MINUTES
of the
THIRD MEETING IN 2011
of the
REVENUE STABILIZATION AND TAX POLICY COMMITTEE

August 25-26, 2011
Mid-Region Council of Governments
Albuquerque

The third meeting of the Revenue Stabilization and Tax Policy Committee (RSTP) for 2011 was called to order by Senator Tim Eichenberg, chair, on Thursday, August 25, 2011, at 9:43 a.m. in the board room of the Mid-Region Council of Governments (MRCOG) located at 809 Copper Avenue NW in Albuquerque.

Present
Sen. Tim Eichenberg, Chair
Rep. Edward C. Sandoval, Vice Chair
Sen. Mark Boitano (8/25)
Rep. Donald E. Bratton
Sen. Carlos R. Cisneros
Rep. Anna M. Crook
Sen. Clinton D. Harden, Jr.
Sen. Timothy M. Keller
Rep. Ben Lujan, Speaker of the House
Rep. Rodolpho "Rudy" S. Martinez
Sen. Howie C. Morales
Rep. Henry Kiki Saavedra
Rep. Thomas C. Taylor
Rep. Jim R. Trujillo
Rep. Bob Wooley (8/25)

Absent
Sen. Timothy Z. Jennings, Senate President Pro Tempore
Sen. Gay G. Kernan
Sen. John Arthur Smith

Designees
Sen. Rod Adair (8/25)
Sen. William F. Burt
Sen. Steven P. Neville
Sen. Nancy Rodriguez
Rep. Ray Begaye
Rep. Zachary J. Cook
Sen. Kent L. Cravens
Rep. Brian F. Egolf, Jr.
Rep. Miguel P. Garcia
Rep. Thomas A. Garcia
Rep. Roberto "Bobby" J. Gonzales
Sen. Eric G. Griego
Sen. Phil A. Griego
Rep. Sandra D. Jeff
Rep. Antonio Lujan
Rep. Antonio "Moe" Maestas

Sen. George K. Munoz
Rep. Debbie A. Rodella
Sen. Bernadette M. Sanchez
Sen. John M. Sapien
Sen. William E. Sharer
Rep. James R.J. Strickler
Rep. Don L. Tripp
Rep. Luciano "Lucky" Varela
Sen. Peter Wirth

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

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

Guests
The guest list is in the meeting file.

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

Thursday, August 25

Revenue Estimate
Demesia Padilla, secretary of taxation and revenue, Tom Clifford, tax policy director, Taxation and Revenue Department (TRD), and Elisa Walker-Moran, chief economist, Legislative Finance Committee (LFC), briefed the committee on the July 2011 consensus revenue estimate. The July estimate increased fiscal year 2011 revenue projections by $110 million, fiscal year 2012 revenue by $120 million and fiscal year 2013 revenue by $165 million. General fund revenue growth is expected to be five percent in each of fiscal years 2012 and 2013. The primary 2011 legislative change affecting revenues was the reduction of film production tax credits. The change in how much credit can be claimed per year is expected to increase revenues by $20 million annually. A sharp increase in film production tax credit claims at the end of fiscal year 2011 reduced that year's revenue by $40 million. Mr. Clifford said that the increase in revenue in fiscal years 2011 and 2012 is due to increased gross receipts tax (GRT) and oil and gas revenues. Fiscal year 2013 increases are expected to come from corporate income tax (CIT) revenue and from the oil and gas sector.

Mr. Clifford mentioned several developments since the July consensus revenue estimate that might indicate a slower-than-expected economic rebound, including that stock markets have fallen 15 percent recently and that crude oil and natural gas prices have fallen. However, employment growth has increased and corporate earnings for the latest quarter were higher than expected.

Ms. Walker-Moran reviewed the July 2011 consensus revenue estimate for the committee. She said that one risk to the consensus is that the state could lose up to $20 million annually if it is determined to not be in compliance with the tobacco manufacturers' Master Settlement Agreement (MSA). She said that the consensus economists are fairly confident that fiscal year 2012 revenues will exceed the budgeted amount for the year. For fiscal year 2011, May and June accrual amounts indicate that GRT revenue may exceed the July estimate by $21 million, and the total revenue for that fiscal year may be as much as $40 million higher than previously estimated.

