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

June 2, 2005
Santa Fe

On June 2, 2005, the first meeting of the Revenue Stabilization and Tax Policy Committee (RSTPC) for the 2005 interim was held in Room 307 of the State Capitol.

PRESENT

Sen. John Arthur Smith, Chair
Rep. Donald L. Whitaker, Vice Chair
Sen. Ben D. Altamirano
Sen. Kent L. Cravens
Rep. Anna M. Crook
Sen. Joseph A. Fidel
Rep. Keith J. Gardner
Rep. Roberto "Bobby" J. Gonzales
Rep. George J. Hanosh
Rep. Ben Lujan
Sen. William E. Sharer
Rep. Daniel P. Silva
Sen. H. Diane Snyder
Sen. James G. Taylor
Rep. Thomas C. Taylor

ABSENT

Rep. Janice E. Arnold-Jones
Sen. Mark Boitano
Sen. Carlos R. Cisneros

Staff
Amy Chavez, Pam Ray and Tim Crawford

Guests
The guest list is in the meeting file.

The chair called the committee to order at 9:40 a.m.

POST-SESSION FISCAL SUMMARY

David Abbey, director of the Legislative Finance Committee (LFC), provided an updated post-session fiscal summary for the RSTPC members. Mr. Abbey highlighted major changes in recurring general fund revenues. According to LFC estimates, recurring fiscal year 2006 general fund revenues are projected to rise up to $342 million from the fiscal year 2005 budget level. Energy-related revenues account for approximately 40 percent of the growth. Mr. Abbey also highlighted recurring general fund appropriations for fiscal year 2006. Approximately $2.1

billion of the appropriations are for public education. Additionally, $714 million is for higher education, $559 million is for Medicaid and $560 million is for other health and human services expenditures. The legislature passed legislation in 2005 to raise an additional $14.9 million. Another $11.2 million is expected to be generated by the state through enhanced audits. LFC estimates indicate the possibility that projected recurring revenue growth may be too low to support recurring expenditure levels in fiscal years 2007 through 2009. If a structural imbalance arises, it could reach up to $419 million by fiscal year 2009.

Mr. Abbey further discussed the fiscal impacts of some major pieces of tax legislation that passed during the 2005 session, including House Bill 410, the governor's tax package, and legislation affecting Medicare, public education, post-secondary education, health and human services, public safety, natural resources and economic development. Overall, total recurring general fund appropriations equal $150.8 million.

2005 TAX LEGISLATION REVIEW

Kelly O'Donnell, assistant secretary and director of tax policy, Taxation and Revenue Department (TRD), summarized 2005 legislation affecting tax policy. A major bill affecting tax policy creates the Tax Fraud Investigations Division of the TRD to investigate criminal tax fraud. Several bills affecting the personal income tax also became law, including a $2,800 refundable income tax credit for uncompensated medical expenses and an additional income tax exemption for those expenses. A $2,500 income tax exemption was also added for certain personal income tax filers. In addition, personal income tax rate reductions slowed and the nursing home bed tax credit was repealed. Heads of households are also now subject to lower income tax rates due to the passage of a bill that permits them to file in the same income tax brackets as married couples filing jointly.

Bills affecting the gross receipts tax and the compensating tax also became law. First, the legislature passed a bill to authorize the secretary of taxation and revenue to enter into the streamlined sales and use tax agreement with other states to develop a plan to simplify administration of sales and use taxes. In addition, the legislature created a gross receipts tax holiday during the first weekend in August for gross receipts from the sale of clothing, school supplies and computers. To partially offset the effects of gross receipts tax pyramiding that occurs during the sale of services for resale, the legislature passed a credit against the gross receipts tax on services sold for resale. Local governments will benefit from additional legislation giving them the authority to impose local option quality of life gross receipts taxes and eliminating a delayed repeal of the capital outlay gross receipts tax. The legislature also passed several tax incentive bills to promote renewable energy production, the provision of rural jobs and growth in the film, housing and research and development industries.

FOOD AND MEDICAL GROSS RECEIPTS TAX DEDUCTION UPDATE

Ms. O'Donnell provided the committee with the TRD's estimates of the impact of the food and medical gross receipts tax deductions on state finances. Those gross receipts tax deductions for receipts derived by retail food stores from the sale of certain food items and for receipts derived from medical service providers for certain medical receipts became effective on January 1, 2005. Through April, average deductions with respect to food gross receipts approximate $172.2 million and medical gross receipts tax deductions approximate $39.5 million. Ms. O'Donnell explained the specific rules concerning receipts that qualify for the gross receipts tax deduction. She also explained that local governments are "held harmless" from any reduction in gross receipts tax revenues by general fund distributions to the local governments.

Some gross receipts taxpayers have encountered difficulties in correctly reporting their deductions for gross receipts from food or medical services. When the deductions are overstated, local governments receive distributions that are too high. If the deductions are underreported, local governments receive distributions that are too low. Thus, a statutory penalty applies to both underreporting and overreporting. Ms. O'Donnell discussed the TRD's efforts to assist taxpayers in avoiding the penalty by providing various seminars, fact sheets and other information. Ms. O'Donnell explained that incorrect reporting of the deduction by large retailers was discovered shortly after the February 25 filing deadline. Auditors contacted those retailers and many reporting errors were resolved. Despite the TRD's efforts, Ms. O'Donnell warned that some errors persist and others may still arise. To avoid additional problems, the TRD has permitted a filing deadline extension for the gross receipts tax deduction and will adjust local distributions to correct previous reporting errors.

