Sen. Nancy Rodriguez
Rep. Luciano "Lucky" Varela

Rep. Donald E. Bratton
Sen. William F. Burt
Sen. Jacob R. Candelaria
Rep. Miguel P. Garcia
Sen. Phil A. Griego
Rep. Jason C. Harper
Rep. Sandra D. Jeff
Sen. Gay G. Kernan
Rep. Tim D. Lewis
Rep. Bill McCamley
Sen. George K. Munoz
Rep. Paul A. Pacheco
Rep. Debbie A. Rodella
Sen. John M. Sapien

Rep. Carl Trujillo
Sen. Pat Woods

Staff
Damian Lara, Staff Attorney, Legislative Council Service (LCS)
Tessa Ryan, Staff Attorney, LCS
Pam Stokes, Staff Attorney, LCS

Guests
The guest list is in the meeting file.

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

<u>Tuesday, May 14</u>

Interim Committee Procedures
Raúl E. Burciaga, director of the LCS, reviewed some protocols particular to the RSTP. Mr. Burciaga explained that a statutory blocking provision applies; that is, if a majority of the members from a chamber rejects a proposed action, then it fails. The RSTP is also distinct in that it does not have advisory members, but designees. A quorum of the RSTP, which is composed of 18 members, forms when at least 10 of its members or designees are present.

Mr. Burciaga highlighted protocols applicable to all interim committees. A quorum is presumed to exist unless the issue of its nonexistence is raised. If it is acknowledged that a committee lacks a quorum, it may operate as a special subcommittee and accept testimony, but not formally act. Other standard rules are: the committee may act by consensus and a formal action requires a motion and a voice, hand or objection vote; absent approval from the New Mexico Legislative Council, the committee must meet in Santa Fe after September 30; and a legislator may be compensated for attending a maximum of four meetings of committees of which the legislator is not a member.

Mr. Burciaga distributed a calendar of interim committee tentative meeting dates that was created with the goal of minimizing scheduling conflicts for committee members and staff. He encouraged members to express their communication preferences to committee staff so that staff can effectively plan meetings.

A member suggested that the staff consider ways in which the RSTP might collaborate with other committees that focus on topics that the RSTP addresses, such as the Transportation Infrastructure Revenue Work Group and the Jobs Council. Another member asked that members receive a list of interim committee names and abbreviations.

Post-Session Fiscal Report
David Abbey, director, Legislative Finance Committee (LFC), summarized the state's fiscal status. He characterized the 2013 legislative session as, generally, a success. Lawmakers

enacted a balanced budget for fiscal year 2014. Spending of $5.88 billion from the general fund, which includes capital appropriations of about $510 million, increased by 4.3% from fiscal year 2013. Projected reserves exceed 10%. A major tax reform package, also signed into law and that generally adheres to the principles of good tax policy, will phase in a corporate income tax cut and phase out certain corporate income tax loopholes. When implemented, the session's tax legislation should initially increase and then gradually reduce general fund revenue. Mr. Abbey indicated that the reduction is cause for concern.

Mr. Abbey summarized revenue trends and forecasts. In the past several fiscal years, there were dramatic swings in revenue and appropriation levels; potentially deeper declines were tempered by the injection of federal money and the capture of unused capital appropriations. Overall, fiscal year 2014 revenues and spending reflect a relative return to pre-recession impact levels. Oil and natural gas prices and production levels, which have a tendency to fluctuate rapidly, have closely matched forecasts and will continue to be monitored attentively.

Changing revenue forecasts and other developments posed challenges in budget formation during the periods leading up to and into the session. "New money" projections increased slightly from August to December and then dropped mid-session. Further complicating budget matters were: a $70 million set-aside to account for possible discrepancies between cash account and bank balances; potential liability for not maintaining adequate special education spending; the state's commitment to expand Medicaid pursuant to the federal Patient Protection and Affordable Care Act; and concerns about federal sequestration.

Ultimately, the LFC's total for recommended appropriations differed by $1 million from that of the Department of Finance and Administration (DFA). The LFC recommended concentrating spending in the areas of Medicaid, education, public safety and general fund liabilities.

Certain categories of spending received more general fund money from the General Appropriation Act of 2013 than in fiscal year 2013: public schools, higher education, Medicaid, public safety and other categories. Public schools will receive the greatest share of additional funding, a 4.6% increase from the fiscal year 2013 appropriation of $112.1 million. The public school increase, in part, is for satisfying special education maintenance of effort requirements; meeting increased formula funding demands; and programs that target early childhood services, particularly those that bolster reading and math proficiency. Meanwhile, higher education institutions will receive an additional $38.2 million, or 5% more than in fiscal year 2013. In this area, the General Appropriation Act of 2013 emphasizes outcomes in degree completion; science, technology, engineering and math (STEM) degree awards; and the participation of minorities in STEM programs. Increased Medicaid spending reflects Medicaid expansion, a development that, despite some associated uncertainty, is expected to attract enough federal dollars to generate a net gain in revenue over time.

Mr. Abbey highlighted other pieces of legislation that will affect fiscal resources. New formulas for the unemployment compensation insurance program will generate more revenue and improve the solvency of the program's fund. Modifications to the educational retirement and the public employees retirement programs will improve those programs' funds' solvency. Meanwhile, having not been changed through legislation, the Retiree Health Care Fund's solvency remains a concern. The Lottery Tuition Fund and Judicial Retirement Fund solvency and federal transportation funding are other areas of concern that will need to be addressed in future legislative sessions.

Questions and comments from committee members included the following.

- The estimated range of liability for the issues with the Statewide Human Resource, Accounting and Management Reporting System (SHARE) and cash reconciliation is between $70 million and $400 million. The cost of conducting the reconciliation, a necessary step, will be between $600,000 and $1 million. Updating SHARE at a cost of about $10 million will help to prevent similar problems.

- The Public Education Department has not received a decision on its appeal for a waiver by the federal government of the state's past underfunding of special education. It might take a long time for the state to know its precise liability.

- How much of the state's revenue derived from, and what is the primary source of, reversions? How does the amount compare with other years? In fiscal year 2012, there was about $66 million in reversions. The primary sources of that revenue were employee vacancies, unneeded capital outlay funding and savings from efficiencies realized through programs such as SHARE. The reversion amount fluctuates from year to year, but it ordinarily ranges from about $40 million to $50 million.

- For a host of reasons, the lottery scholarship program is facing insolvency. The cost of tuition, which is rising, is linked to the cost of the program; meanwhile, the rate of lottery play is stagnant. What can the legislature do to intervene? Because the cost of tuition has a direct impact on the Lottery Tuition Fund, the legislature might consider taking a tuition credit against increases of tuition in order to persuade universities to keep tuition low or prevent tuition increases.

- What is the effect of the partial veto of the appropriation to the Department of Information Technology for an upgrade to SHARE? The governor's veto struck a contingency related to certification by the Information Technology Commission, but that certification is otherwise required by law. The partial veto, then, is probably without effect.

- The federal government's full payments for Medicaid expansion might not materialize because of sequestration. It may be useful to consider the possibility of modifying gross receipts tax exemptions in order to make up for potential federal payment shortfalls.

Organizational Business — Work Plan and Meeting Schedule

Mr. Lara presented the committee's proposed work plan and meeting schedule for the 2013 interim. Members recommended the addition of several items and then adopted the plan. In the 2013 interim, the committee will:

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

(a) adequacy;
(b) efficiency;
(c) equity;
(d) simplicity; and
(e) accountability;

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

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

4. continue to examine exemptions, deductions and credits to determine the ability to report and track the effectiveness and value to the state of tax incentives;

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

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

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

(a) increasing the working families tax credit;
(b) achieving revenue adequacy for the State Road Fund;
(c) addressing the limitation on property tax valuations and resulting property tax lightning;
(d) responding to congressional action to allow state taxation of remote sellers and internet sales; and
(e) formalizing procedures to provide more accurate and timely fiscal impact reports (FIRs) that might also provide dynamic scoring;

8. evaluate recent tax and revenue-related legislation introduced in an effort to

reduce ambiguity, mitigate unintended consequences and ameliorate deficiencies;

9. review the revenue status of gaming within the state, including lottery gaming, Indian gaming and gaming conducted by racinos and fraternal and other organizations; and

10. coordinate, as needed, with other committees regarding presentation of subject matter of common concern, particularly regarding sources of revenue that can be used to support transportation needs in New Mexico. The committee will hear a final report from the Transportation Infrastructure Revenue Work Group regarding its recommendations and proposed action.

Questions and comments from committee members included the following.

- The revenue derived from the Indian gaming compacts and other gaming activities is significant to the state; therefore, the RSTP might collaborate with the Committee on Compacts, if the Committee on Compacts meets. In any case, the RSTP will review the revenue status of gaming within the state, including lottery gaming, Indian gaming and gaming conducted by racinos and fraternal and other organizations, during the 2013 interim.

- The RSTP needs accurate FIRs in order to assess proposed legislation and should work closely with the LFC and various departments to get all FIRs as soon as possible with the proposed legislation presented to the committee.

Taxation of Internet Sales/Remote Sellers

Richard Anklam of the New Mexico Tax Research Institute updated the committee on online sales taxation compliance and legislative changes that might become necessary, a topic that he presented to the RSTP in October 2012. He noted that changes to his original presentation are marked with striking and underscoring.

The key legal issues related to states' ability to tax internet sales by remote retailers to in-state buyers are whether a state has jurisdiction, or nexus, over the seller and whether tax compliance is unduly burdensome. Increasingly, businesses have nexus with states because of in-state physical presence. The Marketplace Fairness Act (MFA) being considered by Congress would constitutionally grant states the option to tax even more online retailers, many of which lack in-state physical presence.

Mr. Anklam addressed other features of the MFA and its status. It would exclude from its provisions businesses that have less than $1 million in United States sales. It would require states to provide detailed rate and boundary information and hold harmless any taxpayer that relies on that information, if incorrect. A state would have the option to collect local, not just state, taxes. Nevertheless, there is a strong indication that the MFA in its current form will not progress through the House of Representatives; changes to the bill are expected.

Mr. Anklam discussed legislative changes that might be required for the state to tax pursuant to the MFA. Since the state generally does not tax based on destination, it might need to adopt an origin-based sourcing system. Bifurcating the sourcing rules — that is, having a set of rules for remote sellers and another for in-state sellers — would probably be acceptable. Though much of what will be required is subject to change, it nonetheless seems clear that the state will have to provide information on taxes required to be paid and furnish software to facilitate those payments.

United States Senator Mike Enzi, sponsor of the MFA, provided additional clarification in a response to a letter. Mr. Anklam noted that most significant for New Mexico is that the MFA contemplates the gross receipts tax and its collection if the state adheres to the simplifications and protections provided in the MFA.

Questions and comments from committee members included the following.

- How much is New Mexico losing from untaxed online sales? One study has estimated losses at around $70 million, but the study did not consider the small business exception, which would reduce that amount.

- Who would enforce compliance with the tax? The state would ensure compliance by out-of-state retailers. Since many of these retailers are already obligated to pay taxes to the state, the state's current efforts would expand.

2013 Tax Legislation: New Mexico Jobs Package

Secretary Tom Clifford of the DFA spoke about recently enacted laws with fiscal impact, revenue trends, revenue forecasts and fiscal challenges. Despite challenges faced leading up to and during the session, lawmakers were able to compromise and enact several important pieces of legislation. Revenue- and spending-related challenges — many of which persist — included cuts in federal laboratory, military and education spending; mandatory increases in pension contributions; threat of insolvency of the unemployment insurance and employee health programs; and the need for critical upgrades to information technology systems.

Secretary Clifford highlighted several legislative measures with fiscal impacts. The unemployment insurance program and the public employee pension program were reformed so that, although the programs might warrant future changes, improvements are expected. The lottery scholarship program, which received stop-gap funding, will require future action to become solvent. Capital outlay appropriations, the result of a legislative/executive compromise, provided funding for statewide and local projects, including development of water supply and tribal infrastructure and voting system modernization.

A major session accomplishment was the tax reform package. It reduces the corporate income tax rate to align more closely with rates of — and make New Mexico more competitive with — other states. The package also features a narrowing of the gross receipts tax deduction for manufacturers; mandatory combined reporting for most "big box" retailers; tightening of the high-wage jobs tax credit; an expansion and streamlining of the process for receiving the film tax credit; and the phase-out of local government hold-harmless distributions coupled with a new local option tax. Twelve counties and 20 cities, because of their size, will be particularly affected by the hold-harmless provisions. Secretary Clifford indicated that he will provide to LCS staff tables that illustrate in detail the anticipated impacts of those provisions.

Secretary Clifford discussed the need for the tax package, the need for diversification of the state's economy and the sustainability of the tax reform. New Mexico's per capita income and manufacturing levels fall below national measures, and its recession has lasted longer than the nation's. Meanwhile, two of the state's prominent revenue sources, federal funding and oil and gas revenues, have become tenuous: competition for federal funding has stiffened and oil and gas prices fluctuate unpredictably. The tax package, aimed in part to address these issues, can be sustained with less than 10% revenue growth and, hence, is affordable.

The levels of forecasted general fund revenue growth for fiscal year 2013 have been modified to reflect observed developments. The anticipated growth in most categories of revenue, excluding income taxes, has decreased. These lower expectations result largely from cuts in federal oil and gas leasing payments, high refundable tax credit claim levels and weak inflation. Countering these trends, oil and gas revenues have been relatively strong, and the number of issued housing permits has risen. Forecasted growth in fiscal year 2014 is 3.9%.

Secretary Clifford identified some foreseeable budget issues. They include: federal sequestration; special education maintenance of effort liabilities; the potential for weak federal Medicaid funding; lottery program solvency; and the effect of the hold-harmless provisions on local governments. Secretary Clifford added that the governor's recent executive order conditioning receipt of fiscal year 2014 capital outlay appropriations on compliance with the Audit Act has prompted the DFA to assist those appropriations' recipients.

Some tax policy concerns are: implications that would arise from the MFA's passage; the need for independent tax hearing officers; the income tax exemption for military pensions; new jobs tax incentives and tax relief for the research and design and small business sectors; property tax lightning; and dynamic scoring to fully assess the impact of tax incentives and their effectiveness.

Questions and comments from committee members included the following.

- A problem plaguing economic development — one that tax incentives cannot overcome — is the low quality of the state's work force. Funding for education is about average among the states, yet academic performance is below average. More and more, colleges are offering remedial courses in response to need. These facts foster a negative perception of the state among potential employers. Secretary Clifford responded that he has met with the secretary of higher education, who in turn is working with economic developers, to discuss some of these issues. They have considered implementing an outcome-based funding formula and increased funding for bridge schools.

- The tax reform package's hold-harmless distribution curtailment could be very harmful to affected local governments. On the other hand, adjusting related provisions at the next session carries risk.

- When the new, stricter Governmental Accounting Standards Board rules take effect in fiscal year 2015, will the unfunded liability percentage drop from its current level of 91%? Most likely, but the degree of change will depend on the Public Employees Retirement Fund's performance.

- Is there an executive plan to restore the lottery scholarship program to long-term solvency? Can the tuition rate be changed to immediately improve the program's solvency? Consensus around the issue needs to be built soon so that measures to improve the program's solvency can be taken next session. Secretary Clifford commented that the DFA is reviewing proposals made during the session and would like to build consensus on a chosen pursuit. The tuition rate cannot be adjusted in time for the fall because the rate must by law be published by June 1. Two options for dealing with the impending shortfall are to cut the rate of reimbursement or issue a supplemental appropriation.

- Does the DFA know the tax reform package's effect on long-term — approximately 15 to 20 years in the future — revenues? Secretary Clifford replied that that information is not immediately available, but he will try to relay it to the committee in the future. A member commented that forecasting the tax reform's effects on revenue generation is particularly difficult because baseline figures are not static.

- What are the circumstances around the recent letter from the federal Department of Housing and Urban Development to the state suggesting that the state has not properly overseen the Section 108 community development block grants loan guarantee program? Secretary Clifford said that he met with a regional representative who expressed concerns about procedural, but not substantive, issues. If found that the state has not exercised proper oversight, future funding would be withheld. The state is working on a response to the letter, which Secretary Clifford will present to the committee.

- A member solicited a response from Secretary Clifford about information regarding the tax reform package communicated to the House of Representatives by Secretary Clifford. On the last day of session, Secretary Clifford represented that the package would have a positive revenue effect for each of its first five years in law; updated reports cite a negative downturn in that time. Secretary Clifford responded by stating that, regrettably, his initial calculation was erroneously based on a different variable — that the hold-harmless distributions would be phased out at a more rapid rate — that was in an earlier version of the bill, but did not make it into the final version enacted.

- How many — and which — local governments will be impacted by the governor's recent executive order? About 60 of the 670 local governments are at risk of not receiving capital outlay appropriations. Secretary Clifford indicated that he will prepare and provide to staff a list of affected recipients for distribution to members.

2013 Tax Legislation: Impacts and Implementation

Demesia Padilla, secretary, TRD reported on recent bills signed into law and other developments affecting the department.

New laws include provisions that:

- allow for the transfer of gross receipts liability from a utility seller to a manufacturer buyer, which will improve the ease of implementation of an existing anti-pyramiding measure;
- phase out hold-harmless distributions and allow local governments to impose additional gross receipts tax, on which the TRD is educating local government representatives;
- limit the credit that a taxpayer can receive on taxes paid to another state;
- create an option for taxpayers to contribute to the Horse Shelter Rescue Fund;
- create a tax incentive for corporations to establish nonretail operations that employ at least 750 in-state workers;
- permit manufacturing companies to use a single sales factor apportionment method in calculating income tax liability;
- tighten the definition of "consumable" in relation to gross receipts tax deductions to exclude — and therefore require tax payment on — tangible personal property used in the generation of power, the processing of natural resources and the preparation of meals;
- with certain exceptions, require the Property Tax Division of the General Services Department to conduct at least one sale in each county in which there are delinquent tax payment properties; and
- change the application deadline for a landowner who wishes to qualify for the agricultural tax valuation method from the last day of February of the tax year to 30 days after the date of mailing a notice of valuation.

