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

August 29-30, 2007
Clovis Civic Center
Clovis

The third meeting of the Revenue Stabilization and Tax Policy Committee (RSTP) was called to order by Senator Timothy Z. Jennings, chair, on August 29, 2007 at 9:15 a.m. at the Clovis Civic Center in Clovis.

Present
Sen. Timothy Z. Jennings, Chair
Rep. Edward C. Sandoval, Vice Chair
Sen. Mark Boitano
Rep. Anna M. Crook
Sen. Dianna J. Duran
Rep. Keith J. Gardner
Rep. William J. Gray
Rep. Daniel P. Silva
Sen. John Arthur Smith
Sen. H. Diane Snyder
Sen. James G. Taylor
Rep. Thomas C. Taylor (8/29)

Absent
Sen. Carlos R. Cisneros
Sen. Kent L. Cravens
Rep. Roberto "Bobby" J. Gonzales
Rep. George J. Hanosh
Rep. Ben Lujan, Speaker of the House
Sen. Bernadette M. Sanchez

Designees
Rep. Janice E. Arnold-Jones
Sen. Stuart Ingle
Rep. Henry Kiki Saavedra
Rep. Luciano "Lucky" Varela

Sen. Ben D. Altamirano
Sen. Sue Wilson Beffort
Rep. Donald E. Bratton
Rep. Nathan P. Cote
Sen. Phil A. Griego
Sen. John T.L. Grubesic
Rep. Manuel G. Herrera
Sen. Gay G. Kernan
Sen. Cisco McSorley
Sen. Steven P. Neville
Rep. Andy Nuñez
Rep. John Pena
Sen. Leonard Lee Rawson
Rep. Debbie A. Rodella
Sen. Nancy Rodriguez
Sen. John C. Ryan
Sen. William E. Sharer
Rep. Don L. Tripp

Also Present
Rep. Richard J. Berry (8/30) ATA*
Rep. Jose A. Campos (8/29) ATA*
Sen. Clinton D. Harden, Jr. (8/30) NVI**

(Attendance dates are noted for members not present for both days of the meeting.)

Staff
Tim Crawford, Legislative Council Service (LCS)
Doris Faust, LCS
Pam Ray, LCS

Guests

The guest list is in the meeting file.

Handouts

Copies of all handouts and written testimony are in the meeting file in the LCS library.

Wednesday, August 29

Welcome and Local Issues

Senator Jennings invited Representative Crook to chair the meeting. Mayor David M. Lansford of Clovis thanked the committee for coming to Clovis, expressed his appreciation for the legislature's hard work and gave a brief history of Clovis. Curry County Commissioner Albin Smith reported that Curry County is booming and that the county is always looking for funding to provide services because the county has greater needs than it has funding.

Senator Smith noted that the state may not have much money in future years, in light of the state constitutional mandate for a balanced budget and the fact that 60% of the general fund goes to education, 25% goes to health care and social services, 7% goes to corrections and less than one-half of 1% goes to operate the legislature. Senator Smith further commented that the state may need to spend more money on transportation infrastructure due to concerns raised by the recent Minnesota bridge disaster and the likelihood that the federal Road Trust Fund will run out of money in 2009.

Cannon Air Force Base Transition Update

General Hanson Scott, retired, director of the Office of Military Base Planning, and Randy Harris, vice chair of the Commission on Military Base Planning, reported that local community support helped avoid closure of Cannon Air Force Base and thereby avoided a huge economic disaster in the Clovis area. General Scott provided an overview of the New Mexico military base planning program, the New Mexico Military Base Planning Commission, the base realignment and closure process and how Cannon was affected by the process. Cannon was one of two bases proposed for closure in 2005, but concerted efforts by all levels of New Mexico

*ATA means "Approved to Attend".
**NVI means "No Voucher Issued".

government were rewarded by a Department of Defense recommendation that a new mission be found for Cannon. The New Mexico team aggressively looked for new missions for Cannon, and in June 2006, the U.S. Air Force announced that a special operations wing would be established at Cannon, effective October 1, 2007.

