MINUTES
of the
FOURTH MEETING IN 2010
of the
REVENUE STABILIZATION AND TAX POLICY COMMITTEE

September 14-15, 2010
Room 322, State Capitol
Santa Fe

The fourth meeting of the Revenue Stabilization and Tax Policy Committee (RSTP) for 2010 was called to order by Representative Edward C. Sandoval, chair, on Tuesday, September 14, 2010, at 9:37 a.m. in Room 322 of the State Capitol in Santa Fe.

Present
Rep. Edward C. Sandoval, Chair
Sen. Carlos R. Cisneros
Rep. Nathan P. Cote
Rep. Anna M. Crook
Rep. Keith J. Gardner (9/14)
Sen. Timothy M. Keller
Sen. Gay G. Kernan
Rep. Ben Lujan, Speaker of the House
Rep. Rodolpho "Rudy" S. Martinez
Sen. Howie C. Morales (9/14)
Rep. Henry Kiki Saavedra
Rep. Thomas C. Taylor
Rep. Jim R. Trujillo

Absent
Sen. John Arthur Smith, Vice Chair
Sen. Dianna J. Duran
Sen. Tim Eichenberg
Sen. Timothy Z. Jennings
Sen. William E. Sharer

Designees
Sen. Mark Boitano
Sen. Phil A. Griego
Sen. Clinton D. Harden, Jr.

Rep. Ray Begaye
Rep. Donald E. Bratton
Rep. Zachary J. Cook
Sen. Kent L. Cravens
Rep. Miguel P. Garcia
Rep. Roberto "Bobby" J. Gonzales
Rep. Sandra D. Jeff
Sen. Carroll H. Leavell
Rep. Antonio "Moe" Maestas
Sen. Steven P. Neville
Rep. Debbie A. Rodella
Sen. Nancy Rodriguez
Sen. Bernadette M. Sanchez

Sen. John M. Sapien
Rep. James R.J. Strickler
Rep. Don L. Tripp
Rep. Luciano "Lucky" Varela
Sen. Peter Wirth

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

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

Guests
The guest list is in the meeting file.

Handouts
Handouts and other written materials are in the meeting file.

Tuesday, September 14

Tax Policy — Gross Receipts Tax and Pyramiding

Richard Anklam, president and executive director, New Mexico Tax Research Institute, and Tom Clifford, chief economist, Legislative Finance Committee (LFC), gave a presentation to the committee about the gross receipts tax (GRT) and pyramiding issues associated with the tax. Mr. Anklam began by providing a general definition of "pyramiding", which is when a general consumption or transaction tax is charged on business inputs and becomes embedded as part of the cost of the ultimate goods or services sold to the consumer. For example, a construction company that buys engineering services is normally charged GRT. Part of the cost of engineering services includes accounting services for the engineering company, which also includes GRT. Part of the cost of the accounting services includes printing services on which the GRT is charged. Part of the cost of printing services includes business supplies on which the GRT is charged. Economists have argued that, ideally, the GRT should be applied only to the final consumption and not to business inputs. However, this ideal often conflicts with another tax principle: that the GRT tax base should be as broad as possible. With a broad tax base, the GRT is imposed on more goods and services purchased by businesses.

Pyramiding of sales taxes is a common problem in most states. Many states have taken steps to alleviate pyramiding in an attempt to reduce the economic distortions it causes. Pyramiding has many effects, including:

- if the sales tax rate is higher, the effects of pyramiding are much more pronounced;

- small businesses often feel the effect of pyramiding on services because they tend to purchase business services instead of having those services provided in-house;

- businesses and individuals that make in-state purchases are impacted more than those that purchase from out-of-state vendors, which creates an incentive to purchase from out-of-state vendors;

- most of the tax burden caused by pyramiding is likely borne by in-state households, which makes the tax more regressive;

- in-state companies are placed at a disadvantage compared to their out-of-state competitors; and

- the tax becomes less transparent with greater levels of pyramiding.