Questions and comments from committee members included the following:

- Did the consensus revenue estimate consider the negative multiplier effects of limiting the amount of film production tax credit? Mr. Clifford said that the multiplier effects of tax credits are not explicitly tracked, but state economists do track labor and industrial sector trends following important tax law changes.

- Will the extra public employee retirement contribution provided for in the 2011 legislative session be eliminated if the revenue estimate for fiscal year 2012 is good enough? Mr. Clifford said that may happen, which will add more expenses to the fiscal year 2012 budget.

- Why is New Mexico at risk for losing tobacco settlement revenue? Ms. Walker-Moran said that the state is facing its second legal challenge from the participating tobacco manufacturers, which are claiming that the state no longer has a valid statute to enforce the MSA.

- How will the administration's strategy of reforming the tax system achieve the goal of reaching a 10 percent appropriation reserve without providing for revenue enhancements? Secretary Padilla said that the administration is currently looking at tightening up some tax credits. Another option being investigated is to structure the tax credit system differently, such as providing competitive granting of tax credits based on job creation performance. More state revenue could also be allocated for business development efforts, which eventually provide more tax revenue to the state.

- The primary reason why businesses choose not to locate in New Mexico is because of the state's poor educational system, not because of the amount of business incentives provided.

- If the governor had not vetoed the 2011 bill to fix the escrow provisions relating to cigarette sales, would the state still have been at risk of losing MSA revenue? Mr. Clifford said that TRD attorneys did not think that the governor's veto of that bill put the state at risk.

- The Tobacco Settlement Permanent Fund was included as a reserve fund for the general fund operating reserve several years ago, but that fund is really not a reserve. It can only be appropriated by the legislature. The actual general fund operating reserve is at about three percent of expenditures, not the nine percent figure used.

- LFC staff members were instructed to provide the committee with the actual costs of the retirement swaps enacted in recent years.

- The July revenue estimate does not show the $103 million Medicaid reimbursement the state might be required to make to the federal government. Mr. Clifford said that, for several years, the state's Medicaid reimbursement system has not tracked with the federal government's system.

- The large increase in CIT revenue confirms the trend that the rich are just getting richer and the poor and middle classes are getting poorer.

- A state employee recently reported that the Department of Finance and Administration (DFA) is now taking seven weeks to reimburse state employees for per diem and travel expenses. Secretary Padilla agreed that reimbursements are behind schedule. She said that she waited nine weeks for a travel reimbursement. Some employees qualify for per diem advance payments, she said.

State Road Fund Update

The committee heard a presentation from Department of Transportation (DOT) representatives regarding the status of the State Road Fund (SRF). Presenters included Alvin C. Dominguez, secretary of transportation, Tom Church, deputy secretary for business support, and Christian Sanchez, chief economist, DOT. Mr. Church said that revenues accruing to the SRF are expected to increase by $18 million in fiscal year 2013, the first increase in several years. The DOT is planning on budgeting all increases to the SRF toward highway operations. Gasoline tax revenues in fiscal year 2012 are expected to decline by $2.5 million, but weight distance and special fuel tax receipts have increased significantly.

Secretary Dominguez reported that federal transportation funding is currently authorized only through September 2011. There has been no transportation funding bill passed by Congress in two years, except for several continuing resolutions. He said that some congressional plans would reduce federal transportation funding by 37 percent, which would dramatically affect New Mexico's ability to maintain highway infrastructure. Since the state has annual bond payments of $122 million tied to federal funding, a 37 percent reduction in Federal Highway Administration funding would reduce the construction budget from $200 million to $112 million.

Questions and comments from committee members included the following:

- The SRF needs a dedicated revenue stream to address the poor road conditions in the state, but the current administration is opposed to any sort of tax increase. How much money does the state's road infrastructure need to become adequately maintained? Secretary Dominguez said that another looming problem is that the federal gasoline tax is due to expire September 30. The expiration of that tax would have huge consequences for New Mexico's transportation infrastructure. He mentioned that the SRF used to collect a portion of the revenue from the motor vehicle excise tax, but now it does not receive any portion of those receipts. Mr. Church said that the state needs approximately $11 billion to fix its road infrastructure problems.

- Has the congressional impasse of funding for the Federal Aviation Administration related to the subsidization of regional airports affected the DOT's operations at its airports? Mr. Church said that the Aviation Division of the DOT had put all of its pending contracts on hold until the funding issue had been resolved.