Secretary Padilla also commented that the TRD has been meeting target time line and budget marks on its upgrade to the GenTax System, a computer application that performs many of the TRD's functions. Upon completion, the system will be more efficient and effective, particularly in the area of taxpayer compliance.

The TRD is also exploring the possibility of using independent tax hearing officers. Taxpayers have complained about conflict of interest and fairness issues in the hearing process.

Questions and comments from committee members included the following.

- What retailers will be exempt from the combined reporting requirement of the tax reform package? Will that requirement apply, as was intended, to wholesale clubs, which could be considered both distribution centers and sellers to the end user? Secretary Padilla responded that the requirement does not apply to a corporation that employs at least 750 people in the state in a nonretail capacity. As with all tax laws, reasonable minds can differ in interpretation; the TRD's audit and protest hearing systems can be used to provide clarification. A member commented that it would be helpful to know more in the fall about how this aspect of the package will be officially interpreted so that the legislature might modify it, if needed, next session. Another member suggested that the TRD consider clarifying the issue through rulemaking.

- A member requested that the TRD disclose to the committee both the number of corporations that changed their filing to the combined reporting method and the revenue impact of the shift when that information is available. Secretary Padilla indicated that she will provide the information to the extent that she can without revealing taxpayer identity.

- Prompted by an earlier discussion about the likely usefulness to the committee of pre-session access to FIRs on tax legislation, a member asked Secretary Padilla about the feasibility of producing analysis during the interim. Secretary Padilla responded that the division that handles FIRs is fully staffed and the TRD would welcome receiving requests for analysis ahead of session. She added that it would help the TRD to be able to anticipate the legislature's priorities and the level of complexity of requests for analysis so that TRD staff could effectively prepare for session requests.

There being no further business, the committee adjourned at 2:29 p.m.

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

July 15-16, 2013
Room 307, State Capitol
Santa Fe

The second meeting in 2013 of the Revenue Stabilization and Tax Policy Committee (RSTPC) was called to order by Senator Carlos R. Cisneros, chair, on Monday, July 15, 2013, at 10:05 a.m. in Room 307 of the State Capitol in Santa Fe.

Present
Sen. Carlos R. Cisneros, Chair
Rep. Edward C. Sandoval, Vice Chair
Rep. Anna M. Crook
Rep. Brian F. Egolf, Jr.
Rep. Rodolpho "Rudy" S. Martinez
Sen. Mark Moores
Sen. Clemente Sanchez
Sen. William E. Sharer
Sen. John Arthur Smith
Rep. Thomas C. Taylor (7/16)
Sen. Lisa A. Torraco
Rep. Jim R. Trujillo
Sen. Peter Wirth
Rep. Bob Wooley

Absent
Sen. Sue Wilson Beffort
Sen. Timothy M. Keller
Rep. Henry Kiki Saavedra
Rep. James R.J. Strickler

Designees
Sen. William F. Burt
Rep. Jason C. Harper (attending as a guest 7/16)
Rep. Tim D. Lewis (attending as a guest)
Rep. Dennis J. Roch

Guest Legislator
Rep. Nathan "Nate" Cote

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

Staff
Pam Stokes, Staff Attorney, Legislative Council Service (LCS)
Amy Chavez-Romero, Assistant Director for Drafting Services, LCS
Jennifer Dana, LCS

Guests

The guest list is in the meeting file.

Handouts

Handouts and other written testimony are in the meeting file.

<u>Monday, July 15</u>

Review and Explanation of the New Mexico Jobs Package — HB 641 (2013)

Demesia Padilla, CPA, secretary, Taxation and Revenue Department (TRD), and John Tysseling, Ph.D., chief economist, TRD, provided the committee with a summary of the economic impacts of HB 641, which passed during the 2013 legislative session. The legislation will result in changes with respect to New Mexico's corporate income tax, certain gross receipts tax deductions, the high-wage jobs tax credit, the film tax credit and "hold harmless" distributions to certain local governments.

Beginning January 1, 2014, Dr. Tysseling explained, a reduction in the highest corporate income tax rate will be phased in over five years, from 7.6 percent to 5.9 percent. Effective July 1, 2013, corporations with retail facilities exceeding 30,000 square feet will be required to file corporate income tax returns using the combined reporting method. An exclusion from the requirement for combined reporting will be available to corporations that employ at least 750 workers in "non-retail" business activities. Secretary Padilla noted that the TRD intends to make regulatory changes to permit a corporation to change its filing methodology if it meets that threshold, yet previously elected to use the combined reporting methodology.

Next, Dr. Tysseling explained that HB 641 will permit a manufacturer to elect to apportion its business income to New Mexico using a single-weighted sales factor. This change will apply to 2014 and subsequent taxable years. The single-weighted sales factor will be phased in over a period of five years.

Dr. Tysseling provided the committee with a summary of forecasted impacts of HB 641 to corporate income tax receipts. For fiscal year (FY) 2017, he projected that the corporate income tax rate reduction would have a negative impact of about $70.5 million. The implementation of the single-weighted sales factor for manufacturers would have a negative impact of about $45.3 million. The requirement for combined reporting for certain unitary corporations would have a positive fiscal impact of approximately $4.2 million.

Dr. Tysseling spoke about the impact of changes to local governments' "hold harmless" distributions. The "hold harmless" distributions are made to compensate local governments for revenue reductions due to the implementation of the gross receipts tax deductions for food and medical services. The legislation would phase out the "hold harmless" distributions for certain local governments over a period of 15 years.

Certain local governments could continue to receive "hold harmless" distributions. A municipality with a population of less than 10,000 would continue to receive the distributions if it does not impose an additional gross receipts tax, often referred to as a "hold harmless gross receipts tax". That tax may be imposed, by ordinance, in an amount up to three-eighths percent of the local option gross receipts tax. The "hold harmless gross receipts tax", as it is intended, would offset the funds that would no longer be received by a municipality or county due to the phaseout of the "hold harmless" distribution. A county with a population of less than 48,000 would continue to receive its "hold harmless" distribution if it does not impose a "hold harmless gross receipts tax".

Secretary Padilla cautioned that smaller local governments should be mindful of the unintended consequences that might stem from imposition of a "hold harmless gross receipts tax". A small local government might face adverse consequences if losses from elimination of the "hold harmless" distributions outweigh the positive revenue impacts from imposition of the "hold harmless gross receipts tax". Secretary Padilla said that the TRD is willing to work with local governments and the Department of Finance and Administration (DFA) to gauge the potential impacts of such an imposition. Dr. Tysseling forecasted that in FY 2017, the general fund will enjoy a positive fiscal impact of approximately $15.7 million as the result of reduced "hold harmless" distributions to local governments.

Dr. Tysseling also spoke about the impact of the legislation's definition of a "consumable" in the context of a gross receipts deduction for sales to manufacturers. Effective July 1, 2013, a "consumable" would include tangible personal property, including electricity, fuels, water, manufacturing aids and supplies, chemicals, gases, repair parts, spares and other tangibles used to manufacture a product. The definition specifically excludes tangible property used in the generation of power, the processing of natural resources and the preparation of meals for immediate consumption. Secretary Padilla added that since the legislation passed, about 70 firms have submitted applications for Type 12 nontaxable transaction certificates, which are used as evidence of eligibility for the deduction. She stated that larger entities will tend to benefit the most from the deduction. Dr. Tysseling noted that the restrictions now explicit with the definition of "consumable" are forecasted to have a positive fiscal impact in FY 2014 of about $16.9 million.

Dr. Tysseling summarized the various changes to the high-wage jobs tax credit, which became effective June 14, 2013. He summarized the clarifications made to the existing law and the credit's extension for an additional five years. He mentioned that the wage threshold for a job to be considered eligible for a credit under the new law has increased. The wage threshold for new, high-wage jobs created after July 1, 2015 will increase to $40,000 for jobs created in areas outside of municipalities and to $60,000 for areas within municipalities. Dr. Tysseling explained that another key component of the new credit excludes a job from credit eligibility if the job is related to a business merger, acquisition or other change in organization. Secretary Padilla noted that in light of impending, stricter provisions for credit qualification, the TRD received a number of applications for the credit before the effective date of the new requirements. Secretary Padilla highlighted other changes that will result from the implementation of the new law, including limitations during which the high-wage jobs tax credit must be claimed. Dr. Tysseling projected that the modifications to the high-wage jobs tax credit would have a positive general fund impact of about $6.4 million in FY 2014, with a positive impact of approximately $19.6 million in FY 2015.

Dr. Tysseling discussed the legislation's changes to the film tax credit that allow an additional five percent credit for television shows, subject to certain requirements. The new law also permits up to $10 million of an unused portion of the $50 million cap on the film production tax credit to be carried forward and added to the subsequent fiscal year's film production tax credit cap. The law also modifies the manner of scheduled payments of multiyear credit claims with respect to years in which the $50 million credit is not reached. In addition, the law imposes more specific requirements for withholding taxes related to services provided by artists and clarifies tax obligations for nonresident vendor services.

Finally, Dr. Tysseling provided the committee with a summary of the recurring revenue impacts of HB 641. By FY 2017, the negative fiscal impact to the general fund would be $70 million. Considering revenue impacts to local governments, the Small Counties Assistance Fund and the municipal equivalent distribution, the overall fiscal impact approximates $68 million.

Committee members discussed a number of issues with Secretary Padilla and Dr. Tysseling, including:

- concerns about the state's ability to bear the $70 million general fund fiscal impact over a period of four years;
- the impact of the changes to existing "hold harmless" provisions on municipalities whose populations are soon expected to exceed 10,000;
- whether the "hold harmless tax" must be used in a manner similar to the use of the "hold harmless" distributions;
- whether there is a correlation between reduced corporate income tax rates and job creation;
- strategies, outside of tax policy, that might be used to attract businesses to the state;
- a strategy to comprehensively examine all taxes to achieve the goal of revenue stabilization; and
- the impact of the ability to impose the "hold harmless tax" and loss of "hold harmless" distributions on small and large municipalities.

Approval of Minutes

The committee, without objection, approved the minutes of the first meeting of the RSTPC held on May 14, 2013.

Comparing New Mexico's Tax Structure to Other States — An Overview

Richard Anklam, president and executive director, New Mexico Tax Research Institute (NMTRI), provided a comparison of New Mexico's tax structure to the tax structures of other states. He first provided an overview of states that do not impose certain taxes. He noted that New Hampshire, Oregon, Montana, Alaska and Delaware do not impose sales taxes. He added that Florida, Nevada, South Dakota, Texas, Washington and Wyoming do not impose personal income taxes. He also stated that Nevada, Ohio, South Dakota, Texas, Washington and Wyoming do not impose corporate income taxes. When a state does not impose a "primary tax", Mr. Anklam indicated, the state will often have a substitute tax program in place. For example, Ohio, Washington and Texas impose broad business activity taxes, such as gross receipts taxes, in lieu of corporate income taxes.

Mr. Anklam expressed that a comparison of state tax programs must involve more than a comparison of tax rates. He said that a number of other factors should be considered, including the composition of the tax base and the relative impacts of credits, incentives and other adjustments. Mr. Anklam indicated that states impose a vast range of general and narrow tax programs, which are designed around their economies and to fund their operations.

Relative to other states, Mr. Anklam stated that New Mexico imposes a fairly high tax burden on new business investment. In particular, New Mexico has a broad-based gross receipts tax on business inputs, including services. According to Mr. Anklam, gross receipts tax rates tend to rise, which could further magnify the impacts of tax pyramiding and regressivity.

Another tax affecting new businesses is the corporate income tax. Mr. Anklam explained that New Mexico's corporate income tax rate of 7.6 percent is higher than the average rate of 6.7 percent. He additionally stated that New Mexico offers no real tax incentives for exporters outside of the standard three-factor formula for apportionment of income.

Mr. Anklam also compared New Mexico's property taxes and personal income taxes to those same taxes imposed in other states. While New Mexico is characterized by low property tax rates among the states, property tax rates imposed in Albuquerque are close to the national average. With regard to the personal income tax, Mr. Anklam noted that the top rates are reached at lower income levels. Although New Mexico's average personal income tax rate is lower than the national average, the state's average rate is still comparable to surrounding jurisdictions that impose income taxes, except California. Mr. Anklam added that the 50 percent exclusion for capital gains income in New Mexico is more generous than similar capital gains provisions in other states. Mr. Anklam next presented a table comparing New Mexico's tax revenues from different tax programs as a percentage of the gross state product (a state's counterpart to a country's gross domestic product) to the average tax revenues from the similar tax programs among the other states.

Mr. Anklam described the results of a new study published by the Council on State Taxation (COST). The study was initiated to examine returns on investment for corporations in five different sectors within the context of the tax structures of all 50 states and the District of Columbia. The study ranked the states with respect to the calculated returns on investment. According to the study, the top performers were Maine, Oregon, Ohio and Wisconsin. The states that ranked the lowest included Kansas, Rhode Island and New Mexico and the District of Columbia. Mr. Anklam emphasized that the study had some limitations. For instance, he noted, the study did not consider state tax incentives and used limited corporate income assumptions.

Mr. Anklam explained how incentives, such as statutory credits, may reduce the total state and local effective tax rates. He indicated that if those incentives are considered across all industries, a 60 percent reduction in the total state and local effective tax rate could result. Mr. Anklam next presented a table comparing New Mexico's average and effective state and local business tax rates net of tax credits. In the services business sector, New Mexico had the eighth-highest effective tax rate. In the manufacturing sector, New Mexico had the third-highest effective tax rate, and across all industries, New Mexico had the sixth-highest effective tax rate.

Mr. Anklam briefly reviewed another study by the Tax Foundation, a nonprofit organization. That study ultimately resulted in the development of a "state business tax climate index" meant to compare the business tax climates of the states. In that study, New Mexico ranked thirty-eighth.

Mr. Anklam indicated that comparative studies are effective when they compare after-tax returns on investment, but they are also assumption-driven. Mr. Anklam stated that it is important to understand the assumptions and the goals of the information sources with respect to such studies.

Senator Cisneros invited Mr. Anklam to attend the committee's future meetings and provide additional information on tax reform issues. The committee members then discussed possibilities for the study of the economic development performance of other states relative to the taxes imposed by those states.

Cultural Affairs Department: Selected Capital Outlay Projects

Jeff Canney, program evaluator, Legislative Finance Committee (LFC), presented the results of the LFC's evaluation of specific capital outlay appropriations and the funding process by which the Cultural Affairs Department (CAD) supports its capital projects and other needs. Overall, the LFC concluded that the dedicated funding to maintain CAD properties is inadequate, thus requiring the CAD to request additional capital outlay funding each year. Mr. Canney noted that capital outlay requests are not a sustainable solution to the CAD's ongoing needs. Mr. Canney elaborated on a number of key findings and recommendations developed during the course of the LFC's evaluation.

Mr. Canney indicated that, as a result of its evaluation, the LFC found that the CAD does not use a credible statewide maintenance and improvement plan to address critical needs. While the CAD relies on capital appropriations to address critical needs, that source of funding is not reliable for year-to-year demands. Moreover, the CAD does not have a formal capital outlay plan to prioritize critical needs, project accurate revenues and costs and plan for surpluses or shortfalls. Mr. Canney indicated that the CAD currently uses capital outlay funds to address emergencies on a case-by-case basis and that the CAD has underutilized its Capital Improvements Fund for museum repairs and improvements. He noted that the CAD holds $1.3 million for museum and historic site capital improvements, which is at risk of reverting. Mr. Canney stated that the CAD's capital outlay request is not prioritized based on the greatest needs and is not supported by reliable estimates.

To address these issues, the LFC made a number of recommendations, including the development of a workable capital outlay plan that prioritizes capital repairs and improvements, reliably projects revenues and expenditures and plans for deficits or surpluses. The LFC recommends that the legislature identify a reliable and adequate funding source of museums and historic sites and consider placing CAD facilities under General Services Department (GSD) oversight.

Another key finding from the LFC's evaluation involved management issues with respect to a capital appropriation for the revitalization of a school house in Ribera, New Mexico. The school house had been gifted by the Los Pueblos Community Center (Los Pueblos) to the CAD, and in 2007, the state appropriated $600,000 to plan, design, construct, renovate and preserve the school house. The CAD sold the school house back to Los Pueblos for $39,000 after the appropriation was made and spent on various repairs and improvements to the school house. The TRD found that an independent appraisal of the property, which had assumed that the property was a vacant and unimproved lot since the repairs and improvements were not completed, reasonably supported the sale price, and the State Board of Finance (SBF) narrowly approved the sale. The LFC additionally found that the CAD contracted with Omni Development Corporation, a company convicted of embezzlement. In 2009, the CAD hired the company to perform carpentry services. The same company was debarred from six GSD contracts following its conviction. The LFC's evaluation additionally concluded that the CAD did not comply with the Procurement Code when it contracted with Omni Development Corporation because the contract was not the result of a competitive bidding process. Finally, Mr. Canney indicated that the CAD incurred inappropriate costs on the Ribera project.

Mr. Canney presented a number of recommendations to address these issues, including that the CAD follow the Procurement Code and require competitive bids for construction projects and professional services. The LFC further recommends that the CAD hold contractors accountable for deliverables and that the GSD expeditiously notify the Attorney General's Office to enforce consequences for agencies, individuals and businesses that have not complied with the Procurement Code. Finally, Mr. Canney suggested that the SBF consider the value of improvements when it makes determinations regarding the sale of property.

Next, Mr. Canney discussed the details of the LFC's finding that the CAD does not effectively track New Mexico's art in public places. Since 1986, the state has appropriated more than $19.7 million to provide art in public places; however, the database used to manage the Art in Public Places (AIPP) program is fragmented and does not produce reliable reports. An upgrade of the database is currently performed in-house without a formal information technology plan, and surplus amounts remaining after an AIPP project's completion are commingled with other auxiliary funds. The result is a lack of accountability and transparency. Finally, Mr. Canney indicated that the artwork owned by the CAD is not identified in the agency's financial audit.

The LFC recommends that the legislature limit the amount of administrative costs that may be charged against the AIPP Fund and makes the following key recommendations for the CAD:

- maintain inventory control for all artwork procured with public funds;
- prepare an information technology plan for the AIPP database and any new information technology project before the work begins; and
- reconcile the AIPP database against SHARE balances.

