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

July 25 - 26, 2007
San Juan College
Farmington, New Mexico

The second meeting of the Revenue Stabilization and Tax Policy Committee (RSTP) was called to order by Senator Timothy Z. Jennings, chair, at 9:15 a.m. at San Juan College in Farmington.

Present
Sen. Timothy Z. Jennings, Chair
Rep. Edward C. Sandoval, Vice Chair
Sen. Carlos R. Cisneros
Sen. Kent L. Cravens
Rep. Anna M. Crook
Sen. Dianna J. Duran
Rep. Keith J. Gardner
Rep. Roberto "Bobby" J. Gonzales
Rep. William J. Gray
Sen. Bernadette M. Sanchez
Rep. Daniel P. Silva
Sen. John Arthur Smith
Sen. H. Diane Snyder
Sen. James G. Taylor
Rep. Thomas C. Taylor

Absent
Sen. Mark Boitano
Rep. George J. Hanosh
Rep. Ben Lujan, Speaker of the House

Designees
Sen. Steven P. Neville (NVI)*
Rep. John Pena (AtA)* *
Sen. John C. Ryan
Rep. Henry Kiki Saavedra
Sen. William E. Sharer (AtA)**
Rep. Luciano "Lucky" Varela

Sen. Ben D. Altamirano
Rep. Janice E. Arnold-Jones
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. Stuart Ingle
Sen. Gay G. Kernan
Sen. Cisco McSorley
Rep. Andy Nuñez
Sen. Leonard Lee Rawson
Rep. Debbie A. Rodella
Sen. Nancy Rodriguez
Rep. Don L. Tripp

*** NVI means "No Voucher Issued"**
****AtA means "Approved to Attend"**

Additional Legislators in Attendance
Rep. Ray Begaye (AtA) 7/25/07

Former Legislators
Former Rep. Sandra Townsend

Staff
Legislative Council Service (LCS)
Tim Crawford, LCS
Doris Faust, LCS
Cleo Griffith, LCS
Pam Ray, LCS
Doug Williams, LCS

Legislative Finance Committee (LFC)
David Abbey
Norton Francis
Linda Kehoe

Guests

The guest list is in the meeting file.

Copies of all handouts and written testimony are in the meeting file and in the Legislative Council Service library.

<u>Wednesday, July 25</u>

Welcome and Local Issues

Dr. Carol Spencer, president, San Juan College, Bill Standley, mayor, Farmington, and Dr. Jim Henderson, member and former chair, San Juan County Commission, all welcomed the committee to Farmington and San Juan County.

Dr. Spencer welcomed the committee to Farmington and San Juan College. She explained that renovations at the student center are in progress and that the renovations would provide an expanded cafeteria.

Mayor Standley noted that the Farmington-Aztec-Bloomfield area has been designated a metropolitan statistical area (MSA) because it has a combined population in excess of 50,000. Farmington has 2,200 motel rooms and an aquatic center. The city is hosting the Western States Swim Meet, the Connie Mack Little League World Series and the national finals of a rodeo circuit in 2008.

Dr. Henderson, who was the original president of San Juan College, stated that only 6% of land in Farmington is in private ownership. Twenty-nine percent is federal land, 60% is Navajo Nation land and 5% is state land. There are 743 miles of road and 22 bridges that are maintained by the county. The county as a whole occupies 5,500 square miles and has a population in excess of 100,000. It became a class A county due to the 2000 federal census count.

Tax Incentives and Economic Development

Richard Anklam, president and executive director, New Mexico Tax Research Institute (NMTRI), began the presentation. Dr. Anthony Popp, academic department head, Economics and International Business, New Mexico State University, later joined in the presentation.

Mr. Anklam began by providing a reminder of basic tax principles. NMTRI has adopted the following principles of taxation.

- State and local taxes should be adequate to provide an appropriate level of those goods and services best provided by the public sector, such as education, public safety, law enforcement, streets and highways and the courts.

- State and local tax policy should do the least harm to the private economy. Therefore, tax bases should be as broad as possible so that tax rates can be as low as possible in order to raise the necessary revenues.

- State and local tax policy should be fair and equitable toward individuals and businesses similarly situated. Individuals with the same income level should be taxed the same. Businesses engaged in similar commercial activities should be subject to the same level of taxation.

- State and local tax policy should not be costly to administer and should be easily understood by taxpayers so as to minimize taxpayer compliance costs.

- The state and local tax burden should be evaluated on the basis of the impact of all taxes levied on a given taxpayer, not just on a single tax or tax rate.

- Deviations from established tax policy in pursuit of economic development, social or other goals should be well-reasoned and pursued only when established tax policies are not significantly undermined and the results of such deviations can subsequently be measured and evaluated.

The idea of economic growth is very simple in one sense and very complex in other ways. Most individuals would define state economic growth as the long-term increase in output and per capita income. Another definition would be the increase in the well-being of the residents of the state. How to achieve that long-term growth is the difficult part.

Government has a number of policy options available to promote economic development. The various policies can generally be put into one of three categories: legal policies, spending policies and taxation policies. Legal policies are the rules of the game. Spending policies would include expenditures for infrastructure and amenities, investment in human capital, business assistance centers and general promotion of the advantages of locating in the state. Taxation policy includes the overall tax structure of the state and the various tax incentives that could be granted to particular companies. The question of how to distribute scarce resources between the two sets of policies to enhance economic development effectively and efficiently is an important question.

Any discussion about overall taxes and changes in taxes should be done in the context of what makes a good tax structure. In general, the tax structure should provide adequate revenues, be efficient and equitable, be transparent and be easily administered. A formal statement of these principles was adopted by the NMTRI and is replicated here.

If the state chooses to deviate from the general principles of taxation, the deviation should be well-reasoned and subsequently measured and evaluated. Tax incentives fall into this definition of deviation. Most individuals would agree that, even if the tax incentives passed over the years by the New Mexico Legislature have been well-reasoned, they have not been measured or evaluated.

In general, economic growth will take place when economic base companies expand or new economic base companies locate in the region, selling more output to those outside the region, increasing employment and buying more intermediate goods and services within the region. This is known as the multiplier process. Spending takes place within the region from buyers outside the region. The spending of that revenue by the local firms for labor and intermediate goods and services generates more income to those within the region. The more goods and services and labor purchased within the region, the bigger the multiplier and the better off individuals within the region become (at least in terms of dollars).

The theory behind tax incentives is that the state or regional government unit is providing relief in terms of taxes paid by the business entity. The result of a tax incentive should either cause the cost of production to decrease or the amount of profits subject to tax to decrease. Either situation increases the amount of profit earned by the business. Generally, tax incentives lower the cost of production either through lowering the cost of labor (tax credits for hiring certain types or amounts of labor), capital (lower cost of borrowing) or land (lower property taxes). Given lower costs, profit margins increase, thus enticing firms to expand or enticing new firms to locate in the state or region.

The return to the state or region comes in the form of other tax revenues received. More business means higher gross receipts taxes and higher personal and corporate income taxes. The increase in any particular category depends on the form of the tax incentive package. In order for the tax incentive package to be cost-effective, the increase in other revenues must be large enough to offset the initial loss in taxes the firm does not have to pay.

In order for a tax incentive package to be cost-effective, it must first generate a response from firms and then generate enough business to repay the taxes foregone. In addition, if the goal is to increase the well-being of the residents of the state, the increase in jobs and income should accrue to residents and not to others outside the state. The increase in tax revenues should also be large enough to offset any other increase in costs to the government due to the provision of other services created by the activity.

The literature indicates that general tax incentives are not very cost-effective. In order to get a response from businesses, there has to be a deviation in tax rates across jurisdictions. While there are certainly differences in particular tax rates across states, the deviation in overall taxes is fairly small. Taxes are not very high on the list of considerations when businesses are making location decisions. Taxes are a small cost relative to labor, transportation and utility costs. This is not to say that, after businesses determine a number of places or regions that fit their intended profile, tax structures are not considered important. General tax breaks may give businesses a break for activity that would have taken place even in the absence of the incentives.