New Mexico has a GRT that is a business privilege tax imposed on a seller's gross receipts and has a very inclusive definition of most goods and services provided. The state GRT rate is 5.125 percent, and local governments can charge additional GRT. The average local option GRT is two percent. The state also charges the compensating tax of 5.125 percent on purchases of goods used in New Mexico that are purchased from out-of-state sellers. Services provided by out-of-state vendors are not subject to the compensating tax. The GRT and compensating tax base have several exemptions and deductions to reduce the pyramiding effect, including exemptions from wages and salaries; transactions taxed under other taxes; dividends; deductions of items sold for resale; tangible property sold to governments; food for home consumption; certain medical services; and a long list of special industry deductions.

Even with the exemptions and deductions from the GRT and compensating tax base, a substantial portion of purchases by businesses in New Mexico remain. The state has greater pyramiding effects than most other states because New Mexico taxes more service and non-service business inputs. Historically, the broad-based GRT in New Mexico made sense because the minimal role of cross-border transactions kept retail competition mostly local; the large role of government facilities and the imposition of the GRT on sellers of services to those facilities increased the tax base tremendously; and the imposition of the GRT on services for the resource extraction industry further increased the tax base. However, the relative isolation of the New Mexico economy is changing, and competitiveness with out-of-state businesses is becoming a bigger issue.

The debate surrounding the pyramiding issue is complex. Pyramiding is seen as a problem not just by economists, but also by businesses that perceive that the tax on their purchases adds to their costs, making them less competitive. In addition, sales of services are becoming a larger portion of the economy, which leads to other problems, including how to determine where the sale of a service takes place and when a service becomes an input of another subsequent service. Although many business inputs are allowed a deduction if they are to be resold, many inputs are still taxable.

Because one-third to one-half of GRT revenue comes from pyramiding, the problem will be expensive to address. In 2003, the Blue Ribbon Tax Reform Commission recommended fixing the deduction allowed for items and services for resale, but the solution had a $50 million annual cost to state coffers. Any solution to the problem should not involve raising GRT rates because that will compound the inefficiency of the tax and increase its regressivity. The use of tax incentives should be strictly limited because they reduce the base and put upward pressure on tax rates. In general, GRT reform should focus on taxing final sales and exclude intermediate sales. Specific deductions should be made for business inputs. The GRT could also be split into two taxes: a retail sales tax on consumption and a business privilege tax.

Mr. Clifford then discussed pyramiding issues in New Mexico and highlighted some of the same points made by Mr. Anklam. The GRT accounts for more than 40 percent of all tax collections in New Mexico. The higher New Mexico sales tax offsets the lower-than-average property taxes the state imposes. The GRT tax base is composed of services (43 percent), retail (26 percent), construction (15 percent), wholesale (five percent), utilities (four percent), manufacturing (three percent) and other industries (four percent). The largest one percent of companies in New Mexico make up more than one-half of the GRT base, while the smallest two-thirds of companies make up less than one percent of the base. As a company size increases, the taxable share of its total sales decreases, because larger companies tend to export more.

Mr. Clifford gave an example of GRT pyramiding, describing all the business activities in producing electricity. Each time one business entity sells the product, it is taxed, which has the effect of raising the GRT rate on the final product from an average 7.4 percent to 13.88 percent. This effect can induce businesses to avoid the GRT by importing, or by bringing operations in-house. Although the overall business tax burden is about average nationally, the sales tax on business inputs is almost twice the national average. Businesses that purchase inputs from within New Mexico have a higher overhead than businesses that import. Depending on whether the seller has nexus in the state, this advantage can be either 2.5 percent or 7.5 percent.

Questions and comments from committee members included the following:

- Mr. Clifford was asked to provide a comparison of the amount of pyramiding in other states.

- Is pyramiding of the GRT passed on to consumers? Mr. Clifford said that this is difficult to determine, but said that increased GRT incidence reduces the total amount of sales.

- How could the state increase the percentage of property tax revenues going to the general fund? Mr. Clifford said that would require a constitutional amendment if the millage cap is increased. Mr. Anklam said that one idea raised in the past would be to impose a transfer tax on sales of real property. That idea met with stiff opposition from the real estate industry.

- If businesses pass on the pyramiding effects of doing business to consumers, how does that make a business less competitive? Mr. Anklam said that the pyramiding raises the final cost of the services or products being sold. The pyramiding effect depends on what is being produced and where the competitors are located.