Additional recommendations are included in the LFC's evaluation report.

The LFC's last finding is that the CAD generally administers the library bond program effectively, despite some lack of expediency in spending. The library bond program has received $11.7 million from state-appropriated and voter-approved general obligation bonds since 2009. From May 2011 to May 2013, only 11 percent of the statewide public library funds were expended, and less than one percent of FY 2011 amounts for tribal libraries were expended. Despite this issue, Mr. Canney concluded that the library bond program is administered transparently and benefits local and tribal communities. To improve spending expediency, the LFC recommends that the CAD revise administrative rules to require an encumbrance of capital outlay funds within 10 business days after a bond sale notice from the SBF.

Veronica Gonzales, secretary, CAD, thanked the committee for the opportunity to provide testimony in response to the LFC's report. Secretary Gonzales pointed to the CAD's response letter provided at the end of the LFC's evaluation report. Secretary Gonzales said that the CAD has taken a number of steps to address the issues identified by the LFC. She indicated that the CAD has:

- halted unfunded expansions characterized by a lack of planning and funding;
- divested the CAD of the Ribera school;
- hired a facilities manager;
- developed a condition assessment index for CAD facilities;
- developed a condition assessment database using best practices;
- initiated a capital outlay repair process to prioritize projects statewide and reduce risk; and
- worked with the DFA to ensure an expeditious use of capital outlay funds.

Secretary Gonzales emphasized that the exemption for GSD oversight over CAD facilities should be maintained. She said that since the facilities under CAD management are historic, those facilities require specialized preservation efforts and oversight. Secretary Gonzales also noted that some historic buildings are preserved using support from the private sector. If the GSD becomes the oversight entity for buildings under CAD management, Secretary Gonzales indicated that some private support for those buildings could be lost. She also expressed concern whether the GSD would be able to provide historic buildings with sufficient priority.

The committee members discussed a number of issues with Secretary Gonzales and Mr. Canney, including:

- any inquiries made to the Attorney General's Office with respect to the CAD's contract with Omni;
- whether the CAD had any other possible Procurement Code compliance issues outside of the scope of the Ribera project;
- the use of funds from general obligation bonds for libraries;
- possibilities for expediting the CAD's use of capital outlay funds;
- sources of funding for tribal libraries;
- the reasons for the state's purchase of the Ribera school house;
- strategies for development of a sustainable revenue source for CAD capital needs, while maintaining transparency;
- the SBF's process in approving sales of state property; and
- whether private funding for state historic buildings would be implicated by GSD oversight of those buildings.

Telecommunications Access Fund — Status and Concerns

Lisa Dignan, M.Ed., acting executive director, Commission for Deaf and Hard-of-Hearing Persons (CDHHP), and Shannon Smith, relay administrator, CDHHP, provided the committee with an update of the status of the Telecommunications Access Fund. Ms. Dignan explained that the source of money in the fund is the telecommunications relay service surcharge. The surcharge of .33 percent is imposed on the gross amount paid by customers for intrastate telephone services and intrastate mobile telecommunications services. Ms. Dignan estimated that distributions to the fund for FY 2013 would reach approximately $2.7 million.

Ms. Dignan identified a number of challenges with regard to the sustainability of the existing revenue source for the fund. Consumers are increasingly using voice over internet protocol (VoIP) communications options, which are not subject to the surcharge. Thus, the fund balance has significantly declined. Ms. Dignan added that although New Mexico does not collect the surcharge from VoIP providers, consumers may access the services provided by the CDHHP, regardless of the phone service they use. According to Ms. Dignan, the federal government currently collects the interstate surcharge from VoIP providers.

Ms. Dignan indicated that wireless carriers have experienced difficulty in distinguishing between intrastate calls, which are subject to the surcharge, and interstate calls, which are not subject to the surcharge. The difficulty in isolating intrastate calls upon which the surcharge should be imposed likely has a negative impact on the balance of the Telecommunications Access Fund.

Ms. Smith reiterated the challenges with respect to the Telecommunications Access Fund and emphasized the CDHHP's desire to continue to provide adequate services to New Mexico's deaf and hard-of-hearing residents.

Committee members discussed several issues with Ms. Dignan and Ms. Smith, including:

- services offered by the CDHHP, including advocacy services, administration of the relay service, provision of interpreters and provision of specialized telecommunications equipment;
- federal funding for services to deaf and hard-of-hearing residents;
- challenges in obtaining timely payments from telecommunications providers;
- challenges in imposing the surcharge on customers who have moved to New Mexico from other states; and
- the potential to make innovative technological equipment available to the population served by the CDHHP.

Update on Selected Tax Expenditures

Secretary Padilla prefaced her discussion of selected tax expenditures by explaining that the TRD is in the process of updating its tax expenditure report and hopes to provide the updated report that will be completed by August. The TRD will seek to identify credits that are underutilized and determine why they are underused. The TRD also intends to determine the impact of recent changes on the overall use and efficiency of certain credits.

Secretary Padilla and Dr. Tysseling provided a number of statistics relating to the use of existing tax expenditures. They focused on the most used credits in New Mexico's tax structure. Dr. Tysseling indicated that the film production tax credit is the most used credit with an estimated revenue impact of $50 million for FY 2013. The second most used credit is the high-wage jobs tax credit, with a total estimated revenue impact of approved or projected credits to be about $22.1 million. However, Secretary Padilla explained that a number of existing credit applications are currently under review. From the TRD's initial review of such applications, it appears that there are some duplicate applications, and it is likely that the figures associated with approved credits will change. The aggregate revenue impact for all tax expenditures in New Mexico could approximate $104.7 million.

Next, Secretary Padilla and Dr. Tysseling provided the committee with an update on the use of the renewable energy production tax credit. Dr. Tysseling stated that the total credit claims could potentially approximate $20 million per year, but the average annual claims received by the TRD usually fall below $10 million. Between 2003 and 2015, the total maximum non-refundable tax credits earned could approximate $129 million. Between 2009 and 2022, the total maximum of refundable credits earned could approximate $149 million. Dr. Tysseling predicted that claims for renewable energy production tax credits could rise over the next several years as renewable energy projects become increasingly integrated into rural economic development plans.

The committee members and Secretary Padilla discussed whether a cap should be placed on the high-wage jobs tax credit. Secretary Padilla expressed that recent legislative changes to narrow application of the credit would, in her opinion, eliminate any need to cap the credit.

<u>Tuesday, July 16</u>

Trends in Tax Policy Issues Relevant to New Mexico

Helen Hecht, tax counsel, Federation of Tax Administrators, provided a report on trends in tax policy issues relevant to New Mexico, including trends affecting corporate income taxes and sales taxes, in addition to reviews of tax-incentive effectiveness and independent administrative hearings.

Ms. Hecht explained that states are moving toward "market-based" sourcing for all sales. The formula used to apportion a multistate business's income to New Mexico is based on the property, payroll and sales of the business, relative to a measure of all three factors for that business in all of the states in which it operates. The sales factor is the factor that most represents the market value of a business because the location of a business's customers is often where a service is performed or where a tangible cost is created. Thus, about one-half of the states have moved from "traditional" sourcing characterized by a three-factor formula to "market-based" sourcing. Many states are increasingly using a single sales factor. Ms. Hecht noted that the Multistate Tax Commission is currently developing uniform rules to assist with the implementation of "market-based" sourcing.

Next, Ms. Hecht described trends affecting sales taxes and gross receipts taxes. She explained that in 1992, the U.S. Supreme Court, in the *Quill* case, ruled that mail-order sellers without physical presence in a state could not be forced by that state to pay or collect a sales tax. However, since that decision, the U.S. Supreme Court held that a state may impose a sales tax on a business that establishes a market for goods or services in that state through the use of contract representatives.

Ms. Hecht indicated that New York has amended its sales tax to ensure that an internet seller with a physical presence in the state and a web site would be required to collect the sales tax. Affected internet sellers, including Overstock and Amazon, challenged the law and lost in state court. The companies have been granted an extension to appeal to the U.S. Supreme Court.

Ms. Hecht described a similar case involving Barnes and Noble, and its internet entity, barnesandnoble.com. In that case, the internet entity was related to an entity with retail stores in New Mexico. The New Mexico Supreme Court found that the internet entity and the retail entity shared trade names, trademarks and marketing and promotional programs. The court held that the internet entity must pay gross receipts tax on sales to its customers in New Mexico.

Ms. Hecht stated that other states, such as Colorado, have passed laws to require internet sellers to report sales customers in their states. Internet sellers successfully challenged the Colorado law in federal court. However, the same case is currently on appeal. If Colorado prevails, other states might adopt similar laws to require remote sellers to provide information on their sales. Such laws would not necessarily require those sellers to collect a sales tax.

Ms. Hecht next indicated that lawmakers have increasingly become focused on the evaluation of state economic and tax incentives. The measure of a tax incentive includes whether the incentive accomplished the goal intended, but the measurement of the effectiveness of tax incentives is difficult because incentives cannot be rated in a laboratory-controlled environment. Despite this difficulty, states have found that the following reasons justify the review of the use of tax incentives:

- preventing abuse and unintentional or inadvertent inclusion (or exclusion) of taxpayers or activities;
- discovering reasons for the popularity of some incentives and examination of whether unused incentives should be eliminated;
- determining if a tax expenditure devoted to an incentive ought to be limited or capped;
- evaluating whether an incentive can be migrated to become part of the "fabric" of the tax itself; and
- imposing prospective reporting requirements.

The last tax policy trend discussed by Ms. Hecht involves independent administrative hearings. States are increasingly trying to provide for more independent administrative hearings in an effort to increase taxpayer confidence in the hearing process. The COST publishes a scorecard ranking states on the independence of their administrative hearing processes. While 30 states received an "A" or a "B" on the last scorecard, New Mexico received a "D". Ms. Hecht stated that a hearing office independent from the TRD might improve the perception of independence with respect to the administrative hearing process for New Mexico taxpayers.

The committee members discussed the following issues with Ms. Hecht:

- whether sales could be sourced to the location of a business, rather than to the location of sales;
- the potential burden for internet sellers that might become responsible for tracking customer locations;
- the potential benefits to New Mexico businesses if a "market-based" apportionment formula is implemented;
- whether recent tax trends would promote fair treatment among taxpayers;
- perceived reasons for New Mexico's "D" rating in the COST scorecard;
- possible methods to achieve increased independence in New Mexico's administrative tax hearings; and
- methods to measure the effectiveness of tax incentives.

Current County and Municipal Tax Issues

Paul Gutierrez, executive director, New Mexico Association of Counties (NMAC), provided the committee with an overview of current issues affecting counties in the state. His discussion focused upon revenue sources for counties.

First, Mr. Gutierrez and Bill Fulginiti, executive director, New Mexico Municipal League (NMML), addressed current issues affecting county and municipal gross receipts tax revenues, including the impacts of the anticipated phaseout of "hold harmless" distributions to local governments. They explained that counties and cities are authorized to implement a tax on gross receipts at a rate of three-eighths percent under the existing law, and this tax was meant to permit local governments to offset losses from the elimination of hold harmless distributions. However, the hold harmless distributions will be phased out over a period of 15 years. For some local governments, the imposition of the three-eighths percent gross receipts tax will result in a revenue stream that exceeds the revenue stream that existed when only the hold harmless distributions were available. For others, imposition of the three-eighths percent tax could result in an expedited loss of hold harmless distributions and result in revenue losses. Mr. Gutierrez and Mr. Fulginiti indicated that the unintended consequences might be especially prevalent in some areas that are within both city and county limits. They also expressed concern that some counties and cities will benefit more than others as a result of the imposition of new local option gross receipts taxes and simultaneous hold harmless distribution phaseouts. Mr. Gutierrez and Mr. Fulginiti presented a chart containing the expected revenue impacts to New Mexico's counties and municipalities.

Next, Mr. Gutierrez called the committee's attention to the revenue impacts upon counties with respect to payments of state administrative fees in connection with the state's collection of county gross receipts taxes. He presented an analysis of the gross receipts tax increments imposed by the various counties and noted that it is the NMAC's position that the state should consider removing all gross receipts deductions and exemptions, and possibly lowering the overall rates.

Mr. Gutierrez expressed concern about reduced funding for the County Detention Facility Reimbursement Fund. He noted that in the 2013 session, funding from House Bill 2 was reduced from $4.9 million to $3.3 million. Thus, the NMAC anticipates requesting a legislative initiative to provide for an increased gross receipts tax increment for detention facilities.

The NMAC is also working on an initiative with the New Mexico Realtors Association to address property tax lightning issues. In particular, Mr. Gutierrez indicated that the NMAC hopes to examine removal of the three percent cap on property values. Mr. Gutierrez indicated that while there may be winners and losers in the revaluation of individual properties, the NMAC anticipates that a reduction in mill rates could result.

Finally, Mr. Gutierrez discussed issues affecting other county funds, including the Local DWI Grant Fund. Mr. Gutierrez stated that an increased percentage of the liquor excise tax should be diverted to that fund. Moreover, he stated that an increased portion of insurance premium taxes should be distributed to the Fire Protection Fund. He explained that while reversions to the general fund from the Fire Protection Fund have been legislatively reduced, distributions to the Fire Protection Fund have not simultaneously increased. Mr. Gutierrez indicated that the NMAC hopes to return to a future committee meeting with a specific proposal to address this issue.

The committee members discussed a number of issues with Mr. Gutierrez and Mr. Fulginiti, including:

- the possible disparate impacts of the immediate imposition of the three-eighths percent gross receipts tax increment in various counties and municipalities;

- possible solutions for decreased funding with respect to sole community providers; and
- possible sources of additional funding at the state level for the Local DWI Grant Fund.

Gross Receipts Tax Take-Backs — Local Government Perspective and Update from the TRD

Mr. Fulginiti discussed how gross receipts tax "take-backs" have impacted various municipalities in the state. He explained that municipalities will receive gross receipts tax distributions from the TRD, which include their share of the state gross receipts tax, in addition to local option taxes imposed by the municipalities. At times, the TRD will take back a portion of those revenues and reduce distributions to municipalities. Mr. Fulginiti said the take-backs are used to correct erroneous distribution amounts made to municipalities in prior periods. He explained that the "errors" are not necessarily attributable to the TRD, but often arise due to incorrect reporting by taxpayers. It is the NMML's position that Section 7-1-6.15 NMSA 1978 requires the state to absorb the cost of an erroneous distribution if the "error" is discovered more than one year after the distribution. Mr. Fulginiti explained that the TRD has a different interpretation. He stated that legislation was proposed in 2013 to alleviate the impacts of take-backs to municipalities. Mr. Fulginiti elaborated on impacts to specific municipalities.

Secretary Padilla and Nelson Goodin, chief counsel, TRD, presented the TRD's position on the same issue. Secretary Padilla stated that the TRD acknowledges the challenges that take-backs present to some municipalities. However, Secretary Padilla said it is the TRD's position that, pursuant to Section 7-1-6.15 NMSA 1978, take-backs do not signify any error for which the state must absorb the cost. According to the TRD, reduced distributions to municipalities due to take-backs reflect a correct and proper distribution of net receipts to municipalities. Secretary Padilla further stated that the TRD must administer the provisions of Section 7-1-6.15 NMSA 1978 as written and protect the general fund.

Secretary Padilla indicated that the application of Section 7-1-6.15 NMSA 1978 was recently litigated by the TRD before a district judge in Eunice. The judge ruled against the TRD, but the TRD is appealing that decision.

The committee discussed the following issues with Mr. Fulginiti, Secretary Padilla and Mr. Goodin:

- the role of taxpayers in creating the necessity for take-backs;
- the reasons for the recent court decision against the TRD;
- the possibility for legislative solutions to the problems inherent with gross receipts tax take-backs; and
- the possible negative effects of take-backs on small communities.

There being no further business, the committee adjourned at 11:55 a.m.

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

August 19-20, 2013
Salon Ortega, National Hispanic Cultural Center
Albuquerque

The third meeting of the 2013 Revenue Stabilization and Tax Policy Committee (RSTP) was called to order by Senator Carlos R. Cisneros, chair, on Monday, August 19, 2013, at 10:02 a.m. in the Salon Ortega of the National Hispanic Cultural Center in Albuquerque.

Present
Sen. Carlos R. Cisneros, Chair
Rep. Edward C. Sandoval, Vice Chair
Sen. Sue Wilson Beffort
Rep. Anna M. Crook
Sen. Timothy M. Keller
Rep. Rodolpho "Rudy" S. Martinez
Sen. Mark Moores
Sen. Clemente Sanchez
Sen. William E. Sharer
Sen. John Arthur Smith
Rep. James R.J. Strickler
Rep. Thomas C. Taylor
Sen. Lisa A. Torraco (8/20)
Rep. Jim R. Trujillo
Sen. Peter Wirth
Rep. Bob Wooley (8/20)

Absent
Rep. Brian F. Egolf, Jr.
Rep. Henry Kiki Saavedra

Designees
Sen. William F. Burt
Rep. Jason C. Harper (8/20)

Rep. Donald E. Bratton
Sen. Jacob R. Candelaria
Rep. Ernest H. Chavez
Rep. Miguel P. Garcia
Sen. Phil A. Griego
Rep. Sandra D. Jeff
Sen. Gay G. Kernan
Rep. Tim D. Lewis
Rep. Bill McCamley
Sen. George K. Munoz
Rep. Paul A. Pacheco

Rep. Dennis J. Roch
Rep. Debbie A. Rodella
Sen. Nancy Rodriguez
Sen. John M. Sapien
Rep. Carl Trujillo
Rep. Luciano "Lucky" Varela
Sen. Pat Woods

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

Staff
Pam Stokes, Staff Attorney, Legislative Council Service (LCS)
Amy Chavez-Romero, Assistant Director for Drafting Services, LCS
Jennifer Dana, Intern, LCS
Tessa Ryan, Staff Attorney, LCS

Guests

The guest list is in the meeting file.

Handouts

Handouts and other written testimony are in the meeting file.