Once a firm decides to locate in a particular area, the question then becomes whether or not the activity generates enough other tax revenue to replace that which is lost due to the incentive. This will depend on the size of the multiplier. The size of the multiplier will depend on how integrated that firm becomes with the rest of the local market. If the firm buys lots of inputs from the local market, the multiplier will be large. If the firm buys most of the inputs from out of the region or state, the multiplier will be small. Also, if the firm is selling goods and services to the local market, displacing sales from local firms, the multiplier will be small.

One of the important issues is whether or not the firms receiving the incentives actually hire from the local labor pool. Firms locating in the state or region from outside the state will also relocate a management team and some essential workers. If few workers are hired from the local labor pool, the residents of the state are not better off.

Once a new business locates in the region, governmental services may need to be increased. Pressure may be put on the transportation system, the utility system, the police department, the fire department and the school system. Depending on the types of firms relocating, there may be some environmental concerns that need to be dealt with. In New Mexico, the effect on the water supply is particularly important.

The following principles should be considered:

- If the tax system is not sound, small changes will not affect businesses very much. Any deviations from the tax principles listed above should be well thought out and evaluated.

- Targeted tax incentives will be more effective than general tax incentives. Most incentives are given to business activity that would have occurred in the absence of the incentive.

- Targeting of those companies that will hire substantially from the local market and pay wages relatively high for the skills is needed.

- Targeting of those companies that will have a high multiplier or will entice other firms to relocate because of the existence of the new firm is needed. Most incentives are not cost-effective. Only if the original firm attracts other firms that do not receive the incentive will the overall effect be cost-effective.

- The evaluation of a tax incentive should include considerations of population pressure, traffic congestion, environmental issues and distribution issues.

- Spending on public services and infrastructure has a positive impact on growth. The right mix of spending and tax incentives is important.

- All regions have different economic characteristics. An active business location program with local business participation can be very effective.

Senator Jennings noted that: state government has unmet needs of approximately $200 million to $300 million in water issues; the Retiree Health Care Authority has a $5 billion problem; K-12 education will require between $0.5 billion to $1 billion; and the Educational Retirement Fund still needs $3 billion. When all requirements are totaled, they add up to approximately $11 billion, and the forecast is for only $400 million in new money for fiscal year 2009. These needs should be considered before new tax incentives are created.

Representative Crook stated that she learned a long time ago not to spend more money than that which is taken in.

Representative Sandoval asked about the use of sunset and claw-back provisions. Mr. Anklam responded that sunset provisions are good because they provide for program review; however, he noted that such review has generally not provided sufficient analysis prior to extending tax incentives. Only the City of Albuquerque has been actively pursuing claw backs.

Representative Sandoval asked about the "but for" question. Mr. Anklam agreed that this is always the problem with tax incentives, but he also noted that the Intel Corporation locating in Rio Rancho would surely not have occurred in the absence of incentives.

Representative Sandoval asked if New Mexico has gone too far with tax incentives. Dr. Popp stated that most incentives have benefited large businesses in large cities like Albuquerque, but he does not know if the state has gone too far because the impact of incentives has not been measured.

Senator Ryan asked for a comparison of New Mexico tax policy to that of other states. Dr. Popp responded that 20 years ago, New Mexico had one of the best tax structures of all the states. However, over time, the economy has shifted from commodities-based to service-based and he would now rate New Mexico a C+. Mr. Anklam stated that the pyramiding of the gross receipts tax (GRT) is a problem, but the personal income tax (PIT) is now favorable compared to other states.

Senator Smith was concerned about local government property transfer taxes and tax rates. Mr. Anklam noted that rural parts of the state do not benefit from the property transfer tax. Senator Smith is considering legislation that would restrict local property transfer taxes.

Senator Smith asked about the feasibility of allowing local governments to impose a GRT on commodities such as retail grocery food. Dr. Popp stated that there are administrative problems with local taxes and that rates are already high.

Senator Smith asked for an opinion on proposed tax incentives for Ruidoso related to its water issues. Dr. Popp responded that the best incentive for economic development in Ruidoso is to build water infrastructure.

Senator Snyder asked which NMTRI principle is referred to as the three-legged stool. Mr. Anklam responded that the first principle, related to adequacy, is the three-legged stool principle. Senator Snyder stated that New Mexico does not have a balanced tax system because of the limited use of the property tax.

Senator Snyder asked if other states have a requirement to reduce spending when cutting taxes. Mr. Anklam said that no state has such a requirement; however, numerous states have balanced budget requirements, and this constitutes an indirect method for reducing spending.

Representative Taylor asked about the "real" multiplier. Dr. Popp said that the multiplier depends upon the sector. Generally, 1.30 to 1.75 is an appropriate multiplier for statewide use. For local government, the multiplier would be less.

Update on Current Tax Incentives

Dr. Kelly O'Donnell, deputy secretary, Economic Development Department, Norton Francis, chief economist, LFC, and Jim Nunns, tax policy director, Taxation and Revenue Department (TRD), presented information on tax incentives currently in statute.

Dr. O'Donnell gave some background on tax incentives. She noted that New Mexico has the fifth-greatest rate of job growth in the United States. This is causing an increase in the standard of living in the state. New jobs bring new revenue into the state. The greatest value of tax incentives comes to the state when incentives are targeted at economic base industries that provide high-wage jobs. Dr. O'Donnell used the aircraft manufacturing industry as an example. She noted that it is difficult to identify revenue expectations from incentives. The fiscal impact of most tax credits does not have a great impact on the tax base. For instance, the high-wage tax credits add to approximately $300,000 statewide and the rural jobs tax credit has a statewide impact that is similar.

Mr. Francis discussed the accountability that should be built into tax credits. Although some credits, such as the aviation services tax credits, are reported, it is unclear if those taxpayers are also able to claim, or do claim, other tax credits as well. Very few of the current tax credits have a statutory requirement to report to either the LFC or RSTP. He said that four out of the 45 tax credits now in statute have specific reporting requirements. There are some data available for about 18 of the credits. Corporate income tax credits are especially difficult to monitor because the reporting dates are not specific. A historic archive of tax credits claimed has to be kept to track each corporate taxpayer's claims.

There is also limited transparency. When a taxpayer claims a tax credit, a report should be made available to the public online. Accountability increases the reporting burden on the taxpayer. Use of information from taxpayer reports must be used or released conservatively, and concerted attempts to limit the increased reporting and tracking burden on the taxpayer should be made by the TRD.

Mr. Francis suggested that tax credits be written with a four-year sunset provision to enable the TRD to report on the value of the tax incentive to the state.

Tax increment financing also needs to be reviewed to determine if the projects that have been established are in some way preventing growth in other parts of the state.

Mr. Francis also suggested that the legislature begin to track the issued and outstanding industrial revenue bonds to gain a better understanding of how widely those are used as an economic development incentive and what effect they have on local government tax bases.

Mr. Nunns discussed several projects that the TRD has underway related to tax incentive accountability:

- implementing new legislative requirements for business tax credit disclosure;
- a multiyear tax expenditure analysis that will initially focus on tax credits; and
- a comprehensive review of business tax credits that may lead to recommended legislation to make these credits simpler, more uniform and more effective.

1. Reporting and Disclosure of Business Tax Credits
    - House Bill 667 (Laws 2007, Chapter 164) brought several new business tax credits under the provisions of the Tax Administration Act.
        - o One of these provisions is the requirement under Section 7-1-29 NMSA 1978 that the department make available, for inspection by the public, records related to tax credits claimed in amounts greater than $10,000.
        - o HB 667 clarified that the following information will be provided under this provision: taxpayer name, credit amount, type of business tax credit claimed and the date the credit was issued.
    - Beginning with the 2006 tax year, the TRD has expanded the information captured on tax credits claimed on corporate income tax returns.
    - The TRD will continue to review rules governing public disclosures of business credits to determine whether additional disclosures could aid in making the credits more effective.

2. Tax Expenditure Analysis
    - The department is undertaking a multiyear, comprehensive review and analysis of tax expenditures.
    - This year, the TRD plans to complete a report that describes in depth the conceptual framework of tax expenditures.

