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

October 20
State Capitol, Room 307

On October 20, the fifth 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
Rep. Janice E. Arnold-Jones
Sen. Carlos R. Cisneros
Sen. Kent L. Cravens (10/21)
Rep. Anna M. Crook
Sen. Joseph A. Fidel (10/20)
Rep. Keith J. Gardner (10/21)
Rep. Roberto "Bobby" J. Gonzales
Rep. Ben Lujan
Rep. Daniel P. Silva
Sen. H. Diane Snyder
Rep. Thomas C. Taylor

Absent

Sen. Mark Boitano
Rep. George J. Hanosh
Sen. William E. Sharer
Sen. James G. Taylor

Designees
Rep. Debbie A. Rodella (*designee for George J. Hanosh*)
Sen. John C. Ryan (*designee for Sen. Mark Boitano on 10/20)*

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

Staff
Amy Chavez, Tim Crawford, Cleo Griffith and Pam Ray

Guests
The guest list is in the meeting file.

Thursday, October 20

Call to Order and Approval of Minutes

Senator John Arthur Smith, chair, called the committee to order at 9:40 a.m. The committee unanimously approved the minutes from the fourth meeting of the RSTPC on September 15-16 in Taos.

Energy, Minerals and Natural Resources Department (EMNRD) Clean Energy Proposals

Joanna Prukop, secretary, EMNRD, and Craig O'Hare, special assistant for renewable energy, EMNRD, discussed the activities and benefits of New Mexico clean energy programs. Clean energy initiatives in New Mexico involve the production or use of renewable energy sources, promotion of energy efficiency and use of clean fuels. Mr. O'Hare provided the committee with an overview of solar resources and initiatives in the state, including distributed solar, photovoltaic and solar thermal energy sources. He discussed the potential for projects to develop concentrating solar power in the state and the availability of resources from national laboratories to develop this technology. He also discussed the potential for development of biomass and wind-power technologies in the state.

Energy efficiency initiatives are an additional priority of EMNRD. Mr. O'Hare explained that the development of energy-efficient technologies is essential in reducing high gasoline and natural gas costs. EMNRD supports initiatives to build highly energy efficient buildings, also known as green buildings. Green building techniques are encouraged in the construction of public buildings such as schools.

Mr. O'Hare provided the committee with an overview of the benefits of clean energy programs. Among those benefits are the positioning of the state as a leader in the emerging clean energy economy and the reduction of consumer energy bills. Additional benefits include reduction of state operating costs, the protection of New Mexico's natural areas, reduction of consumptive water use and reduction of air pollution and greenhouse gas emissions.

Secretary Prukop described various clean energy programs in New Mexico. The 2005 Efficient Use of Energy Act created one of those programs. The act requires electric and gas utilities to develop energy efficiency programs, which must be deemed cost effective to be approved by the Public Regulation Commission. The Clean Energy Grants Program, created in 2003, provides funding for clean energy projects for public schools, local governments and tribal entities.

The department plans to support several clean energy proposals during the 2006 legislative session. The proposals will include distributed solar tax incentives, amendments to the Renewable Energy Production Tax Credit and gross receipts tax exemptions for concentrating solar power projects. Funding for clean energy grants will also be sought during the upcoming legislative session.

Questions and comments from the committee members addressed:

- the reason for slower growth in the photovoltaic sector in New Mexico relative to other states;
- safeguards that might be employed to encourage only companies with adequate technologies and workforces to develop clean energy technologies;
- the efforts of EMNRD in changing building codes to promote energy efficiency;
- which states are candidates for development of concentrating solar power projects;
- the resources that New Mexico has to offer in development of concentrating solar power projects;
- the effectiveness of tax credits alone in the promotion of growth in the solar energy market;
- whether the development of fusion as a power source is prevalent;
- large land areas that might be needed for the development of wind power;
- participation of universities in promotion of energy efficiency projects; and
- the percentage of clean energy produced in New Mexico.