The Cannon transition is moving ahead, and the new mission will ensure that New Mexico continues to play a key role in national defense. Under its new mission, Cannon will have more activity than it has had since the 1990s.

Restoring Progressivity to Personal Income Tax

Norton Francis, chief economist, Legislative Finance Committee (LFC), reported that New Mexico is right in the middle of the 50 states in terms of progressivity of taxes, based on a 2003 comparison study of state taxes nationwide. The progressivity of New Mexico's income tax is offset by the regressivity of the gross receipts tax. The burden on taxpayers in middle-income brackets is staying the same, but taxpayers in the upper and lower brackets are changing with changes in the tax code.

Bill Jordan, deputy director for policy for New Mexico Voices for Children (NMVFC), and Gerry Bradley, research director for NMVFC, provided the committee with copies of the Citizen's Guide to New Mexico's Tax System, a new publication by the NMVFC fiscal policy project. Mr. Jordan stated that in 2003, New Mexico had a somewhat regressive system, but has since cured some of the problems. NMVFC contends that improved progressivity increases social justice.

NMVFC would like to close a perceived loophole in the New Mexico personal income tax law that is attributed to the linkage of the federal and state income tax. Under current state law, taxpayers may deduct state and federal taxes paid in the previous year that are itemized on their federal returns. The itemized deduction is carried over from the federal tax return to the state tax return. Because wealthy taxpayers are more likely to file itemized returns, this policy is likely to favor wealthy state taxpayers.

New Mexico is one of only eight states with an income tax that allows itemizers to deduct state and local taxes paid in the previous year when calculating state taxable income. The majority of other states require taxpayers to add this amount back in when calculating taxable state income. The Taxation and Revenue Department (TRD) estimates that requiring New Mexico taxpayers to add previously paid taxes to their taxable income would have generated $66 million in additional revenue in 2005.

Mr. Francis reported that the proposal would affect one in four state taxpayers who itemize deductions and that a bill had been introduced in 2006 to change the tax code as proposed by the NMFVC, but the bill died in committee. Representative Taylor noted that the committee should be careful with changes that would affect taxpayers making $50,000 to $100,000, such as two teachers who are married and filing a joint return and whose state tax payment would be adversely affected by the proposal. The committee expressed doubt that families earning $50,000 to $75,000 should be considered wealthy and suggested that corrective action should be taken, but that it may be premature to consider this proposal.

Duplicate Issuance of Income Tax Refund Checks

Mitch Simms, owner of Mr. Payroll Check Cashing, described a $375 loss incurred by his business that was caused when the TRD issued duplicate tax refund checks. Mr. Simms asserted that the problem has been ongoing since 2006, that the TRD told him that nothing would be done to reimburse Mr. Payroll Check Cashing for its loss and that under the Uniform Commercial Code (UCC), he is a holder in due course and should be reimbursed by the state.

Jan Goodwin, secretary of taxation and revenue, stated that the department has been aware of the problem from the beginning and is looking into it. Secretary Goodwin noted that the UCC section cited by Mr. Simms is inapplicable because it applies to checks, whereas the state issues warrants. However, the department believes it should resolve the problem and has worked out a solution that has gone to the Department of Finance and Administration (DFA) for review.

Corporate Income Tax Reform, Combined Reporting

Eric Griego, NMVFC executive director, began the panel discussion by stating that his intent is to make the tax code more fair. Although the NMVFC is part of a nationwide organization that is looking at state budgets through the lens of how money is spent on children, the NMVFC also believes that fairness is an issue for small businesses and that they are not on a level playing field with large multistate corporations. Mr. Griego urged the committee to consider combined reporting as one of the policy choices that the legislature should make.