- Has the potential funding impasse for federal highways affected any DOT projects? Secretary Dominguez said that the DOT currently has several projects under way worth about $261 million. The department is still letting contracts for new projects until the federal government says otherwise.

Comments from Local Entities

Eric Baca of Intel briefly addressed the committee. He said that Intel is involved in pre-positioning future investments in New Mexico. There are no current plans to expand in the state, but Intel wants to be ready to act should the opportunity arise. Intel has major investments in many states, including New Mexico. He said that the three main incentives for future expansion are the regulatory environment, the quality of the work force and tax incentives provided by the state and by local governments.

Dewey Cave, executive director, MRCOG, welcomed the committee members to Albuquerque. He invited any legislative committee or group of legislators to use the MRCOG's offices for future meetings. He briefly described the activities of the MRCOG, including economic development, local government planning, water resource planning, work force development and local agricultural development, in addition to running the Rio Metro transportation system.

Tax Increment Development District Revenue Effects and Updates

The committee heard a panel discussion on tax increment development districts (TIDDs) in the state. Presenters included Mr. Clifford; Gilbert Montano, deputy chief administrative officer, City of Albuquerque; William Sletton, downtown development coordinator, Las Cruces; Emily Madrid, accounting manager, county treasurer's office, Bernalillo County; and Jacques Blair, economist, City of Albuquerque. Mr. Clifford began by discussing the criteria that need to be met in order for a TIDD to be created, including that it must serve the interests of the owners and residents of the district and also those of the municipality or county; that it support the governing body's efforts in job creation, work force housing, public school development and redevelopment of underdeveloped areas; and that it contribute to the long-term planning goals of the governing body. TIDDs are eligible for several types of tax increments, including several municipal and county GRTs, property tax and the state GRT. The TRD's role in TIDD administration is to establish location codes for TIDDs; to collect the GRT from businesses operating within a TIDD; and to distribute GRT revenue dedicated to a TIDD.

The TRD is currently tracking distributions for several TIDDs around the state. The Mesa del Sol TIDD began receiving GRT increments in 2008. Mesa del Sol receives 75 percent of the state GRT from the area included in the TIDD and 67 percent of some Albuquerque GRTs. Total distributions to the TIDD in fiscal year 2011 were $885,000. The downtown Las Cruces TIDD began in 2009 and receives 75 percent of state and local GRT increments from within the TIDD boundaries. This TIDD was set up to redevelop downtown Las Cruces, and it already had an existing GRT base. This made it somewhat more complicated for the TRD to calculate the distribution, since the TIDD is only designated to receive a portion of the new GRT revenue after the TIDD began. In the first year of operation, distributions to the TIDD were calculated based on an assumed growth rate. Since then, the actual base year period has been used to calculate the base amount.

There are three TIDDs located in the Winrock/Quorum area of Albuquerque. The Winrock 1 and 2 TIDDs have not had very much activity thus far, but they are scheduled to begin activity in the near future. The Quorum TIDD has had a change of plans, and the property is now slated to be sold for the construction of a Target store. Although $470,000 has already been distributed to the TIDD, the change in purpose for the property raises serious questions about its viability. Finally, the Village at Rio Rancho TIDD, which began in 2010, has received $107,000 in tax increment distributions.

Mr. Montano discussed the TIDDs in Albuquerque and said that Mesa del Sol has received $5.3 million in tax increment revenues and created 2,000 new jobs in the area. The Winrock TIDDs are still viable, but development has been delayed by the economic downturn the past few years. The biggest problem for the city has been the Quorum TIDD, which is now destined to become a Target retail store rather than the original plan of a 785,000-square-foot mixed retail and hotel development. The city is questioning whether the Quorum TIDD should be dissolved.

Mr. Sletton discussed the progress of the downtown Las Cruces TIDD, which is the first project in the state for the revitalization of a downtown district. The Las Cruces downtown area has been a TIDD project since 2010 and has received $2.7 million in tax increment revenue. The total cost for the public infrastructure portion of the project is estimated at $13 million. Mr. Sletton said that local businesses have been very supportive of the project and appreciate that taxes generated by businesses in the area are paying for the infrastructure improvements. He said that some businesses within the TIDD did not know that they were supposed to report their gross receipts under a new TRD location code, which has led to some lost revenue for the TIDD. He suggested that the TIDD statutes be streamlined so that smaller communities could create TIDDs without such a large administrative overhead requirement.