Laboratory Partnership with Small Business Tax Credit Update

Victor Chavez, Office of Advocacy and Small Business, Sandia National Laboratories (SNL), asked the committee members to support additional tax credits pursuant to the Laboratory Partnership with Small Business Tax Credit Act. The act provides tax incentives to national laboratories to promote small business development through the use of laboratory resources. Tax credits provided to SNL have assisted SNL in expanding its New Mexico Small Business Initiative to address small business needs and requirements with expertise and resources from the laboratories. Mr. Chavez encouraged committee members to consider providing additional tax credits to promote continued growth of the program. He introduced Jim Manatt of Focus Energy Corporation and Dr. Mike Tripodi of Clean Air Systems, who discussed how their start-up businesses have benefited from the use of SNL resources. Mr. Manatt and Dr. Tripodi also provided committee members with an overview of the activities and goals of their respective companies. Focus Energy Corporation develops technologies to facilitate oil field development, while Clean Air Systems develops technologies to reduce particulate matter, carbon monoxide and hydrocarbon emissions from diesel engines.

Questions and comments from the committee members addressed:

- whether technologies developed by Focus Energy Corporation are being used;
- whether technologies developed by Focus Energy Corporation might be used to find natural resources such as water;
- the manner in which SNL's New Mexico Small Business Initiative evaluates small business candidates that receive SNL assistance; and
- the potential return on investment to the state in discovering untapped oil resources using technologies such as those developed by the Focus Energy Corporation.

Consumer Information on Propane Pricing

Tony Provencio, president, New Mexico Propane Gas Association (NMPGA), provided the committee with an overview of the propane industry's role in informing consumers about energy costs. According to Mr. Provencio, the price of propane is influenced by several factors, including crude oil and natural gas prices, supply and demand and weather conditions. Mr. Provencio mentioned that propane is distributed by 136 propane marketer locations throughout the state. Mr. Provencio discussed factors that have driven propane prices up, including recent natural disasters. In response to propane price spikes, the propane industry placed radio advertisements to encourage propane consumers to contact propane dealers to discuss methods to reduce propane price volatility. As a result of the passage of Senate Memorial 1 during the last special session, the propane industry is also providing information to customers about the state's Low-Income Home Energy Assistance Program. In addition, the NMPGA plans to begin a new initiative to pay $300 of the cost to replace inefficient electric water heaters with more cost-effective water heaters in homes. The NMPGA estimates that the new propane water heaters will save New Mexico consumers an estimated $25,000 each year, or a total of $275,000 over the eleven-year estimated life of the water heaters.

Mr. Provencio discussed the cost of liability insurance for propane marketers. He stated that the hazardous nature of propane distribution has made propane marketers a prime target for lawsuits involving property damage and personal injury. Although the NMPGA believes that propane marketers should be held responsible for incidents in which they are at fault, the association also holds that the marketer should not be held liable when the marketer had no role in the cause of an accident. The association thus will seek support from legislative members during the upcoming legislative session for statutory protection from lawsuits involving accidents not caused by the propane industry. Mr. Provencio stated that such legislation might ultimately reduce insurance costs and energy prices for consumers.

Questions and comments from the committee members addressed:

- the expected increase in propane prices;
- regional propane price estimates;
- whether the propane industry is regulated by the Public Regulation Commission;
- average propane costs for consumers;
- employment in the propane industry;
- the purchase of propane on credit; and
- propane company actions in the event of consumer payment default.