- The claim that two-thirds of household spending is not taxed does not seem accurate. Mr. Clifford said that figure is the measure of direct GRT and does not include embedded GRT.

- Which sectors of the economy receive the biggest deductions from the GRT? Mr. Clifford said that the biggest deduction in the retail sector is on food. New Mexico does not have many deductions for services, which is the largest GRT sector. Most other states do not tax services. The committee member said that some business sectors cannot pass along the GRT.

- For every one percent increase in state taxation, the state gross domestic product decreases by .3 percent. Mr. Clifford said that studies of that type are very difficult to perform, but that figure seems plausible.

- The GRT deduction on food was supposed to pay for itself with the repeal of the .5 percent municipal credit. Mr. Anklam said that the state actually loses $150 million per year from that change in law.

- Do other states have different taxes that make up for the amount of money New Mexico raises from GRT pyramiding? Mr. Clifford said that is true, but now that internet transactions are increasing, the pyramiding effect in New Mexico is probably causing more economic distortions. Mr. Anklam said that New Mexico's tax burden is not transparent. Some industries win and others lose, based on the state's tax structure.

- If pyramiding is such a problem in the state, why are prices generally comparable with other states? Mr. Clifford said that for some businesses, pyramiding is a large burden. Most states do not tax services as much as New Mexico does, and every increase in the GRT rate compounds the pyramiding problem.

- The Taxation and Revenue Department (TRD) has a regulation that says winnings from a rodeo are subject to the GRT. A high school student who won purse money at a rodeo was recently fined by the TRD for not paying the GRT.

- If the state enacts laws that reduce the pyramiding effect on businesses, those businesses will end up paying more federal income tax, rather than paying the state taxes.

Tax Incentives

Dorothy Rodriguez, secretary-designate, TRD, presented a chart of 310 tax expenditures provided by New Mexico statutes. The chart was an expansion of the tax expenditure report discussed at the August meeting. Although tax expenditures account for a significant portion of a state budget, they often receive far less scrutiny than direct appropriations. There is no systematic review of tax expenditures, and there is no process to determine their effectiveness.

She emphasized that the chart is still a work in progress, and there are many errors and gaps in data. The report is the TRD's draft of a tax expenditure report, which hopefully will be continued in the future.

The state has more information on credits because those amounts are often listed on tax returns. Deductions, however, are more difficult to track because they are often reported in the aggregate, and exemptions are usually not reported at all. Many of the exemptions and deductions are not really tax expenditures, but they are necessary to comply with federal law to reduce pyramiding and multiple taxation and to provide reciprocity with other states. As an example, the state provides an exemption from the GRT on wages because wages are already subject to other taxes.

Secretary-Designate Rodriguez described how other neighboring states track tax expenditures. Arizona provides a lengthy report of tax expenditures, but the report does not attempt to evaluate their effectiveness. Colorado produces a report of sales and use tax deductions and exemptions but also does not track effectiveness. Oklahoma provides a detailed listing of revenue foregone of about 450 tax statutes but does not evaluate their effectiveness.

Secretary-Designate Rodriguez presented a list of tax expenditure evaluation guidelines that New Mexico should consider adopting. She suggested developing a model statute for tax expenditures that would include the following elements:

- clearly defined purpose;
- application and claim procedures;
- clear definition as to how credits are calculated;
- certification requirements;
- carryforward rules (better to not allow carryforward);
- transferability (not preferred; this creates a secondary market for the credit at less than the full value of the credit);
- refundability (fully refundable credits are easier to administer but are essentially a cash subsidy);
- recapture or post-performance credit provisions;
- limits on use and duration;
- reporting requirements; and

- resources for administration and evaluation.

The model statute should also contain procedures for evaluating whether the objectives of the tax expenditures were accomplished. She suggested that credits not meeting the criteria specified have provisions for automatic repeal of those statutes. Reporting requirements need to be established in law, and sufficient resources and expertise need to be provided in order to allow the department to properly certify the credit applications.