Mr. Bradley stated that:

* a combined reporting bill has been introduced three times, but has failed each time;
* the fiscal impact report on the most recent combined reporting bill projected that combined reporting would raise $80 million in tax revenue;
* combined reporting would eliminate corporate ploys to avoid New Mexico taxes;
* the state will not solve the problem of corporations moving profits around until it mandates combined reporting;
* the Blue Ribbon Tax Reform Commission recommended combined reporting in 2003;
* only one other state west of the Mississippi River does not mandate combined reporting; and
* combined reporting is not an economic development issue because New Mexico's competitor states already have combined reporting.

Jim Nunns, director of tax policy for TRD, reviewed the current reporting methods available in New Mexico to corporate taxpayers. The default reporting method is filing as a separate corporate entity. Combined reporting can be elected by unitary corporations. This requires a common owner holding more than a 50% share in each corporation. Once combined reporting is elected, a taxpayer cannot file as a separate corporate entity without permission from the secretary of taxation and revenue. Another option is consolidated reporting, which follows federal rules and requires 80% corporate ownership by a common parent entity. Once consolidated reporting is elected, a taxpayer cannot file as a separate corporate entity without permission from the secretary of taxation and revenue.

Mr. Nunns also informed the committee that:

* the largest corporate taxpayers (49 of the 19,875 filers) pay most of the tax liability ($234 million of $331 million, or 71%);
* 63% of corporations do not pay corporate income tax;
* 92% of filers use the single corporate entity method;
* combined and consolidated filers pay 45% of the corporate taxes received by the state; and
* mining, manufacturing and oil and gas industries pay over 60% of the state's corporate income tax.

After a discussion of the policy issues, the committee discussed possible approaches, including mandatory combined reporting, mandatory consolidated reporting and additional tools that could be given to the TRD to combat understatement of New Mexico income.

Helen Hecht, a board member of the Association of Commerce and Industry of New Mexico (ACINM), spoke regarding the business community's concerns. A transcript of her testimony is in the meeting file. The ACINM opposes mandatory combined reporting on the basis that:

* the majority of states that impose a corporate income tax still allow or require separate corporate filing in all or a large number of cases;
* many other states successfully curb perceived abuses of the separate filing method without getting rid of that method altogether;
* a number of businesses have located in New Mexico based on the existing tax law, and it would be unfair to change the rules on those companies who have already made significant investment in this state;
* New Mexico has enjoyed several years of significant revenue surpluses and should not need to raises taxes;
* there are solutions to abuses of the current tax system that will have less chance of unintended effects;
* mandatory combined filing is likely to generate a lot of litigation;
* corporate income tax revenue has significant fluctuations and should not constitute a significant piece of state revenue; and
* New Mexico's top corporate tax rate is already higher than that in most of the western states.

Ms. Hecht read the committee a letter from Tempur-Pedic regarding Tempur-Pedic's opposition to mandatory combined reporting. Tempur-Pedic moved to Albuquerque after considering 50 other cities and believes that mandatory combined reporting is hostile to business and would negatively affect economic development in this state.

James O'Neill provided a brief history of corporate income tax in New Mexico and concluded his remarks by opining that combined reporting should be one of the options available to corporate taxpayers.

Discussion ensued regarding where New Mexico ranks in tax rates in relation to other states, tax equity for all businesses located in new Mexico, tax policy as it affects economic development, encouraging business development in New Mexico and retaining a business presence in the state and other options to increase tax revenue, such as a weight/distance tax on commercial transit.

TRD Legislative Proposals

Secretary Goodwin and Mr. Nunns presented an outline of alternatives under consideration for the TRD's legislative proposals. The proposals fall into the categories of personal income tax simplification, tax increment financing and business tax credits.

The TRD policy goals for personal income tax simplification include reducing the time taxpayers devote to record keeping, reducing out-of-pocket payments to return to payers and increasing fairness across families. Mr. Nunns described the current law and rates, how progressivity is achieved and how family- and child-related tax benefits contribute to progressivity. One alternative under consideration to simplify personal income tax returns is to combine family- and child-related tax benefits into a new credit.

