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

June 11-12, 2009
State Capitol, Room 322
Santa Fe, New Mexico

The first meeting of the Revenue Stabilization and Tax Policy Committee (RSTP) for 2009 was called to order by Senator John Arthur Smith, chair, at 9:10 a.m. in Room 322 of the State Capitol in Santa Fe, New Mexico.

Present	**Absent**
Sen. John Arthur Smith, Chair	Sen. Timothy Z. Jennings
Rep. Edward C. Sandoval, Vice Chair	Sen. Howie C. Morales
Sen. Carlos R. Cisneros	
Rep. Nathan P. Cote (June 12)	
Rep. Anna M. Crook	
Sen. Dianna J. Duran	
Sen. Tim Eichenberg	
Rep. Keith J. Gardner	
Sen. Timothy M. Keller	
Sen. Gay G. Kernan	
Rep. Ben Lujan, Speaker of the House	
Rep. Rodolpho "Rudy" S. Martinez	
Rep. Henry Kiki Saavedra	
Sen. William E. Sharer	
Rep. Thomas C. Taylor	
Rep. Jim R. Trujillo	

Designees

Rep. Sandra D. Jeff	Rep. Donald E. Bratton
Sen. Nancy Rodriguez	Sen. Kent L. Cravens
	Sen. Carroll H. Leavell
	Sen. Steven P. Neville
	Rep. Debbie A. Rodella
	Sen. Bernadette M. Sanchez
	Sen. John M. Sapien
	Rep. Don L. Tripp
	Sen. Peter Wirth

Approved for Attendance
Sen. Mark Boitano
Rep. Miguel P. Garcia (June 11)

Rep. Antonio "Moe" Maestas (June 11)
Rep. Luciano "Lucky" Varela

Other Legislators Attending
Rep. Janice E. Arnold-Jones (June 11)
Sen. Cisco McSorley (June 11)

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

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

Guests

The guest list is in the meeting file.

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

<u>Thursday, June 11</u>

Review of Committee Protocol

Paula Tackett, director, LCS, presented a refresher of committee protocol. She began by discussing quorums and said that a quorum for the RSTP is 10 members present since the committee consists of 18 members. Once established, a quorum is presumed to exist unless it is challenged. Committees can meet as a special subcommittee without a quorum, but only for hearing testimony and not for taking action.

Ms. Tackett also discussed the blocking provision for most committees, in which a majority of those members appointed from the house or senate can block the action of the committee. She explained the per diem and travel reimbursement system for the legislature and asked members to indicate their preferred method of being contacted for committee business.

Raúl Burciaga, assistant director, LCS, discussed the difficult task of scheduling committee meetings during the interim to avoid scheduling conflicts. He said that the current proposed schedule minimizes conflicts as much as possible for voting members of committees, but that the scheduling is not able to address conflicts for advisory members.

Clarification of voting privileges of advisory members was requested by the committee. Ms. Tackett said that committee chairs can allow action to be taken through "no objection" motions or voice votes, typically when dealing with uncontroversial or procedural motions. However, if an objection does occur, or if a vote is taken in which a count of yeas and nays is needed, only voting members are allowed to vote. In the case of the RSTP, designees are considered voting members for the meeting they are attending.

Another comment from the committee dealt with the tendency of the committee to hear and endorse legislation without fiscal impact reports (FIRs) being produced. A committee member indicated that he does not want to vote on proposed legislation this interim unless an FIR is available. Ms. Ray said that she has discussed this issue with the Legislative Finance Committee (LFC) and the Taxation and Revenue Department (TRD). The intention is to have all proposed legislation in draft form in October so that FIRs can be prepared, and the committee will be able to take informed votes starting in November. She said that the committee will begin hearing proposed bills as soon as possible. Jim Nunns, tax policy director, TRD, said that it is important to have actual legislation to prepare an FIR.

Basics of Responsible Tax Policy

Richard Anklam, director, New Mexico Tax Research Institute (NMTRI), Tom Clifford, research director, NMTRI, and Mr. Nunns provided the committee with an overview of the elements required to generate responsible tax policy.

NMTRI's View of Basic Principles and Current Issues in New Mexico's Tax Policy

Mr. Clifford introduced to the committee the basic principles that the NMTRI believes should guide state and local tax policy. Those principles include adequacy, efficiency, equity, administrative and compliance simplicity, comprehensiveness and accountability.

<u>Adequacy</u>: "Revenues should be adequate to provide an appropriate level of those goods and services best provided by the public sector."

One way to examine the issue of revenue adequacy is to compare the size of the state and local government sector in New Mexico with that of other states. As a relatively poor state, New Mexico faces a higher demand for services to low-income residents and a smaller tax base from which to fund these services. New Mexico's tax collections as a percentage of personal income is seven percent above the national average. New Mexico has a high sales (gross receipts) tax structure but a low property tax. Income taxes are about average, said Mr. Clifford.

Mr. Clifford discussed how New Mexico taxes businesses in comparison to other states. Businesses benefit from the relatively low property tax rate structure, but they are burdened by the high sales tax on business inputs. Generally, New Mexico taxes businesses at 4.6 percent of the gross state product, which is slightly lower than the national average. However, if severance taxes are included in the comparison, the percent rises to 6.0 percent, much higher than the national average. High severance taxes on the mineral extraction industry pose a challenge for policymakers, because the high revenues to the state could be at risk if major price shifts or technological developments occur, possibly making New Mexico a less-desired location for extraction industries.

Mr. Clifford discussed another indicator of tax burden, measuring the size of government (expressed as tax revenue) per capita. Accounting for inflation, the NMTRI analyzed collection of gross receipts tax (GRT), property tax and personal income tax (PIT) per capita from 1987 to 2007. All tax types showed a steady increase over the 20-year period, but GRT collections per capita increased the most, from around $1,000 to nearly $1,600, while PIT per capita increased from under $400 to close to $600. Property tax data increased slightly, but data were only available for a nine-year period. In summary, said Mr. Clifford, real per capita collections of GRT revenue are approximately three times as large as those for the PIT or property tax.

Oil and gas revenues make up a significant portion of the general fund, and Mr. Clifford presented a chart that tracked oil and gas collections and the percent of general fund deposits made by collections from that industry. The volatility of oil and gas revenues makes it difficult to provide for reliable state budgeting. Mr. Clifford provided suggestions for the state to better manage oil and gas revenue volatility. First, the state should continue its practice of maintaining 10 percent reserves as a hedge against volatility. Second, he suggested designating a portion of revenues as "nonrecurring" once prices reach a certain level deemed unlikely to be maintained. Next, industry experts should be consulted in an attempt to understand and incorporate their methods of financial risk management. Last, the consensus revenue estimating group should establish a standard of conservatism in estimating oil and gas revenue.

Finally, Mr. Clifford mentioned the NMTRI's dismay at the lack of discussion in the recent legislative session about the tax policy merits of a proposal to increase the GRT to fund education. He said that almost no debate occurred about the economic or tax policy aspects of increasing the tax and its potential pyramiding problems. Studies need to be done to estimate the economic impacts of increasing the GRT. Although finding a funding source for the educational funding formula may be necessary, increasing the GRT may not be the best method, said Mr. Clifford.