Secretary-Designate Rodriguez said that the legislature should consider repealing Section 7-1-29.2 NMSA 1978, which automatically grants a credit if an application has not been reviewed by the TRD within 180 days. Finally, she suggested that a consensus group be established to continue the work of tax expenditure reporting, similar to the consensus revenue forecasting group already established.

Questions and comments from committee members included the following:

- Having a clearly defined purpose for tax incentives may conflict with the legislative tendency to not have purpose sections in statute.

- How should the reform recommendations be accomplished? Secretary-Designate Rodriguez said that a model statute should be drafted and existing credits should be conformed to the new standards. Enacting limits on some deductions and exemptions may also be appropriate to reduce the estimated $1.3 billion the state is spending.

- How is the TRD's tax amnesty program progressing? Secretary-Designate Rodriguez said that the department has received 2,000 claims so far in the program, and taxpayers have until September 30 to file claims.

- Are there any limitations on how many credits, exemptions or deductions a taxpayer can claim? Secretary-Designate Rodriguez said that, in general, if a taxpayer qualifies, there are no limits to how much a taxpayer can claim. She said that there are only a few credit exclusions in law.

- TRD staff was requested to consolidate some of the deduction and exemption categories in the report so it can be better understood.

- The RSTP should study the revenue impact on the state of rules proposed by agencies. Staff was instructed to investigate the possibility of legislation that would penalize state agencies that do not perform economic impact studies of proposed rules.

- Tax incentive law should include purpose sections in the legislation so that the incentives can be evaluated for effectiveness.

TRD Review — Summary and Discussion

Ms. Ray and Secretary-Designate Rodriguez discussed with the committee the structure and operational budget of the TRD. Ms. Ray began by stating that LFC staff has recommended that the premium tax, which is currently administered by the Public Regulation Commission, would be better administered by the TRD. The TRD consists of seven divisions and the Office of the Secretary. The five main functions of the TRD are tax administration, collection and disbursement; tax fraud elimination; motor vehicle control; property tax administration; and program support.

The department in fiscal year 2010 distributed $5.7 billion in tax revenue, more than 60 percent, or $3.7 billion, of which came from the GRT. Oil and gas revenues accounted for $860 million in distributions; the personal income tax (PIT) raised $336 million; combined fuel taxes raised $260 million; and motor vehicle fees and taxes raised $253 million. Other smaller tax programs include the weight distance tax, corporate income tax (CIT), gaming tax, cigarette tax, liquor excise tax and workers' compensation taxes.

The TRD has a total operating budget in fiscal year 2011 of $84.2 million, which is six percent smaller than the previous year. There are 1,183 total authorized full-time-equivalent (FTE) positions, which is 132 fewer than in fiscal year 2010. The TRD is implementing several budget reduction strategies, including:

- reducing the frequency of account statements from monthly to quarterly, although this may have a negative impact on audit and compliance collections;

- evaluating the need for driver's license and registration renewal notices to be mailed;

- closing one Albuquerque Motor Vehicle Division (MVD) office location;

- closing MVD field offices at 3:30 p.m. to eliminate staff overtime;

- discontinuing the printing of driver's manuals because they are available online;

- increasing the fee for the sale of data by $.50;

- implementing the Drive MVD program, which will include private operator driving test administration, more private retail agents across the state and fast-track services in 13 field offices for the disabled and elderly;

- reducing the number of PIT and CIT tax forms produced;

- reducing information technology maintenance agreements;

- restricting the use of supplies and inventory exempt purchases;

- using cash balances in the Property Tax Division for operating expenses;

- retaining a percentage of revenue from state-assessed property tax activities;

- keeping vacancies frozen in the Tax Fraud Investigations Division;

- increasing the use of electronic filing of returns by taxpayers;

- replacing the current customer call center with a more efficient system;

- redesigning the MVD web page, which will reduce customer demands on staff;

- redesigning the TRD intranet site to improve staff communications and reduce paper use; and

- redesigning the TRD web page for better customer service.

The TRD is also engaging in several revenue-enhancing efforts, including increasing delinquent collections and implementing the Fair Share Initiative, which has recurring costs of $5.1 million, has raised $21.3 million in fiscal year 2010 and is anticipated to raise $44.4 million in the current fiscal year. The department is also upgrading its compliance efforts by making upgrades to its data warehouse to better identify tax evaders; consolidating tax levy actions to increase efficiency; allowing tax collectors to have an overall view of a taxpayer's debts across tax programs; making upgrades to the bankruptcy program to ensure timely court filings; and increasing the use of payment plans for delinquent taxpayers.