Kit Carson Electric Cooperative Propane Pricing

Andrew Chavez, propane division manager, Kit Carson Electric Cooperative, discussed the propane pricing strategies that the cooperative employs to provide affordable prices to consumers in the wake of increasing fuel costs. The cooperative sets a fixed price per gallon of propane. The cooperative has used financial tools and bulk storage capacities to stabilize prices for customers during the last five heating seasons. Despite the cooperative's efforts, high fuel costs have caused the cooperative to increase prices per gallon of propane. However, Mr. Chavez stated that the cooperative continues to offer fixed and affordable prices to customers. He indicated that fixed prices assist customers in avoiding unpredictable heating costs during the winter months. In addition to fixed prices, the cooperative offers budget billing to permit customers to spread heating costs over a twelve-month period. The cooperative also works with low-income heating programs such as the Low-Income Home Energy Assistance Program, Open Hands, Self Help and the Home Education Livelihood Program.

Questions and comments from the committee members addressed:
- whether Kit Carson Electric Cooperative can participate with the New Mexico Propane Gas Association with respect to safety issues;
- whether the cooperative has adopted a policy to prevent heating shutoffs in the winter months;
- propane industry competitors;
- consumer heating shutoff device availability;
- whether the cooperative's propane division is a for-profit entity; and
- the manner in which the cooperative recovers from deficiencies that arise from charging fixed prices during the winter months.

New Mexico Municipal League Proposals

Bill Fulginiti, executive director, New Mexico Municipal League (NMML), indicated that on October 1, 2005, the NMML board of directors adopted its legislative priorities for the 2006 legislative session. The NMML adopted four tax proposals. Legislation that will be supported by the NMML during the upcoming session will include separate proposals to:
- provide authority to local governments to impose a local option gross receipts tax;
- swap a distribution of the municipal gross receipts tax for a distribution of personal income tax that would be returned to the site of residence;
- permit municipalities to enact a low-income property tax rebate program; and
- permit tax increment financing of local projects.

The NMML will also seek support from the legislature for proposals to improve safety and law enforcement and to fund local libraries; street, road and bridge projects; emergency service personnel initiatives; and regional transit districts.

Questions and comments from the committee members addressed:
- the percentage of the state gross receipts tax that municipalities receive;
- the manner in which municipalities are coping with high energy costs;
- whether trading gross receipts tax for income tax distributions will affect tax burdens on in-state residents more than out-of-state consumers;
- the administration of a potential local option compensating tax;
- whether the highway projects contained in Governor Richardson's Investment Partnership, which passed in 2003, are fully funded;
- capital outlay revenues received by municipalities and unexpended balances; and
- who enforces outstanding capital outlay balance spending.

Sithe Power Plant Update and Proposal

Steve Begaye, executive director, Dineh Power Authority, Richard Minzner, lobbyist, and Freddie Sanches, Sithe Global Power, LLC, provided the committee with an update of efforts with respect to the Desert Rock Energy Project. The project involves the development, financing, construction and operation of a coal-fired electric generating facility at the proposed site on Navajo Nation land near Farmington. During the course of the project's operation and construction, gross receipts taxes and compensating taxes attributable to the project would be payable to the state. The Dineh Power Authority is concerned that the combined state and tribal taxes have raised cost concerns with respect to construction of the plant. Mr. Minzner indicated that the Navajo Nation is willing to reduce the tax burden imposed on the project if the state makes a similar tax concession. According to Mr. Minzner, $60 million in compensating taxes and an additional $320 million are expected to be generated in gross receipts taxes during the project's construction and operation beginning in 2006 and ending in 2033. Mr. Minzner proposed that the legislature allow the state to forgo 15 percent of those revenues through gross receipts tax and compensating tax deductions.

Questions and comments from the committee members addressed:

- the ownership of the coal generating facility;
- the consumers of the power generated by the plant; and
- whether wholesale power sales would be exempt from the gross receipts tax.

House Memorial 20 Update

Jeff Dye, co-chair of the Targeted-Issue Trauma System Committee created by 2005 House Memorial 20, discussed the mission and findings of the committee.   That committee was created to study and improve the statewide system of trauma care in New Mexico. Mr. Dye provided several trauma statistics. According to Mr. Dye, New Mexico's trauma death rates are 66 percent higher than national death rates. New Mexico leads the nation in pedestrian deaths and unintentional deaths and is tied for first in violent death rates. Alcohol is involved in 44 percent of motor vehicle crashes, 75 percent of pedestrian crashes, 76 percent of assaults, 66 percent of penetrating injuries and 25 percent of all other injuries.