Tentative outline of Fiscal Year 2008 report:

A. definition of tax expenditure:
   1. "normal" or "ideal" tax law; deductions and exemptions necessary to define the "normal" tax base; and
   2. deviations from "normal" or "ideal" tax law;

B. uses of tax expenditures:
   1. to evaluate government programs administered through taxes; and
   2. tax reform and tax expenditures;

C. tax expenditure analysis in the federal and state governments;

D. measurement of tax expenditures:
   1. measurement conventions; and
   2. differences from revenue estimates on fiscal impact reports;

E. analysis of tax expenditures:
   1. purposes of tax expenditure provisions;
   2. relationship of tax expenditures and other government programs;
   3. criteria for determining the appropriate form of program;
   4. criteria for measuring the effectiveness of tax expenditures; and
   5. data and analytical methods required for the analysis; and

F. illustration: measuring tax expenditure credits:
   1. income tax credits; and
   2. other credits.

The tax expenditure reports produced in future years will define and measure tax expenditures for a number of specific taxes, with final year reports covering the analysis of the effectiveness of specific tax expenditures.

3. In its review of business tax credits, the TRD is focusing on the goal of having greater uniformity in the structure of the tax credits and seeking improved targeting of businesses that benefit from tax credits. The review will determine if the following are specified in the statutory language of the tax credit:

- a requirement that the credit cover activity or property located in New Mexico;
- specification of qualifying periods, activities, etc.;
- events that should trigger credit recapture and the recapture mechanism;
- certification and ongoing monitoring and evaluation by other departments;
- clarification of "double dipping" potential (more than one credit or deduction for the same expenses);
- circumstances under which a credit should be nonrefundable, refundable or transferable;
- the "stacking sequence" of credits and their stacking order against taxes;
- carry-forward periods; and
- reporting requirements required by the TRD and other state agencies.

Consolidation of some of the credits would also be reviewed.

Dr. O'Donnell replied to a question from Representative Gonzales regarding community college involvement in creating and preparing the workforce for jobs available or that will become available in New Mexico. Although the community colleges can respond to current needs of the workforce, planning for future needs is a problem. Workforce shortages exist in many areas and industries in New Mexico.

Representative Varela noted that the NMTRI is intended to be independent of political pressure and should report to the legislature objectively. He also noted that the Big Mac tax legislation was not a good idea with respect to the property tax.

Representative Varela asked about the current average GRT rate. Mr. Nunns stated that it is 6.6%. Representative Varela also asked about the cost of all GRT deductions and what the tax rate might be if they were all repealed. Mr. Nunns could not estimate the cost of all deductions, but suggested that the tax rate might be one-half of the current actual in the absence of deductions. However, he also noted that, in the absence of deductions, the tax would apply to every transaction, including employee wages.

Representative Varela asked about the status of dynamic forecasting efforts. Mr. Francis responded that the LFC, Economic Development Department and TRD are working on a dynamic forecasting methodology that uses multipliers for fiscal impact reports. He also noted that the federal government, in its use of dynamic forecasting, has found that the most new revenue that can be credited to a tax reduction is 20% of the amount of the reduction.

Senator Jennings noted that if a tax cut creates 20% new money, holding municipalities harmless from a cut creates a windfall for them. Dr. O'Donnell stated that not all tax cuts are economic incentives, e.g., the food GRT deduction creates little or no new economic activity and, therefore, does not generate 20% new money.

Dual Taxation

Mr. Nunns, provided information to the committee on the status of tax sharing between the state and the tribal governments of Indian nations, tribes and pueblos located in New Mexico and tax credits currently in statute that affect tribal governments. Amy Alderman, attorney, Navajo Tax Commission, Darrell Paiz, Revenue and Tax Office, Jicarilla Apache Nation, and Teresa I. Leger, attorney for the Jicarilla Apache Nation, presented to the committee information on the success of the current arrangements with the state to eliminate dual taxation on businesses doing business on tribal land within New Mexico.

Intergovernmental agreements between tribal governments and the state, intergovernmental tax credits and specific statutory and regulatory provisions are all aimed at the avoidance of dual taxation of income, sales and property under Indian and state tax systems.

Under Section 9-11-12.1 NMSA 1978, the department may enter into agreements with the Pueblos of Acoma, Cochiti, Isleta, Jemez, Laguna, Nambe, Picuris, Pojoaque, Sandia, San Felipe, San Ildefonso, San Juan, Santa Ana, Santa Clara, Santo Domingo, Taos, Tesuque, Zia or Zuni or the 19 New Mexico pueblos acting collectively, the Jicarilla Apache Nation and the Mescalero Apache Tribe to collect any GRT imposed by the pueblos. If a pueblo, tribe or nation grants a 25% credit against its tax and meets other specified conditions, the state will grant a 75% credit against state and local GRT due from taxpayers subject to both taxes. The result is that taxpayers pay the same tax they would pay under state and local taxes alone, thus resolving any dual taxation issues. Tribal taxes only apply to businesses operating on land owned by a tribe or its members, with restrictions against alienation, or held by the United States in trust for the tribe.

The TRD has currently entered into eight such agreements with the Pueblos of Santa Clara, Santa Ana, Laguna, Sandia, Nambe, Pojoaque and Cochiti as well as the Jicarilla Apache Nation. A ninth cooperative agreement with the Pueblo of Santo Domingo will become effective on January 1, 2008.

The department estimates that a total of $1.27 million in tribal taxes was collected and distributed in fiscal year 2007. In addition, $5.0 million of GRT was collected from nontribal businesses doing business on tribal lands. Of this amount, $3.8 million was distributed to the pueblos/nations and $1.2 million to the state and local governments. Details on these revenues are provided in Table 1 attached to the TRD handout.

Section 67-3-8.1 NMSA 1978 gives the secretary of transportation the authority to enter into a gasoline tax-sharing agreement for up to 10 years with the Pueblo of Nambe or the Pueblo of Santo Domingo as long as it owns 100% of a registered Indian tribal distributor pursuant to the Gasoline Tax Act. The agreement provides that the tribal distributor receive 40% of the gasoline tax revenue paid on 2.5 million gallons per month ($170,000 per month/$2,040,000 per year), while the state and local governments share the remainder of the 60% paid on that gallonage. In exchange, the tribal distributor will not distribute gasoline for resale outside the boundaries of the reservation or pueblo land grant, and will not claim any of the deduction it is otherwise entitled to under Section 7-13-4 (F) NMSA 1978. Section 7-1-6.44 NMSA 1978 allows the TRD to make the necessary distributions pursuant to this gasoline tax-sharing agreement. Distributions have been made under these provisions beginning in March 2004. The cumulative amount distributed to the tribes to date is $13,260,000. The amount shared by the state and local governments is $19,890,000. The $33,150,000 is revenue that would otherwise not be collected by the state due to the exemption in Section 7-13-4 (F) NMSA 1978. The local government share is approximately 10% of the total tax, leaving $16,575,000 that is distributed to the State Road Fund as a result of these agreements.

Section 7-31-27 NMSA 1978 creates a "Jicarilla Apache tribal capital improvements tax credit" against oil and gas emergency school tax on products severed from wells drilled on the Jicarilla Apache Nation. The credit is the lesser of the amount of tribal capital improvements tax imposed by the Jicarilla Apache Nation upon the same products, or seven-tenths of one percent of the taxable value of the products as defined by state laws. The tribal capital improvements tax was imposed on qualifying wells after January 1, 2003 and is dedicated exclusively to fund capital improvements on tribal land. The credit is in addition to the credits claimed under Section 7-29C-1 NMSA 1978.

The credit is allowed only if the Jicarilla Apache Nation has entered into a cooperative agreement with the secretary of taxation and revenue for the exchange of information necessary for the administration of the credit. The TRD and the Jicarilla Apache Nation have entered into such an agreement. An average of $1.9 million in credits was claimed in each of the last two fiscal years. Figures for prior fiscal years are shown in Table 2 attached to this report. These amounts come from revenue that would otherwise be distributed to the general fund.