<u>Efficiency</u>: "State and local taxes should cause the least possible disruption of the private economy."

Mr. Anklam discussed the principle of tax efficiency, especially as it relates to pyramiding of taxes. Since New Mexico relies so heavily on the GRT, the question arises as to whether this imbalanced revenue system is likely to create economic distortions. If the assumption is correct that the GRT is typically shifted forward to buyers in the form of higher prices, businesses that make significant purchases from in-state vendors have a higher burden than if those purchases are made with out-of-state vendors. In addition, businesses that have relatively large property holdings compared to expenditures, like utilities, for example, benefit from the current structure. Mr. Anklam said that most of the ultimate burden of the reliance on the GRT is borne by New Mexico households and is likely to be regressive in its impacts.

Although comprehensive tax reform may be needed, in the interim, Mr. Anklam suggested not providing for any more state or local GRT increases. Additionally, the NMTRI takes a skeptical view of using the tax code to provide economic incentives, regardless of the worthiness of the targeted activity, because those incentives tend to reduce the tax base and put upward pressure on tax rates and increase the burden of existing businesses.

Mr. Anklam then discussed the NMTRI's view of the corporate income tax (CIT) and of various proposals to increase the CIT rate. A common argument made in favor of increasing the CIT has been that it can offset the various loopholes corporations have in avoiding state and federal taxes. Many companies shift income among their separate legal entities in order to avoid paying CIT in a particular state. However, Mr. Anklam suggested that this problem may be overstated, and he presented evidence that shows that the state's CIT collections have actually increased relative to gross state product over the last 20 years. Although the CIT revenues have fluctuated, there is no downward trend that would suggest that CIT avoidance activity has increased. Mr. Anklam referred to a recent New Mexico Supreme Court case, in which KMart was blocked from using one of the most common tax avoidance schemes, trademark license fees, to avoid CIT liability. He said that administrative and court action targeting abusive tax practices may be a better tool than merely raising the CIT on all corporations.

The committee questioned what was meant by "targeting abusive tax practices". Mr. Anklam said that term generally refers to the activity of a business to specifically avoid paying taxes. Mr. Nunns said that in the aftermath of the *KMart* decision, many companies are paying the state back taxes for similar transactions.

The committee also questioned how prevalent the practice is of misstating the value of rental property and other real estate. Mr. Anklam said that it is a very common tax cheating problem.

Mr. Anklam then discussed the NMTRI's biggest problem with the idea of raising the CIT: that it is hard to justify from the standpoint of good tax policy. First, the original justification for taxing corporations as a privilege of access to capital markets and of the privilege of limited liability is no longer valid today, since C-corporations are no longer the only business entity with that privilege. Second, the argument that the CIT contributes to the progressivity, and thus the fairness, of the tax system is suspect, said Mr. Anklam. Since some economic experts have claimed that the CIT is essentially a tax on the apportionment factors of sales, payroll and property, and since all of those factors are already taxed, there seems to be no justification for an additional tax that only applies to certain businesses. In addition, taxing the sales factor again may cause even more pyramiding issues. Finally, Mr. Anklam questioned the idea of the CIT being justified because of the benefits corporations receive from state and local public services. That argument is weakened, he claimed, because it only applies to certain business entities and not all of them.

Equity: "Tax policy should be fair and equitable toward similarly situated taxpayers."

Mr. Anklam provided an update on the status of the Streamlined Sales and Use Tax Agreement (SSUTA) that has been adopted by 22 states. The goal of the SSUTA is to remedy the disparate treatment of in-state vendors and out-of-state vendors and provide a uniform, simplified, equitable sales tax structure for businesses. The SSUTA also encourages Congress to allow the taxation of remote sellers and will prevent sales tax base erosion from the increase in e-commerce. New Mexico has cleared a few of the major obstacles to joining the agreement, since the agreement was modified to mitigate the effects to local governments due to New Mexico's unique source-based GRT compared to most states' destination-based sales taxes. New Mexico still has many technical changes to make, including changing certain reporting requirements, changing certain aspects of the food deduction to comply with the agreement's definition of "food", adopting other definitions so that terminology used is uniform in all states and developing a database that links an address with a vendor in order to determine state and local tax rates. Significant statutory changes will need to be made in order for New Mexico to join the SSUTA, said Mr. Anklam.

Mr. Anklam also discussed the issue of property tax "lightning" — spikes in property tax assessment and severe property tax inequities — which occurs because of different statutes in the Property Tax Code. For example, property valuation increases generally are limited to three percent per year. The county assessors are also required to value properties at their full and correct value, but this only occurs when a property is sold. Often, a new homeowner will be shocked to discover that property taxes increase significantly upon change of ownership. This problem is somewhat exacerbated by the fact that the limit on valuation increases pushes property taxes higher on the rest of the property tax base, including businesses and new homeowners. The NMTRI recommends a comprehensive study of the property tax system in New Mexico, which would require a significant amount of information from county assessors.

Tax Incentive Accountability: "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."

New Mexico currently has over 40 statutes providing economic development incentives at an annual cost to the state of more than $80 million. There are both positive and negative aspects to these incentives, said Mr. Anklam. The NMTRI suggests thoroughly evaluating any proposed incentive, including an evaluation of the goals the incentive is trying to reach; how the incentive interacts with existing tax statutes; and how much state and local incentives are being provided or proposed. Finally, the NMTRI advocates specific reforms to existing incentives to make them easier to use and to improve accountability.

TRD's View of Principles of Tax Policy

Mr. Nunns gave the TRD's viewpoint of responsible tax policy, which, while reiterating many of the principles contained in the NMTRI's presentation, also expressed concert that the focus was not on the broader principles but on some "rules of thumb" that are used to interpret these principles.

Adequacy: "The tax system should generate sufficient revenues to pay for government spending."

Mr. Nunns said that this principle generally means that budgets should be balanced, since they are required constitutionally not to deficit spend, with tax revenues equal to spending. The adequacy principle does not provide any guidance on what the level or mix of government spending should be. Simply stated, tax policy should favor generating enough revenue to fund the services the state provides.

Efficiency: "Taxes should interfere as little as possible with relative prices."

This principle has the goal of a tax structure that does not affect significantly the cost of goods, services, interest rates or wages in comparison to each other.

Equity:

The equity principle has two components: "horizontal" equity means that similarly situated individuals should pay similar taxes; and "vertical" equity means that individuals' tax burdens should reflect their ability to pay. Mr. Nunns pointed out that the equity principle only applies to individuals and not to businesses.

Simplicity: "Taxes should be designed to minimize taxpayers' cost of complying with the tax and the cost of tax departments to administer the tax."

Mr. Nunns contrasted tax principles with "rules of thumb" and how they sometimes are not consistent with the principles. He used the NMTRI's published rules of thumb to elucidate his point. One rule of thumb the NMTRI advocates is that "tax bases should be as broad as possible so that tax rates can be as low as possible to raise the necessary revenues". Mr. Nunns said that while it is true that economic distortions due to changes in relative prices are minimized with lower tax rates, it is also true that an overly broad tax base can significantly distort relative prices. As an example, using the broad tax base rule, having as broad of a tax base as possible for the GRT would also mean that the pyramiding effect would be strengthened. According to the NMTRI's rule, this would be a desirable outcome, since the tax base would be the broadest. However, as pointed out earlier, the NMTRI has identified GRT pyramiding as a significant problem.