Mr. Dye indicated that New Mexico is experiencing a crisis in providing adequate trauma care. Despite the high number of trauma-related injuries in the state, New Mexico has only three hospitals designated as trauma centers. Many areas of the state have inadequate access to trauma care. Patients must often, therefore, experience long waits, delayed treatment and unavailable beds. According to Mr. Dye, New Mexico should have 35 neurosurgeons, but has fewer than 10. Moreover, due to treatment of a large number of patients without the ability to pay, trauma care providers have experienced financial difficulties. In 2004, the overall loss on trauma care for New Mexico's trauma centers was estimated at 26 percent of costs, or about $19.3 million.

As a result of its study, the Targeted-Issue Trauma System Committee developed recommendations to provide funding to strengthen existing trauma centers and encourage the construction and operation of new trauma centers throughout the state. Some proposed funding methods include diverting funds from the alcohol excise tax, the automobile insurance premium tax, the Tobacco Settlement Program Fund, the General Fund surplus or the Severance Tax Bonding Fund. The committee also suggests providing funds to enhance Medicaid matching funds for trauma system enhancement.

Questions and comments from the committee members addressed:

- the manner in which reported statistics are gathered;
- whether funding will be used primarily for services or for capital costs;
- whether trauma centers can use county indigent funding to alleviate some costs; and
- the recommended trauma center resources for new centers.

Telecommunications Access Fund Update

Thomas Dillon, executive director, New Mexico Commission for Deaf and Hard-of-Hearing Persons, provided the committee with an update of the status of the Telecommunications Access Fund. Money in the fund consists of revenues derived from a telecommunications relay service surcharge imposed for the use of intrastate telephone and communications services. Fund revenues are used to provide telecommunications access to hearing- or speech-impaired New Mexicans who are unable to use traditional telecommunications equipment without assistance. Mr. Dillon stated that the fund has grown due to increased cell phone and landline use. However, the expansion of Voice Over Internet Protocol (VOIP) might later threaten the use of those methods of communication and could likewise threaten the revenue stream of the fund. Committee members expressed concern about the potential threat that VOIP may pose to traditional means of telecommunications.

DWI Program Fund Update

Joyce Johnson, Local Government Division, Department of Finance and Administration, Dr. Tasia Young, legislative liaison, New Mexico Association of Counties, and Rob Mitchell, DWI grant program administrator provided the committee with a report of funds received by each county through the DWI Program Fund. The report included budget reports for each county, which contained budgeted amounts for different types of DWI enforcement, treatment and prevention programs.

Questions and comments from the committee members addressed:

- methods of program effectiveness evaluation;
- the need to let communities drive the budgeting needs for local DWI programs;
- whether unexpended balances in local DWI fund reserves are carried over;
- the number of community members that have benefited from local DWI programs;
- the levels of funding by localities for local DWI programs;
- appointment of the statewide DWI grant council; and
- the merit of addressing alcoholism problems before targeting DWI issues.

Compensating Tax Structure Study

Senate Joint Memorial 46, passed during the 2005 legislative session, requested the Taxation and Revenue Department (TRD) to study the potential competitive disadvantages to in-state businesses inherent in New Mexico's gross receipts and compensating tax structure. The TRD conducted the study and provided the RSTPC members with a report of its findings.

Dr. Tom Clifford, chief economist, TRD, first explained how the compensating tax is imposed in New Mexico. The tax is generally imposed for the use of property acquired outside of the state, and that would have been subject to the gross receipts tax. Dr. Clifford indicated that during fiscal year 2005, the TRD collected $54.2 million in compensating taxes. Of that amount, 80 percent was distributed to the General Fund and 10 percent was distributed to the Small Cities Assistance Fund. The remaining 10 percent was distributed to the Small Counties Assistance Fund.