Ms. Madrid reported to the committee on issues that Bernalillo County is having in trying to establish a property tax base year valuation. For example, the Mesa del Sol TIDD originally was valued as one very large parcel, but now it is many smaller parcels. Calculating the valuation differential from the original parcel compared to current year valuations is a difficult task.

Questions and comments from committee members included the following:

- Did existing businesses within the Las Cruces TIDD get a lower tax rate when the TIDD was formed? Mr. Sletton said that the tax rates stayed the same; the only difference is that a portion of the increased tax revenue after the formation of the TIDD is distributed back to the TIDD for infrastructure improvements.

- The state is losing $1 million per year from the Las Cruces TIDD. Mr. Sletton said that the state has not lost any actual revenue; only the increment from the larger tax base is dedicated for the TIDD. Mr. Clifford said that the theory is that TIDDs create new development that otherwise would not exist. The State Board of Finance can reduce the state share of the GRT increment after determining that some of the increase was due to existing businesses relocating to a TIDD.

- Can the City of Albuquerque dissolve the Quorum TIDD since the current development plan does not match the original plan? Mr. Montano said that it can, and the administration is considering that option. The new developer of the property expressed no interest in continuing the TIDD.

- Why has nothing happened at the Winrock TIDDs? Mr. Montano said that the developer of the Winrock area is still committed to the original TIDD plan. The current economic climate has meant that the developer was not able to move as quickly as desired. He said that groundbreaking for a new IMAX theater will happen within six months.

- The legislature should consider ending the authorization for TIDDs that do not meet progress benchmarks within a certain time.

- The legislature rejected a TIDD proposal for the SunCal development on land that has sat unused for centuries, but then it approved a TIDD for a developed area in Albuquerque that did not even need the designation.

- The Winrock/Quorum TIDDs, although consisting of three separate TIDDs, were presented to the legislature as one entity with one plan for development. Since authorization of the TIDDs, major changes have been made to the plans. Mr. Montano said that the City of Albuquerque is also frustrated with those TIDDs. There has been a heavy administrative burden on the city to manage those projects.

- Are there any transfer of property ownership restrictions in TIDDs? Jill Sweeney, legal counsel for the Winrock/Quorum TIDDs, said that the development agreements with the City of Albuquerque do not allow TIDD benefits to transfer without authorization from the TIDD board.

Reconciling Film Production Tax Credit Bills

Mr. Clifford reported to the committee on the TRD's analysis of the reconciliation of two bills amending provisions of the film production tax credit, both of which were signed by the governor. Laws 2011, Chapter 165 and Laws 2011, Chapter 177 made significant changes to Chapter 7, Article 2F NMSA 1978, including limiting the aggregate amount of the tax credit allowed in a fiscal year to $50 million; distributing large tax credits to taxpayers over two to three years; adding "related digital content" to the list of eligible expenditures; naming the film credit sections the "Film Production Tax Credit Act"; adding a purpose section to the act; providing that interest on tax credits paid over multiple years not be paid to taxpayers; requiring that a credit be claimed by the taxpayer only once, at the end of the taxpayer's tax year; providing for outside audits of large credit claims; limiting the list of eligible expenditures for the credit; and providing for definitions of "physical presence" and "New Mexico resident". Mr. Clifford said that all of these changes do not conflict substantively with each other, and they can easily be read together. However, there are four potentially conflicting provisions in the laws, including reporting requirement differences, physical presence eligibility for vendors and how income taxes are withheld. Mr. Clifford said that the TRD determined that those potentially conflicting provisions can be read together.

The statutes may need to be amended to clarify the withholding requirements of performing artists. The new law set up withholding requirements for one type of payment arrangement, but the TRD has learned that there are many other payment structures in the film industry, many of which would not be affected by current withholding requirements.

Questions and comments from committee members included the following:

- What was the total of film production tax credits claimed for fiscal year 2011? Mr. Clifford said that the total claimed was near $100 million.