Monday, August 19

Premium Tax Update

John G. Franchini, superintendent of insurance, and Jolene M. Gonzales, deputy superintendent of insurance, provided some background on the newly formed Office of Superintendent of Insurance. By law, the office became independent of the Public Regulation Commission on July 1, 2013. A nine-member committee oversees the office, which reports to the committee quarterly. The first reporting is scheduled for the end of October.

Superintendent Franchini and Ms. Gonzales gave an overview of the premium tax. The tax applies to insurance companies, health maintenance organizations, New Mexico casualty companies, nonprofit health care plans, prepaid dental plans, property bail bond agents, purchasing groups, risk retention groups, self-insureds and title insurance companies. Generally, insurers pay quarterly at a rate of 3.003% of gross premiums and membership and policy fees collected. Certain health insurers also pay a surtax of 1.0% on all but dental- or vision-only and other exempted premiums, for a total of 4.003%. The superintendent stated that this combined rate distinguishes New Mexico as having the fifth-highest premium tax in the country. However, per New Mexico law, the premium tax is in lieu of all other taxes except property taxes; therefore, the premium tax and property taxes are the only taxes that an insurer in New Mexico might pay. Responding to a question from a committee member, Superintendent Franchini indicated that he would ask a representative of the National Association of Insurance Commissioners and report back to the committee on whether the ranking measure is based on insurers' effective tax rates.

Superintendent Franchini and Ms. Gonzales continued by describing other facets of the premium tax. Taxpayers may deduct returned premiums, certain government-purchased premiums, dividends paid to policyholders and premiums received from authorized companies for reinsurance on New Mexico-based risks. Taxpayers receive a 50% credit of payments made to the Health Alliance Pool and 50% for certain payments made to the New Mexico Medical Insurance Pool (MIP). For payments to the MIP that are attributable to policyholders who receive premiums in whole or part through certain programs — the federal Ryan White Comprehensive AIDS Resources Emergency Act of 1990, the Ted R. Montoya Hemophilia Program of the University of New Mexico (UNM) Health Sciences Center, the Children's Medical Services Bureau of the Public Health Division of the Department of Health or any other program receiving state funding or assistance — an insurer receives a 75% tax credit. Lastly, by statute, a refund or credit for an erroneous payment may be made up to three years after the payment.

Once the premium tax is collected and deposited into the Office of Superintendent of Insurance Suspense Fund, portions are distributed to certain other funds: the Insurance Operations Fund; the Fire Protection Fund; the Law Enforcement Protection Fund; and the Carrie Tingley Crippled Children's Hospital Program Fund. Revenues to the suspense fund have declined since a recent peak in fiscal year (FY) 2010 of over $231 million; in FY 2013, they amounted to nearly $185 million.

Superintendent Franchini highlighted some current and recent revenue and distribution figures and some areas of potential legislation that the office is considering for introduction in a future session.

Committee members raised concerns about the federal Patient Protection and Affordable Care Act's effects on health insurers and the state, including on providers' income, the state's medical insurance pool and credits that insurers may take for payments to the pool. Senator Cisneros invited the presenters to examine these and other issues raised and to present potential legislation for the committee's consideration at a future meeting.

New Mexico Film — Update and Film Production Tax Credit Annual Report

Nick Maniatis, director of the New Mexico Film Division, Economic Development Department, reviewed film production tax credit data and recent changes to the credit. He commented that the credit's annual cap of $50 million does not appear to have deterred companies from filming in the state in order to take advantage of it. For FY 2013, nearly $214 million was directly spent in the state; the figure does not reflect workers' personal consumption spending. During that time, there were 216,461 worker days.

Mr. Maniatis highlighted the following legislative changes to the credit.

- A company filming a television series with an order of at least six episodes, each with a budget of at least $50,000, may qualify for a 30% refund of certain direct production expenditures.
- A company that uses a qualifying production facility in filming other types of productions may add 5% to the 25% credit base for resident crew wages and fringe

benefits when certain criteria are met. The provision is intended to promote the hiring of more in-state workers.
- Certain LLCs may claim the credit.
- A company claiming the credit for a full-length feature must include a New Mexico government logo in the credits.

Mr. Maniatis indicated that a commissioned three-year study to analyze the cost-effectiveness of film incentives is scheduled to start on September 1. The cost and difficulty of the study and the office's budget influenced the study's three-year duration. A member questioned whether three years is too long to wait for results and encouraged Mr. Maniatis to explore options to undertake the study more expediently.

State Land Office (SLO) Annual Status and Revenue Update

Ray Powell, commissioner of public lands, presented an annual SLO revenue and status update. He emphasized the importance of protecting the health and productivity of state trust lands for future generations.

Commissioner Powell's revenue update includes historic and estimated future income figures. Among other factors, past and future calculations are based on the production yield and prices of oil and gas. The second-highest amount of revenue from state trust lands in a fiscal year, $577.5 million, was yielded in FY 2013. FY 2012's revenue yield ($652.3 million, a record high) is largely attributed to that period's global demand for oil and gas, the production of which constitutes the vast majority of state land revenues. Estimated FY 2014 revenue is $635.9 million, and estimated FY 2015 revenue is $610.0 million; figures are based on a five-year trend and UNM's Bureau of Business and Economic Research five-year forecast for oil and gas. The FY 2015 estimate closely mirrors that of FY 2014 but reflects a slight increase in income from commercial and surface resources.

Commissioner Powell reviewed state land revenue distribution. Revenue from renewable sources is diverted to the SLO Land Maintenance Fund; it then pays for SLO operations and is distributed, according to the amount of revenue earned on respectively held lands, to beneficiaries. Revenue from nonrenewable sources is diverted to the land grant permanent funds (LGPFs); some of that revenue is invested and the remainder is distributed to beneficiaries.

Commissioner Powell discussed policies in the leasing of state lands. Though companies working on renewable energy projects to capitalize on the state's wealth of renewable energy are increasingly applying for and entering into leases, inadequate intrastate transmission infrastructure to export that energy to market has retarded more robust development. Commissioner Powell described some of those renewable energy projects. In addition to renewable energy leases, the SLO supports projects that improve the economic health of the state and its residents by having companies locate in the state; some of those projects include the Sandia Science and Technology Park and the Mesa del Sol Innovation Park.

Commissioner Powell indicated that five years ago, for reasons he could not identify, the state traded with UNM the commercial property at Mesa del Sol for a less valuable apple orchard in Dixon. UNM then sold the commercial property to a developer. The orchard has since been badly damaged by fires and floods, and the SLO has been trying to salvage the trees.

RSTP members expressed concerns about the state's future needs and the LGPFs' ability to help to satisfy those needs. One member cited a recent study that indicated that by 2030, the ratio of people whose net contribution to government exceeds their distribution to those whose net distribution exceeds their contribution would grow to 1:1. If true, this would strain state resources, making even more critical the good health of the LGPFs and other funds. The member stressed the need for the state to ensure that it will meet its future revenue requirements.

A committee member asked Commissioner Powell about the current federal Bureau of Land Management's disposing of land at low cost. Commissioner Powell responded that the state is working with its congressional delegation to attempt to receive federal land at no cost but that it is also exploring the purchase of federal land.

Approval of Minutes

Upon a motion made and seconded, the minutes of the July RSTP meeting were approved without any changes.

Severance Tax Bonding Overview

Stephanie Schardin Clarke, director, State Board of Finance, gave an overview of severance tax bonding. Some revenue from the severance tax, one of the several taxes on natural resource production, is diverted to the Severance Tax Bonding Fund and some is diverted to the Severance Tax Permanent Fund (STPF). Subject to certain capacity restrictions, money in the Severance Tax Bonding Fund is used to service severance tax bonds, which are sold to finance capital improvements. Originally, a statutory cap of 50% of the previous year's bonding fund revenue applied to the amount available for debt service. Beginning in 1999 and as a result of a lawsuit requiring that the state more fully fund public school capital improvements, the cap increased to 95%, 50% of which services senior bond debt and 45% or more of which services debt on supplemental severance tax bonds.

Ms. Schardin Clarke presented a chart showing severance tax contributions to the STPF and noted that the contributions have fluctuated for two key reasons. First, the value of the resources from which the tax derives is volatile; second, statutory requirements produce fluctuating contributions from year to year. That is, "statutory capacity" (95% of the previous year's bonding fund revenue) and "cash available" (the current fiscal year's revenue) are considered in determining the amount of contribution. The amount for bond debt service is the statutory capacity calculation or the cash available figure, whichever is less, and the fund deposit is the amount of revenue remaining. The following principles illustrate how this arrangement affects that deposit amount.

- When in a year there is less revenue than in the previous year and the cash available amount is lower than the statutory capacity amount, the entire cash available amount is used for debt service and there is no fund deposit.

- When in a year there is greater revenue than in the previous year, the statutory capacity amount is lower than the cash balance amount, so the statutory capacity amount is used for debt service and the remainder is deposited into the fund.

Ms. Schardin Clarke outlined some considerations of note if a change in the structure of the STPF were contemplated. She commented that investment in the fund and payment for capital projects are both productive uses of the revenue. Capital project funding helps the state through short-term economic stimulation, while fund investment provides a less immediate — but nevertheless gainful — payoff; without the distributions it provides, another source of revenue would need to be tapped or an existing source would need to be expanded. But STPF investing carries risk. Meanwhile, strategically chosen capital assets improve the state's economic productivity. Possible alternatives to the existing forms of investment include lowering the taxpayer burdens, spending revenue in a different way and, like some natural resource-rich states, making direct distributions to households.

Investment Performance for FY 2013; Impact of Contributions and Distributions on the Permanent Fund; New Mexico Private Equity Overview

<u>State Investment Council (SIC) Report</u>

SIC representatives Steven K. Moise, state investment officer, Vince Smith, deputy state investment officer, and Charles Wollmann, communications director, updated the committee on FY 2013 investment performance and on the STPF and the LGPFs, and gave the committee a brief overview of the state's private equity program.

In FY 2013, the SIC representatives reported, permanent fund investments performed well compared with the SIC target (7.5%), policy benchmarks and peers. The investments realized a 13.28% return. The Wilshire Trust Universe Comparison Service ranked the LGPFs' last-quarter performance in the nineteenth percentile among comparable funds. The SIC representatives remarked that despite this good performance, 7.5% remains a prudent target rate of return since markets can be fickle, and having a higher target could induce investments that carry too much risk.

The SIC representatives expressed concern about recent reductions in contributions to the STPF resulting from the relatively high proportion (95%) of its revenue dedicated to bonding. The highest fund value, reached in October 2007, of $4.803 billion exceeded its June 2013 value by $656 million, which marks a 13.7% decrease. By comparison, the LGPFs' value has increased since that time — when it, too, reached a record high — by $731 million, or 6.5%. As a result of the STPF's and the LGPFs' respective performances in these time periods, the STPF distribution to the general fund decreased by $21 million, and the LGPFs' distributions — despite a decreased statutory distribution rate — increased by $14 million. Flagging growth to the STPF results in lower distributions to the general fund and public schools. The SIC representatives indicated that the SIC would welcome a legislative request for a select group of specialists to study ways to increase contributions to the STPF.

Over time, the LGPFs' and the STPF's distribution rates have diverged, despite being managed similarly: the LGPFs increased 4.9% each year on average and the STPF by 1.7%.

The difference is attributable to the degree of the SIC's investment flexibility and the amount of inflows into each fund.

Representatives of the SIC gave an overview of the private equity investment program before introducing presenters from Sun Mountain Capital, who provided more detail on it. The program's aim is to spur economic development and yield investment returns. Although 9% of the STPF is authorized to be invested in private equity funds, the SIC has identified 5% as an appropriate investment level.

New Mexico Private Equity Investment Program Report

Sun Mountain Capital managing partner, Brian Birk, and partner, Sally Corning, outlined key aspects of the state's private equity investment program. A portion of the STPF is invested in private equity funds, which in turn invest in a broad range of New Mexico-based companies. A list of companies invested in through the program was distributed to committee members. To qualify for investment through the program, a company must have a presence in New Mexico.

In its first 10 years, the program's sole focus, which led to low financial return, was economic development. In its last 10 years, the focus has been on achieving financial returns close to competitive national benchmarks. The change in focus resulted in a shift from net financial loss to net financial gain — and performance in line with national venture capital benchmarks.

Mr. Birk and Ms. Corning summarized the private equity investment program's status. The program has rebounded from the 2008 market crash and is making new commitments: at present, over $350 million has been committed to 28 venture capital funds. In response to questions from committee members, Mr. Birk and Ms. Corning indicated that they would welcome a legislative effort to create a plan to analyze the mission and health of the STPF.

The committee recessed at 4:40 p.m.

Tuesday, August 20

The committee reconvened at 9:12 a.m. on Tuesday, August 20, 2013, with Senator Cisneros chairing the meeting.

Gaming — Revenue, Trends and Tribal-State Revenue Sharing

Representatives from the Gaming Control Board (GCB), Paulette Becker, board member, Frank A. Baca, general counsel and acting executive director, and Tom Fair, director of the Audit and Compliance Division, Taxation and Revenue Department, updated the committee on gaming revenue, trends and tribal-state revenue sharing.

In the past seven years, revenue from gaming has generally grown. It fell during the recession and then rebounded to its current level, approximately $130 million. Net racetrack revenue increased from 2006 to 2009 and then began a general decline. Meanwhile, tribal net revenue has generally increased. Historically, the majority of gaming revenue came from racetrack casinos; a shift, likely permanent, took place in FY 2010, when more revenue came from tribal sources than from racetrack casinos. These trends might be attributable to the opening of the Northern Edge Navajo Casino; competition from legal and illegal gaming in Mexico; and the growing concentration in certain geographic regions of gaming facilities, which results in a saturation of these facilities.

The GCB representatives also provided information on generated revenue relative to the agency's budget, tribal and racetrack net win amounts by year, estimated future gaming revenue (predicted to remain relatively constant) and the net impact on state revenue of the presence of tribal casinos. The amount of revenue from the tribal sources results in part from policies embodied in statute, rule and compacts.

A committee member commented that different priorities underlie the state's gaming policies. Some laws are designed with the purpose of revenue generation while others are intended as mechanisms to enhance economic development and infrastructure on tribal land. Other members discussed the issue of saturation and possible limits on the number of opportunities for gaming.

Senator Cisneros invited the presenters to examine issues related to the structure of the state's gaming system and present potential legislation for the RSTP's consideration at a future meeting.

New Mexico Lottery Revenue Update and Legislative Lottery Scholarship Fund Status
New Mexico Lottery Report

Tom Romero, chief executive officer, New Mexico State Lottery (NMSL), and Adriana Binns, director of marketing and communications, NMSL, gave an update on lottery revenue.

Mr. Romero pointed out that, in spite of an FY 2013 record-high deposit ($44 million), the Lottery Tuition Fund is strained because more students are attending college and associated rates are increasing. The record deposit came amid prior years' declining sales and was largely due to four Powerball run-ups and an increase in instant sales of about $1.3 million from FY 2012.

This year's estimated returns are $40 million, about the same as estimated for the next few years. Nevertheless, because of the NMSL's commitment to giving more students an opportunity to take advantage of the program, it has embarked on some initiatives to increase sales. Those initiatives include the following:

- restructure the Scratcher ticket prizes to offer better odds and more winners;
- sponsor Scratcher promotions to give players a second chance to win substantial prizes with their non-winning tickets; and

- refresh the Scratcher brand and introduce a new Scratcher logo through a high-energy campaign.

The NMSL is exploring: the creation of a subscription club, which would also allow for internet wagers; whether to offer video versions of traditional lottery games; and whether to offer higher payouts on premium national games. Further, it is identifying options for addressing a problematic statutory requirement that, each month, 30% of each previous month's gross revenue be deposited in the Lottery Tuition Fund.

Higher Education Department (HED) Report

José Z. Garcia, secretary of higher education, informed the committee about the status of the Lottery Tuition Fund. For FY 2014, there is an anticipated shortfall of $10.2 million in what will be owed to educational institutions. By FY 2018, under the assumption that tuition — and therefore lottery payment requirements — will increase by 4%, that shortfall is expected to increase to about one-half of what will be owed. Secretary Garcia stressed that this is a large-scale problem that needs an appropriately scaled solution.

Secretary Garcia reviewed FY 2013 lottery scholarship awards and payments to recipient institutions, noting that 69.8% of awards were given for research institutions, 9.4% for comprehensive institutions and 20.8% for two-year institutions. Because of schools' varying tuition and fee levels, 88.1% of payments went to research institutions, 5.5% to comprehensive institutions and 6.5% to two-year institutions.

Secretary Garcia also reviewed some data on family income of students receiving the scholarship and on retention of recipient students. Of the spring 2012 first-time recipients, 1,294 came from families whose annual income was under $30,000; 933 came from families whose annual income was greater than $120,000. Eleven percent of all recipient students did not file a federal financial aid form — so information on their families' annual income is unknown. Over time, the percentage of recipient students who continue enrollment decreases. An average of 75.2% of first-time recipient students remain enrolled in the next semester and 63.9% in the next.

Lastly, Secretary Garcia turned committee members' attention to a table of legislatively proposed solutions to the lottery shortfall problem and highlighted Senate Memorial (SM) 101 (2013 session). SM 101 requested that the HED form a work group to study the solvency of the Lottery Tuition Fund and to make recommendations to improve solvency. Secretary Garcia reported that the group had its first meeting in July and will discuss options at its second meeting in September. In October, it will decide on recommendations. A committee member requested that the HED transmit the report containing those recommendations to the committee.

Committee members and Secretary Garcia discussed some aspects of and recommendations concerning the lottery shortfall problem, including that: a per-pupil cut would disproportionately affect students from lower-income families; the arrived-at solution should affect as few students as possible; the state should consider eliminating the qualification requirement that a student attend college immediately after high school; more students attending two-year colleges would help to defray lottery tuition payments, since those schools charge less in tuition; and incorporating in the scholarship incentive a graduation requirement would deter dropping out.

Adjournment

There being no further business, the RSTP adjourned at 11:12 a.m.

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

September 23-24, 2013
Room 307, State Capitol
Santa Fe

The fourth meeting in 2013 of the Revenue Stabilization and Tax Policy Committee (RSTP) was called order by Senator Carlos R. Cisneros, chair, on Monday, September 23, 2013, at 10:05 a.m. in Room 307 of the State Capitol in Santa Fe.