Questions and comments from committee members included the following:

- Every new TRD employee generates significant revenue for the state. Revenue-generating state agencies should not have their FTEs cut because that will further reduce the state's revenues.

- How many new private MVD offices are being opened? Mike Sandoval, director, MVD, said that the MVD has just issued 10 to 12 requests for proposals (RFPs) for private MVD offices.

- TRD staff was asked to provide a cost-versus-revenue-raised report of an FTE employed by the MVD.

- Many state residents complain about poor services provided from state government, but few people are in favor of revenue-increasing measures. The PIT rates probably should be raised, but everybody is afraid of having that discussion. It costs much more to put somebody in prison than to provide that person a good education and decent health care.

- The only opportunity to reform state government is when there is a lack of money. Unfortunately, the state government merely seems to be rearranging itself, rather than engaging in true reform.

- The state needs to prioritize the most important functions of government, including education, health care and safe highways.

Committee members made recommendations for better tax administration, including:

- performing economic impact studies of proposed state agency rules;

- providing expiration dates and legislative review of tax credits;

- providing for a single state agency to track the effectiveness of all tax incentives; and

- using information technology improvements to save money, including the simple example of making direct deposits for legislative per diem reimbursements.

Department of Transportation (DOT) Review — Summary and Discussion

Ms. Ray and Secretary of Transportation Gary Giron discussed with the committee the structure and operations of the DOT and State Transportation Commission (STC). The STC is composed of six members appointed by the governor, one from each transportation district. Commissioners serve six-year staggered terms. The commission sets policy regarding the state's transportation system and oversees all expenditures from the State Road Fund (SRF).

The DOT is authorized by law to perform any of the duties assigned to the commission if the commission so designates those duties. The DOT consists of the Office of the Secretary, the Programs and Infrastructure Division and the Business Support Division. The DOT has its own treasury, which consists of the SRF, and it is allowed by law to have cash balances. This is due to the nature of financing for highway construction, which is typically on a reimbursement basis from the federal government. However, the department is required to have a balanced budget, so shortfalls in funding result in a reduction of road programs. In fiscal year 2009, the DOT had cash balances of $55 million, and cash balances totaled $102 million at the end of fiscal year 2010. The total state-funded budget for the department in fiscal year 2011 is $402 million. Federal funds for the year amount to $803 million.

The economic recession has impacted the DOT significantly. The department has cut 250 FTEs, all of which were vacant positions. This is a 23 percent reduction from the previous year's FTE authorization. Other reductions include:

- a 100 percent reduction in state-funded construction for roads that are not eligible for federal funding;

- a contract maintenance of highways reduction of $21 million in the past two fiscal years;

- heavy equipment replacement;

- winter services, including sweeping, guardrail repair, bridge deck preservation, striping, culvert cleaning and repair and provision of flashers and signals;

- spring activities, including chip seal application, pothole patching, equipment repair, mowing, sweeping, guardrail repair, dust storm mitigation, herbicide application and striping;

- summer activities, including chip seal application, road patching, blade patching, mowing, guardrail repair, dust storm mitigation and striping;

- overtime budgets, which resulted in reductions in snow removal and public safety and school safety programs; and

- operational and road maintenance budgets.

If revenue increases are not realized by the SRF soon, the DOT will be forced to make even more drastic cuts. There is no guarantee that federal highway funding legislation will be reauthorized, but even with that funding, the DOT faces huge shortfalls in highway repair, construction and maintenance funding. Secretary Giron said that there will be no new DOT construction programs in two years unless the federal or state government provides new revenue.

Secretary Giron discussed several revenue-raising options, including raising fuel taxes. New Mexico has the lowest gasoline tax in the region, and studies have shown that there is no direct correlation in the price of gasoline at the pump with the level of state taxation on gasoline. For every $.01 increase in the gasoline tax, the state would raise $8.3 million, and for every $.01 increase in special fuels taxes, $4.3 million would be raised. Secretary Giron noted that gasoline and special fuels taxes are assessed for every gallon of fuel sold. As vehicle efficiency standards have increased, less money is raised for each mile driven on the state highways.