Dr. Clifford provided the committee with information regarding the payment of the compensating tax by businesses in different industry sectors. Of the industries for which data was collected, the health services industry paid the least amount in compensating tax, while utilities paid the most.

The TRD study identified three major anticompetitive effects caused by the compensating tax structure. First, the tax does not apply to services or intangible property. Thus, consumers have an incentive to purchase out-of-state goods and intangible property. Second, there are no local option tax rates. Since the compensating tax rate of five percent is ultimately lower than the five percent gross receipts tax rate and the added local option gross receipts tax rates, consumers have another incentive to purchase out-of-state goods and services. Finally, state law prohibits the collection of the compensating tax with respect to the purchase of household items. Thus, if household consumers purchase goods such as furniture from out-of-state sellers, the consumers pay only the out-of-state sales tax and are not responsible for any compensating tax for the purchase. Consumers might thus ultimately choose to purchase goods from states with sales tax rates that are lower than the New Mexico gross receipts tax rate.

Dr. Clifford indicated that at least four solutions to the competitive disadvantages of the compensating tax structure might exist. First, the legislature might impose the compensating tax on services and repeal the gross receipts tax exemption for certain services performed outside of the state. That action might eliminate the tax advantage to consumers of purchasing services from out-of-state sellers. However, Dr. Clifford warned that since most sales of services are between businesses, the added taxes might contribute to tax pyramiding.

Another solution includes the elimination of the prohibition of compensating tax imposition on residential purchases. New Mexico could follow the practice of most states with sales and use taxes and require households to report their taxable purchases on their personal income tax returns. This solution would likely eliminate the tax advantage from out-of-state sellers. On the other hand, additional recordkeeping requirements for households and only small revenue gains might act as a disincentive to enforce the compensating tax on residential households.

Imposition of a local option compensating tax might additionally alleviate the problems inherent in the existing compensating tax structure. A local option compensating tax could be imposed in the same manner as a local option gross receipts tax. The local option tax could also eliminate the tax advantage of buying from out-of-state sellers by ensuring greater tax rate parity with other states. Administrative costs generated by the tax, however, might be significant.

Finally, Dr. Clifford indicated that New Mexico's conformance with the Streamlined Sales and Use Tax Agreement might serve as an effective alternative in improving the state's compensating tax structure. By becoming an agreement participant, the state could join other states in taxing remote sellers that do not have any business presence in the state. This ability would be dependent on congressional action. Since there are many solutions to the compensating tax structure problems and because of uncertain potential for the Streamlined Sales and Use Tax Agreement to provide solutions, the TRD recommends that it should report to the RSTPC in 2006 the advantages and disadvantages of conforming with the Streamlined Sales and Use Tax Agreement.

Questions and comments from the committee members addressed:

- the actions taken by TRD to simplify business tax reporting requirements;
- the percentage of Internet purchases made by households;
- whether the Streamlined Sales and Use Tax Agreement will affect alcohol and cigarette sales;
- whether Congress will enact legislation to permit states to tax remote sales; and
- whether the Streamlined Sales and Use Tax Agreement terms are consistent with a national retail sales tax.

Oil and Natural Gas Industry Update and Outlook

Dr. Tom Clifford, TRD, discussed the supply and demand factors that affect oil and natural gas prices and revenues in New Mexico. Dr. Clifford indicated that natural gas sales have declined by about 5 percent since 2001. Production has stabilized to approximately 1,560 billion cubic feet during the last two years. The average New Mexico price increased by 22 percent in fiscal year 2005 from the 2002 average price. In fiscal year 2005, gross natural gas industry revenue was approximately $9 billion, which is about double the historical norm. The price increases were significantly driven by the natural disasters of 2005. Despite the fact that recent disasters have driven Henry Hub prices, western natural gas prices have not been as affected.