Present
Sen. Carlos R. Cisneros, Chair
Rep. Edward C. Sandoval, Vice Chair
Sen. Sue Wilson Beffort (9/23)
Rep. Anna M. Crook
Rep. Rodolpho "Rudy" S. Martinez
Sen. Mark Moores
Rep. Henry Kiki Saavedra
Sen. Clemente Sanchez
Sen. John Arthur Smith
Rep. James R.J. Strickler
Sen. Lisa A. Torraco
Rep. Jim R. Trujillo
Sen. Peter Wirth
Rep. Bob Wooley

Absent
Rep. Brian F. Egolf, Jr.
Sen. Timothy M. Keller
Sen. William E. Sharer
Rep. Thomas C. Taylor

Designees
Sen. Jacob R. Candelaria (9/23)
Rep. Ernest H. Chavez
Rep. Jason C. Harper (9/24)
Rep. Bill McCamley (attending as a guest 9/24)
Rep. Luciano "Lucky" Varela (attending as a guest 9/23)

Rep. Donald E. Bratton
Sen. William F. Burt
Rep. Miguel P. Garcia
Sen. Phil A. Griego
Rep. Sandra D. Jeff
Sen. Gay G. Kernan
Rep. Tim D. Lewis
Sen. George K. Munoz
Rep. Paul A. Pacheco
Rep. Dennis J. Roch
Rep. Debbie A. Rodella
Sen. Nancy Rodriguez
Sen. John M. Sapien
Rep. Carl Trujillo
Sen. Pat Woods

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

Staff
Pam Stokes, Staff Attorney, Legislative Council Service (LCS)
Amy Chavez-Romero, Assistant Director for Drafting Services, LCS
Tessa Ryan, Staff Attorney, LCS
Jennifer Dana, Intern, LCS

Guests

The guest list is in the meeting file.

Handouts

Handouts and other written testimony are in the meeting file.

Monday, September 23

Revenue Forecast

Leila Burrows, chief economist, Department of Finance and Administration (DFA), Elisa Walker-Moran, chief economist, Taxation and Revenue Department (TRD), and Peter van Moorsel, economist, Legislative Finance Committee (LFC), reported on the general fund revenue forecast prepared by the Consensus Revenue Estimating Group. The group comprises economists from the DFA, the LFC, the TRD and the Department of Transportation (DOT). The group projected that general fund revenues would approximate $5.65 billion for fiscal year (FY) 2013 and $5.78 billion for FY 2014.

Ms. Burrows outlined certain national economic factors upon which the consensus revenue forecast is predicated. For instance, Ms. Burrows explained that gross domestic product growth is expected to improve and that low interest rates will support business investment, construction and demand for durable goods. According to Ms. Burrows, job growth is expected to improve, with an expected national unemployment rate of 6% at the end of FY 2015.

Next, Ms. Burrows provided an overview of a number of New Mexico economic indicators. Overall, Ms. Burrows stated that the state's economy moved from stagnation to growth in the spring of 2013. She stated that the housing market has improved, as demonstrated by a 15% rise in building permits in the first half of 2013. Taxable gross receipts have shown continued strength, and New Mexico's unemployment rate of 6.7% is lower than the national average of 7.6%.

Ms. Burrows discussed the status of New Mexico's energy markets. She highlighted that New Mexico crude oil prices are expected to average $87.00 per barrel (bbl) in FY 2013, $94.00 per bbl in FY 2014 and $87.50 per bbl in FY 2015. Ms. Burrows explained that the crude oil price spike in FY 2014 is attributable, in part, to ongoing crises in Egypt. The consensus group further predicts that crude oil production will increase gradually over the next few years.

Ms. Burrows additionally discussed the status of natural gas prices in New Mexico. She stated that natural gas prices are expected to average $4.50 per thousand cubic feet (mcf) in FY 2013, which is $0.50 per mcf lower than FY 2012 levels. The consensus forecast predicts that natural gas prices will average $5.00 in FY 2014 and $5.40 in FY 2015. Yet, natural gas production declined in FY 2013, and is expected to decline by 4.7% in FY 2014 and 3.6% in FY 2015.

Ms. Walker-Moran informed the committee that the general fund revenue estimate was revised from the revenue forecast produced in December 2012. For FY 2013, the general fund revenue estimates were revised downward by $96 million and for FY 2014, the estimates were revised downward by $73 million. Ms. Walker-Moran pointed out that the forecast is marked by uncertainty and has been revised for several reasons, including federal fiscal sequestration. Ms. Walker-Moran stated that other factors that resulted in revised general fund expectations included unexpected increases in high-wage jobs tax credit claims and reductions in professional, scientific and technical services gross receipts.

Ms. Walker-Moran identified negative risks to the forecast, including potential federal actions, such as sequestration and uncertainty surrounding implementation of the federal Patient Protection and Affordable Care Act. Ms. Walker-Moran noted that the August forecast does not adjust for a potential sequestration of federal mineral leasing in federal FY 2014, but this could reduce forecasted revenues by an additional $18 million in FY 2014 and $6 million in FY 2015. Ms. Walker-Moran indicated that positive risks to the forecast include potential for stronger growth in personal income tax and corporate income tax revenues, plus interest rate increases.

Ms. Burrows updated the committee on severance tax bonding capacity. She stated that severance tax bonding capacity was reduced from the amount provided in the December 2012 forecast due to an anticipated reduction in severance tax collections. Total senior severance tax bond capacity in FY 2014 is estimated to be $286.4 million, with $186.2 million of that amount expected to be available for new capital projects authorized during the 2014 legislative session. Earmarked appropriations for FY 2014 include: $28.6 million for Water Trust Board projects; $14.3 million each for colonias and tribal infrastructure projects; $38 million for previously authorized projects for which bonds have not yet been issued; and $5 million for projects funded in August 2013 through series 2013S-C bonds. Total supplemental severance tax bond capacity available for public school facilities is expected to be $175 million in FY 2014. Ms. Burrows added that by targeting a flat property tax mill levy of 1.36 mills, the amount available for appropriation from the general obligation bond program is expected to be $165 million for the 2014 legislative session.

Mr. van Moorsel provided the committee with the LFC's report on the consensus revenue estimate, noting that the LFC's report shows revisions made to the general fund revenue estimates in February 2013. Mr. van Moorsel highlighted the report's discussion of the possible risk of loss of tobacco settlement payments due to a legal challenge from cigarette manufacturers participating in the Master Settlement Agreement. He said that since the report was produced, an adverse ruling would negatively affect New Mexico's tobacco settlement payments for 2014 and that future tobacco settlement payments could be adversely affected.

Committee members discussed related issues with Ms. Burrows, Ms. Walker-Moran and Mr. van Moorsel, including:

- concerns about federal sequestration and amounts set aside to prepare for it;

- concerns about volatile oil and gas revenues;
- the effects of oil and gas production and federal sequestration on high-paying jobs in the state;
- trends in government growth, including flat or declining growth for state and local governments;
- the possible impacts of 2014 tax legislation on general fund revenues;
- the possible impacts of premium taxes on general fund revenues;
- the possible impacts of Patient Protection and Affordable Care Act implementation on general fund revenues;
- the uncertainty concerning reduced tobacco settlement revenues to the general fund; and
- whether any statutory changes are necessary to prevent future loss of tobacco settlement revenues and the changes that have been made to prevent those losses.

State Road Fund Update

Tom Church, secretary-designate of transportation, and Clinton Turner, chief economist, DOT, presented a State Road Fund forecast update. Mr. Turner indicated that the update is one of two annual forecast updates to DOT revenues. The next will be released in January 2014.

Mr. Turner listed the four major sources of revenue for the State Road Fund, which are gasoline taxes, special fuel taxes, weight distance taxes and vehicle registrations. Secretary-Designate Church said that, while previously forecasted FY 2014 State Road Fund revenues are expected to decrease slightly from $379.8 million to $379.45 million, FY 2015 revenues are expected to approximate $381.4 million. The projected FY 2015 revenues reflect a $1.55 million — or .4% — difference from FY 2014 projected revenues.

Secretary-Designate Church highlighted that the DOT's report also includes projections for other funds administered by the DOT, such as the State Aviation Fund. Mr. Turner pointed out that the projected revenue for the State Aviation Fund has increased significantly since the DOT's last estimate, due to recently passed legislation that will require gross receipts tax distributions to be made to the fund. The DOT projects that revenues for the funds it administers will rise by $2.27 million — or .5% — from FY 2014 to FY 2015.

Mr. Turner concluded the DOT's testimony with a presentation of a graph showing growth trends in the general fund and the State Road Fund relative to New Mexico population growth. He highlighted that New Mexico's population has grown by 60% since 1985. Meanwhile, the general fund has grown by 110% and the State Road Fund has decreased by 40%.

Committee members discussed several issues with Secretary-Designate Church and Mr. Turner, including:

- the availability of federal money to rebuild or repair New Mexico highways and roads affected by recent flooding;
- previous efforts to increase taxes for highway construction, including Governor Richardson's Investment Partnership (GRIP);
- the inability to use GRIP money for operations;

- options, in light of limited revenue growth, to satisfy New Mexico's infrastructure needs, including the imposition of mileage fees in lieu of gasoline taxes and the issuance of severance tax bonds;
- the efforts of the Transportation Infrastructure Revenue Subcommittee to identify revenue sources for New Mexico's highways and roads; and
- the status and stability of bridges that the DOT oversees.

Reforming the Gross Receipts Tax

Richard Anklam, president and executive director, New Mexico Tax Research Institute, and Helen Hecht, tax counsel, Federation of Tax Administrators, reported on New Mexico's gross receipts tax system and an analysis of the general structure of modern tax systems.

Mr. Anklam explained that modern state tax systems are typically characterized as "three-legged stools" supported by property, income and consumption tax systems. Property tax systems typically are based on ad valorem taxes, which are calculated using the value of the subject item. Mr. Anklam indicated that property taxes are usually imposed by local governments and are more stable than other taxes. According to Mr. Anklam, property tax revenues tend to be less affected by economic trends.

Mr. Anklam explained that income taxes are imposed by federal and state governments and are usually taxes on wages, earned income, investment returns and profits. He said that income taxes tend to be the most volatile taxes. For instance, in the second quarter of 2009, state income taxes, on average, declined by 28%. Mr. Anklam further stated that corporate income taxes are the most volatile of all state taxes.

Mr. Anklam said that consumption taxes include sales taxes and excise taxes. The legal incidence may fall on the purchaser or seller, but the economic incidence often is intended to fall on the consumer. Mr. Anklam pointed out that consumption taxes are susceptible to pyramiding.

Property taxes, according to Mr. Anklam, are the simplest taxes for governments to administer. Usually, no report filing is required for real property taxes, and only annual reports are required for tangible personal property taxes. Moreover, the values on which property taxes are based tend to remain stable and are predicated on accepted academic and economic principles, not statutory formulas. Mr. Anklam noted that property tax collection can be problematic when property owners lack the means to pay the assessed tax. Moreover, Mr. Anklam stated that local government property tax administration can present other challenges.

With respect to income taxes, Mr. Anklam stated that New Mexico, like most states, piggybacks on federal law to determine the tax base. Most income tax returns are filed by households with relatively simple returns. Pass-through entities are generally not taxed at the entity level, although a few states have imposed taxes directly on those entities. Mr. Anklam stated that corporations have more complex filing requirements than individuals, and identifying the state in which income is earned is typically the greatest challenge for corporate income tax filers.

Mr. Anklam stated that sellers are required to collect and report consumption taxes. Sellers, not purchasers, maintain records of the transactions subject to the taxes. Sourcing can become complicated for some types of sales. Mr. Anklam elaborated that under United States Supreme Court holdings, states cannot collect consumption taxes from certain remote sellers. Thus, collecting consumption taxes on internet and mail-order sales can be problematic.

Ms. Hecht described how other countries impose consumption, property and income taxes. For instance, she noted that the Organization for Economic Cooperation and Development (OECD) reported that in 2012 consumption taxes constituted, on average, 31% of total government tax revenues. One hundred fifty countries have imposed a value-added tax, and of the 34 OECD member countries, 33 have value-added taxes. The United States is the only OECD member country without a national value-added tax.

Ms. Hecht stated that, according to the OECD, individual and corporate income taxes constituted, on average, 33% of total international government tax revenues in 2012. Personal income taxes accounted for 24% of income tax revenues, while corporate income taxes accounted for the remaining 9%.

Ms. Hecht noted that in the United States, the "three-legged stool" exists to the extent that the tax systems of the local governments, states and the federal government are aggregated. The federal government relies on income and payroll taxes, while the states rely on sales and income taxes. Local governments rely primarily on property taxes. Ms. Hecht said that about 60% of all tax revenue in the United States is collected by the federal government, while 21% is collected by the states and about 19% is collected by local governments. At the state and local levels, property taxes account for 33% of revenue, income taxes about 25% and consumption taxes about 34%. Ms. Hecht said that all states impose some form of consumption tax, but not every state imposes a general sales tax.

Ms. Hecht described some common characteristics of income, property and consumption tax schemes among the states. For instance, Ms. Hecht indicated that all states impose lower personal income tax and corporate income tax rates than those imposed by the federal government. Moreover, states do not rely heavily on property taxes, and such taxes are mostly intended to be collected by local governments. Ms. Hecht stated that consumption taxes are controlled the most by state governments and that most states have room to expand the tax base. However, Ms. Hecht noted that consumption taxes are regressive and difficult to enforce with remote sellers. In addition, consumption taxes are subject to pyramiding issues.

Citing a 2012 report by the Federation of Tax Administrators, Ms. Hecht stated that New Mexico ranked twenty-sixth among the states in collected revenue per capita. New Mexico ranked lower than most states with respect to personal income tax revenues and higher than most states with respect to gross receipts tax revenues.

Ms. Hecht provided the committee with a summary of the recent history of the gross receipts tax. She stated that since the early 1990s, the gross receipts tax base has eroded due to pressures to grant taxpayers exemptions from the tax. Ms. Hecht said that this pressure was exacerbated because New Mexico's gross receipts tax was imposed on items that other states did not tax. Ms. Hecht stated that New Mexico's gross receipts tax system became increasingly different from other state tax systems when the streamlined sales tax effort began in 1999. While New Mexico's gross receipts tax system does not fit the streamlined sales tax template, 26 other states have conformed to that uniform system.

Ms. Hecht provided a detailed description of New Mexico's gross receipts tax system, noting that the system includes the compensating tax, municipal and county gross receipts taxes, tribal taxes, special state taxes and tax credits. She stated that the compensating tax is intended to keep consumers from purchasing items out of state in an effort to avoid payment of the gross receipts tax. Special state taxes include excise taxes such as the governmental gross receipts tax, interstate telecommunications gross receipts tax, leased vehicle gross receipts tax and surtax and the telecommunications relay service surcharge.

Ms. Hecht stated that, in her opinion, the gross receipts tax system is imperfect. She stated that the gross receipts tax is overly broad and creates economic interference through pyramiding. She further stated that the tax is inefficient and might have negative consequences on economic development. She suggested that if a gross receipts tax is not imposed at a low rate, it can become distortive. Thus, she stated, New Mexico's gross receipts tax is too high. In addition, Ms. Hecht mentioned that overreliance on ad hoc measures, such as credits, can result in reduced transparency and fairness. Finally, Ms. Hecht highlighted other issues with the gross receipts tax system, including regressivity and local government dependence on gross receipts tax revenues.

According to Ms. Hecht, a number of reforms could improve New Mexico's tax system. She suggested that implementation of a pure sales tax, as opposed to a gross receipts tax, would be one solution. She said that this solution is simple, would restore consumption to the tax base and would eliminate business-to-business service taxation. Ms. Hecht added that conformity with the streamlined sales tax project could be advantageous.

Another solution for improvement of New Mexico's tax system, according to Ms. Hecht, is implementation of a "true" gross receipts tax. Such a tax would be characterized by rates below 1%. It would also not be subject to most exemptions and deductions. Ms. Hecht stated that despite the potential advantages of a lower gross receipts tax, detriment to local government finances, a negative fiscal impact and increased regressivity could result.

Ms. Hecht discussed trends in other state tax systems. She said that other states have attempted to expand their tax bases by taxing services and digital goods and have replaced certain taxes with an expanded sales tax. Ms. Hecht highlighted that many states have joined the Streamlined Sales and Use Tax Agreement and are attempting to persuade Congress to permit them to collect sales taxes from remote sellers. Senate Bill 743, which passed the U.S. Senate with bipartisan support but is pending in the U.S. House, proposes to enact the Marketplace Fairness Act. That act would grant states the authority, when certain conditions are met, to require remote sellers to pay sales tax at the time of a transaction. Another bill would enact the Digital Goods and Service Tax Fairness Act, which would specify how and when states could tax digital goods and services.

Mr. Anklam indicated that a comprehensive plan would be necessary to improve the state's gross receipts tax system. He suggested that it might be beneficial to craft a new system, which could include a basic consumption tax that fits within New Mexico's overall system. He said that issues such as digital goods, imported services and exportation and importation rules would likely need to be addressed.

Committee members discussed a number of issues with Mr. Anklam and Ms. Hecht, including:

- advantages and disadvantages of certain approaches to stabilize tax revenue, including imposition of a general sales tax and examination of property taxes;
- the implications of New Mexico's ranking among the states with regard to per capita tax revenues collected;
- efforts to study New Mexico's gross receipts tax system in the context of other New Mexico taxes;
- instances in which gross receipts pyramiding affects consumption and economic growth;
- the difficulty in ascertaining any relationship between elimination of gross receipts tax pyramiding and economic growth; and
- the possible fiscal impact of a transition to a pure sales tax and options to phase in that transition.

Approval of Minutes

Upon a motion made and seconded, the minutes of the August RSTP meeting were approved without any changes.

Laboratory Partnership with Small Business Tax Credit Annual Report

Genaro Montoya, New Mexico small business assistance program manager at Sandia National Laboratories, Belinda Snyder, economic development program manager at Los Alamos National Laboratory, and Bruce McCormick, owner of SAVSU Technologies, introduced themselves to the committee. Mr. Montoya and Ms. Snyder reported to the committee on the small business assistance program. The program stems from the Laboratory Partnership with Small Business Tax Credit Act, which is intended to promote economic development in the state, particularly in rural regions.