Section 7-1-8(U) NMSA 1978 authorizes the TRD to provide tax information to an authorized representative of an Indian nation, tribe or pueblo whose territory is within New Mexico pursuant to an information-sharing agreement with the Indian nation, tribe or pueblo. The Indian nation, tribe or pueblo must have enacted a confidentiality statute similar to Section 7-1-8 NMSA 1978. The information exchanged under such an agreement is to be used by either government entity for the administration of its respective tax laws to ensure the proper enforcement of the tax laws of each government. Currently, the department has entered into the following information-sharing agreements:

- joint powers agreement (gasoline tax) — Jicarilla Apache Nation;
- exchange of information agreement (various tax programs) — Navajo Nation;
- joint powers agreement and information-sharing agreement (fuel taxes) — Pueblo of Zuni;
- joint powers agreement and information-sharing agreement (fuel and GRTs) — Pueblo of Nambe;

- joint powers agreement (gasoline tax) — Pueblo of Laguna;
- joint powers agreement (gasoline tax) — Pueblo of Cochiti; and
- joint powers agreement (gasoline tax) — Pueblo of Santo Domingo.

Section 66-5-27.1 NMSA 1978 authorizes the Motor Vehicle Division (MVD) of the TRD to enter into intergovernmental agreements with Indian tribes to exchange information for the purpose of recording traffic convictions. Provided an intergovernmental agreement has been signed, this section gives the MVD authority to suspend or revoke a driver's license when an offense is committed within a tribal jurisdiction, provided that the offense would have been grounds for such action had it occurred within the jurisdiction of the state. The MVD is further authorized to suspend or revoke the license of a driver who has failed to appear in tribal court or has failed to pay a penalty assessment imposed by the tribe. This section allows the MVD to forward to a tribal court the records of a resident driver subject to the jurisdiction of the tribe. This law also mandates recognition of a DWI conviction pursuant to tribal law. The department has not yet entered into any such agreements.

Taxpayers who are liable for payment of the oil and gas severance tax, the oil and gas emergency school tax, the oil and gas conservation tax or the oil and gas ad valorem tax ("the four monthly taxes") on products severed from Indian tribal lands are eligible for this credit (Section 7-29C-1 NMSA 1978). The credit is equal to the lesser of 75% of: (1) the aggregate amount of the four monthly taxes imposed by the Indian nation in effect on March 1, 1995; or (2) the aggregate amount of the four monthly taxes imposed by the state. A separate credit is available against the oil and gas production equipment ad valorem tax ("annual tax"). This credit is also equal to the lesser of 75% of the tribally imposed tax or the state tax. Both credits are available only for production from wells that were drilled on or after July 1, 1995.

An average of $4.4 million per year has been claimed in each of the last two fiscal years. Figures for prior fiscal years are shown in Table 2 attached to this report. About half of these credits apply against general fund taxes, 45% against oil and gas severance taxes and the remainder against local taxes.

Section 9-11-12.2 NMSA 1978 provides a GRT credit (Section 7-9-88.1 NMSA 1978) on receipts from selling coal severed from Navajo Nation land when the Navajo Nation imposes a similar tax. An agreement with the Navajo Nation concerning this credit has not been entered into.

An average of $8.6 million in credits has been claimed in each of the last two fiscal years. These amounts come from revenue that would otherwise be distributed to the state general fund.

Taxpayers liable for the severance tax on coal severed from tribal land are eligible for a credit for a portion of similar taxes paid to a tribal government on that coal (Section 7-29C-2 NMSA 1978). The credit amount is 75% of the lesser of : (1) the tax due under tribal taxes in effect on March 1, 2001; or (2) the amount of severance tax and surtax due to the state. An average of $6.6 million per year in credits has been claimed in each of the last two fiscal years from revenue that would have gone to the Severance Tax Bonding Fund.

Ms. Alderman described the tax system of the Navajo Nation. The two main Navajo Nation taxes imposed are the possessory interest tax imposed on the right to operate a business or other enterprise within Navajo Nation jurisdiction and the business activity tax (BAT) levied on sales that take place within Navajo Nation jurisdiction. In addition, the Navajo Nation has imposed a fuel excise tax on gasoline and on diesel fuel. The distributor of fuel to retailers of gasoline on the Navajo Nation may claim a deduction against the state tax on the same gasoline in an amount equal to the fraction of the state tax that the tribal fuel tax represents, not to exceed a deduction of 100% of the state tax. This deduction is set forth in Section 7-13-4.4 NMSA 1978.

Ms. Alderman continued by saying that this deduction does not apply to the diesel fuel tax, so any person who purchases diesel on the Navajo Nation must pay both the tribal fuel excise tax and the special fuels excise tax imposed by the state. This is a total of $0.36 per gallon of gasoline. She also noted that the taxes imposed by the Navajo Nation are imposed nationwide and not just in the part of the nation in a particular state. All fuel excise taxes go into a fund to be used for Navajo Nation road maintenance

Mr. Paiz and Ms. Leger described the Jicarilla Apache Nation tax structure. The Jicarilla Apache Tax Department was established in 1975. The following taxes are presently imposed:

- privilege tax, J.A.N.C. § 11-2-2;
- possessory interest tax, J.A.N.C. § 11-2-3;
- severance tax, J.A.N.C. § 11-2-3;
- gasoline tax, J.A.N.C. § 11-2-4;
- capital improvements tax, J.A.N.C. § 11-2-5; and
- GRT, J.A.N.C. § 11-2-6.

Court cases on the Jicarilla Apache Nation's right to tax and dual taxation are as follows:

- *Jicarilla Apache Tribe v. Merrion*, 455 U.S. 130 (1982), inherent sovereign right of tribe to impose taxes; and
- *Cotton Petroleum v. New Mexico*, 490 U.S. 163 (1989) dual taxation of non-Indian producer allowed. In evaluating facts, the court noted that an important consideration was that dual taxation placed no economic burden on the tribe. The tribe was not a party to suit and, therefore, the court did not have before it information on economic burden dual taxation imposed on the tribe.

The tribe provides 90% of funding for government services available on the reservation. It is estimated that the state receives approximately $20 million to $23 million a year from oil and gas production taxes on the Jicarilla Apache Reservation.

Senator Taylor stated that Navajo tax revenue does not filter down to certain chapters of the Navajo Nation. Ms. Alderman responded that sales tax collections are not general fund revenue and that this revenue is put in a trust fund. Fifty percent of the earnings on the sales taxes in the trust fund are divided equally among the chapters. Only six chapters are certified pursuant to the Navajo Nation Local Governance Act and are able to receive and administer their own funds, out of 110 chapters. A certified chapter, among other administrative duties, retains sales tax revenue generated within the chapter and does not have to wait for the revenue-sharing distributions from the trust fund. The certified chapters are mostly in Arizona and are the following: San Juan, Shonto, Steam Boat, Newcomb, Tuba City and Hogback. San Juan, Newcomb and Hogback are chapters in the Shiprock area.

Senator Taylor suggested that the capital of the Navajo Nation should be in Shiprock, not Window Rock. He also inquired about the status of the Desert Rock power plant. Ms. Alderman said that a tax incentive has been approved by the Navajo Nation Council but that no further incentives are under consideration.

Representative Begaye asked what problems do private companies who want to produce oil or gas or develop other extractive resource operations face when seeking to begin business on the Navajo Nation. He also requested a list of companies drilling oil on Navajo land. Ms. Alderman said that 12% of all revenue collected by the Navajo Nation in taxes is deposited into the permanent fund. Oil and gas companies must enter into oil or gas leases. Possessory interest tax and an oil and gas severance tax are imposed on the revenue generated from the extracted product. The Bureau of Indian Affairs still must approve all mineral extraction leases on Indian land.

Representative Crook noted that it appears that a lot of money appropriated to the Navajo Nation for capital outlay projects is not being used.

Senator Snyder observed that the State Road Fund is bankrupt, and part of the problem is the diversion of gasoline tax revenue due to agreements with the tribes.

Senator Ryan noted that dual taxation is a disincentive to economic development.

Senator Duran asked about the percentage of Navajo land in New Mexico, Arizona and Utah. The amount of land is 17.5 million acres, and approximately 35% is in New Mexico.

Senator Jennings said that New Mexico capital outlay appropriations to the Navajo Nation are appropriated to be spent in New Mexico. He also noted that the federal government is not paying its fair share of Indian health care.