Another rule of thumb the NMTRI espouses is that "businesses engaged in similar commercial activities should be subject to the same level of taxation". Mr. Nunns pointed out that the equity principle does not apply to businesses and that the "fairness" of a tax is related to the efficiency principle and not the equity principle. Even using the efficiency principle, there are plenty of situations in which businesses engaged in similar activities should be taxed at different levels, including taxing coal-fired power plants differently than clean energy facilities, to mitigate differential environmental impacts.

Inevitably, conflicts arise, said Mr. Nunns, among the four principles of tax policy when they are used to guide tax legislation, which requires making tradeoffs. Examples of such conflicts include the GRT, which, according to the efficiency principle, should apply to all final sales but would cause conflict with the simplicity principle if "isolated and occasional sales" were also taxed. Another example would be to tax the users of roads on efficiency grounds to compensate for damage to roads and the environment, but such a tax would most likely violate the simplicity principle and possibly the equity principle.

Mr. Nunns concluded his remarks by contending that tax expenditures, which usually consist of deductions, exemptions and credits, are really not intended to be an integral part of tax policy; rather, they are incentives designed to achieve a particular purpose that use the tax system to administer the program. There is no inherent conflict between tax expenditures and tax policy principles because the tax system is merely the administrative mechanism by which the state provides the tax expenditures, or more accurately, the incentives. Thus, said Mr. Nunns, tax expenditures generally should not be evaluated using the four tax policy principles, but should be evaluated instead by looking at the intended and actual outcomes of the policy.

The committee questioned how New Mexico compares with other states in its level of severance taxes. Mr. Clifford said that in order to compare accurately with other states, other related taxes, like property taxes, need to be included in the analysis, but that New Mexico falls somewhere in the middle compared to other states.

Another query of the committee was whether New Mexico is in danger of losing extractive industries due to its severance tax structure. Mr. Clifford said that he will provide to the committee a recent University of Wyoming study that studied that issue in many states.

The committee also asked if other states have taken a different approach to minimizing risk to the treasury from volatile oil and gas prices. Mr. Clifford said that Alaska diverts a large portion of its oil revenue so its general fund is not completely dependent on that source.

Referring to the NMTRI chart that describes GRT revenue increases compared to PIT revenue, a member of the committee noted that the steep GRT revenue increase coincided with the 2003 cuts in the PIT. He postulated that as taxes are reduced, spending goes up, which probably accounts for some of the GRT revenue spike. He also suggested that the reserves were illusory and, by including the Severance Tax Permanent Fund as part of the general fund reserves, state reserves could be made to look even more substantial. That fund, which is untouchable by the legislature or executive, will add to the already mostly meaningless other "reserve" funds backing the general fund reserves to bring New Mexico to an astounding 75 percent reserve level, he said.

The committee questioned why having an "overly broad tax base" is a problem. Mr. Nunns explained that sales between businesses are generally an undesirable tax revenue stream because it increases the relative value of products and ends up taxing items multiple times. That issue generally is that inefficiencies result in distortions of the tax base due to multiple taxation of the same service or input. Another example is the fact that the state generally disallows deductions for employee expenses since it would be too difficult to administer such a deduction. However, those are real costs, which are then added to the tax base, making the PIT tax base bigger than it really should be.

The committee commented that the state has lost revenue from internet sales not being taxed. It was suggested that the federal government track and tax internet sales and apportion the revenue to the states.

Another committee member suggested that the data indicating sales taxes as a percent of personal income are probably skewed because they do not reflect economic activity occurring on tribal land. That activity is not taxed by the state. The TRD tax policy principles are beneficial reminders to committee members. The state should identify out-of-state businesses doing business in New Mexico in order to get them to pay their fair share of taxes.

A question arose from the committee regarding whether the state had a more responsible tax policy prior to 2003, when the PIT and capital gains tax were reduced, amounting to more than $468 million in lost revenue to the state. Questioned was whether it was a responsible tax policy to tax a person making $24,000 per year at the same rate as a person making $24 million. Mr. Clifford said that it is difficult to define "responsible". The 2003 tax cuts were aimed at the efficiency principle in an attempt to create a more attractive climate for businesses and individuals to locate in the state. He cautioned that people may not move to New Mexico if there is too high of a PIT. Mr. Nunns said that there were provisions to benefit low-income people in that tax package. He said that the tax cuts met the adequacy principle until this past year. The committee noted that the low-income comprehensive tax rebates have amounted to only $50 million, compared to the nearly $500 million reduction in income taxes to New Mexico's wealthier residents. It appeared that New Mexico did away with its formerly responsible tax policy. It may be a very popular policy but not a very responsible one. Mr. Clifford acknowledged that although New Mexico's tax policy overall might be slightly regressive, the state spends its revenues in a manner that helps to restore the progressivity to income taxes.

The committee asked what the state needs to do to participate in the SSUTA. Mr. Nunns said that a study on that issue is being completed, and he will forward the results to the committee. New Mexico will need to revise its GRT statutes and how the tax is imposed and will need to bring its statutes into compliance with uniform rules.

Review of Enacted Tax and Motor Vehicle Legislation

Rick Homans, secretary of taxation and revenue, Mr. Nunns and Michael Sandoval, director, Motor Vehicle Division (MVD), TRD, reviewed tax and motor vehicle legislation adopted or introduced in the 2009 legislative session.

Legislation That Became Law

- CIT Estimated Payments (Senate Bill 80; Laws 2009, Chapter 4). This law restored the first quarter estimated payments that were erroneously deleted a few years ago and clarifies that withholding and oil and gas proceeds withholding payments are estimated payments. The bill is estimated to raise a total of $58 million in fiscal year 2009.

- Changes to Cigarette Tax and Enforcement Statutes (Senate Bill 219; Laws 2009, Chapter 197). The bill made changes to ensure New Mexico's compliance in enforcing the Master Settlement Agreement with tobacco product manufacturers; amended the Cigarette Tax Act and the Cigarette Enforcement Act to conform rules and definitions and to improve enforcement; extends from 10 to 30 days the time distributors have to affix stamps; applies the tobacco products tax to samples and gifts of tobacco products; exempts tribal sales from taxation; and creates a felony offense of knowingly making a materially false statement in any record required to be kept pursuant to the Cigarette Tax Act.

- Extension of Life of Investment Tax Credit and Double-Weighted Sales Factor for Manufacturers (Apportionment of Income) (House Bill 75; Laws 2009, Chapter 147).

- Tax Increment Development District (TIDD) Oversight (House Bill 451; Laws 2009, Chapter 179). The law adds notice requirements to the secretaries of finance and administration and taxation and revenue and to the director of the LFC; makes the secretary of finance and administration a member of all TIDD boards; and provides for a distribution of remaining balances in debt service funds, after bonds have been retired, to the governments that dedicated the revenue.