Together, the laboratories serve as a catalyst for the transfer of cutting-edge technology to a variety of small businesses. The TRD administers the program, and program representatives consult with the secretary of economic development to improve program operations. A third-party entity conducts surveys and collects data on the program's economic impact and customer satisfaction.

Mr. Montoya cited some program-related statistics:

- from 2000 to 2012, 2,036 small businesses, 65% of which were in rural areas, received $34.3 million in assistance;
- in that time, 3,510 jobs were created or retained and there was a $172.5 million increase in revenue, a $78.9 million decrease in operating costs, a $56.4 million

investment in New Mexico goods and services and $59.6 million in new funding and financing; and
- for 2013, it has been projected that 315 to 350 small businesses will receive $4.3 million to $4.7 million in assistance.

Ms. Snyder described program goals. One is to concentrate on solving small businesses' needs while maximizing projects' economic benefits. Another is to keep the program aligned with its original purpose, with the state's current economic development strategies and with the two laboratories' technology transfer and commercialization objectives.

Ms. Snyder articulated the program's industry-specific focuses, which include the following.
- **Agriculture** — The labs have interacted substantially with the agricultural industry, particularly in the area of water management. Both laboratories have evaluated water quality and consulted with industry businesses on irrigation, reservoir and water conservation needs. Other projects have addressed bovine health and dairy waste streams.
- **Oil and Gas** — Primarily, projects have focused on developing technologies to treat and reuse water in order to reduce disposal costs and save energy and ground water.
- **Renewable Energy** — Projects have focused on biofuel production, solar-thermal and wind-turbine design and evaluating production and distribution.
- **Manufacturing** — The laboratories have helped a diverse range of companies at the start-up and improvement stages.
- **High Tech** — Small businesses that have received assistance include those in the bio-tech, advanced manufacturing and scientific-services fields. Lab expertise has helped to improve performance and design.

Mr. McCormick related how the program was instrumental in his company's development of a passively cooled storage container that can help to improve the health of people in developing countries. He received a grant from the program to develop a high-performance cooler to store vaccines in places otherwise lacking in the resources necessary to maintain the conditions that the vaccines require.

Recess

The committee recessed at 3:20 p.m.

<u>Tuesday, September 24</u>

The committee reconvened at 9:34 a.m. with Senator Cisneros chairing the meeting.

Tax Expenditure Oversight and Replacing the Gross Receipts Tax with a Sales Tax

Representatives Harper and McCamley spoke on ways to potentially improve New Mexico's tax policy. They presented ideas that the two cultivated during the 2013 session and in continued conversations with each other and Mr. Anklam. Their discussions focused on improving the business climate in revenue-neutral ways.

The presentation initially highlighted four proposed structural changes. The first would establish a system to analyze the effectiveness of proposed and enacted exemptions, deductions and credits. This work could be conducted in standing committees. Committee members suggested that such efforts would be more effectively carried out if performed in collaboration with the LFC and committee analysts. Representatives Harper and McCamley reviewed some examples that illustrate the potential obsolescence of certain existing tax measures and stressed that they were not advocating for any particular change, but rather for concerted efforts to examine existing laws' utility. Secretary of Taxation and Revenue Demesia Padilla, who was in the audience, commented in reference to the first proposed structural change that the department's tax expenditure report would be updated in October and presented to the committee at its next meeting.

The second structural change would involve standardizing and simplifying taxes, partly through a broadening of the tax base and a flattening of the tax rate. The third change would make tax incentives transparent and measurable so that their effectiveness could be more easily analyzed. Lastly, a measure to sunset all tax legislation would ensure that tax benefits are reviewed periodically for their effectiveness. A committee member commented that sunset clauses might not be useful in all situations; sometimes interests in predictability and stability outweigh the interest in periodic scrutinizing for effectiveness.

Representatives Harper and McCamley next proposed a second major tax policy change: eliminating tax pyramiding by shifting from a gross receipts tax to a sales tax. They stressed that many experts agree that the state's gross receipts tax deters business activity and economic growth, and they added that any approach should have a revenue-neutral impact. They concluded by recognizing that the effects of such a shift on those who in the current system are exempted from paying tax and on local governments that rely on proceeds from the gross receipts tax should be considerations informing the discussion.

Several committee members commended the representatives for their interest in reforming the state's tax system. Committee members also revealed their observations of and reflections on past attempts to reform the state's tax policy, including the following.

- Many who benefit from the existing system apply pressure to preserve the status quo, making efforts to narrow the gap between those who pay a lot in taxes and those who pay little or nothing (especially not-for-profit organizations) politically difficult.
- Efforts to expedite movement of legislation through the political process often result in laws that are susceptible to unintended exploitation.
- The governor has previously stalled efforts to effect some proposed changes discussed and, without her agreement, could stand in the way of others.
- Acceptable changes would preserve the reliability and adequacy of the state's revenue streams.
- While tax regressivity is widely considered undesirable, tax progressivity can also be detrimental. Balance among all tax revenue sources should be sought.
- Tax reform has mostly been implemented in piecemeal, not in a more ideal, holistic fashion.

Committee members further commented that the upcoming 30-day session will limit the opportunity to effectively promote comprehensive changes, but it is nevertheless a time in which the discussion of a tax reform proposal by members of relevant committees and legislative bodies can occur. Committee members also recommended that any large-scale tax-reform effort be well organized, intellectual, gradual, implemented in stages and nonpartisan.

Senator Cisneros closed by requesting the presenters to have draft legislation prepared for distribution and discussion at the committee's next meeting.

Gross Receipts Deduction for Durable Medical Equipment and Medical Supplies

Richard Minzner, a lobbyist who represents home medical equipment specialists and purveyors of durable medical equipment, reviewed the status of past and current efforts to create a gross receipts tax deduction for sales of durable medical equipment and medical supplies. The deduction would create parity in tax treatment of prescription drugs and prescription medical equipment.

In the past several years, the idea of creating the deduction has been brought before the committee. In the past two years, a bill that would create this deduction has been vetoed. The executive message concerning the veto of the last session's bill expressed that the reason for the veto was the presence of an overexpansive sunset clause. Meanwhile, many affected businesses have gone out of business in part because they cannot pass the tax on to the payer, which in many cases is the Medicaid system.

Mr. Minzner indicated that he has been working with the governor on the sunset clause issue and would request the committee's endorsement of a new bill to the committee at a future meeting.

Adjournment

There being no further business, the RSTP adjourned at 11:05 a.m.

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

October 21-22, 2013
Room 307, State Capitol
Santa Fe

The fifth meeting in 2013 of the Revenue Stabilization and Tax Policy Committee (RSTP) was called order by Senator Carlos R. Cisneros, chair, on Monday, October 21, 2013, at 10:09 a.m. in Room 307 of the State Capitol in Santa Fe.

Present
Sen. Carlos R. Cisneros, Chair
Rep. Edward C. Sandoval, Vice Chair
Sen. Sue Wilson Beffort
Rep. Anna M. Crook
Rep. Brian F. Egolf, Jr.
Sen. Timothy M. Keller
Rep. Rodolpho "Rudy" S. Martinez
Sen. Mark Moores (10/22)
Sen. Clemente Sanchez
Sen. William E. Sharer
Sen. John Arthur Smith
Rep. James R.J. Strickler
Rep. Thomas C. Taylor (10/21)
Sen. Lisa A. Torraco
Rep. Jim R. Trujillo (10/21)
Sen. Peter Wirth

Absent
Rep. Henry Kiki Saavedra
Rep. Bob Wooley

Designees
Rep. Jason C. Harper
Rep. Tim D. Lewis

Rep. Donald E. Bratton
Sen. William F. Burt
Sen. Jacob R. Candelaria
Rep. Ernest H. Chavez
Rep. Miguel P. Garcia
Sen. Phil A. Griego
Rep. Sandra D. Jeff
Sen. Gay G. Kernan
Rep. Bill McCamley
Sen. George K. Munoz
Rep. Paul A. Pacheco
Rep. Dennis J. Roch
Rep. Debbie A. Rodella
Sen. Nancy Rodriguez

Sen. John M. Sapien
Rep. Carl Trujillo
Rep. Luciano "Lucky" Varela
Sen. Pat Woods

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

Staff
Pam Stokes, Staff Attorney, Legislative Council Service (LCS)
Amy Chavez-Romero, Assistant Director for Drafting Services, LCS
Tessa Ryan, Staff Attorney, LCS
Jennifer Dana, Intern, LCS

Guests
The guest list is in the meeting file.

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

Monday, October 21

Tax Expenditure Report
Demesia Padilla, secretary of taxation and revenue, Ryan Gleason, tax policy and research director, Taxation and Revenue Department (TRD), and Elisa Walker-Moran, chief economist, TRD, discussed the 2013 TRD-produced New Mexico Tax Expenditure Report, which was distributed to committee members. Also distributed were Senate Finance Committee Substitute for Senate Public Affairs Committee Substitute for Senate Bill 7, as amended (2013), and Senate Executive Message No. 47 explaining the veto of that bill.

Mr. Gleason gave an overview of the report and indicated that it enables policymakers to periodically review whether a given tax expenditure is necessary and effective. In preparing the report, its writers had to determine the definition of a tax expenditure. Generally, they considered tax credits, exemptions and deductions as expenditures. But some tax programs, such as certain wage exemptions and tax rate differentials, were not treated as expenditures.

Ms. Walker-Moran stressed that the report was not a comprehensive review, but rather an overview of tax expenditures. She named principles of good tax policy — adequacy, equity, efficiency, simplicity and accountability — that can be used to review tax expenditure programs and noted that the lack of reliable, readily available data posed a challenge for report compilers in determining whether certain tax expenditures fit within that framework. Tax credits are generally associated with reliable data, but exemptions and deductions are not. Further complicating the analysis are considerations of other externalities that make it difficult to say whether, for instance, a given credit spurred economic development. Ms. Walker-Moran also noted that some information was redacted because of confidentiality requirements. She highlighted major sections of the report and key changes from the previous year's report. Namely, the most used and the most underused tax expenditures are listed in this year's report.

Mr. Gleason added that not all unused tax expenditures are useless; some function as safety nets for certain industries. For example, one tax program remains dormant until the price of oil and gas falls to a particular threshold. Nevertheless, unused tax programs should be evaluated for whether, in a case like that, the threshold level is appropriate, or whether the programs are underutilized because of competition with other programs.

Committee members' questions and comments and the presenters' responses to them are summarized as follows.

- Legislators who must defend measures that they advocate for wish to know the value of tax programs — to the individuals benefiting from them and in terms of revenue to the state. Information like that appears to be missing from the report.
- Does the governor consider enacting a sunset provision of a credit a tax increase? Secretary Padilla replied that any sunset provision will be perceived as a tax increase, since it would render at least one taxpayer unable to take advantage of it; nevertheless, it would be good to remove programs that are expired, are unused or have outlived their usefulness. Other programs, as laid out, are confusing and could be improved through better drafting. A member commented that wisely targeting certain programs that are no longer effective and making them sunset, if done in a revenue-neutral way, is not a tax increase, but rather effective policy. Further, the "losers" would not lose much, and the state would benefit from eliminating certain programs. Another member clarified the difference between a "sunset" and a "repeal": a sunset of a tax credit or deduction requires that its proponents substantiate their claim at some point in the future.
- In order to get more data for analysis, simplicity would be compromised. Simplicity should be the guiding principle behind tax policy. Too few — if any — taxpayers understand the system and know the details of their tax obligations. To overcome this complexity, they must pay professionals to figure it out, and this is a drain on resources. If it were a simple system, most taxpayers would pay what they owed. Another member argued that a way for policymakers to determine the effectiveness of a program without excessively burdening the taxpayer should be sought. Secretary Padilla noted that reporting requirements exist for deductions and credits, but not for exemptions. A way to encourage the availability of information is to avoid enacting exemptions. She advised not making the combined reporting system more burdensome for taxpayers, since local governments depend on the monthly distribution of revenue from that program; similarly, deductions, unlike credits that take longer for taxpayers to collect, produce a monthly cash flow to businesses, a frequency that is important to them. Mr. Gleason added that increasing the taxpayer's burden would discourage companies from conducting business in the state.
- Would the administration support a measure to change exemptions to credits and deductions for the purpose of imposing simple reporting requirements? Secretary Padilla replied that she would willingly look at proposals and attempt to negotiate a measure that would strike a balance between the executive's, the legislature's and taxpayers' interests.
- Are the omissions of some tax expenditures from last year's report, which are referenced in one of the memoranda, included in this year's report? Secretary Padilla and Ms. Walker-Moran answered that the included tax programs are listed in section

three of the table of contents. Some programs might be missing because they were not clearly considered tax expenditures or because they lack associated data. The member remarked that it would be helpful for legislators if even programs without data were listed and identified accordingly.

- When will information on programs' cost-effectiveness, referred to in the executive order requiring that the report be compiled, be included in the report? Ms. Walker-Moran replied that certain tax programs, such as the film production tax credit, are being analyzed on a contractual basis. Others programs are too small to warrant an analysis. Others are time-consuming, expensive and undertaken when there is a specific need or request. Secretary Padilla added that, in the case of recently enacted tax exemptions, it is sometimes simple to compare relevant pre- and post-exemption periods to determine the costs of the exemptions.
- When information on a given tax program is not made available to the legislature, it can be assumed that the program functions as a huge subsidy. Furthermore, the executive and legislative branches should strive to strike a balance in the approach to considering whether a sunset provision is a tax increase. Without such cooperation, good tax policy, the principles of which are frequently invoked, will never be realized. Meanwhile, the state's resources are eroding. Above all, adequacy and sustainability should be considered in making changes to the tax system.
- Report compilers should explain why they decided that certain programs were not tax expenditures. Mr. Gleason replied that, in the future, compilers would delineate which programs are definitely tax expenditures, which are arguably tax expenditures — noting the arguments for and against that classification — and which are clearly not tax expenditures.
- The requirement for the provision of this type of information is not in statute. Since the governor has vetoed attempts to put this requirement in statute, the TRD should consider promulgating a rule to that effect. Secretary Padilla said that a statute authorizing rulemaking in that area would be required before such a rule could be properly promulgated.
- There seems to be a proliferation of nonprofit organizations, the definition of which is expressed in federal law. Some nonprofit organizations that appear to be financially prosperous might be abusing the state tax system by taking advantage of tax benefits associated with the "nonprofit" designation.

Senator Cisneros requested that the TRD prepare a list of credits, deductions and exemptions that are unused, unusable or archaic.

Effect of *Gillette* Litigation on New Mexico

Nelson Goodin, chief legal counsel, TRD, and Bruce J. Fort, counsel, Multistate Tax Commission (MTC), discussed with the committee a concern raised recently by the National Conference of State Legislatures (NCSL) in a letter that the NCSL sent to state leaders. Committee members received a copy of the letter and a memo from the MTC produced in response to the letter.

Mr. Fort remarked on some of the NCSL letter's content and stressed that its message sounds an unnecessary alarm. The letter suggests that, by joining the Multistate Tax Compact, states (including New Mexico) might have forfeited some of their right to determine how to tax corporations. This conclusion (presented to an NCSL task force by a law firm representing taxpayers) was based in part on ongoing litigation in California and other states. A critical difference between what was at issue in the California case — California's *mandate* that corporations calculate tax using a division-of-income formula different from the compact's formula provisions — and New Mexico's approach is that New Mexico allows corporations to elect to calculate tax by using either the compact's formula or New Mexico's heavily weighted sales factor alternative. Moreover, it is premature for state leaders to worry about the situation, given that court opinion on the subject remains unsettled.

Mr. Fort pointed out what he sees as other errors in the law firm's reasoning. The Multistate Tax Compact, unlike interstate water compacts, is not binding on its member states. Rather, the MTC makes rules that states can choose to adopt or not to adopt.

Although a state can withdraw from the compact at any time, Mr. Fort identified reasons New Mexico should not. The state relies on the audit program and other functions provided by the MTC. In the case of the audit program, the MTC performs work that, if performed independently by New Mexico, would be cost-ineffective because of the scale of the state. Of further benefit, the audit function allows the state to select which taxpayers to audit.

Senator Cisneros requested that the presenters continue to inform the committee about pertinent developments in the litigation.

Evaluating Tax Incentives for Jobs and Growth

Robert Zahradnik, director of state policy, state fiscal health and economic growth for The Pew Charitable Trusts (Pew), testified on Pew's recommendations, which derive from the findings of Pew studies, for states that offer tax incentives. (Corresponding reports are "Evidence Counts: Evaluating State Tax Incentives for Jobs and Growth" and "Avoiding Blank Checks: Creating Fiscally Sound State Tax Incentives".) Mr. Zahradnik furnished copies of his testimony, an accompanying slide handout and an overview of Rhode Island's plan for evaluating tax incentives.

Mr. Zahradnik noted that the studies' reports outline policies and practices that states can implement to ensure that those states: 1) have evidence of tax incentives' effectiveness; and 2) are properly managing the financial risks of tax incentives. Pew found that, in general, lawmakers make tax incentive-related decisions using unreliable information. Pew chiefly recommends that, instead, those lawmakers plan carefully to ensure fiscal soundness of a new or expanded tax incentive and that they routinely and rigorously evaluate the economic impact of tax incentives. Much of that planning should be directed toward making cost estimates of and putting limits on tax incentives.

Mr. Zahradnik discussed the principles behind Pew's recommendations and provided examples from some states that have put the principles to use. He noted that no state has yet mastered all of the principles, but some have been more successful than others.

In response to Mr. Zahradnik's presentation, committee members offered the following comments and questions.

