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

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

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

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

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

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

Rep. Ray Begaye
Rep. Donald E. Bratton
Rep. Zachary J. Cook
Sen. Kent L. Cravens
Rep. Miguel P. Garcia
Rep. Sandra D. Jeff
Sen. Carroll H. Leavell
Sen. Steven P. Neville
Rep. Debbie A. Rodella
Sen. Bernadette M. Sanchez
Sen. John M. Sapien
Rep. James R.J. Strickler
Rep. Don L. Tripp

Other Legislators Attending
Sen. Stuart Ingle (November 24)
Rep. Danice Picraux (November 23-24)
Sen. Mary Kay Papen (November 23-24)

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

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

Monday, November 23

Streamlined Sales Tax — New Mexico's Options

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

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

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

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

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

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

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

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

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

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

Questions and comments from committee members included the following:

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

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

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

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

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

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

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

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

Robert Desiderio, attorney and former dean of the University of New Mexico School of Law, reviewed for the committee the role of GRT exemptions. New Mexico has a comprehensive base for gross receipts taxation, which captures too many goods and services that should not be taxed. There are many transactions that are prohibited from taxation by federal law or on constitutional grounds, including exemptions for the federal government, foreign governments and Indian nations; services performed out of state; food stamps; and railroad equipment and aircraft used in transportation. Many activities are exempt from gross receipts taxation for normative reasons, including exemptions for the state and its political subdivisions; wages; dividends and interest; personal effects; homeowners' association assessments; occasional transfers; and social organization dues. Many exemptions have been enacted to avoid multiple taxation, including exemptions from the stadium surcharge and the event center surcharge and from sales of vehicles, boats, insurance, fuel and natural resources, all of which are taxed elsewhere. Specific taxpayers have also been exempted from taxation, including the use of property by and sales to federally recognized tax-exempt nonprofit organizations; sales to students at on-campus bookstores; receipts of nonprofit organizations operating facilities for retired or elderly persons; religious activities of ministers; and receipts of disabled street vendors. Finally, some industry-specific exemptions have been enacted, including receipts from the sale of livestock agricultural products, livestock feeding, fuel for space ships and race purses at New Mexico racetracks.

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

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

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

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

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

Film Tax Credits and Other Business Incentive Credits — Update

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

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

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

Questions and comments from committee members included the following:

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

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

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

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

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

Taxation and Revenue Department Legislative Proposals

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

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

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

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

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

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

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

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

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

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

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

Questions and comments from committee members included the following:

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

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

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

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

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

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

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

The Economy's Impact on Business in New Mexico

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

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

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

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

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

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

Questions and comments from committee members included the following:

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

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

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

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

- Are there any negative effects of state regulation of the private sector? Ms. McClure said that the ACI will provide a report to the committee that quantifies the job impacts of recent

Department of Environment regulations. Mr. Madrid said that many relocating businesses have difficulty getting licenses in New Mexico. Especially troubling is the 190-day average to receive a simple beer and wine license for a restaurant, compared to 20 days in many other states. A committee member said that he has been attempting to get the Regulation and Licensing Department to become more efficient for years.

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

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

Meal Tax for Tourism Marketing

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

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

Questions and comments from committee members included the following:

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

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

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

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

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

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

The committee recessed at 5:17 p.m.

<u>Tuesday, November 24</u>

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

Energy, Minerals and Natural Resources Department (EMNRD) Bills

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

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

Questions and comments from committee members included the following:

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

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

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

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

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

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

Property Tax Education and Study Committee Update

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

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

Questions and comments from committee members included the following:

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

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

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

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

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

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

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

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

Property Tax Litigation Update

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

Questions and comments from committee members included the following:

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

Tax Expenditure Budget Legislative Proposal

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

Questions and comments from committee members included the following:

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

Nonprofit Taxation

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

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

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

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

Questions and comments from committee members included the following:

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

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

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

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

Revenue Forecast

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

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

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

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

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

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

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

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

Questions and comments from committee members included the following:

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

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

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

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

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

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

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

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

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

Goals and Principles

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

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

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

Questions and comments from committee members included the following:

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

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

The committee recessed at 4:37 p.m.

Wednesday, November 25

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

Income Tax

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

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

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

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

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

Questions and comments from committee members included the following:

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

- The PIT is now mostly a flat tax.

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

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

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

Corporate Income Tax

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

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

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

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

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

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

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

Questions and comments from committee members included the following:

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

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

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

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

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

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

Budget Balancing Task Force Report

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

The task force is composed of 42 members representing business, labor, local government, health care, religious, environmental, higher education, transportation and nonprofit groups and will complete its work by December 21, 2009. The task force will not make any policy recommendations to the governor, but it will discuss the pros and cons for each proposal.

Revenue estimates have been completed for about one-half of the more than 50 proposals. All of the proposals and FIRs are available on the task force's web site, www.nmrevenueoptions.com. Mr. Nunns said that some of the proposals are best packaged together.

Questions and comments from committee members included the following:

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

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

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

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

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

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

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

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

Gross Receipts Tax

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

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

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

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

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

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

Questions and comments from committee members included the following:

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

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

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

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

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

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