- Winrock/Quorum Town Center TIDD (Senate Bill 467; Laws 2009, Chapter 58). The bill authorizes up to $137 million in bonding for TIDDs 1 and 2 and $27 million for TIDD 3 for an urban infill project on the site of the Winrock Mall.

- Estimated Future Property Tax Information to Buyers (House Bill 261; Laws 2009, Chapter 165). The law requires sellers to disclose to potential buyers, prior to making an offer, a county assessor's estimate of what the property tax will be based on the asking price; the county assessor's estimate must contain a disclaimer that the estimate is based on the asking price, but that the actual "current and correct" valuation may be higher or lower than the asking price; and prospective buyers may waive the disclosure requirement. Immunity from any liability for providing incorrect information was included in the bill for those required to provide the information.

- Confidentiality (House Bill 257; Laws 2009, Chapter 243). The bill adds new key definitions; adds general rules governing the confidentiality of tax information;

provides that tax information can only be used for specific, official purposes; provides that tax information cannot be revealed without specific statutory authorization; reorganizes information release exceptions into groups of related entities; and conforms penalty provisions.

- Alternative Vehicle Registrations (House Bill 12; Laws 2009, Chapter 156). The bill provides a five percent discount for motor vehicle registrations made by phone or the internet, which is mostly offset by the credit card fee charged; and appropriates certain fees and charges to the MVD and makes them nonreverting.

Failed Legislation

Several key tax-related bills that failed the legislature were discussed by Secretary Homans. They include a PIT simplification bill; a bill to completely rework how the CIT and franchise tax are imposed; a bill that would have provided a revenue stream for the public school funding formula; a bill to grant approval of the SunCal TIDD; a bill to make technical changes to the TIDD statutes; a bill to address the unintended effects of the three percent limitation on valuation of property; a bill to allow state residents to withhold taxes as a pass-through entity and to make that withholding quarterly; a bill to require withholding on all payments for film performing artists; a bill to improve the combined reporting system (CRS) and to raise the threshold level that requires monthly reporting to the CRS; and a bill to correct food and medical deductions and to provide for a better system for taxpayers in disputes with the TRD.

The committee questioned the progress of the selection of the contract for a sole-source provider of a database for the sale of driver registration information. Secretary Homans explained that there had previously been six contracts with companies to provide driver data, but that four of them had expired. The Purchasing Division of the General Services Department had notified the TRD that it needed to follow a request for proposals (RFP) process in order to properly enter into a new contract.

The committee expressed concern that a bill to specifically give the TRD the power to establish such a database failed in 2004, but now the TRD seems to be circumventing the legislature's intent. It was speculated that the state stands to gain a significant amount of revenue from that system and that businesses needing services from the database will be charged too much. Secretary Homans responded by saying that the 2004 legislation was only to set up a governance committee to oversee the sale of driver information. The TRD already has the statutory authority to provide driver information to certain entities, so long as the state receives a royalty for the service. The proceeds from the fees first will go to pay for the actual costs of the database, and the rest go toward the operations of the MVD. He said that the state will collect $4.95 per record request. It is difficult to know how much end users will pay, because some of the data will be re-sold to other entities. He said that the national average cost for driver records is $7.00.

Further concern was expressed that the TRD should have waited for an opinion from the attorney general before proceeding. There are unresolved questions as to whether the TRD has the legal authority to perform this function. Another concern was that existing contracts that could have been renewed were allowed to expire. Secretary Homans said that the end result of the new system will be much better than the previous systems. Two of the contracts are still in effect and will be phased out as the new system is put into place. The contracts that expired were not able to be renewed due to the terms of the contracts. He also said that he informed the attorney general personally that the TRD was proceeding with a new contract and asked if there were any concerns with the process; he has not heard back from the Attorney General's Office (AGO). Finally, Secretary Homans discussed several concerns with some of the previous contracts, including serious confidentiality breaches and a lack of data security.

A question from the committee sought to determine why the Foundation for Open Government is opposed to this particular procurement. Secretary Homans said that one newspaper publisher told him that as the government moves toward relying on electronic governance, the print media, which often relies of the publication on legal notices to survive, is slowly becoming obsolete. Although this database has nothing to do with newspapers or legal notices, Secretary Homans said that he understands newspaper publishers' concerns.

It was noted by a committee member that the size of the state's contribution to the approved TIDDs was quite large, especially in comparison to the local contribution. Secretary Homans responded that it is the TRD's responsibility to implement the policy that the legislature sets, but that the department is open to more policy discussion about TIDDs in the future.

Returning to the sole-source MVD information technology contract, a member commented that the state needs to hire more in-state firms and that there should be some competition allowed between information vendors.

Secretary Homans was asked what the expected revenues to the state will be from the new information database contract. In addition, he was asked to clarify whether the attorney general gave passive approval to the proposed contract. Secretary Homans said that the state expects to receive $4 million to $5 million annually. He said that he informed the attorney general that the TRD was proceeding deliberately with the contract. The TRD has not received any response from the AGO.

Property Tax Overview

Rick Silva, director, Property Tax Division (PTD), TRD, and Michael O'Melia, deputy director, PTD, TRD, gave the committee an overview of their responsibilities and the status of the property tax system in the state from the perspective of the PTD. Property tax is the second largest tax base in the state, accounting for $1.4 billion in revenue per year, said Mr. Silva. Compared to other states, New Mexico ranks near the lowest in terms of total property tax revenue; property tax as a percentage of total state and local taxes; per capita property tax; and property tax as a percentage of personal income.

Some of the key aspects of property tax in New Mexico are that property tax is an alternative source of revenue to local gross receipts taxes and state-supported spending; property tax generates the revenues for debt service for state and county infrastructure; and property tax is the most stable source of recurring revenue for local government. Property tax revenue in 2008 was distributed to school districts (32.1 percent), counties (30.7 percent), municipalities (14.3 percent), higher education institutions (9.8 percent), health facilities (8.5 percent) and the remainder to state debt service and conservancy districts.

The PTD does not generally collect property taxes; that responsibility lies with counties. The division acts to provide limited oversight of county assessors, as well as providing assessments for special types of properties and multi-county properties; certifies the property tax base for all counties; performs some appraisals and technical assistance for counties; evaluates county assessors; coordinates training; pursues collection efforts on delinquent accounts; and has the authority to sell delinquent properties as a last resort. The PTD funds 80 percent of its budget from fees and collections, said Mr. Silva.

Mr. Silva reviewed some of the pending regulation changes the PTD is contemplating, including changes to the sales ratio study, agricultural valuation, obsolescence of property and veterans' and disabled valuations.

Finally, Mr. Silva identified some of the major property tax issues facing the state, including the following.

- Lack of assessment uniformity, often caused by rapid increases or declines in home values; the limitation on residential value increases and exceptions to that limitation; and the yield control formula.

- Requirement for more reliable data, including the need for better financial modeling capabilities; the need for better data on commercial and multi-family properties; the need for full disclosure, which would result in better and less expensive assessments; and the need to enforce existing affidavit regulations.

- Low-income relief. Mechanisms currently in law do not always reach their intended recipients.