- New Mexico is deficient in tax incentive reporting and in measuring effectiveness, in large part because of political interference with attempts to improve in those areas.
- New Mexico has made some progress toward the goals of improved reporting and effectiveness: the state has a requirement that tax incentive legislation name a purpose; a requirement that the Economic Development Department report on economic development incentives; and a push for a reporting requirement to attach to all new tax incentives.
- Sunset provisions on tax incentive legislation can deter businesses from coming to the state, since businesses seek predictability. Mr. Zahradnik replied that laws can be structured to grandfather in existing taxpayer beneficiaries in order to avoid having a tax benefit unexpectedly disappear.
- New Mexico's incentives should differ from those of neighboring states in order to reduce competition with those states.
- In designing tax incentives, policymakers should capitalize on New Mexico's labor force and natural resources.
- How can the economic impacts of a tax bill be accurately determined before that bill's passage, particularly given New Mexico's lack of access to sophisticated software systems? Mr. Zahradnik commented that most states do not have sophisticated analytical ability. Up-front evaluations are much more difficult than post-implementation evaluations of tax incentive measures. Even after tax incentives have been implemented, it is often difficult to determine program effectiveness. But states should nevertheless try to analyze effectiveness, even if only on the basis of a program's comparison with other state programs.
- What is involved in conducting an effective evaluation system? Mr. Zahradnik estimated that a system to analyze effectiveness of economic development tax incentives requires two to three full-time employees. It takes approximately three to five years after a program has been implemented to gather the data needed for effective evaluation. A member expressed willingness to support directing more resources to the TRD for this purpose.
- How do other states that offer tax exemptions gather relevant data for analysis, since those who benefit from exemptions do not have to report relevant data? Do they employ extrapolation methods? Mr. Zahradnik replied that states often get information by conditioning receipt of a benefit on reporting, although there is seldom an incentive for businesses to report accurately. Extrapolation methods are helpful and probably used in other states.
- Are there tax incentive programs identified as having generally succeeded or failed, so that states could use such a list in determining what to employ? No, replied Mr. Zahradnik, but some programs — such as those affecting the film industry and enterprise zones — have been studied more than others. Pew has not drawn any conclusion on the matter. Work on the matter done by others, though not definitive, presents some findings from which one could draw conclusions.

Capital Outlay Process: Concerns and Options for Improvement

Linda Kehoe, principal analyst, Legislative Finance Committee (LFC), brought to the committee's attention issues in local capital outlay funding and options for improving the funding process. Mr. Gleason spoke about the capital outlay process's effects on the development of water systems. Debbie Romero, bureau chief, Department of Finance and Administration (DFA), was in the audience and offered input on certain topics relevant to the DFA.

Ms. Kehoe provided background and elaborated on those issues. Post-recession efforts to recover unspent money appropriated for local capital outlay projects shed light on the need for more careful scrutiny of local project planning, funding and progress. Between 2002 and 2008, the legislature authorized over $3 billion for more than 14,500 local projects. In 2008, $670 million dedicated to almost 3,000 projects went unspent; and so in 2010, over $280 million of that sum was redirected to the general fund. Since 2012, when capital outlay funding resumed, the legislature has authorized $168.8 million for almost 1,200 local projects. The governor vetoed $25 million for 264 of those projects, reasoning that the earmarks were for projects with little or no vetting and that many of those appropriations covered less than 10% to 20% of the projects' costs.

Ms. Kehoe referred to Exhibit A of her handout, a sample list of 2012 and 2013 projects that she said appear to be significantly underfunded. She commented that if no local, federal or other-source money matches the state appropriations, the appropriations will remain unexpended or recipients might expect the state to provide future appropriations to make up the balances. A committee member inquired whether it was known that those projects were to be funded by other sources. Ms. Kehoe responded that the LFC does not have this information, but that it could attempt to get it. Ms. Romero indicated that the DFA has collected some of that information. Committee members emphasized the importance of the timely relaying of that information to legislators so that they can make better informed project-sponsorship decisions. They also expressed a need to follow through on information collection so that legislators could track whether funding from those other sources materialized.

Ms. Kehoe reviewed Exhibit B of her handout, which outlines the nature of the capital outlay problem, details of the challenges inherent in the problem and changes proposed to improve the situation. She noted that none of those changes would dilute the legislature's authority to review and advance projects for funding. One proposed change, which would be enacted through legislative rule and would provide that an interim committee vet projects for the full legislature's consideration, provoked a committee member to suggest that the fairness of that proposal might be compromised by political interference. Mr. Gleason responded by citing examples of other, similar processes that serve as examples in which such a concern is largely unwarranted.

Mr. Gleason described the major challenges to coordinating resources for maximizing efficiency in the funding of local water-related capital projects, and he offered a non-comprehensive list of the funding sources available to various types of entities. In short, decision-making authority is spread among many funding-source entities. Those entities' priorities conflict, and their processes are not mutually aligned. In most cases, no one source has enough money to fully fund any one project. State programs are not coordinated for applicant ease, and local, state and federal governments do not function in unison to ease project implementation. As an example, Mr. Gleason cited a situation in which Silver City-area local governments agreed many years ago to collaborate on a wastewater project. As a result of some of the inefficiencies that Mr. Gleason had described, payment for the project came over time from various sources. Inflation then drove up the project's cost by several times its initial cost, and the community's enjoyment of the project's benefits were unnecessarily delayed for 10 years. Mr. Gleason pointed to another sample result of the situation: last year, millions of dollars in loans and grants available to the state through the United States Department of Agriculture rural development program were not used, despite the great need for rural development.

Committee members made the following comments and received the following responses.

- The capital outlay system is dysfunctional, unfair and in need of an overhaul. The time it takes for a project to be fully funded leads to its obsolescence, cost inflation and a delay in the realization of its benefits. Money tied up in unused appropriations exacerbates the problem.
- New Mexico's capital outlay process is ranked low compared with other states. The state should look at other states' approaches to glean ideas for improvement.
- Some local governments are not contributing enough of their existing resources. Bill Fulginiti, executive director of the New Mexico Municipal League (NMML), noted that many local governments are bearing a substantial share of debt for capital projects.
- The impetus and a specific approach for systemwide change should originate in the executive branch, because it is a high level of government. Ms. Romero noted that leaders in the executive branch are trying to address some of the problems and that the process for water-related projects has improved because relevant agencies collaborate to prioritize projects for funding. She suggested that a similar approach be used for other types of projects. A member commented that having state agencies work together has delayed some projects and interfered with the paramount goal of prompt execution.
- The current policy surrounding state funding for nonprofit organizations seems inconsistent with past practices. There should be more consistency in this area. Ms. Romero responded that the DFA relies on bond counsel for guidance as to what projects can be lawfully funded. Ms. Kehoe added that, in the past, the policy around funding for nonprofit organizations was loose. Then rating agencies and the State Board of Finance raised concerns, which led to the tightening of the policy.

Approval of Minutes

Upon a motion made and seconded, the minutes of the September RSTP meeting were approved without change.

Heritage Series License Plates, House Bill (HB) 625 (2013)

Representative Lewis, who was joined by Mark Williams, director of the Motor Vehicle Division (MVD) of the TRD, and Mac Lewis, MVD policy and procedure manager of the TRD, discussed the possibility of adding a "heritage" series of license plates to the existing set of license plate choices. Representative Lewis, who introduced the bill in the last session, brought it to the committee at the recommendation of the House Transportation and Public Works Committee. He named four key aspects of the plates: 1) they promote tourism by highlighting notable aspects of the state's history and character; 2) their simple designs improve readability for scanning devices used by law enforcement personnel; 3) they are cost-effective and feasible to produce on an on-demand basis; and 4) they can be personalized.

In response to questions posed by committee members, Mr. Williams clarified some aspects of the proposal. The bill would not diminish the existing spectrum of available plates. It also would not impose an added fee for the benefit of any organization, as many existing license plate options do. A committee member commented that part of the point of many special license plates is to generate revenue for certain causes.

Committee members offered the following suggestions for revising the bill:
- require that the plates be produced in the United States; and
- curtail the proliferation of proposed plate designs brought to the legislature for its approval, create broad design criteria and authorize the MVD to promulgate rules through which plate design options are created.

Senator Cisneros directed Representative Lewis to continue work on the bill and to bring it to a future meeting.

Recess

The committee recessed at 5:15 p.m.

Tuesday, October 22

The committee reconvened at 9:09 a.m. on Tuesday, October 22, 2013, with Senator Cisneros chairing the meeting.

Local Government Legislative Priorities

Mr. Fulginiti and Tasia Young, legislation liaison for the New Mexico Association of Counties (NMAC), talked about municipal and county priorities for the next legislative session.

Referring to a handout on the topic, Ms. Young cited and briefly described five tax-related issues and corresponding measures that the NMAC will pursue in the 2014 legislative session. Discussion on the topics ensued. Ms. Young described, and the committee discussed, those issues as follows.
- Property Tax Equity — The NMAC will promote a bill from the 2013 legislative session, as that bill was amended by the House Taxation and Revenue Committee, that will do away with tax "lightning" and improve equity, transparency and ease of understanding in the property tax system. A committee member remarked that the current system was adopted, in part, with the support of county commissioners and assessors.
- Real Property Sales Disclosure — The measure, also introduced in the 2013 legislative session and which will be reintroduced in its amended form in the upcoming legislative session, would provide for the disclosure to a county assessor

(not a clerk, so as to remain confidential to the public) of sales data for all but some real property. Not included is agricultural land because, Ms. Young explained, cattle growers as a group opposed that inclusion. One committee member commented that their noninclusion would seem to invite more government intrusion, since assessors would be required to conduct site visits in order to conduct assessments. Another committee member responded that assessing agricultural land is a complex undertaking for which the state lacks expertise. Referring to sales of subsurface mineral rights — the other proposed exclusion — Cline Ward, a lobbyist in the audience, articulated that assessments are based on factors other than market value.

- <u>Delinquent Property Tax Payments and Delinquent Property Tax Lists</u> — County treasurers have requested changes to improve the efficiency and effectiveness of collecting delinquent property tax payments. The NMAC has met with the TRD on these issues, but the entities have not reached consensus on how to address the matters.
- <u>County Correctional Facility Gross Receipts Tax</u> — The measure would increase the existing county local option gross receipts tax for county correctional facilities. The remainder of the handout provided a chart that illustrated what Ms. Young characterized as the complexity of the county gross receipts tax system. A committee member commented that the counties need the increase — or some alternate source of increased revenue, such as a federal per diem for housing out-of-state prisoners — in part because the state has cut back its appropriations to counties for correctional facility-related costs.

Ms. Young added that two non-tax items, notice of liens and Medicaid benefits suspension, are issues that the NMAC also wishes to address in the upcoming legislative session. The Medicaid benefits suspension issue concerns hospital funding; the NMAC is working with the Human Services Department to ensure that Medicaid benefits are suspended, not terminated, when people are incarcerated in county detention centers.

Mr. Fulginiti indicated that the NMML board of directors met recently to discuss the NMML's priorities for the next session. Those priorities include: 1) addressing some implications of the prior session's HB 641; 2) encouraging the reimposition of a local tax on food, a measure that 67 of 68 municipalities voted to support; and 3) examining the state's tax expenditures, particularly those that are part of the gross receipts tax system. Elaborating on the third priority, Mr. Fulginiti indicated that the many state credits, deductions and exemptions offered as tax relief have hurt local governments.

Mr. Fulginiti explained another issue for municipal governments — tax distribution take-backs by the TRD — and referred to a bill draft, distributed to the committee, that the NMML is using in conversations with representatives from the TRD in an effort to reach consensus on an approach to the situation. Sometimes, the calculation of a local government's share of tax revenue is corrected after a distribution has been made. If there was an overpayment, the TRD takes the money back. The law does not require that notice be given. Some adversely affected local governments have pursued litigation, but the courts have not squarely resolved the issue.

Hold Harmless Changes

Mr. Fulginiti and Peter van Moorsel, chief economist, LFC, spoke about the recent changes to the hold harmless laws, which are embodied in HB 641 (2013).

Mr. Fulginiti cited local governments' chief concerns about the most recent legislative changes to the hold harmless provisions and referred to a table that shows how the new law, had it been in place in 2012, would have affected counties and municipalities. In allowing municipalities and counties to impose an up to 3/8% gross receipts tax increase, the law creates winners and losers among the 21 municipalities whose hold harmless distributions will be phased out. Eleven of those municipalities face a situation in which, even if the municipality imposes the full increase, that imposition would yield less revenue than under the original hold harmless provisions. The prospect of raising the tax rate concerns some municipalities: it might be politically difficult, it might drive consumers from the area, or both. For instance, if Gallup and McKinley County imposed the maximum rate increase, then the gross receipts tax rate on sales in Gallup would exceed 9%, a factor that might induce people to shop in neighboring towns or in Arizona, thereby reducing the tax base and hampering the local economy.

Mr. van Moorsel summarized options, outlined in a memo to the committee, that the LFC generated in response to concerns voiced by parties in a recent meeting on the topic of the hold harmless provisions changes. Lawmakers could enact measures, as outlined, to address issues such as: "stacking", in which a municipality within a county imposing the increase could also impose the increase and drive the rate up by as much as 3/4%; windfalls to local governments resulting from their taking advantage of timing differences between the tax imposition and the hold harmless phaseout; and the lack of a requirement for referendum.

Committee members expressed the following reactions to the hold harmless provisions changes and to the presenters' comments.

- The intent of the law is to give local governments a way to offset losses from the phase out, not to generate windfalls.
- Given that revenues from oil and gas production have waned and food prices are inflating, had lawmakers not amended the hold harmless provisions, the state would have born a growing financial burden. That burden would have resulted in cuts to education funding.
- It is lamentable that the state forfeited a stable portion of the tax base when it exempted food sales.
- By not putting the tax increase issue to a referendum, the taxes are less stable. That is, they are subject to the whim of local government leaders. Those leaders move in and out of office.
- Many local governments are waiting to see whether lawmakers further adjust relevant provisions before they act within their powers under existing law.

A committee member expressed an interest in knowing the likely fiscal impact of the combined reporting provision and other aspects of HB 641 in order to better analyze the bill in its full context. Ms. Walker-Moran offered that the fiscal impact report on the bill suggests that the combined reporting measure will initially increase revenue, but that that revenue will taper off as companies adjust in an effort to keep their tax payment obligations to a minimum. Senator Cisneros requested that this information be reviewed at in the next meeting.

Senator Cisneros directed staff to work with Mr. Fulginiti and others to seek input from TRD and the LFC staff and to bring draft legislation to an upcoming RSTP or LFC meeting for committee consideration.

Compensating Tax Deduction — Equipment Used in the Production and Processing of Chile

Charlie Marquez, lobbyist, brought to the committee a draft of a bill that would create a three-year deduction from the gross receipts and compensating taxes for the purchase of equipment used in the production and processing of New Mexico chile. A version of the bill has been introduced in past sessions and was endorsed by the RSTP last year. The current version has an added section that would allow the TRD to reveal taxpayer-related information for the purpose of reporting to the RSTP and the LFC. Mr. Marquez indicated that a sponsor has agreed to introduce the current version of the bill at the next session and that Mr. Marquez would seek the committee's endorsement of the bill at the committee's next meeting.

Adjournment

There being no further business, the RSTP adjourned at 12:02 p.m.

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

December 17-18, 2013
Room 307, State Capitol
Santa Fe

The sixth meeting of the Revenue Stabilization and Tax Policy Committee (RSTP) was called to order by Senator Carlos R. Cisneros, chair, on Tuesday, December 17, 2013, at 10:10 a.m. in Room 307 of the State Capitol in Santa Fe.

Present
Sen. Carlos R. Cisneros, Chair
Rep. Edward C. Sandoval, Vice Chair
Sen. Sue Wilson Beffort
Rep. Anna M. Crook
Rep. Brian F. Egolf, Jr.
Sen. Timothy M. Keller (12/18)
Rep. Rodolpho "Rudy" S. Martinez
Sen. Mark Moores
Sen. Clemente Sanchez
Sen. William E. Sharer
Sen. John Arthur Smith
Rep. James R.J. Strickler
Rep. Thomas C. Taylor
Rep. Jim R. Trujillo
Sen. Peter Wirth
Rep. Bob Wooley

Absent
Rep. Henry Kiki Saavedra
Sen. Lisa A. Torraco

Designees
Rep. Ernest H. Chavez (attending as a guest 12/17)
Rep. Jason C. Harper (attending as a designee 12/17 and as a guest 12/18)
Rep. Sandra D. Jeff (attending as a guest 12/17)
Rep. Bill McCamley (attending as a guest 12/18)
Rep. Debbie A. Rodella (attending as a guest 12/18)
Sen. Nancy Rodriguez (12/17)

Rep. Donald E. Bratton
Sen. William F. Burt
Sen. Jacob R. Candelaria
Rep. Miguel P. Garcia
Sen. Phil A. Griego
Sen. Gay G. Kernan
Rep. Tim D. Lewis
Sen. George K. Munoz
Rep. Paul A. Pacheco
Rep. Dennis J. Roch
Sen. John M. Sapien
Sen. Pat Woods
Rep. Carl Trujillo (attending as a guest 12/17)
Rep. Luciano "Lucky" Varela

Guest Legislator
Rep. Roberto "Bobby" J. Gonzales

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

Staff
Pam Stokes, Staff Attorney, Legislative Council Service (LCS)
Amy Chavez-Romero, Assistant Director for Drafting Services, LCS
Tessa Ryan, Staff Attorney, LCS
Jennifer Dana, Intern, LCS

Guests
The guest list is in the meeting file.

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

Tuesday, December 17

Approval of Minutes
Upon a motion made and seconded, the minutes of the October meeting were approved.

Revenue Forecast
Leila Burrows, chief economist, Department of Finance and Administration, Peter B. van Moorsel, chief economist, Legislative Finance Committee (LFC), and Elisa Walker-Moran, chief economist, Taxation and Revenue Department (TRD), spoke about the consensus revenue estimating group's December 2013 consensus revenue estimate.

Mr. van Moorsel, referring to a handout distributed to the committee, summarized the group's major findings and revisions to the revenue outlook. He remarked that gridlock in Congress, federal sequestration and changes in energy prices have affected, and are predicted to continue affecting, revenue generation.