Produced Water — Current Disposition and Status and Future Possibilities

Mark Fesmire, director, Oil Conservation Division (OCD), Energy, Minerals and Natural Resources Department, and John Volkerding, basin disposal, gave a presentation to the committee.

Mr. Fesmire explained that when a well is new, very little conventional produced water is created. As the well ages, more and more conventional produced water is created in the drilling process. Last year, New Mexico produced approximately 60 million barrels of oil and about 1.6 trillion cubic feet of natural gas. But, along with that oil and gas, New Mexico produced over 640 million barrels of produced water. That is about 83,000 acre-feet of water. Most of that water is of such a poor quality that it is unusable for almost any purpose and must be disposed of, usually by injecting it back into the ground. Sometimes this injection is for secondary recovery or pressure maintenance, and sometimes the injection is an expedient way to dispose of the wastewater. However, desalinization and purification technology is quickly making this waste a potential asset.

Produced water in New Mexico can be categorized into two types, conventional produced water and water associated with coal bed methane (CBM) production. Conventional produced water occurs in volumetric oil and gas reservoirs and is generally created by the concentration of seawater components present when the geologic formations were originally deposited. CBM produced water is the water that is present in coal deposits, which is produced with the methane, and may or may not be associated with the original deposition of the coal. Last year, the produced water in New Mexico was made up of about 94.5% conventional water and about 5.5% CBM water. However, the production trend for conventional produced water was relatively flat, while the amount of CBM produced water has tripled since 2000.

While the water quality of both can be extremely variable, it can generally be said that CBM produced water is of a much higher quality than conventional produced water. Another major difference is the water production profile during the life of the well. Another difference between conventional produced water and CBM produced water is seen in the water production profile, in that CBM produced water will generally begin as a large percentage of the total production, as much as 100%, and tapers off over the life of the well. Conventional produced water (along with the oil and gas) is contained in the pores and fractures of the reservoir rock. CBM produced water also occurs in the pores and fractures (called cleats) in the coal, but the gas, at least initially, is usually present as molecules adsorbed to the face of the coal, and the pressure that keeps the gas adsorbed to the coal is provided by the hydrostatic column of water.

Removing the water from the coal lowers the hydrostatic pressure and causes the gas to begin desorbing and flowing through the cleats to the well bore. In conventional oil and gas production, the water is produced with the oil and gas, whereas CBM reservoirs must be "dewatered" to the point that the pressure is less than the desorption pressure before the gas will begin to flow to the well. Additionally, coal bed waters can contain coal fines that are generally not present in conventional produced water, but CBM waters will not contain the hydrocarbons prevalent in conventional produced water. Also, conventional produced water can be produced from geologic formations at virtually any depth, where CBM, and consequently CBM water, is usually produceable from depths less than 3,000 feet.

A characteristic related to the depth of the produced water is whether the produced water is in hydrologic connection, or hydrologic communication with currently usable water. If the production of the produced water will deplete the pressure or decrease the volume of usable water, it is said that the water sources are in hydrologic communication. The deeper the water and the poorer the quality, the less likely it is to be in hydrologic communication with usable water. Conversely, production of high-quality produced water from shallow depths is more likely to deplete usable water supplies than deeper production.

At present, there is no indication any place in the state where the produced water is in hydrologic communication with usable water supplies, but there is a possibility that this may occur in the Raton Basin. The quality of the produced water is not always bad, and as purification technology advances, more and more of it can be treated economically and put to some sort of use.

In 2004, the legislature passed, and the governor signed, a bill that became Section 70-2-12.1 NMSA 1978. It says, "No permit shall be required from the state engineer for the disposition of produced water in accordance with rules promulgated pursuant to Section 70-2-12 NMSA 1978 by the oil conservation division of the energy, minerals and natural resources department". As long as this water is a waste byproduct of the production of oil and gas, and as long as the OCD promulgates rules regulating its "disposal", no permit will be needed from the state engineer for the use of that water.

At least in New Mexico, produced water does not fall within the jurisdiction of the state engineer, but is the regulatory responsibility of the OCD. This includes the purification and use of that water. In regulating the produced water, the OCD has identified three potential areas of regulation in which it must eventually promulgate rules. The first is that the state must promulgate rules that clearly establish the ability to use the water. The second area is the regulations governing the actual use of the water to protect the environment, and the third area is the disposal of the water after it has been used so that the state does not violate state or federal laws or cause contamination.

The OCD has a draft of these proposed rules and will be holding stakeholder meetings, tentatively scheduled to begin in early October, to receive input on the regulation of produced water. At the same time, the OCD will comply with Senate Memorial 53 of the last legislative session requiring the secretary of energy, minerals and natural resources to convene an executive task force to review options for use of produced water. During these meetings, the OCD will try to comply with some basic principles in creating the rules on the use of produced water.

Representative Gray asked who would own the cleaned-up water. Mr. Fesmire said that the company that cleans it would own it.

Senator Jennings questioned a tax credit that will reduce general fund revenue and not create a significant amount of usable water.

Mr, Volkerding described Basin Disposal, his business, as the largest produced water disposal facility in northwest New Mexico. It has experienced an increase of 2.5 million barrels in the quantity of the produced water it has handled in the last year. Basin Disposal receives both conventional produced water and CBM produced water. The total of produced water in northwest New Mexico is now 4.0 million barrels annually. There are two methods that best treat produced water. Multiple stage flash evaporation is a proven technology that is simple to operate. It is used on cruise ships to recycle saline water. The disadvantage of this method is that natural gas is required to heat the water. A high volume of natural gas is needed for this purpose. Only 50% of the water is able to be reclaimed.

The second method commonly used is advanced membrane technology coupled with reverse osmosis. Water is first treated using permeable membranes to filter out particulates. Then the water is treated with biological agents that will aerobically convert solid and liquid hydrocarbons. The disadvantage to this method is the high amount of capital outlay money required to initiate use of the method. Advanced membrane technology is not as well proven as multiple stage flash evaporation.

Oil and Gas Industry Update: The Water Dog Project and the Produced Water Options Task Force

Bill Carr, co-chair, New Mexico Oil and Gas Association (NMOGA), and Deborah Seligman, government relations, NMOGA, continued the discussion of oil and gas industry issues. Gary Kilpatric, chair of the NMOGA Legislative Affairs Committee, joined them to discuss prior legislative initiatives.

Mr. Kilpatric noted that the following legislation was adopted in the 2007 legislative session:

- functional and economic obsolescence;
- overweight and oversize permits for transport of oil and gas equipment; and
- the Surface Owners Protection Act.

The Surface Owners Protection Act brought the oil and gas industry, the agricultural industry, represented by the cattle growers, and environmental interests together to resolve problems with oil and gas use of the surface rights above the industry's mineral rights. The practices of the oil and gas industry to proceed to develop resources without taking into consideration the interests of the surface owners were changed to require procedures that include consideration of the surface owner's desires. Now, more time must be allowed to provide notice, and a proposed surface use agreement must be completed to allow production to go forward. For developing oil or gas that will not disturb the surface, five days' notice must be given to the surface rights holders, and if the surface will be disturbed, the notice must be at least 30 days.

Ms. Seligman discussed the Governor's Greenhouse Gas Initiative (GGGI). She noted that CBM produces carbon dioxide (CO_2). The governor's effort would return greenhouse gases by 2012 to the level of greenhouse gases present in 2000. By 2050, greenhouse gases would be reduced by 75% of current levels. Two processes that will help achieve this reduction are sequestration of CO_2 emissions from burning oil and gas. Currently, the state is able to register emission levels and will require all industry in the state to participate in the registration.

Representative Saavedra sought information about the level of involvement of the oil and gas industry in determining the outcomes from the GGGI. Ms. Seligman stated that the industry helped the governor's task force build background on industry emissions levels and content. The TRD is charged with developing financial incentives that will help achieve the goals of the GGGI.

Ms. Seligman also discussed the climate registry, a hemispheric effort involving 31 states and two provinces, to track climate change.