- Residential property tax disclosure. New laws have been enacted to warn potential home buyers of possible large increases in property valuations, but this will probably still be an issue.

- Statewide computer-assisted mass appraisal system. Most counties still do not have this system, which results in more uniform assessments.

Questions from the committee included how personal property assessments are performed. Mr. Silva said that county assessors distribute questionnaires to businesses based on federal Schedule C tax returns.

In addition, the committee wanted to know about the attempt in Bernalillo County to move to a two-year valuation cycle rather than a one-year cycle. Karen Montoya, Bernalillo County assessor, said that she requested that change in order to slow down the rapid rate of valuation increases, especially during the current economic downturn. The PTD has denied that request. Mr. Silva said that the PTD is still working with the Bernalillo County assessor on this issue.

The committee has heard from some county assessors that they will be unable to comply with the new law that requires county assessors to provide an estimate of the future property taxes to potential home buyers. Mr. Silva said that the problem is that some small counties, with limited assessor staff, will not be able to provide the estimate within 24 hours as the law requires. In addition, multiple requests may be held by a real estate agent until there are several to request, and in Bernalillo County, the daily requests can be numerous.

Senator Rodriguez requested that PTD staff investigate an apparent calculation error in the handout detailing the amounts distributed to various entities. She said she wants to ensure that all the money is being distributed properly.

Concern was expressed regarding outreach to low-income residents not being sufficient, and that people are still at risk of losing their homes because they do not know about the available property tax relief programs. The PTD was asked to provide an FIR of legislation that would exempt from taxation residential property for elderly residents over 75 years of age with incomes under $15,000 per year, and also exemptions for disabled persons with the same income category. Mr. O'Melia said that the PTD will try to gather that information, but he is not sure if the PTD's data collection abilities are sophisticated enough to provide an exact estimate.

Another question was in regard to the number of valuation protests the PTD oversees each year. Mr. Silva said he is not sure how many will reach the PTD, but that there are over 7,000 protests filed with just Bernalillo County this year.

It was pointed out that after 10 years of delinquency, a tax liability on a property becomes void. When asked how much money this is costing the state and counties each year, Mr. Silva said that there are currently 78,000 delinquent properties in the state, and the PTD usually can handle 12,000 per year. He said that he does not know how much money is delinquent or how much revenue is lost due to property liability being dropped from the rolls.

Also noted was that Bernalillo County has 27,000 mobile homes that have property tax liabilities greater than the value of the homes. The committee sought information about how to fix that problem. Mr. Silva said that mobile homes are considered chattel, which is personal property, and the counties deal exclusively in that province.

Another question raised was how the PTD is dealing with one property owner in Socorro County who reportedly has delinquent property tax accounts for 9,000 properties. Mr. Silva said that the PTD is currently negotiating with that individual, and he hopes to enter into a payment plan to recover the liabilities. Mr. O'Melia said that the PTD can sell delinquent properties, but only does so as a last resort after exhaustively attempting to make arrangements with the owner.

The committee asked how the PTD receives revenue. Mr. O'Melia said that the state receives penalties, interest and a portion of delinquent tax paid. Extra collections go into a reserve fund to cover more lean years. He estimated the reserve fund balance to be $1.1 million, and said he expects the PTD to use about $400,000 of it this year to cover expenses.

Another member asked whether New Mexico's property tax system is regressive or progressive. Mr. O'Melia said that the PTD conducts a progressivity study every year and is currently in the middle of that study. He said that New Mexico is mostly neutral on the progressivity scale.

Concern was expressed regarding the reliability of PTD figures showing New Mexico to have a relatively low property tax burden when the most common complaint heard from business owners is that valuations and assessments are too high. The member asked how many properties are not assessed, which tends to drive up assessments on the rest of the properties. Mr. Silva said that the PTD does not have that information, and most county assessors do not know, either. He said that the PTD only has the statutory authority to ensure that county assessors are following the law. There is no way for the PTD to fix current inequities unless statutes are changed.

It was suggested by the committee that, eventually, the state will need to take over the duty of performing all valuations and assessment of properties.

The PTD was asked to report back to the committee on a solution to fix the residential tax discrepancies that develop on transfers of residential property due to the three percent valuation limitation.

Post-Session Fiscal Review

David Abbey, director, LFC, and Katherine Miller, secretary of finance and administration, updated the committee on the fiscal status of the state since the legislative session.

Mr. Abbey began by reviewing the economic situation leading up to the 2009 legislative session and how the legislature tackled the problem. New Mexico state government faced a $454 million shortfall for fiscal year 2009 before the start of the session. The first priority of the legislature and the governor was to enact a solvency package consisting of four prongs: first, revenue measures were enacted to capture first-quarter CIT payments (SB 80) and to transfer money from various funds, which measures were predicted to generate $148 million; next, $164 million in appropriation reductions was enacted; third, $152 million in capital outlay projects was voided; and last, $56 million was transferred from reserves.

The legislature then turned its focus toward the need to enact a balanced budget for fiscal year 2010. The February 2009 revenue estimate revised downward fiscal year 2010 revenues by an additional $282 million from the December 2008 estimate, projected to be $5.5 billion. Energy revenues and CIT revenues were the major portion of the new shortfall. The federal government pledged $1.9 billion in stimulus money, some of which was incorporated into the fiscal year 2010 operating budget. By the end of the legislative session, a $5.49 billion budget was approved, which was nine percent smaller than the original fiscal year 2009 budget. The fiscal year 2010 budget, as a hedge against more economic troubles, maintains high reserve levels. The only capital outlay package approved in 2009 was from severance tax bond proceeds, and most of that money was directed toward critical-need state projects. No local legislative projects were funded.

The general fund outlook for fiscal years 2011 and 2012 so far look better than the current cycle. Revenues to the state are expected to grow 4.9 percent in the upcoming two fiscal years. However, spending must increase $275 million each year just to maintain the current program level budgeted for fiscal year 2010. Additionally, more than $450 million in new revenue will be needed, most of which consists of replacement of federal stimulus money.

Finally, Mr. Abbey said that the state is still facing about a $170 million shortfall for fiscal year 2009, but federal revenues and transfers will be able to balance the books. He said that PIT and CIT collections are lower than expected, and the boost in CIT revenue from the first-quarter payment requirement is also lower than predicted.

Secretary Miller gave an update on the current fiscal situation and said that the Department of Finance and Administration's (DFA's) numbers agree with the LFC's numbers. The budget saw a nine percent reduction in revenues, and a three percent reduction in spending. The federal stimulus money that covered the shortfall will have to be replaced with state money fairly soon, she said.

The fiscal year 2009 solvency plan has come close to its estimates. The capital outlay reversions were mostly reverted, except for a few projects that already had let contracts. Appropriation reductions were made through the SHARE accounting system, and other entities that had reductions have been billed. She expects the actual reductions to be within $2 million of the budgeted reductions.

Secretary Miller presented scenarios for the completion of fiscal year 2009, depending on actual revenues that the state collects. With a $50 million shortfall in revenue, the state can absorb the shortfall without using federal stimulus money. At shortfalls of $100 million or $200 million, the state will need to transfer money from the newly created New Mexico Recovery and Reinvestment Fund, which was set up to follow strict federal guidelines on how stimulus money could be spent.