Ms. Walker-Moran and Ms. Burrows, referring to a separate handout distributed to the committee, expanded on Mr. van Moorsel's commentary. Ms. Walker-Moran reviewed some trends in gross receipts tax revenues, particularly those driven by the phase-out of hold harmless payments, federal budget austerity, payroll tax cuts, the spike in high-wage jobs tax credit claims, the rollout of the new federal health law, changes in personal and corporate income tax collection levels and changes in oil and gas production and prices. Ms. Burrows highlighted some forecast risks and gave an update of the general fund's status and details of the fund's reserves. She also spoke briefly about the estimated authorized bonding capacity.

Committee members' questions and comments and the presenters' responses to them are summarized as follows.

- Will oil production increases in Mexico and other foreign countries drive down oil prices, thereby decreasing state revenues? Ms. Burrows speculated that such foreign activity would reduce the price, but likely not dramatically.
- Why is revenue from the "Professional, Scientific and Technical Services" category trending low? Ms. Walker-Moran responded that the indicator reflects a decline in federal contract spending.
- Would Congress' reaching a budget deal improve economic indicators? Mr. van Moorsel prefaced his answer by saying that forecast data were compiled before the deal was proposed, and so the prospect of its realization was not considered when the forecast was developed. He answered that the deal, if made, would likely increase revenue generation.
- With general fund reserves at between 9% and 10% of the budget — about $500 million — and evidence of recovery, a state the size of New Mexico could consider tapping some of its savings for use by the private or public sector. Mr. van Moorsel explained that the official target for reserves is set at around 10% because the state is so heavily dependent on volatile revenue sources. David Abbey, director, LFC, who was in the audience, articulated more reasons that the state should aim for that approximate level of reserves.
- What explains the increases in gross receipts tax revenue from the manufacturing and construction sectors? Ms. Burrows said that part of the increase in revenue from the manufacturing sector results from a tax-liability shift to utility companies. Ms. Walker-Moran attributed the increase in construction-sector revenue in part to that sector's post-downturn recovery.
- Are protests of denials of high-wage jobs tax credit claims likely? Ms. Walker-Moran said that the TRD is in the process of reviewing claims, that many claims are being denied and that protests will likely follow.

Attorney General Opinion No. 13-03: May the Governor Unilaterally Withhold a Capital Outlay Appropriation Made to an Agency by the Legislature?

Albert J. Lama, chief deputy attorney general, reviewed a recently issued attorney general opinion on the question of whether the governor may unilaterally withhold a capital outlay appropriation made to an agency by the legislature. Copies of the opinion were distributed to the committee.

Mr. Lama summarized the legal precedent relevant to the question and the reasoning that formed the basis of the conclusion, which is that the governor violated the separation of powers doctrine by withholding capital outlay appropriations that were properly appropriated by the legislature. In response to questions by committee members, Mr. Lama remarked that the issue: 1) could likely be pursued in court if certain requirements were met; and 2) did not involve the question of a governor's authority to veto an appropriation. Members commented that: 1) rather than attempting to bind agencies after appropriations were made, the governor could have vetoed projects and stayed within her authority; 2) project-related audits are worthwhile, and legislators who request funding for particular capital outlay projects should investigate whether appropriate audits have been performed and have yielded positive findings; and 3) this request for and the rendering of an opinion might have the unintended consequence of provoking the governor to veto more appropriations in the next cycle. In response to a question, Pam Ray, contract worker, LCS, said that she believed that the new capital outlay form will have a question asking whether audits for a recipient agency are current. In closing, Mr. Lama commented that the legislature could, if it wished, incorporate terms of the executive order into either a particular appropriation or, by passing an all-encompassing law, all future capital outlay appropriations.

Retiree Program Solvency Report

Wayne Propst, executive director, Public Employees Retirement Association (PERA), gave a presentation on the status of the public employee retirement program, information on which was contained in a handout and distributed to the committee.

Mr. Propst highlighted some key facts: 1) the PERA fund reached a high-water mark of nearly $14 billion in October and has stayed at that approximate level since then; 2) the PERA fund's investment gain for fiscal year (FY) 2013 was 13.26%; 3) recently enacted legislation that reduced the cost-of-living adjustment (COLA) for current and future retirees both reduced the PERA's unfunded liability and, beyond expectations, increased the funded ratio; and 4) all but the volunteer firefighters plan, which is still well funded but which saw a decrease in funding due to a law modestly increasing the benefit, experienced an increase in the funded ratio. Mr. Propst directed the committee's attention to charts showing a 40-year projection of the overall PERA funded ratio, with and without the enactment of pertinent 2013 legislation, and a 40-year projection for each PERA division. He detailed reasons that the PERA board is optimistic, but cautious, in thinking about long-term solvency. Lastly, he presented information on FY 2013 data, including: PERA's obligations; average annual pension amounts and ages at retirement; and payroll by county.

Committee members' questions and comments and Mr. Propst's responses to them are summarized as follows.

- Why is the average retirement age for municipal police and firefighters significantly lower than in the other divisions? Those employees were eligible to retire after 20 years of service. Eligibility for them now begins at 25 years.
- Does PERA intend to support legislation in the next session? Yes, it will support revisions to the judicial and legislative plans. Before making changes to the overall PERA plan, the board will wait to see the impact of 2013 legislation.
- Will the legislative changes to the firefighter plan continue to decrease the funded ratio? Most likely, the ratio will be greater than 100% for the foreseeable future, but the plan's provisions might need to be adjusted to ensure solvency.
- Is the average retirement age expected to increase? Yes.
- Rapid fluctuations in the stock market would seem to put expectations at risk. Mr. Propst responded that analysts use a "smoothing period" to account for losses and gains, but nevertheless, investment insecurity is a reason to exercise caution and to determine whether targeted assumptions are met before requesting a further change in law.
- Should the COLA be tied to a cost-of-living index? The board has concluded that it is better to have a fixed COLA than one that fluctuates.
- How will the Governmental Accounting Standards Board's (GASB's) new reporting requirements change current practices? They will change what may be used as a discount rate for actuarial purposes. Also under the new rules, funding entities will have to report their net pension liability more prominently.
- The recently enacted changes have helped to satisfy a long-standing need.

A member requested that in the future, the map showing payroll by county include the number of retirees in each county.

How Tax Policy Can Be Used to Improve Child Well-Being

James Jimenez, director of policy, research and advocacy integration, New Mexico Voices for Children (VFC), and Bill Jordan, senior policy advisor, governmental relations, VFC, talked about how tax policy affects child well-being in New Mexico. Handouts entitled "Tax Policy & Child Well-Being", "New Mexico State & Local Taxes", "Working Families Tax Credit" and "NM KIDS are COUNTing on Us: A Policy Agenda for a Better New Mexico" were distributed to the committee. In addition, individualized handouts showing how much money is channeled to particular districts by the federal earned income tax credit and the state working families tax credit programs were distributed.

Referring to the first handout, Mr. Jimenez cited reasons for New Mexico's consistent ranking at the bottom of states in child well-being and remarked that some factors contributing to the low ranking are beyond the legislature's control. He said that the presentation would focus on one of four domains related to the ranking — of economic well-being — and the indicators that define it. Income inequality, which he said will always exist but has grown, worsens when government structures reward the highest earners. Mr. Jimenez stressed that the state's tax system is regressive.

Mr. Jordan continued the presentation by citing LFC-identified tax policy principles, noting that "adequacy" and "equity" have the greatest potential, when applied, to improve child well-being. With improved adequacy, more resources are available to fund education, health care and other services that help children. Mr. Jordan commented that the recession caused a scaling back of funding for those types of programs. He asserted that some ways for the state to improve adequacy and equity are to: 1) increase the working families tax credit, which would cost the state about $23 million; 2) repeal the 50% capital gains deduction; 3) impose a 5.9% personal income tax rate on high-income earners; and 4) mandate combined reporting for all corporate filers. VFC further supports the enactment of a tax expenditure reporting requirement to enhance transparency and accountability in the tax system.

Questions and comments from committee members included the following.

- Which taxes are most regressive? Mr. Jimenez indicated that reducing the gross receipts tax rate would most effectively moderate overall tax regressivity.
- All policymakers have the goal of helping the poor; the debate centers on how best to accomplish that goal. Often, proposals intended to increase the burden on the rich and to ease the burden on the poor would, if implemented, invite unintended consequences. The capital gains deduction is an example of a program that, if eliminated, would deter people from selling their businesses in the state and deprive the state of those corresponding tax payments.
- Tax revenues derive from private-sector economic activity, which should be encouraged. Further, the state's tax system is too complicated, and there is too much government

regulation. These circumstances deter private-sector economic activity and, thus, dampen potentially robust tax revenues.

- If there were more wealthy people, there would be more tax revenue. With more revenue, there would be more programs to support low-income children.
- A competitive business environment would help children by encouraging job creation.
- This committee is nominated to focus on revenue stabilization, which is synonymous with predictability, reliability and planning. States that have been too progressive in their tax policy have experienced resulting economic downturns. Much of the state population is in the throes of poverty and relies on entitlement benefits, which cost the state heavily. Nevertheless, New Mexico has managed, among other achievements, to avoid a reduction in force of its public employees because it has a broad-based tax policy that is neither too regressive or progressive. The key to this juggling of resources and needs is balance. In the quest for revenue stabilization, revisions to all taxes should be considered.

Status Report of the Proposed Navajo Compact

Ben Shelly, president, Navajo Nation, and LoRenzo Bates, delegate, Navajo Nation Council, addressed the committee. Each spoke from a prepared statement distributed to committee members. Materials related to the Navajo Nation-proposed gaming compact with the state were also distributed to the committee.

Following the formal presentations, committee members asked for clarification on certain points raised by President Shelly and Mr. Bates, including the status of negotiations between the Navajo Nation and the state and on matters that the interim Committee on Compacts will address. The presenters and certain committee members who also serve on the Indian Affairs Committee offered information on developments that were reported to that committee. Derrick Watchman, chief executive officer, Navajo Nation Gaming Enterprise, who was in the audience, addressed the committee in response to some of the questions raised.

Recess

With no further business for the day, the meeting recessed at 4:40 p.m.

<u>Wednesday, December 18</u>

Senator Cisneros reconvened the meeting at 9:16 a.m.

Tax Reform Study

Senator Sharer and Representative Taylor presented to the committee for its consideration a draft bill that would provide funding for experts to conduct a tax reform study. Accompanying their presentation was a handout with a table that outlines many of the state's tax exemptions, deductions and credits. The legislation proposes that experts study and develop recommendations for a tax policy that is simpler and fairer for taxpayers and that makes the state more competitive.

Hold Harmless Gross Receipts Tax and Distribution Changes

Representative Harper, Bill Fulginiti, executive director, New Mexico Municipal League, and Tasia Young, legislation liaison, New Mexico Association of Counties, discussed proposed changes to the hold harmless provisions and provided handouts illustrating aspects of the discussion.

Representative Harper presented for the committee's consideration proposed legislation that would reduce the amounts that local governments can collect from the hold harmless distributions and gross receipts taxes. Mr. Fulginiti presented a draft bill that would adjust the hold harmless distributions to municipalities and counties.

A motion to endorse both bills in concept and with the understanding that work on them would continue was made and seconded. With three members in opposition, the motion passed.

Separate Reporting of Certain Gross Receipts and Compensating Tax Deductions and Exemptions

Representatives Harper and McCamley presented a draft bill for the committee's consideration that would require separate reporting of certain gross receipts and compensating tax exemptions and deductions and sunset procedures for certain of those provisions. A handout showing exceptions to the separate-reporting requirement that are reflected in the bill was distributed to the committee. Senator Keller presented a draft bill that would require separate reporting of certain gross receipts and compensating tax exemptions and deductions. The proposed legislation presented by Representatives Harper and McCamley was endorsed, and Senator Keller's proposed legislation was removed from consideration.

Legislative Proposals: Reporting Requirements; Changes to Working Families Tax Credit and Capital Gains Deduction; and State Graduate Employment Tax Credit

Senator Keller presented a draft joint resolution that would propose a constitutional amendment requiring the annual preparation of a tax expenditure report.

Senator Keller also presented two bills for the committee's consideration: one that would require the TRD to promulgate rules for reporting tax expenditures and one that would increase the working families tax credit and repeal the capital gains deduction. A motion to endorse the first bill was made and seconded. With two members in opposition, the proposed legislation was endorsed by the committee. A motion to endorse the second bill was made and seconded. With six members in opposition, the proposed legislation was endorsed by the committee.

County Government Legislative Proposals

Ms. Young, who was accompanied by Clyde Ward, assessor, San Juan County, and Steve Harris, treasurer, Chaves County, presented two bills for the committee's consideration: one that would address the limitation on increases in valuation of residential property and one that would clarify that a county retains payment of delinquent taxes, penalties and interest for property that is delinquent for two years or less. A motion to endorse the first bill was made and seconded. With three members in opposition, the proposed legislation was endorsed by the committee. A motion to endorse the second bill was made and seconded. With no opposition, the proposed legislation was endorsed by the committee.

Capital Outlay Planning and Monitoring Act

Linda Kehoe, principal analyst, LFC, presented proposed legislation that would increase fiscal and programmatic scrutiny of capital outlay expenditures. Handouts accompanying her presentation — a fiscal impact report and attachments outlining the reasons for and aspects of the legislation — were distributed to the committee. To allow for the legislation to be introduced in both houses, no endorsement was sought.

Endorsement of Legislative Proposals

The committee reviewed for endorsement the following bill drafts.

1. This proposal was removed from consideration.

2. Hold Harmless Gross Receipts Tax and Distribution Changes. ENDORSED, Representative Harper to sponsor.

3. Adjustments to the Hold Harmless Distributions to Municipalities and Counties. ENDORSED.

4. Require Separate Reporting of Certain Gross Receipts and Compensating Tax Exemptions and Deductions; Sunset Certain Gross Receipts and Compensating Tax Exemptions and Deductions. ENDORSED, Representative Harper to sponsor.

5. This proposal was removed from consideration.

6. This proposal was removed from consideration.

7. Require the Taxation and Revenue Department to Promulgate Rules for Reporting Tax Expenditures. ENDORSED, Senator Keller to sponsor.

8. Changes to Working Families Tax Credit and Capital Gains Deduction. ENDORSED, Senator Keller to sponsor.

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

10. Changes to the Limitation on Increases in Valuation of Residential Property. ENDORSED, no sponsor identified.

11. Require Affidavits to Be Filed with County Assessors for Real Property Sold in the Counties. ENDORSED, no sponsor identified.

12. Clarify That Payment of Delinquent Taxes, Penalties and Interest for Property That is Delinquent for Two Years or Less Be Retained by the County. ENDORSED, Representative Martinez to sponsor.

13. This proposal was removed from consideration.

14. Determine In-State Sales of Intangibles and Services. ENDORSED, Senator Wirth to sponsor.

15. This proposal was removed from consideration.

16. Require the Valuation of Residential Property at Current and Correct Value for Property That Changes Ownership on or After January 1, 2015. ENDORSED, Representative Egolf to sponsor.

17. Increase the Working Families Tax Credit to 15% of the Federal Earned Income Tax Credit. ENDORSED, Representative Sandoval to sponsor.

18. Deduction for Receipts for Durable Medical Equipment and Medical Supplies. ENDORSED, Representative Jim R. Trujillo to sponsor.

19. This proposal was removed from consideration.

Adjournment

There being no further business, the committee adjourned at 12:45 p.m.

LEGISLATIVE PROPOSAL CHART

Bill #	202#	Description	Agency	Endorsement & Sponsor
1	195102.2	Tax Reform Study	Sen. Sharer / Rep. Taylor	Withdrawn
2	195161.9	Hold Harmless GRT and Distribution Changes	Rep. Harper	**ENDORSED / REP. HARPER**
3	195301.2	Adjustments to the hold harmless distributions to municipalities and counties	New Mexico Municipal League	**ENDORSED / TBD**
4	194886.1	Require separate reporting of certain gross receipts and compensating tax exemptions and deductions; Sunset certain gross receipts and compensating tax exemptions and deductions; Appropriate $500,000 to the Taxation Revenue Department	Rep. Harper / Rep. McCamley	**ENDORSED / REP. HARPER**
5	194648.1	Require separate reporting of certain gross receipts and compensating tax exemptions and deductions	Sen. Keller	Withdrawn
6	194942.2	Constitutional amendment requiring a Tax Expenditure Report	Sen. Keller	Not Endorsed
7	194941.1	Require the Taxation and Revenue Department to promulgate rules for reporting tax expenditures	Sen. Keller	**ENDORSED / SEN. KELLER**
8	194537.3	Increase the Working Families Tax Credit and limit the capital gains deduction against income tax	Sen. Keller	**ENDORSED / SEN. KELLER**
9	194917.1	State Graduate Employment Tax Credit	Sen. Keller	**ENDORSED / REP. SANDOVAL**
10	195155.1	Changes to the limitation on increases in valuation of residential property	New Mexico Assoc. of Counties	**ENDORSED / TBD**
11	195158.1	Require affidavits to be filed with county assessors for real property sold in the counties	New Mexico Assoc. of Counties	**ENDORSED / REP. WOOLEY**
12	195160.3	Clarifying that payment of delinquent taxes, penalties and interest for property that is deliquent for two years or less be retained by the county	New Mexico Assoc. of Counties	**ENDORSED / REP. R. MARTINEZ**
13	195017.4	Capital Outlay Planning and Monitoring Act	Committee	Not Endorsed
14	194793.2	Determining in-state sales of intangibles and services	Sen. Wirth	**ENDORSED / SEN. WIRTH**
15	195236.1	Reduce the amount of certain short-term supplemental severance tax bonds that may be issued	Rep. Taylor	Not Endorsed
16	194947.1	Requiring the valuation of residential property at current and correct value for property that changes ownership on or after January 1, 2015	Rep. Egolf	**ENDORSED / REP. EGOLF**
17	195314.1	Increase the Working Families Tax Credit to 15% of the federal earned income tax credit	Rep. Sandoval	**ENDORSED / REP. SANDOVAL**
18	194706.2	Providing a deduction for receipts of certain taxpayers for durable medical equipment and medical supplies from gross receipts and governmental gross receipts	Dick Minzner	**ENDORSED / REP. TRUJILLO**
19	194912.1	Providing a deduction for chile equipment from the gross receipts tax and compensating tax	NM Chile Growers Association	Withdrawn