Mr. Carr discussed regulatory justice and the problems that develop from an uncertain regulatory climate for industry. Right now, Mr. Carr claims, regulatory changes are coming more quickly than industry can adjust to them. The regulatory changes are also coming in areas that are not traditional areas of regulation, such as sequestration and water issues. He noted that common goals between industry and the state have been identified, such as safety, human health and preservation of the environment. The oil and gas industry will help to develop the rules and regulations that are needed. The rules should fall within the delegated authority of the regulatory agency. Factors to be considered in establishing a regulatory framework are costs to the industry and feasibility to achieve the regulation. Stable industry revenue streams to the state rely on a stable regulatory environment for industry. As the committee knows, the oil and gas industry has provided the state with $25 billion in capital outlay funding over the last few years. Increased regulation causes the best operators in the state insecurity about whether they are meeting the requirements of the new regulatory scheme. The oil and gas industry is subject to regulations from the OCD, the Oil Conservation Commission (OCC), the State Land Office (SLO), the Cultural Affairs Department (CAD), the Bureau of Land Management (BLM), the Interstate Stream Commission (ISC), the Department of Game and Fish and from counties and courts. The CAD has laws with which it is difficult to comply. The BLM in May 2007 expanded state and fee surface regulation where there are minerals. The ISC has five-year term easements unless there is an exemption from the State Board of Finance (BOF). The BOF is pulled in many directions and has many issues to deal with, making an exemption unlikely or time consuming to obtain. Counties are establishing their own rules that are difficult to keep track of and courts have not decided that the OCD has primacy regarding much of oil and gas development and rulemaking. The OCD also slows down the process of making rules. Mr. Carr feels that politics trump technology. The NMOGA is appealing new enforcement rules. Orphan wells are an issue, and the OCD is trying to prevent orphan wells from becoming a problem of the state. It took over one year for the OCD to issue surface waste management rules. Initially, these rules were scheduled to be completed in one month, but due to involving others besides the stakeholders, it took much longer.

Mr. Carr thinks a new approach could be effective. He thinks that the OCD could address environmental concerns, but the impact on the oil and gas industry is not clear. Right now there is no place to dump the soil that is cleaned up from oil and gas production sites. The industry feels it is being held up to a higher standard than other industries. Pit waste also presents a problem because there is no place identified where it can be dumped. The rule for this is supposed to be out in mid-August. The cost of all this regulation may push oil and gas development elsewhere. All the industry is seeking is a reliable, predictable regulatory environment.

The CAD focuses on its issues and rules, but fails to address large pieces of the puzzle that might allow the CAD to operate compatibly with the oil and gas industry. Technologies such as horizontal drilling should be considered to abate damage to some cultural properties. The OCD needs to develop rules on acid gas injection wells, where CO_2 is injected into wells to increase production. Also, rules need to be developed for cleaning up tailings ponds from potash development, which are very salty. The clean-up rules are not the same as the OCD rules.

Representative Gray noted that CO_2 disposed of in a well and that is then capped with cement will eventually cause deterioration of the cement cap. He questioned Mr. Fesmire, asking if he knows who would be responsible if the cement cap fails. Mr. Fesmire noted that there is a $60 million grant from the federal Department of Energy nationwide that will have a project on CO_2 sequestration in northwest New Mexico.

The implementation plan for proposed revisions to 20.2.73 NMAC regarding greenhouse gas (GHG) emissions is as follows.

2007

- June — release draft implementation plan for GHG gas emissions reporting under proposed revisions to 20.2.73 NMAC.
- July — begin public comment period regarding revisions to 20.2.73 NMAC.
- September — release GHG emissions reporting procedures to be used (by Title V sources for $C0_2$ emissions) during 2008 if revisions to 20.2.73 NMAC are adopted.
- October — propose revisions to 20.2.73 NMAC before the Environmental Improvement Board.
- October — the New Mexico Department of Environment (NMED) will finalize GHG emissions reporting procedures for the 2008 reporting year.
- If revisions are adopted, inform Title V sources that emissions inventories for 2008 must include $C0_2$ from combustion and vented $C0_2$ if above a threshold level.

2008

- Title V sources will collect data regarding fuel, fuel use and vented $C0_2$.
- The NMED will outreach to major sources to inform them of additional 2009 Title V source inventory requirements for GHGs (see below).
- The NMED will outreach to minor sources to inform them of 2009 minor source inventory requirements for criteria pollutants and $C0_2$ emissions from combustion and venting.
- As funding allows, the NMED will expand upon existing studies of area source and minor source GHG emissions in New Mexico, particularly emissions in the oil and gas sector and, if the need is indicated, develop proposals for additional minor source GHG reporting for 2010.

- October — the NMED finalize GHG emissions reporting procedures for the 2009 reporting year.

2009

- Title V sources will collect data regarding fuel, fuel use and vented $C0_2$.
- Title V sources will submit 2008 GHG emissions data with annual criteria pollutant emissions inventory report.
- Minor sources will collect data regarding fuel, fuel use and vented $C0_2$, along with information needed for criteria pollutant emissions inventory.
- The NMED will outreach to major sources to inform them of additional 2010 Title V source inventory requirements for GHGs (see below).
- The NMED will announce proposals, if any, for additional minor source GHG reporting for 2010 and outreach to affected sources.
- October — NMED will finalize GHG emissions reporting procedures for 2010 reporting year.

2010

- Title V sources will collect data regarding fuel, fuel use, vented $C0_2$ and direct emissions from the other five GHGs.
- Title V sources will submit 2009 GHG emissions data with annual criteria pollutant emissions inventory report.
- Minor sources will submit 2009 GHG emissions data with criteria pollutant emissions inventory report.

Mr. Carr noted that the industry needs regulatory certainty and would like the legislature to be involved.

Senator Ryan stated that the governor's executive order is very ambitious and that the legislature should be involved.

Senator Smith said that the industry needs to go to court sometimes. Congress and the state legislature have abdicated their responsibility concerning regulatory matters.

Staff was asked by the committee to schedule a future presentation by the NMOGA to discuss the loss of oil and gas activity from the state due to an uncertain regulatory climate.

The New Mexico Oil and Gas Safe Site Program and Award

Butch Tongate, bureau chief, New Mexico Occupational Safety and Health (OSHA) Bureau, Environmental Protection Division, NMED, presented the first Oil and Gas Safe Site Program Award to Aztec Well Service (AWS). Jason Sandel accepted the award for his company, AWS. AWS has 750 employees and is the third-largest employer in San Juan County. Mr. Sandel agreed with the NMOGA representatives, especially Ms. Seligman and Mr. Carr, who emphasized the need for a reliable and predictable regulatory environment so that business can thrive. Mr. Tongate noted that AWS has a program that works well and it has a stable and professional workforce.

The committee recessed at 5:21 p.m.

<u>Thursday, July 26</u>

Senator Jennings reconvened the meeting at 9:11 a.m.

Current Status of Air Service — Farmington Area

Mike Miller, city manager, Farmington, discussed the discontinuation of air service to Farmington by Mesa Airlines.

The City of Farmington's Four Corners Regional Airport was notified that Mesa Airlines will cease to provide B1900 scheduled air service to Albuquerque on August 19, 2007. Mesa Airlines was providing one roundtrip flight daily to Albuquerque, with an average seat cost of $148 per roundtrip plus tax. The average daily use of the flights is 8.5 persons, with a capacity of 19 passengers. This constitutes 10% of the airline seats used at the Four Corners Regional Airport.

The departure of Mesa Airlines from the small community air service market is an across-the-board business decision by Mesa Airlines and affects all communities currently being served by the B1900 aircraft. This, certainly, is not a decision based on service to Farmington alone.

When the city first heard rumors that Mesa Airlines would be departing, the city immediately started the search for a replacement carrier that would fill the flight void. The city first turned to Farmington's most reliable air carrier, Great Lakes Airlines. In several conversations with the president and CEO of the airline, the company expressed a desire to expand services to Farmington and agreed to take a serious look at all opportunities to do so. Great Lakes Airlines is currently trying to purchase additional B1900 aircraft to provide such service. It is also awaiting the results of essential air service (EAS) bids that would free up an -existing aircraft that it could move to Farmington. The results of the bids will be known on July 19, 2007.