A committee member asked how far off the CIT first-quarter estimated payments were from predictions. Mr. Abbey said that the state received $22 million from the new reporting date, but the prediction was for $28 million. He said he expects $20 million to $25 million in CIT collections for the second quarter.

Film Tax Studies — Comparison and Clarification

Dan White, economist, LFC, Anthony Popp, professor and head of the Department of Economics and International Business, New Mexico State University (NMSU), and Andrew Phillips and Robert Cline, Ernst and Young, presented an overview of the analyses completed by Professor Popp, principal author, NMSU study, and Mr. Phillips and Mr. Cline, principal authors, Ernst and Young (E&Y) study, assessing the economic impact of the film production tax credits on New Mexico's economy.

<u>LFC Analysis</u>

Mr. White began with an introduction of the film industry's presence in New Mexico since 2003 and described the various tax credits and incentives available for the industry. From 2001 to 2007, motion picture and video production employment increased nearly 800 percent. In the first three quarters of fiscal year 2009, about $48 million in film production tax credits had been approved, which represents a 1,600 percent increase in a five-year period. Incentives that the state provides to the film industry include a 25 percent film production tax rebate, a film crew advancement program, a pre-employment training program, zero percent production loans from the State Investment Council (SIC) and direct capital expenditures.

In 2008, the LFC commissioned a study of the return on investment (ROI) of the film production incentives. The study was performed by the Arrowhead Center of NMSU, under the direction of Dr. Popp. The study measured the cost of film production incentives against the estimated amount of new film spending in fiscal year 2008 (through April 2008). During the study period, $152.8 million of new spending in New Mexico occurred, which resulted in approximately $5.5 million in additional state taxes. That amounted to an ROI of $.14 gained per $1.00 spent.

The study's authors reasoned that the calculated ROI is probably understated due to the fact the analysis accounted for only one-half of the job growth in the industry since 2001 and due to the exclusion from the analysis of film projects that did not qualify for the tax credit. However, this understating of the ROI was in part tempered by the study's assumption that some of the qualified film projects would have occurred in New Mexico regardless of the tax credit.

Mr. White then described the E&Y study of the ROI of the film industry, which came to very different conclusions than the Arrowhead Center (NMSU) study. The E&Y study found $44.1 million in additional state tax revenue in calendar year 2007, which showed an ROI of $.94. Additionally, the study calculated local government revenue, which showed an extra $.56 to be added to the ROI.

Mr. White described how the two studies came up with such divergent results. The E&Y study used unusually high incomes in its assumptions, using New York City wage levels of $91,000 versus the NMSU study figures of $35,000. The E&Y study also included the very large one-time capital expenditure of the Albuquerque Studios, which probably skewed the results somewhat. The E&Y study also extrapolated data from a Tourism Department study of the effect of the film industry on tourism. While the NMSU study estimated the tourism effect as well, it used more conservative assumptions than the E&Y study.

Mr. White said that it was not possible to determine if the E&Y study used a methodology to exclude certain sectors from its standard economic modeling program in order to avoid double-counting of those sectors it studied separately. The E&Y study also included property taxes in the study, while the NMSU study did not. Finally, the period of time of the two studies was different, with the NMSU study evaluating the first three quarters of fiscal year 2008 and the E&Y study covering calendar year 2007.

In conclusion, Mr. White said that while the NMSU study's ROI is most likely understated and that the E&Y study is overstated, neither study shows results that the state is gaining revenue from the film production credits. Although the recent growth in the New Mexico film industry has had undeniably significant economic impacts on the state, said Mr. White, it appears that these impacts thus far have not generated sufficient additional tax revenues to offset the costs to the state.

<u>NMSU Analysis</u>

Dr. Popp also provided the committee with a comparison of the two studies. In addition to the differences identified by Mr. White, Dr. Popp presented the following conclusions:

- The two studies had different charges, with the NMSU study only showing returns to the state, while the E&Y study showed returns to state and local governments.

- Both studies showed a substantial change in industry employment and income.

- Major differences in the methodology include tourism spending, capital expenditures, property taxes, time frame, non-qualifying expenditures, tax rates and labor compensation proportion of expenditures.

- The E&Y study omits state costs from the SIC loans still outstanding, job training and direct capital outlay for various film-related programs and projects at public colleges.

- The E&Y study attributed nearly all employment in the film industry to the film production incentives.

Dr. Popp then presented an analysis of the two studies that calculated the effects of the different methodologies and assumptions the two studies used. Using this comparison, Dr. Popp showed that when all of the variables in the two studies are made comparable, the E&Y study shows an ROI of $.25, versus the NMSU study ROI of $.14.

E&Y Response

Mr. Phillips and Mr. Cline presented to the committee via telephone, since they had last-minute transportation difficulties. Mr. Cline began by saying that Dr. Popp presented an accurate summary of the differences in the two studies. He said that it is important to take into account not only the public sector benefits (or losses), but also the private sector benefits from state incentives. He also said that the E&Y study was comprehensive in that it studied both state and local government impacts. One of the strengths of the E&Y study is that its study separates out the various economic components and fiscal impacts.

Mr. Phillips said that the E&Y study looked at film production, film tourism and capital expenditures in relation to state expenditures. Film production expenditures were obtained from the New Mexico Film Division of the Economic Development Department, and direct labor costs accounted for two-thirds of production costs. Approximately 2,000 direct jobs were created, creating $253 million in wages, and 1,800 indirect jobs were created, which were estimated using standard economic modeling software. Finally, Mr. Phillips reported that a Tourism Department study found that 3,800 tourism jobs are directly related to the film industry. A total of 9,200 jobs can be attributed to the film industry in New Mexico, which corresponds to $71 million in additional state and local taxes, for a combined ROI of $1.50, or $.94 if local government revenue is excluded.

The committee asked about the economic modeling methodology used by both studies, including whether the studies measured indirect tax impacts. Dr. Popp said that both studies used the same modeling software, which is standard for such studies. That software does measure indirect tax impacts. He said that the economic modeling methodology of both studies was similar, but the assumptions were different.

It was suggested by the committee that it would be useful to extend this kind of study over a number of years, since there are always yearly distortions in ROI studies.

The committee questioned whether a film industry would still be in New Mexico if there were no state incentives. A committee member indicated that the film industry has a large presence in New Mexico because of the incentives. Dr. Popp responded by agreeing that the film industry is undoubtedly much larger due to the incentives, and that there has been a large economic impact from the industry, but he also said that there was a film industry in New Mexico before the incentives began, and there would most likely still be one (although much smaller) if the incentives were ended.

It was postulated by a committee member that with the recent conclusion of the film actors strike, New Mexico should see another spike in film production activity.

Committee members asked that the committee be provided with the Tourism Department study that analyzed the tourism component of the film industry. Mr. Phillips said that a few of the components of the study were adjusted downward, but he feels that it is a credible study.

Recess

The committee recessed at 5:05 p.m.

Friday, June 12

The committee reconvened at 9:05 a.m.