Oil production has decreased during the last two years. The annual average oil price has correspondingly increased by 39 percent in fiscal year in 2005, a cumulative increase of almost 100 percent since 2002. Oil industry revenue was approximately $2.8 billion, about double the historical average. Oil price increases began in fiscal year 2005 before Hurricane Katrina occurred. Those increases indicated strong demand pull and a tight global supply margin. Despite waning supply levels, drilling activity in North America is at an all-time high. New Mexico drilling is also at a high of 79 rigs.

Dr. Clifford provided the committee members with an overview of the natural gas and oil markets. He stated that hurricane-related production outages will result in low natural gas inventories at the beginning of the heating season. Those inventories might improve significantly by next winter if the hurricane season improves; if imports of liquefied natural gas increase; if domestic production increases; and if industrial demand growth is reduced.

With respect to the oil market, hurricane-related disruptions have escalated prices over already high levels due to demand growth and tight supply margins. Long-term factors that might affect the oil market in the future include political stability in oil-exporting regions and the emergence of China and India in the world oil market. Short-term factors include record worldwide drilling activity and shortages in new oil supply sources. Oil and gas production state and local revenues are projected to be approximately $1.748 billion in fiscal year 2006; $1.660 billion in fiscal year 2007; $1.509 billion in fiscal year 2008 and $1.358 billion in fiscal year 2009.

Questions and comments from the committee members addressed:

- the reason for production reductions despite increased rig purchases;
- whether increased gross receipts tax revenues are generated from higher natural gas prices;
- gas price differentials in different localities;
- the effect of increased regulatory requirements on in-state drilling; and
- gasoline consumption levels.

Taxation of Irrigation Systems

Dr. Mick O'Neill, New Mexico State University (NMSU), and Dr. Robert Flynn, NMSU, discussed the benefits of using underground drip irrigation systems for farming purposes. Dr. Flynn indicated that underground drip irrigation systems are often more efficient than above-ground drip systems. Despite the benefits of the increased efficiency of underground systems, gross receipts taxes imposed on the sale of those systems are higher than those imposed on the sale of above-ground systems. The sale of the components of above-ground systems are subject to a 50 percent gross receipts tax deduction pursuant to Section 7-9-62 NMSA 1978 for the sale of agricultural implements to farmers or ranchers. According to written testimony submitted, the difference in tax treatment stems from TRD regulation requirements. Hoyt Pattison, lobbyist, Dairy Producers of New Mexico, encouraged committee members to support legislation to permit gross receipts tax exemptions for the sale of underground drip irrigation systems.

Questions and comments from the committee members addressed:

- the need to encourage greater crop yields;
- whether assistance is available to farmers in making transitions to underground drip irrigation methods; and
- whether the TRD might change regulatory barriers to permit gross receipts tax deductions for the sale of underground drip systems.

Gross Receipts Tax Deduction for Boxing Promoters

Art Jaramillo, superintendent, Regulation and Licensing Department (RLD), Richard Guay, Athletic Commission, RLD, and Dennis Lada, executive director, New Mexico Sports Authority, asked the committee to support legislation to exempt boxing promoters from the gross receipts tax. Superintendent Jaramillo indicated that New Mexico is not competitive in attracting boxing promoters and boxing events to the state. T.J. Trujillo, a New Mexico boxing promoter, added that boxers also are not attracted to pursue their boxing goals in New Mexico because of the low-paying events sponsored in the state.

Questions and comments from the committee members addressed:

- the number of in-state boxing promoters and fighters;
- whether it is the state's responsibility to provide a market for boxing events;
- whether a boxing commission is needed to regulate boxing standards in New Mexico;
- whether boxing events would be more successful than concert events; and
- whether the state could develop professional wrestling.

The committee adjourned at 4:30 p.m.