Another option for raising money for the SRF would be to increase vehicle registration fees, which would raise $15 million for every $10.00 increase.

Questions and comments from committee members included the following:

- Has the DOT completed the purchase of the Lamy-Raton section of the Burlington Northern Railroad? Secretary Giron said that the purchase will be finalized next year, and $5 million has already been budgeted for that purchase. He said the state receives $2.5 million each year from the company for use of the Belen-Santa Fe portion of the tracks. The entire purchase price of the tracks was $75 million.

- Instead of cutting crucial services such as DOT funding, the legislature should focus on reducing waste in other sectors such as health care. Waste and fraud can be reduced without eliminating services.

- A small gasoline tax increase will not affect retail fuel prices but will significantly help the DOT annual budget shortfall.

- Has the department considered using toll roads to help its budget? Secretary Giron said that toll roads may be appropriate in a few areas of the state, but that will not address the overall statewide need for funding. The Federal Highway Administration has not authorized any new toll roads on interstate highways in a few decades. Mike Gibson of the Associated Contractors of New Mexico said that toll roads have consistently ranked lowest in polls for methods of raising revenue for state highways. He said that recent polling suggests that the public is in favor of increases in fuel taxes, if those increases are dedicated for highway maintenance and construction.

- Intermodal rail transport, which the state is prohibited from taxing, is reducing revenue to the state. DOT comptroller Greg Geisler said that he believes the interstate commerce clause of the federal constitution bars states from taxing rail transport. He said he will research that issue and confirm the answer for the committee.

- Some people claim that the reason Governor Bruce King lost his bid for reelection in 1994 was because he supported an increase in the gasoline tax, and any politician today supporting another increase is committing political suicide. However, there were many more important factors in Governor King's defeat, including the Indian gaming issue, the fact that the gasoline tax increase was distributed to the general fund and, probably most important, the presence of a strong Green Party candidate in the race.

- DOT staff was asked to provide a breakdown of each district's budget and any inter-district transfers. Staff was also asked to provide the number of lane miles in each district. Secretary Giron said that inter-district transfers are rare. He has been working with each district engineer to cut budgets.

- The idea that the government can spend money to create wealth is false. Spending money to prop up the economy has not worked.

- DOT staff was asked why there was a street sweeping crew in Encino during the legislator's commute to Santa Fe that day.

- DOT staff was asked to provide information on which road projects were deauthorized under the general language of "certain road projects" from the 2010 budgetary solvency package.

The committee recessed at 5:15 p.m.

Wednesday, September 15

The committee was reconvened by Representative Sandoval at 9:15 a.m.

Permanent Funds — Source, Earnings and Distributions

Commissioner of Public Lands Patrick H. Lyons and State Investment Officer Stephen K. Moise presented to the committee about state trust lands and income from permanent funds.

State Land Office (SLO)

Commissioner Lyons described the operations of the SLO and the history of the state's trust lands and how those lands are managed for trust beneficiaries. The U.S. Congress granted Sections 2, 16, 32 and 36 of every township in New Mexico for the benefit of public schools and other purposes, including universities; capitol buildings; charitable, penal and reform institutions; water reservoirs; Rio Grande improvements; and health institutions. The SLO manages lands owned by each beneficiary, and revenue raised on each property is credited to the beneficiary. The SLO manages 8.9 million acres of land in New Mexico, which is 11 percent of the total land in the state.

Revenue earned from state lands goes into two different funds, depending on the type of activity. Leases, rights of way, leasing bonuses and interest income are deposited into the Land Maintenance Fund (LMF). The SLO reserves two percent of the revenue for its operations, and the rest is distributed to the beneficiaries. The public school distributions are deposited into the general fund. Royalties from mineral and oil and gas extraction activities and land sale proceeds are deposited into the Land Grant Permanent Fund (LGPF), which is managed by the State Investment Office (SIO). Distributions are made to trust beneficiaries of a percentage of income earned from the fund, according to the amount invested on behalf of each beneficiary. Distributions for the public schools are made into the Common School Fund. The vast majority of distributions goes to the Common School Fund.