In addition to contacting Great Lakes Airlines, the city asked Fixed Base Operators if it would be interested in providing enhanced air charter services to Albuquerque to provide a means of air transportation if no scheduled airline services are available. 7Bar Aviation responded that it would be interested, and it is currently surveying the feasibility of the venture.

The city also found the name of the air service provider that was bidding on other New Mexico EAS routes vacated by Mesa Airlines. The airline was, at that time, Pacific Wings of Maui, Hawaii. Pacific Wings has since established a local company known as New Mexico Airlines. The city contacted it, and on June 9, it flew an aircraft to Farmington for an introduction to the community. It is flying the single-engine, nine-passenger Cessna caravan aircraft. Although this would be a downgrade in size from the twin engine, 19-passenger Beechcraft 1900 aircraft, the Caravan is a reliable airframe with an excellent safety record. New Mexico Airlines has since taken delivery of three aircraft for routes in New Mexico. It has stated that the aircraft cabins are not pressurized.

The city met with the CEO of New Mexico Airlines in Mr. Miller's office on Monday, July 16, to discuss the details of a draft agreement for it to provide air service from Farmington to Albuquerque. The following points of agreement were reached and will serve as the basis of the official proposal to the city council.

- There will be two flights per day, Monday through Friday, and one flight per day, Saturday through Sunday.
- Ticket prices are 5% less than that currently paid on Mesa Flights (approximately $70.48 one way).
- $325,000 subsidy paid to New Mexico Airlines per year for two years. This is contingent upon the city receiving funds from the Federal Aviation Administration (FAA) for a Small Community Air Service Development Program (SCASDP) project for which it has applied ($650,000 total).
- The agreement is dependent upon the receipt of the SCASDP funds from the FAA and the approval of the city council. Should the funds not be available or the city council not approve the agreement, the deal is off.
- Should the city receive the SCASDP funds, the city is obligated to fund a local share of $119,706 in matching funds or in-kind service. Of these matching funds, $15,000 must be spent by the city to market commercial air flights from the Four Corners Regional Airport in support of this grant.
- New Mexico Airlines has provided a fare summary break-even report that will be submitted to the FAA along with a letter of interest to show commitment to the project. The city is trying to convince the FAA to do two things: (1) award the SCASDP grant money to use for this purpose; and (2) extend the grant period to match the two-year agreement period.

The departure of Mesa Airlines presents a modest impact to the Four Corners Regional Airport. The city will still have far more scheduled airlines options than any other airport in New Mexico, except the Albuquerque International Sunport, with over 41,000 annual seats available to over 250 destinations worldwide.

Representative Silva inquired about the locations that might be served by New Mexico Airlines. Mr. Miller said it is considering Farmington, Albuquerque, Santa Fe and Durango.

Senator Ryan suggested a government subsidy to the airline in order to reduce air fares for New Mexico residents.

Senator Smith asked what other airlines serve Farmington. Mr. Miller said that Great Lakes Airlines flies to Phoenix and Durango from Farmington. Senator Smith noted that it is difficult for the state to commit to a recurring subsidy because oil and gas revenues will eventually decline. Mr. Miller responded that the subsidy is only intended to build ridership and would not be long term.

Representative Silva suggested that the Department of Transportation should be working on a statewide plan for serving small New Mexico airports.

Representative Taylor supports a short-term, perhaps two-year, subsidy in order to develop reliable air service. He noted that the nine passenger Cessna Caravan is an ideal aircraft for regional service.

Senator Cisneros asked how much of a subsidy would be needed. Mr. Miller responded that a two-year match for the federal funds would reduce airfares and would cost approximately $120,000 per year.

Senator Jennings noted that a key to building ridership is reliability. Mesa Airlines flies when it wants to and cannot be counted on.

Consensus Revenue Estimate

Jan Goodwin, secretary of taxation and revenue, introduced the topic of the consensus revenue estimate by thanking the economists involved for their participation and cooperation. She identified the people who worked on the consensus estimate as: Mr. Francis; Stephanie Schardin, deputy chief economist, LFC; Laird Graeser, chief economist, Department of Finance and Administration (DFA); Tom Clifford, chief economist, TRD; and Bill Mueller, chief economist, Department of Transportation.

Mr. Graeser began the discussion of the preliminary consensus estimate. He noted that the national economy seems to be in a nervous recovery, and the state economy seems to be doing well at this time. The revision of the December forecast numbers was $24.3 million and was the least revision made in many years. The forecast was very solid. Overall, general fund recurring revenue is expected to total $5.69 billion for fiscal year 2007, or by 2% over the fiscal year 2006 recurring revenue total. This is an increase in $450 million in recurring revenue.

The July revenue forecast may be summarized as follows:

FY07:

- The preliminary estimate for actual collections is $24.3 million higher than the December 2006 forecast, adjusted for tax law changes. This will leave the general fund operating reserve of $91.3 million.

FY08:

- The new forecast is $126.5 million higher than the forecast used for building the budget during the 2007 session. Total general fund revenue is now expected to be

$5,895.5 billion. During the next session, this revenue will be available for appropriations in addition to the operating reserve noted above.

FY09:

- The forecast for revenue growth from 2008 to 2009 is modest at 3.9%. However, because this is based on a higher fiscal year 2008 estimate, it means that the outlook is $176.8 million higher than was believed to be the case last January. Once again, this takes into account all tax law changes.
- The result of these changes is that the estimate of "new money" for fiscal year 2009 is $417.9 million on a recurring basis.
- Per capita income data rank New Mexico at forty-sixth in the nation, above Louisiana, Mississippi, West Virginia, Utah and Arkansas.

All reserves taken together, including the Tobacco Permanent Fund, etc., should exceed $0.5 billion at the start of fiscal year 2008.

Representative Varela noted that spending needs to decline by 3% to 4% from fiscal year 2007 to 2008 in order to build the operating reserve.

Senator Cravens asked about corporate revenue. Secretary. Goodwin said that it is being driven by oil and gas profits. Mr. Graeser noted that two-thirds of corporate income tax revenue is from the minerals sector.

Senator Smith is concerned about local government GRT revenue declining because of a slowdown in construction.

Senator Taylor asked about factors other than oil and gas driving revenue. Mr. Graeser responded that manufacturing, e.g., Eclipse Aviation, Intel, electric cars, is helping.

Coal Surtax, Review Senate Bill 220 (Vetoed)

David Saliba, manager, Four Corners Power Plant, Arizona Public Service Company (APS), Justin Jones, governmental relations, BHP-Billiton (BHP), and Joe Grennwalt, BHP, presented Senate Bill (SB) 220 and their case for submitting a similar bill in 2008.

SB 220 was sponsored by Senate President Pro Tempore Altamirano during the 2006 legislative session. SB 220 phased out the coal surtax by June 30, 2009. SB 220 passed both houses of the legislature in 2007. SB 220 received a "pocket veto" in that it was not signed into law by the deadline; therefore, it did not receive a veto message from Governor Richardson, but the veto is thought to have been a comment on the air quality degradation in the Four Corners area caused by coal-fired power plants and the open pit mining of coal.

A dialogue between the Governor's Office and interested parties, APS and BHP's Navajo Coal Company (BNCC) was requested. Representatives of all three groups met at the Four Corners Power Plant on May 25, 2007. The air quality in the Four Corners area is not significantly degraded below national standards. Federal Environmental Protection Agency (EPA) data indicate that the Four Corners area has air quality that is a fraction of a percent lower than national ambient air quality standards. The Four Corners Power Plant is in the process of meeting or exceeding all ambient air quality standards of the EPA. The sulfur dioxide (SO_2 or SOX) levels will be reduced by 100 tons, and APS has searched for leadingedge technology to be in place and operating to accomplish this goal. The CO_2 emissions will be used in biodiesel fuel technology beginning in six months by Greenfuels, a technical partner with APS, even though CO_2 emissions are not regulated at this time. APS has submitted an application to the Energy, Minerals and Natural Resources Department for energy innovations. Nitrous oxide (NO_2 or NOX) and particulates will be lowered through use of the "best achievable retrofit technology" or BART. The Four Corners Power Plant will reduce NOX emissions significantly over the next five to 10 years. The APS investment with its partners in the Four Corners Power Plant is about $0.5 billion to accomplish these goals.