Bill Fulginiti, executive director of the New Mexico Municipal League, provided the committee with a survey of municipalities throughout the state with respect to the issues they have encountered as a result of the transition to the elimination of the gross receipts tax on food and on medical services. Many municipalities initially encountered reduced revenues due to low "hold harmless" distributions stemming from underreporting of deductions by large retailers and medical offices. However, revenues stabilized for most of those municipalities after working with the TRD to correct the reports. Mr. Fulginiti also noted that misreporting is more likely to occur by filers for the medical service gross receipts tax deduction than for the food tax deduction because large food retailers are better equipped to deal with the specific issues that arise from the deduction and because there are fewer large food retailers than medical service providers in the state. Medical care deduction issues also tend to be more complicated due to complex bookkeeping issues that affect medical offices.

OVERVIEW OF TAXATION ON NATIVE AMERICAN LANDS

Joe Lennihan, general counsel, TRD, provided the committee with an overview of state tax policy with respect to taxation of activities on Native American lands. He explained that the courts have used two tests to determine whether certain activities on Native American lands could be taxed by the states. One test determines whether the legal incidence of a tax falls upon tribal or nontribal members. Generally, if the lawful incidence of a tax falls upon a nontribal member, the state has authority to tax the nontribal member. If the incidence falls upon a tribal member, however, the state is less likely to have the authority to tax that person. Another test balances the economic impacts of the taxed activities on tribes, the state and federal government. Courts have held that if a tribe bears the economic impact of an activity, that activity cannot be taxed by the state. Mr. Lennihan briefly listed the tax-sharing and information-sharing agreements entered into by the state and various tribes throughout the state.

Wayne Bladh, specialist in Indian taxation issues from the Nordhaus Law Firm, LLP, elaborated on the various common law tests of the state's authority to tax various activities on tribal land. Mr. Bladh explained that a key element in determining the state's authority to tax is the legal incidence of the tax, or who is legally responsible for paying the tax. Geographical location of the activity and the political status of the party on which the legal incidence of the tax falls are additional factors to be considered. Mr. Bladh indicated that the balancing test of the economic impacts on the state, tribe and federal government previously mentioned by Mr. Lennihan is applied uniquely by different courts, and decisions in other states might not necessarily have an impact upon whether the state is legally permitted to tax an activity. He further indicated that in formulating tax policy with respect to activities on tribal lands, the state should focus on local issues and structure New Mexico taxes to achieve tax policy to achieve broader objectives, rather than simply maximizing the types of activities it can tax. He encouraged minimizing litigation between the state and tribes through negotiation and increased information-sharing.

DESERT ROCK PROJECT

Richard Minzner, lobbyist, and Freddy Sanches, vice president of Sithe Global Power, LLC, discussed the initiative to begin the Desert Rock Energy Project south of Farmington on the Navajo Nation. Mr. Minzner and Mr. Sanches explained that the Navajo Nation Council established the Dine! Power Authority to develop Navajo energy resources. The authority selected Sithe Global Power to develop, finance, construct and operate a coal-fired electric generating facility at the proposed site near Farmington. Mr. Sanches identified objectives of the project, including improvement of the existing electrical power system in the southwestern states; delivery of competitively priced power; generation of electricity from Navajo Nation coal; relief from dependence on gas-fired power plants; and promotion of economic development for the Navajo Nation. He stated that Sithe Global Power, if the Desert Rock Project is constructed, would be the largest taxpayer on the Navajo Nation and would account for 30 percent of the Navajo Nation's budget. Taxes anticipated to be paid to the Navajo Nation include the Navajo business activity tax, the possessory interest tax and sales tax. Water fees, leases and royalties would also be paid to the Navajo Nation. State taxes, consisting of primarily compensating taxes, would also be payable to the state. Stephen Begaye, CEO of Dine! Power Authority, stated that the combined state and tribal taxes have raised concerns that construction of the plant might not be economical. The Navajo Nation is willing to reduce the tax burden it imposes and desires that the state likewise reduce its tax burden to provide incentive for construction of the project. The Navajo Nation anticipates obtaining financing for the project by 2005 and beginning construction soon after that. Construction is anticipated to last about five years.

PROPOSED WORK PLAN AND MEETING SCHEDULE

Amy Chavez, Legislative Council Service (LCS), introduced herself, Pam Ray, Cleo Griffith and Tim Crawford as staff for the RSTPC for the 2005 interim and presented a proposed work plan and meeting schedule to the committee members. The committee adopted the meeting schedule in accordance with a master calendar prepared by the LCS upon request of the Legislative Council. The committee agreed to schedule out-of-town meetings in Hobbs, Rio Rancho and Taos, with the meeting places to be assigned to scheduled meeting days according to meeting facility availability. Remaining meetings in October and November are to be held in Santa Fe. Ms. Chavez presented a list of proposed work topics to the committee for the 2005 interim. Those topics include examination of economic development tax incentives, study of competitive disadvantages in New Mexico's gross receipts and compensating tax structure, examination of the role of the Motor Transportation Division of the Department of Public Safety in enforcing highway-related taxes and fees and review of the state's progress in entering into the streamlined sales and use tax agreement. Other topics suggested by RSTPC members for review include:

- general obligation bond capacity and indebtedness status;
- examination of the effect of transportation-related taxes on state vehicle use;
- property tax development updates;
- revenue enhancement tools and tax relief possibilities;
- highway funding mechanisms;
- methods of funding local infrastructure projects; and
- updates on the food and medical gross receipts tax deduction.

The committee adopted the work plan with the additional changes proposed by the committee members. The committee adjourned at approximately 4:25 p.m.