Federal Stimulus Update

Governor Toney Anaya, director, New Mexico Office of Recovery and Reinvestment (NMORR), Dona Cook, chief deputy director, NMORR, Gene Moser, principal analyst, LFC, and Paul Aguilar, principal analyst, LFC, updated the committee on federal stimulus funds targeted for New Mexico.

NMORR Presentation

Governor Anaya began by saying that Governor Richardson created the temporary NMORR in April 2009 by executive order, whose unofficial motto is "ensure no dollar is left behind". The office's purposes are to facilitate compliance with the federal American Recovery and Reinvestment Act of 2009 (ARRA), to identify available funding opportunities through the act, to conduct extended outreach to state and local entities, to keep stakeholders informed of funding opportunities and to ensure that New Mexico competes effectively for funds.

Although initial allocations showed New Mexico receiving $1.9 billion in federal stimulus funds, the state now stands to receive more than $3 billion, said Governor Anaya. In addition to the state direct share, New Mexico can compete for a portion of $74 billion available in competitive grants. Other parts of the ARRA stimulus package include $288 billion in tax relief to individuals and businesses and $30 billion in bonding authority nationwide for businesses and communities. Estimated stimulus funding includes $738 million for Medicaid, $470 million for public education, $420 million for environment-related programs and projects, $369 million for infrastructure, $296 million for transportation projects, $246 million for benefits to individuals and families, $191 million for higher education programs, $115 million for unemployment benefits, $82 million for energy efficiency projects, $58 million for other government services and $14 million for public safety projects.

One area of funding that has caused some confusion around the state is for infrastructure, transportation and environment projects, said Governor Anaya. Because of federal regulations, the NMORR is only working with existing applications for projects that are "shovel-ready" for the current funding cycle. He expects a new round of funding for projects to become available this winter, and his office has been encouraging communities to submit applications for the next funding cycle.

With $74 billion available nationally in competitive grants, the NMORR is working with the newly created Competitive Grants Advisory Team to apply for as much grant funding as possible. The state will be applying for grants for broadband, green grid and health information technology projects, and is looking into green jobs programs. The NMORR is inviting any public or private entity interested in those areas to collaborate in this process. Governor Anaya said that a tremendous spirit of cooperation has developed, and the state is in a very good position to receive large competitive grants.

Ms. Cook briefed the committee on how the NMORR is overseeing and tracking all of the ARRA money coming to the state. New Mexico created one fund to budget, track, account for and monitor all of the federal stimulus money, and the DFA also set up separate SHARE codes for each state agency receiving stimulus money. The office also provides guidance to state agencies on compliance with federal regulations, which are still changing. Although the federal government allows up to 10 percent of funding to be used for administrative costs, the NMORR has a goal of keeping those costs to under five percent.

The NMORR has been working with the State Treasurer's Office and the State Board of Finance to ensure that cash flow does not become a problem, since most ARRA funds are disbursed on a cost-reimbursement basis. The office is preparing for new federal quarterly reporting requirements and is preparing to review the status of agency compliance with federal requirements. Finally, the NMORR is currently establishing a process to conduct audit and compliance oversight and to prevent federal audit exceptions. Ms. Cook said that intense federal scrutiny is expected on the expenditure of ARRA funds. New Mexico will be prepared to give detailed reports for all ARRA expenditures, she said.

<u>LFC Presentation</u>

Mr. Moser began his presentation by saying that although the governor pocket vetoed a bill to give the LFC oversight of ARRA funds, the NMORR has been very cooperative in providing any information the LFC has requested. The LFC decided to wait until June to start tracking actual expenditures, since the process is still being organized. The major concern that the LFC has with the expenditure of ARRA money is to make sure the state is not obligating itself into creating new recurring expenditures.

Mr. Moser divided the stimulus package into two rough parts: fiscal stabilization in order to shore up New Mexico's budget; and infrastructure. Just in the transportation sector, the Department of Transportation (DOT) has identified over $16 billion in unmet highway needs, but only $30 billion is available nationally. New Mexico will use its share toward completing GRIP I projects, but will still be $350 million to $450 million short.

Another concern the LFC has is how competitive grants will be chosen by the NMORR. As an example, the DOT is trying to coordinate all affected communities to submit one grant request for the U.S. Highway 491 project. That is an example of good collaboration. The DOT and LFC are concerned that without collaboration, individual communities will flood the federal government with grant funding requests, with the end result that less money will be awarded to New Mexico.

Mr. Aguilar discussed some of the details of the stimulus money. The stimulus money is not recurring revenue, and it is important that entities not treat it as such. Some school districts are trying to be creative with how they spend the money. For example, Albuquerque Public Schools indicated that it wants to use some of the stimulus money to give teachers a pay "bonus" instead of using its operational revenue to establish pay raises. The Public Education Department (PED) has said that this is an inappropriate use of stimulus funds, said Mr. Aguilar.

There has been some confusion about reversion dates for Title I and IDEA-B funds, said Mr. Aguilar. Don Moya, deputy secretary of public education, said that school districts will need to encumber all stimulus funds within 18 months, but that they will be able to spend the money for an additional 27 months.

Mr. Aguilar said that a new federal requirement that states have an educational longitudinal data system in place has spurred the governor to create by executive order the New Mexico Data Warehouse Council.

The committee questioned if funding is available for libraries and colonias and to address flooding issues. Governor Anaya said that there is currently no funding available for library infrastructure. Colonias are eligible for funding for various infrastructure projects. Regarding flood mitigation, he said that all money currently available flows through existing state programs, and he is not sure if any provide for flood mitigation projects.

In response to a question regarding how much ARRA money has been spent to date, Ms. Cook said that data available to the NMORR, which is one month old, indicates that $103.8 million has been spent.

Also asked was when the stimulus money will have an effect on the state's economy. Governor Anaya said that that economic effects are starting to happen, since many projects are beginning. Another not-so-noticed effect is that the state will not be experiencing widespread layoffs.

The committee questioned whether individual schools can apply for competitive grant funding. Governor Anaya said that they are eligible, but the NMORR is discouraging individual entities from applying for grants. He wants a more collaborative process, which will lead to better success in getting funded.

A question arose regarding how priorities for funding highway projects are set. Specifically, the question referred to U.S. Highway 491, which had some funding that was taken away recently. Mr. Moser said that the U.S. Highway 491 project has been funded in increments, but never fully. When the governor committed to making the highway a four-lane highway, that increased the cost significantly. Mr. Moser said that the State Transportation Commission committed in May to make the highway project a priority.

Governor Anaya concurred, and said that the DOT has not yet made final decisions about which projects to fund.

Another question from the committee was whether education money would be distributed in time for school districts to avoid a cash flow crisis. Mr. Moya said that the PED and the federal government have been discussing this issue. He said that he is now confident that the money will be distributed before July 1.

Concern was expressed that many nonprofit organizations that provide essential state services are being squeezed to the breaking point. Governor Anaya said that nonprofit entities are eligible for various types of grant funding, just not recurring funding.

The committee questioned whether any money is available to assist individuals with propane bills. Governor Anaya said that stimulus money is not available for fuel costs, but that the money can be spent for energy retrofitting of homes.