With regard to tax increment financing (TIF), Mr. Nunns reported that Mesa del Sol will begin receiving gross receipts tax increment distributions for gross receipts tax liabilities reported on or after January 1, 2008, and other TIF districts are under consideration.

In order to clarify the TIF law, the TRD is considering: (1) amendments to certain definitions in the TIF statute; (2) estimating actual receipts from the first year a district has a dedicated gross receipts increment; (3) reducing the incentive for projects to be divided into multiple districts; (4) describing the circumstances under which there are "excess increment revenues" that can be used for purposes other than debt service on increment bonds; and (5) some minor technical changes to facilitate tax compliance and administration.

With regard to business tax credits, it was noted that the TRD would like to improve the specification of business tax credits to make them simpler, more uniform and more effective. There is currently a variation among credits and different rules that make them more difficult to administer. The alternatives under consideration include legislation to:

* require that all business tax credits apply only to investment in New Mexico, compensation of employees in New Mexico or other qualifying activities or expenditures in New Mexico;
* carefully specify the qualifying periods, activities, etc., that entitle a taxpayer to a business tax credit;

* make credits subject to recapture in a specified manner if the conditions of the credit are not met over a specified time following qualification for the credit;
* require that a department with expertise in the objectives of each business tax credit be required to certify, monitor and evaluate the credit;
* prevent "double dipping", or the allowance of more than one credit or deduction for the same expenses, which should be addressed explicitly in the statutory language for each credit;
* specify the stacking sequences of credits and their stacking order against taxes; and
* re-codify credits with general rules and definitions in one section of the statutes.

Gail Reese, Albuquerque chief financial officer, reported that Albuquerque has already looked at the TIF legislation with the TRD. Albuquerque's concerns are that the definition of the term "governing body" is not clear and that the organization of TIF districts is becoming incestuous. Albuquerque would like to come back to the committee closer to the legislative session and talk to the committee about these issues.

The committee also discussed whether taxpayers that overpay taxes should get interest on their refunds, whether small businesses can change their information electronically on the TRD web site and whether the TRD can provide an estimate of how much revenue would be generated by a flat 3% personal income tax so that the legislature could compare that number to taxes generated by the current tax system.

The committee recessed at 5:15 p.m.

Thursday, August 30

The committee reconvened at 9:05 a.m.

Chase Gentry, executive director of the Clovis Industrial Development Corporation, and Gene Hendriks addressed the committee regarding House Bill 606, which was signed into law in the last session. Under the new law, economic development tax funds can be used for tourism-related activities and projects, such as museums, theaters, libraries, galleries, cultural compounds, educational organizations, studios, media laboratories and live-work housing facilities.

Property Tax Limitations — Update and Policy Impact

Tim Eichenberg, director for the Property Tax Division of the TRD, and Al Maury, senior economist for the TRD, gave a presentation on property tax rates, revenue and collection and on property tax limitations. Leo Barraza, deputy assessor for Los Alamos County, and Tracy Langford, a Los Alamos real estate agent representing the Realtor's Association of New Mexico, joined in the discussion regarding property tax inequities and the issues raised by House Memorial 85 and Senate Memorial 45.

The current property tax system generates approximately $1 billion in revenues annually from $43 billion in net taxable value. Approximately two-thirds of the revenues flow to counties and school districts in equal proportions. Slightly less than one-sixth is distributed to municipalities, with the remaining amounts distributed to various health facilities, higher education, conservancy districts and the state for capital construction projects. Approximately 626,000 residential parcels generate $605 million in revenue, with an average residential property tax bill of $970. Approximately 1,040,000 nonresidential parcels generate approximately $377 million in revenue annually, and oil, natural gas and copper ad valorem taxes generate approximately $160 million annually.