Annual distributions from the LMF have varied between $28 million to fiscal year 2010's distributions of $76 million. Total distributions in the last eight fiscal years were $417 million. Distributions from the LGPF have steadily increased from $333 million in fiscal year 2003 to $526 million in fiscal year 2010, although a large portion of the increase was attributable to the adopted constitutional amendment that increased the percentage of the distribution to public schools for several years.

Oil, gas and mineral extraction activities account for 95 percent of the income earned by the SLO. Other sources of income include renewable energy, rights of way, community and business development and agricultural leases. Total revenue earned by the SLO has increased from $263 million in fiscal year 2003 to a peak of $546 million in fiscal year 2008. Fiscal year 2010 revenues were $420 million. The operating budget for the SLO has remained flat for the past fiscal year at $13.9 million. The office has reduced the number of FTE positions, and no employee earns more than $100,000 per year.

State Investment Council (SIC) Overview

Mr. Moise described the functions and structure of the SIC, which was recently reorganized by the legislature. The council is composed of 11 members, including the governor, the secretary of finance and administration, the state treasurer, the commissioner of public lands, a university representative, two public members appointed by the governor and four public members appointed by the New Mexico Legislative Council. Public members must be confirmed by the senate, have extensive investment or finance experience and have no previous contracts with state investment, and they are precluded from having investment contracts with the state two years following their service. The SIC has investment oversight and approval powers and has the power to appoint the state investment officer. The officer oversees the day-to-day operations of the SIO. Currently, the SIO has 30 full-time employees.

The SIO manages approximately $13.7 billion in assets, including the LGPF, the Severance Tax Permanent Fund (STPF), the Tobacco Settlement Permanent Fund, the Water Trust Permanent Fund and investment assets of 19 other state and local government clients. Fifty-six percent of the SIO's investments are in public equities; 18.5 percent are held in bonds; and 23.5 percent are invested in alternatives, including private equities, hedge funds and real estate. The office also has the ability to invest a certain percentage of the STPF in economically targeted investments, including nine percent of the fund in New Mexico private equity funds; six percent in film loan investments; and 20 percent in New Mexico bank certificates of deposit (CDs). Mr. Moise said that the state has not yet earned any money from film investments. The bank CD program has just begun, and the SIO has not yet invested any money in the program. The state has invested $289.9 million in New Mexico private equity funds.

Distributions from the state's two largest permanent funds, the LGPF and the STPF, have totaled $3.4 billion in the past five years. The current distribution rate from the LGPF is 5.8 percent of the five-year fund average. That rate will decline to 5.5 percent in fiscal years 2013 through 2016 and further decline to 5.0 percent beginning in fiscal year 2017. The STPF distribution rate is set at 4.7 percent of the five-year fund average and has totaled $909 million in the past five years. Money from the fund is distributed to the general fund. Mr. Moise cautioned that the current level of distributions from the fund will be difficult to maintain in the upcoming years.

The previous state investment officer had set a long-term annual investment return goal for the SIO's assets of 8.5 percent. Mr. Moise said that rate is no longer realistic. The SIC will soon set a new investment goal, probably at 6.5 percent or seven percent. That new estimate will have significant effects on future distributions from the funds and will be aggravated by scheduled reductions in the percentage of distributions from the LGPF.

Mr. Moise said that the SIO just hired a film investment auditor to ensure that the office receives adequate returns from its film investments. The office also recently hired Vince Smith, former state investment officer of Kansas, to be the deputy state investment officer.

Questions and comments from committee members included the following:

- Is the state getting its money's worth from film investments? Mr. Moise said that the audit process is just being established and that the state should be seeing some revenue soon from the process.

- How did state trust lands get designated? Commissioner Lyons said that each beneficiary chose its lands in 1913. Any money earned from a piece of land is designated for that particular beneficiary, either as a monthly check from the LMF or as a percentage of its investment in the LGPF.

- Is income from renewable energy increasing? Commissioner Lyons said that the SLO has four wind farms on its land. The problem with getting more wind farms is the difficulty in obtaining financing and the lack of transmission lines to suitable locations.