The committee requested more detail regarding how school districts will be spending their funding. Governor Anaya said that Secretary of Public Education Veronica Garcia has stressed that districts need to be very careful on how they spend the money.

Another question was in regard to $57 million in discretionary funding that the governor can direct. Governor Anaya said that the administration is still deciding how to prioritize that grant.

It was stressed that there is a need for a post-audit review to ensure that programs comply with the ARRA. Governor Anaya said that he has met with the state auditor twice, and the NMORR is setting up a compliance office. The federal government will require a separate audit for each agency receiving more than $500,000. The state auditor said the extra auditing should not cost state agencies more than they are already paying for their regular auditing.

Adoption of Committee Work Plan and Meeting Schedule

Ms. Ray discussed with the committee the proposed work plan and meeting schedule. She presented a list of items the committee is proposing to study during the 2009 interim, and committee members made several additional requests for areas of study. Committee members also requested changes to meeting dates and locations, specifically requesting that the New Mexico Legislative Council allow a meeting in Raton August 27-28, switching the Cloudcroft meeting to September 14-15 and switching the Santa Teresa-Deming meeting to October 14-15. The committee adopted the work plan and schedule, subject to council approval. A copy of the approved work plan and schedule will be included with the July meeting materials.

Overview and Fiscal Impact of Economic Development Programs

David Lucero, principal analyst, LFC, and Susan Fleischmann, analyst, LFC, presented information to the committee regarding the cost of economic development programs implemented by the state. Mr. Lucero began by describing some of New Mexico's competitive disadvantages for economic development, and the recent Beacon Hill Institute's ranking the state thirty-eighth among states. That institute found that New Mexico ranked very low on many indicators, including health insurance, educational levels, mathematical skills, savings rate, high-speed internet lines and murder rate. The institute found that while the state has done a good job in improving its standing in some areas, including new jobs and small businesses, its under-investment in human capital development threatens the state's capacity for future economic growth.

Mr. Lucero said that economic incentives the state provides to attract business are fragmented among several agencies and performance outcomes. He identified several "best practices" for economic development incentives. Those include: a statewide strategic plan with one entity championing the plan; incentive agreements; incentives linked to performance; job retention requirements; and incentive clawbacks for non-performance. Mr. Lucero said that best-practice states include Utah, North Carolina, Delaware, Minnesota and Texas.

Mr. Lucero highlighted Utah's economic development strategic plan, which includes virtually no risk to the taxpayer; no capital investment incentives; performance milestones required in each incentive agreement; job retention requirements; sustainable job requirements; and clawback requirements. Since 2004 and until the recent national economic downturn, Utah has increased jobs from three percent to five percent, while New Mexico's job growth has only increased jobs from two percent to three percent.

While Utah only gives incentives after businesses have proven certain milestones, New Mexico has the opposite approach to incentives. In addition, New Mexico's incentives are scattered across state and local agencies, and performance outcomes are rarely measured. Additional problems include no statewide plan or budget, inconsistent and fragmented data collection and accounting, lack of consistent statewide performance outcomes and, in most cases, low-level performance measures. In conclusion, Mr. Lucero said that a new approach should be taken toward economic development in the state.

The committee questioned what the state should do differently. Mr. Lucero said that one possibility would be to create a unified board, composed of all the entities that oversee incentives, to create a statewide strategic plan with performance measures. He envisioned an organization in structure similar to the Interagency Behavioral Health Purchasing Collaborative. He also recommended looking into providing post-performance incentives, rather than the current practice of "buying jobs".

Another question from the committee was what the per capita income in Utah is. Mr. Lucero said that he would provide that information.

Concern was expressed by committee members regarding the value of some incentives that only provide a limited number of jobs. When those incentives are coupled with industrial revenue bonds, educational funding is also affected, since property tax collections decline. The committee said New Mexico needs to tie economic development tax credits to performance.

Also of concern was that some incentives have attracted less-desirable industries, rather than industries that enable employees to climb the career ladder. Mr. Lucero said that the state did a good job in developing the film industry and could do the same for developing "green" jobs.

Income Tax — Year-to-Date Revenue Report

Mr. Nunns and Gwendolyn Aldrich, economist, TRD, updated the committee members on the status of income tax revenues received by the state for calendar year 2009. Mr. Nunns began by describing how the consensus revenue estimate is developed. The Consensus Forecast Group is composed of career economists from the TRD, DFA, LFC and DOT. Estimates are now made in February, July, October and December and sometimes before special sessions. Forecasts for each tax attempt to take into account the economic outlook, changes in tax law, changes in administrative procedures and changes in accounting rules that will affect revenues over the forecast period.

For recent PIT and CIT forecasts, many special factors were taken into consideration, including tax law changes that changed 2007 liabilities but were paid by the state in fiscal year 2009 and federal law changes that gave extra depreciation allowances. The TRD also began imposing a penalty for underpayment of estimated taxes, and two accounting procedures were adopted that affect short-term estimates.

Ms. Aldrich described to the committee the five major components of PIT revenues, which include withholding, estimated payments, oil and gas proceeds withholding, final settlements and tentative payments and refunds.

The February 2009 consensus revenue estimate compared with accruals shows that PIT revenues are $47 million below the expected amount, and CIT revenues are $36.9 million lower than expected.

Mr. Nunns said that the TRD, DFA and LFC are looking at ways of improving revenue forecasts. One initiative involves economists and accountants from these agencies meeting to discuss how accounting procedures affect revenues. Finally, the TRD is drafting a new revenue forecasting manual that will document in detail how revenue forecasts are prepared. DFA and LFC economists will also contribute to the manual, he said.

It was noted by the committee that if 14 percent of current PIT revenues are due to penalties and interest, it demonstrates that many businesses are experiencing cash flow problems. Mr. Nunns said that the current revenue forecast did not take into account that many small businesses are in effect using the state as a creditor.

It was suggested that to predict the extreme volatility of oil and gas prices, economists should consult with local industry experts and use New Mexico industry trends, in addition to national forecasts.

Gross Receipts Revenue Comparison — Fiscal Years 2008 and 2009

Mr. Nunns and Clinton Turner, senior economist, TRD, provided the committee with a brief comparison of the revenue received by the state from gross receipts taxes for fiscal years 2008 and 2009. Mr. Turner began with a county map of New Mexico, showing the percentage of gross receipts generated in each county, with Bernalillo, Chaves, Dona Ana, Eddy, Lea, McKinley, San Juan and Santa Fe counties constituting the vast majority of economic activity in the state. Most of those counties have also experienced a reduction in gross receipts in the first three quarters of fiscal year 2009, with the notable exceptions of the oil- and gas-producing counties. However, as a whole, the state has seen increased gross receipts in fiscal year 2009, though not as robust as in previous years. Finally, Mr. Turner segregated gross receipts by category and identified the nearly two percent decline in retail trade and the minimal increase in construction activity as the major factors in the economic slowdown.

It was noted that the big jump in construction activity in southeastern New Mexico is probably due to the construction of the new Louisiana Energy Services enrichment facility.

Adjournment

There being no further business, the committee adjourned at 12:50 p.m.