- Did the state lose any film productions during the period of time when the status of the film production tax credit was in question? Rick Clemente, chief executive officer of I-25 Studios, said that during the winter and spring of 2011, New Mexico was excluded from several productions. His studio lost production contracts for $170 million worth of productions that decided not to film in the state. He thanked the legislature for crafting a compromise bill that provided the needed stability for the film industry to stay in New Mexico. Mr. Clifford said that the governor supported the compromise bill, and he said that she is fully behind the film industry in the state.

- Mr. Clifford was asked to estimate how much the state receives for every dollar spent on the film production tax credit. Mr. Clifford said that after looking at various studies performed for the state and in general, his best guess is that New Mexico receives 50 cents for every dollar it spends on the tax credit.

- Without the film production tax credit, the state's film industry would be minimal.

Adoption of Minutes

The minutes from the July 21-22 meeting of the committee were adopted without changes.

Tax Amnesty Report

David M. Fergeson, deputy director, Audit and Compliance Division, TRD, reported to the committee on the status of the tax amnesty program. The amnesty period took place from June through September 2010 and allowed taxpayers to report previously unreported tax liabilities and have penalties and interest waived. The amnesty was open to 30 tax programs administered by the TRD. The department aggressively advertised the program and received many more applications for amnesty than it had anticipated. More than 9,000 amnesty applications were received, of which nearly 6,000 were completed with an assessment being made. The department assessed $46 million to taxpayers and has collected $16 million so far. It anticipates collecting between $40 million and $45 million from the program. Three-fourths of the amnesty applications were from the combined reporting system (CRS) taxes, of which the GRT is the major component. The CIT and personal income tax (PIT) accounted for another 20 percent of the assessments.

After offsetting for taxes that would have been collected through the department's regular auditing efforts, and for penalties and interest for those collections, the department estimates that it will collect $19 million more net revenue compared to predicted collections without an amnesty program.

Mr. Fergeson was asked by committee members to provide the committee with estimated revenues generated from the tax amnesty program related to the compensating tax.

Albuquerque Metropolitan Arroyo Flood Control Authority (AMAFCA) Yield Control Changes

Danny Hernandez, chair, AMAFCA, and Jerry Lovato, executive engineer, AMAFCA, made a presentation to the committee about a recent problem the AMAFCA has encountered regarding yield control and the mill levy rates it sets. The AMAFCA currently has 22 employees who manage $18 million in annual construction projects, 50 miles of concrete channels and 36 dams to keep the Albuquerque area protected from floods and erosion. The AMAFCA has an annual operating budget of about $3.5 million generated from property tax assessments, and in an effort to not increase property taxes, its board has made its budget flat for the past three fiscal years.

In 1986, the legislature passed property tax legislation that affected how much property tax revenue an entity can collect from year to year. The legislation, commonly referred to as "yield control", was designed to not allow local governments to expand their operational budgets more than five percent each year. Section 7-37-7.1 NMSA 1978 provides a methodology for calculating the mill levy for residential and nonresidential properties to comply with the yield control provisions. Over time, the differential in AMAFCA mill levy rates has grown and currently is set at a 35 percent differential.

In fiscal year 2011, the DFA required the AMAFCA to correct the large disparity between residential and nonresidential mill rates. The AMAFCA board decided to reduce mill levy rates to comply with the DFA requirements, which resulted in a significant budget cut. The DFA has required the AMAFCA in fiscal year 2012 to again correct the disparity, suggesting that residential mill rates be increased. The AMAFCA board does not want to increase taxes during the current economic downturn, but it also cannot make any more budget cuts. Complying with the DFA mandate has left the AMAFCA board with very few options.

Greg Schaffer, chief legal counsel, DFA, said that the DFA is merely trying to enforce the property tax law. Section 7-37-7 NMSA 1978 states, "The tax rates set for residential property ... shall be the same as the tax rates set for nonresidential property ... unless different rates are required because of limitations imposed by Section 7-37-7.1 NMSA 1978". Section 7-37-7.1 NMSA 1978 sets a method for setting those differential rates when calculating the yield control mill levy rates. The AMAFCA board asserts that it has the authority to choose differential mill levy rates without using the yield control formula. This assertion is not in conformance with the law, said Mr. Schaffer. The AMAFCA (and other property-tax-imposing entities) can control the imposed property tax rate, but it cannot control the differential in rates between residential and nonresidential property. There are at least three legislative options to solve the AMAFCA's problem: adjust the yield control formula to only have one calculation for both types of property; exempt the AMAFCA from the yield control limitations; or repeal the yield control statute. Mr. Schaffer emphasized that none of these options has yet to be endorsed by Governor Martinez.