- Would the SIC be interested in investing in New Mexico wind farms on state trust lands? Mr. Moise said that he would investigate that possibility.

- Which entity receives distributions for the New Mexico Boys' School at Springer since that school is no longer open? Commissioner Lyons said that the money has been designated toward a school in Albuquerque operated by the Children, Youth and Families Department.

- Has there been much new interest in oil and gas leases? John Bemis of the SLO said that there has been much renewed interest in extraction leases. The SLO earned $62 million in oil and gas bonuses last year, which was a new record. Bonus income is deposited into the LMF.

- How are the state charitable institutions determined? Commissioner Lyons said that seven entities were named in the Enabling Act for New Mexico. In order for any new entities to be named, the voters would have to approve a constitutional amendment and the U.S. Congress would have to approve an amendment to the Enabling Act.

- Was the previous 4.7 percent distribution rate from the LGPF based on an expected 8.5 percent annual rate of return from investing the fund? Charles Wollman from the SIO said that he believes that the 8.5 percent target was set by the previous state investment officer. However, prior to 2003, the Public Employees Retirement Association (PERA) and the Educational Retirement Board (ERB) each had investment targets of eight percent.

- Does the SIO charge a fee for managing the assets of other entities? Mr. Moise said that the SIO is reimbursed for direct costs associated with managing the funds, depending on the investment class. Most entities pay less than 25 basis points (.25 percent) of the investment.

- SIO staff was asked to provide a complete list of its government clients.

- The SIO needs to invest money in New Mexico bank CDs to encourage lending to local businesses. Mr. Moise said that there has to be a balance between maximizing investment returns with other policy goals.

- Can the state borrow money against the balance of the LGPF or the STPF? Mr. Moise said that he is not aware of that possibility.

- Although the average 19 basis points that the SIO pays to its investment managers seems low, that rate amounts to more than $26 million. The SIO should do a better job of negotiating investment fees because it has such a large portfolio. Mr. Moise said that the SIO is constantly negotiating fees with its managers.

- What percentage of the SIO's real estate investment portfolio is in real estate investment trusts (REITs)? Mr. Moise said that he does not think the SIO has any REIT investments, but he will verify that information and report back to the committee.

- What has been the rate of return in the SIO's investment in private equities? Mr. Wollman said that the office has seen an average nine percent investment return. New Mexico private equities have not yet earned a profit, mostly because they have not been sold off.

- Can the functions of the SIO be combined with the PERA and the ERB? Mr. Moise said that there are many synergies with those entities, and some functions could be shared. He said that he is not sure whether any benefit would be gained from combining the entities, but the the RFP process and legal services could be combined easily.

- Should the responsibility for making economically targeted investments be moved to the Economic Development Department, as those investments may be at odds with the overriding goal of earning as much money as possible for the beneficiaries? Mr. Moise said that those investments require much time to manage, but he had no recommendation about which entity should manage them.

PIT and CIT Proposals — Council on State Taxation Ranking

James P. O'Neill, consultant, presented two legislative proposals designed to easily improve New Mexico's ranking as a good place to do business. The Council on State Taxation publishes a report that ranks states according to how difficult a state taxation department is to deal with from a business point of view. The council has several criteria to measure how business-friendly a state is for tax appeals and general administrative practices, including whether the state has an independent tax dispute forum, whether a business is required to post bond to file an appeal, whether there is even-handed treatment of refunds and assessments, the number of days allowed to protest an assessment and how long a taxpayer has to file with the state after a final determination of federal tax changes has been made.

Mr. O'Neill presented two bill drafts that attempt to mitigate several of the findings of the council. The bills:

- extend the deadline for reporting federal tax status changes from 90 days to 180 days, clarify what changes need to be reported and define "final determination" according to the council's preferred standard;

- extend the grace period from 30 days to 90 days before a taxpayer becomes delinquent;

- extend the time for protesting from 30 days to 90 days;

- extend the time allowed to claim a refund to three years to match the TRD's time frame to make an assessment; and

- extend the reporting date for CIT reporting by an extra month.

There being no further business, the committee adjourned at 11:50 a.m.