Tax rates range from about eight mills to 40 mills, and average about 26 mills statewide on residential property, 30 mills on traditional nonresidential property and 21.6 mills on ad valorem production equipment property.

The presenters briefly explained certain tax limitations, including:

* constitutional 20-mill rate limit;
* $2,000 head-of-household exemption;
* $4,000 veterans' exemption;
* disabled veteran property tax exemption;
* debt limitations on taxable value;
* limitations on increase in value for single-family dwellings owned by low-income owners that are 65 years of age or older or who are disabled;
* yield control provisions; and
* one- and two-year appraisal cycle.

The 3% valuation increase limitation was enacted in 2001 in response to dissatisfaction with property tax increases. After a detailed explanation of how the 3% limitation in Section 7-36-21.2 NMSA 1978 works, the committee heard testimony about concerns with the statute and with property tax law in general, including:

* equity, both horizontal and vertical;
* ease of administration;
* efficiency;
* revenue adequacy; and
* data limitations.

Mr. Barraza discussed the impact of residential property valuation limitations on counties and policy concerns. Under the current 3% limit, a lot of property is locked in at less than market value. Tax on a given property may double if the owner moves and a new buyer purchases the property, resulting in reluctance in property owners to move to a new house. This violates the general theory that good tax policy does not affect a taxpayer's decision to undertake an activity. Other concerns that local government taxing authorities have include:

* a select few are paying the majority of the tax burden required for services that all taxpayers use;
* loss of revenue affects operations;
* loss of valuation affects bonding capacity; and
* specifically, for 2006, Los Alamos had a loss of $99,626,143 in assessed valuation due to the limitation on residential property valuation, corresponding to an actual tax loss of $1,672,507.

Concerns that affect the property tax system and taxpayers include:

* inequities in neighborhoods where homes are very similar;
* confusion in declining markets; and
* title companies understating tax liability, resulting in "tax shock" when taxpayers receive their bills.

Ms. Langford presented her concept of how the law is affecting individuals.

Road Fund Revenue Estimate

Bill Mueller, chief economist for the New Mexico Department of Transportation (NMDOT), and Robert "Bo" Olcott reported on patterns and trends in the road fund. The NMDOT budget for fiscal year 2009 totals $806.7 million, of which $358.7 million are federal funds and $448.0 million are state funds. The five unit-based variables that determine 94% of road fund revenue are:

* number of gallons of gasoline sold;
* number of gallons of special fuels sold;
* number of miles traveled on New Mexico highways by heavy commercial vehicles;
* weight of trucks; and
* number of vehicle registrations.

New Mexico ranks forty-fourth nationwide in gasoline tax, but has the fourth-highest gasoline price at the pump, indicating that there is very little correlation, if any, between the rate of tax on gasoline and the price consumers pay for gasoline.

Among the challenges the NMDOT faces are modest growth in state revenue, flat growth in federal revenue and extraordinary inflation of the cost of materials for road construction that began in fiscal year 2004. As the purchasing power of state taxes has gone down, construction costs have increased.

The committee also discussed whether or not road fund payments to counties are decreasing, railroad crossings, ownership and use of railroad tracks in New Mexico and revenue derived from state-owned railroad tracks.

Energy Challenges in an Era of Change

Art Hull, with PNM's Governmental Affairs Department, reported that New Mexico is using a lot more energy than in the past, which requires a greater level of investment to serve the demand. The increased demand is caused, in part, by population growth, larger homes and many new businesses.

The price of electricity in New Mexico today is 28% below the regional average and 21% below the national average. Today's residential rate is approximately the same as in 1982. However, the cost to produce electricity has gone up. PNM's annual revenue from new customers since 2002 is about $35 million, but the annual cost to serve new customers is about $100 million.

To address the cost issues, PNM is seeking a $68.9 million increase in base rates, which is about a 12% increase.

The committee adjourned at 1:00 p.m.