Questions and comments from committee members included the following:

- The yield control formula is supposed to stabilize operational budgets, but it also has unintended consequences on mill rate differentials. Mr. Clifford agreed and said that yield control also has an impact on another property tax problem, known as "property tax lightning". When the Bernalillo County assessor reduced residential valuations following a district court ruling against the county, the AMAFCA was forced to increase its mill levy just to maintain its budget. He said that allowing taxing entities to set differential mill rates is constitutionally problematic.

- Has the AMAFCA been violating the mill rate calculation law for many years? Mr. Schaffer said that mill rate divergence is a natural byproduct of the yield control formula. When the AMAFCA attempted to set its own rate differential without following the formula is when the DFA stepped in. Mr. Hernandez said that the AMAFCA is a small governmental agency, and it has been relying on the DFA's guidance for years.

The committee recessed at 5:15 p.m.

<u>Friday, August 26</u>

The committee reconvened at 9:44 a.m. in the MRCOG board room.

Federal Health Care Reform Revenue Overview

Bill Jordan and Kelly O'Donnell, New Mexico Voices for Children, discussed with the committee economic and fiscal impacts of recent federal health care reform legislation. Mr. Jordan began by stating that the Patient Protection and Affordable Care Act of 2010 will have an enormous positive economic impact in New Mexico. The state will be receiving billions of dollars in new federal funds in the form of increased Medicaid funding and federal tax credits for individuals. The total new revenue coming into New Mexico is estimated to be between $10.6 billion and $13.4 billion from fiscal years 2014 to 2020. Using those estimates, Mr. Jordan calculated estimated economic effects to the state from spending resulting from that revenue influx. He calculated between $16.5 billion to $21.5 billion in economic activity during that time frame and between 38,500 and 47,800 new jobs created. There will be a budgetary impact on the state, mostly from increased Medicaid spending requirements. However, the state share of the funding burden starts out very small in fiscal year 2014, and the tax revenue realized by the state from the increased economic activity will more than make up for the increased state budget needs.

Ms. O'Donnell discussed the tax revenue benefits from the new legislation in more detail with the committee. Although the state will be required to spend an additional amount of money for Medicaid, estimated between $500 million and $800 million during fiscal years 2014 to 2020, that investment will be more than offset by increased tax revenue collections during that period. She estimated that the state would collect an additional $900 million to $1.2 billion in tax revenue from the increased spending.

Questions and comments from committee members included the following:

- The state's reliance on federal funding for economic growth can be compared to a man standing in a bucket and trying to pick himself up with the bucket's handle. All federal spending originates from taxes paid by citizens. The state is already too dependent on federal spending.

- The state stands to gain fiscally from the legislation, but even more important is that the health of all New Mexicans will be improved. Ms. O'Donnell said that a large percentage of New Mexico's residents do not have health insurance. Many other issues that plague the state are related to the lack of affordable health care. When more people start getting preventive health care, there will be less inflationary pressure on health insurance premiums because people will be healthier.

- How does the federal legislation affect small businesses? Ms. O'Donnell said that a small business premium tax credit is available and that 25,000 small businesses in the state could qualify for the credit.

- Increased competition lowers prices, not increased federal spending.

- The federal deficit reduction estimates are not legitimate. The federal deficit will probably increase by $500 billion from the new law, rather than be reduced. Medicaid is a huge portion of the state budget, and that will increase dramatically when the law takes effect. Ms. O'Donnell said that the increased tax revenues from increased spending and federal tax credits will more than offset the increased state spending.

- What will happen to county sole-community-provider funds that currently are matched by the federal government on a three-to-one ratio? Ms. O'Donnell said that the funding structure for indigent care probably will not need to be changed very much because there will still be a sizeable uninsured population in the state.

- Committee members discussed the University of New Mexico Hospital funding stream and how it is compensated for care provided to residents who do not live in Bernalillo County.