The coal surtax discriminates against a declining number of long-term coal contracts. The existing coal surtax is unfair and is inconsistent tax policy. The electrical generation market is a competitive industry across the western United States. The repeal of the coal surtax will not significantly impact the New Mexico general fund. Removal of the coal surtax will increase the ability of the Four Corners Power Plant to sell electricity at a competitive rate to markets throughout the country. The presenters requested that the coal surtax be repealed.

Coal is the only severed natural resource with a surtax added to the basic severance tax. This surtax on coal has now become discriminatory in that new coal contracts in New Mexico are not subject to the coal surtax. For calendar year 2007, it is likely that only three coal contracts will pay the coal surtax. New coal mines are not subject to the coal surtax, placing existing coal producers with long-term contracts and their customers at a competitive disadvantage in a very competitive marketplace.

Representative Saavedra recommended a field trip to the mine and power plants.

Representative Gray asked about regulation of plant emissions. Air quality is regulated by the EPA. The plant has volunteered to submit to Navajo Nation regulation. The state regulates dam safety.

Senator Ryan supports coal-fired power production and is opposed to taxing coal production unfairly. He noted that repeal of the surtax will lower the cost of electricity in the market and not result in increased profits.

Senator Smith envisions a day when New Mexico will have to increase taxes. He expressed support for combined unitary corporate income tax reporting. He suggested that instead of removing the coal surtax, it could be spread to all contracts. BHP pays the surtax on all of its contracts, but few other producers pay on all of their contracts. Mr. Grenawalt noted that increasing the tax on all contracts would reduce competitiveness of all coal contracts in New Mexico. He encouraged the committee to consider the need for competitiveness in the very competitive coal market in the western states.

Senator Jennings said he is interested in expanding electricity service to the Navajo Nation.

Senator Snyder expressed disappointment that the governor pocket-vetoed SB 220 without adequate knowledge of the emissions controls already in place. She asked about the Energy Innovation Fund. Mr. Saliba stated that it is his understanding that $2 million was appropriated to the Energy Innovation Fund to encourage use of new technologies.

Senator Smith noted that if combined unitary reporting is adopted for corporate income tax, it could make up for the loss of revenue to the state that would occur if the coal surtax was repealed.

The partners in the Four Corners Power Plant are the following companies:

- APS (38% interest)
- New Mexico residents (7% interest)
- Southern California-Edison
- Tucson Electric

San Juan Regional Medical Center — Tax Policy Relating to Local Hospitals

Steve Altmiller, chief executive officer, San Juan Regional Medical Center (SJRMC), and Mike Philips, chief financial officer, SJRMC, presented information on the status of their facility.

Mr. Altmiller thanked the legislature for enabling the one-eighth of one percent hospital GRT. It has financed one-third of the SJRMC renovations. He also thanked the legislature for elimination of the GRT on physicians. This has helped with retention of existing doctors and recruitment from out of state. However, there is a need for 20 additional physicians, which the hospital cannot find or recruit. SJRMC is one of three trauma centers in the state.

Mr. Philips discussed the Trauma System Fund and the needed revenue for fiscal year 2009. In fiscal year 2007, $850,000 was appropriated to the fund. Additional funding is needed. The request for fiscal year 2008 is $1,011,000. This will allow training of emergency medical technicians at San Juan College and fund physician call coverage for trauma work. San Juan College trains 70% of the nurses that work at the SJRMC. The University of New Mexico trains 20% of the physicians that staff the SJRMC and 25% of all physicians practicing in New Mexico. The purpose of this presentation was to inform the committee members about the needs of the SJRMC and to urge the committee to make certain that the Trauma System Fund is fully funded for fiscal year 2009.

Senator Smith asked about ownership of the hospital. Mr. Altmiller stated that the county owns the facility and a private nonprofit leases the hospital from the county.

Capital Projects Quarterly Update

Ms. Kehoe, principal analyst, LFC, and Robert Apodaca, director, Local Government Division, DFA, presented an update of the distribution of capital outlay funds and the completion of projects funded by the legislature.

Deficiencies have been noted in New Mexico's process of allocating capital projects funding. The following are included in those deficiencies:

- develop a consolidated statewide capital projects plan;
- align factors that go into consideration of projects to be funded;
- track the number and dollar amount of appropriations that were included in capital plans;
- generate internal monitoring reports documenting progress on all projects;
- develop a consolidated report on deferred maintenance needs; and
- report on operation and maintenance budgeted at the agency level.

New Mexico has made significant progress in moving forward with capital outlay reform, but there is still more work to be done. Examples of the progress that has been made include:

- a significant share of the capital budget is now linked to policy priorities and is going toward projects of statewide significance;
- fewer small appropriations;
- more rapid completion of projects;
- better planning and information systems (e.g., the Property Control Division, the Higher Education Department and the Public School Facilities Authority (PSFA) have continued to refine the facility index, facility assessment and ranking tools); and
- implementation of significant, well-planned and well-managed infrastructure improvement projects (e.g., GRIP, significant water infrastructure projects, Tribal Infrastructure Fund, colonias initiative, Housing Trust Fund and PSFA process).

The next steps that need to be taken include:

- strengthening appropriation language that will add clarity and facilitate timely project implementation (e.g., remove ambiguity regarding appropriate close dates, ensure language allows intended project);
- providing a reporting tool to assist the executive and legislators in prioritizing projects that are community priorities and are ready to be implemented (e.g., community can accept the project);
- establishing policy guidelines for reversions; and
- communicating throughout the interim on state needs.

The status of 2007 session appropriations from the general fund is summarized below:

- $187 million for 75 projects that are more than $1.0 million (includes severance tax bonds (STBs) if project received both STB and general fund money);
- 48 projects "on track";
- five appropriations for multiple projects that are moving forward (e.g., tribal infrastructure projects);
- 10 projects have had grant agreements sent, but the agreements have not yet been returned;
- three projects have had an award letter sent to a tribal entity, but the scope of work has not yet been received;
- four projects had grant agreements held because the project was funded by both general fund and STB; these agreements are now being sent out; and
- five projects on "watch list":
    - $1.0 million — State Police Crime Laboratory;
    - $3.0 million ($2.5 million STB) — pre-K classrooms;
    - $2.0 million — acequia water storage;
    - $1.5 million — Santa Cruz Dam/Reservoir improvements; and
    - $1.98 million — Moriarty Cultural Arts Center.

The status of 2007 and prior session appropriations from the STBs is summarized below:

- $19.5 million in 32 projects (not including future fiscal years);
- lower than authorized, but unissued in recent years = more projects ready to go ($82.3 million authorized for future years);
- 17 projects from 2007 STB appropriations were not issued:
    - six projects equal to or less than $250,000;
    - four projects more than $250,000 but less than $1.0 million;
    - $2.0 million — parks statewide;
    - $2.5 million — pre-K classrooms;
    - $1.2 million — a veterans' and military technology museum;
    - $3.0 million — Sunland Park sports complex;
    - $3.0 million — Native American behavioral health facilities;
    - $1.3 million — trades and technology building at San Juan College; and
    - $1.0 million — health sciences building at Santa Fe Community College; and
- remaining authorized but unissued projects are all from the 2006 session.

Representative Crook asked about the process for reverting unused appropriations. Ms. Kehoe stated that there is clear reversion language, but some agencies encumber money without a legitimate third-party obligation. For construction projects, money reverts after four years if it is not spent. For vehicles, reversion should occur after two years if the appropriation is not encumbered and expended.

Mr. Apodaca recommended that the encumbrance language be eliminated from the capital outlay bill. Ms. Kehoe also noted that blanket reauthorizations are contributing to money not being spent. Ms. Kehoe mentioned that unused Navajo Nation appropriations do not revert to the original fund, but revert to the Tribal Infrastructure Fund now.

Senator Cravens inquired about the status of individual capital outlay reports for legislators. Ms. Kehoe said that preparation of these reports is in progress and they should be ready in about one month. From then on, the reports will be updated quarterly.

The committee adjourned at 2:04 p.m.