MSA Arbitration and Legislation Update

Nan Erdman, assistant attorney general, provided the committee with an update on the MSA and litigation currently taking place. In 1998, several major tobacco manufacturers entered into the MSA with states to compensate the states for health care issues related to smoking. They agreed to pay the states a per-pack price every year. New Mexico typically receives $35 million to $40 million. The participating manufacturers (PMs) pay about 50 cents per pack, and they pay between $7 billion and $8 billion annually. The states in turn agreed to keep a level playing field in the market by imposing similar costs on nonparticipating manufacturers (NPMs). The MSA requires all states to impose an escrow payment on all NPMs. Money is placed into an escrow account until a state sues the NPMs for compensation. The MSA also requires that the states diligently enforce the escrow statutes. The PMs are currently engaged in a nationwide arbitration dispute. The suit claims that New Mexico did not collect escrow payments on tribal land in 2003 and that the state does not currently have a qualifying escrow statute. The state is at risk of losing the entire $34 million paid in 2003, which would be applied to future MSA payments. If the state is found to have been in violation of the MSA in 2003, Ms. Erdman said that the state would probably be penalized for the payments in 2004 through 2009. The PMs allege that New Mexico only collected 10 percent of the escrow that was required to be collected.

NPMs have proliferated around the world since the MSA has taken effect, and in New Mexico, those brands are sold mostly on tribal land. In 2009, the legislature enacted a statute that required escrow payments from all NPMs, including for cigarettes sold on tribal land. However, in 2010, the state and the tribes agreed on a cigarette tax hike that kept the existing statutory 75-cent differential in price between cigarettes sold on tribal lands and those sold in the rest of the state. No substantive changes were made to the MSA, but the definition of "units sold" in the MSA was not changed to reflect the newly defined term of "tax credit stamp" in the

Cigarette Tax Act. NPMs have claimed that they are no longer required to pay escrow because "units sold" does not include cigarettes sold with tax credit stamps, and they have sued the state on that basis. PMs have also sued the state, claiming that the state no longer has a qualifying statute to enforce the MSA.

The Office of the Attorney General maintains that the change in the cigarette tax provisions does not affect the MSA and that NPMs are required to pay escrow. The 2011 legislature passed a bill that clarified that cigarettes with tax credit stamps are counted as units sold. However, the governor vetoed that legislation because it appeared to raise taxes on a segment of tobacco manufacturers. Ms. Erdman said that NPMs have hired lobbyists who claim that the escrow provisions in the 2010 changes to the Cigarette Tax Act were negotiated between the state and tribes. All NPMs have refused to pay escrow for cigarettes sold on tribal land since the 2010 statute took effect.

Questions and comments from committee members included the following:

- Has New Mexico lost its lawsuit with the PMs? Ms. Erdman said that the arbitration panel has made one ruling against the state, but that ruling is not final. She said that the worst-case scenario facing the state is that New Mexico would be required to pay back $400 million to the PMs, which would be taken out of future MSA payments.

- Has New Mexico entered into agreements with tribes to collect escrow? Ms. Erdman said that escrow payments are paid directly by the manufacturer to the state. Cigarette taxes, however, are collected by tribes under the 2010 statute. The Office of the Attorney General claims that it can collect escrow under the current statutes. However, it is in favor of enacting legislation to clarify the escrow situation and wants the effect to be retroactive to 2010.

- Why were the changes made in 2009 to require escrow not controversial, but today they are seen as a new tax? Ms. Erdman said that escrow payments are not a tax. She said that the governor has not met with representatives of the attorney general to discuss whether she would support a bill in the 2012 session. The Office of the Attorney General has attempted to meet with the governor several times, but to no avail. She said that the attorney general is open to having cigarette escrow on the agenda for the upcoming special session.

- Would the PM lawsuits against the state have been resolved if the 2011 legislation had been signed by the governor? Ms. Erdman said that the litigation about the 2010 law may be resolved, but the state is still facing litigation for 2003 to 2009.

- Who is currently suing the state over tobacco issues? Ms. Erdman said that three NPMs have sued the state: a manufacturer from Canada, a distributor from New Mexico and a distributor from New York. The PMs have also sued the state, and that issue is being handled by the arbitration panel mandated by the MSA. She said that the attorney general is preparing to sue eight NPMs to collect past due escrow payments.

There being no further business, the committee adjourned at 12:36 p.m.