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

July 21-22, 2016
Room 322, State Capitol
Santa Fe

The second meeting of the Revenue Stabilization and Tax Policy Committee was called to order by Representative Jason C. Harper, chair, on July 21, 2016 at 9:13 a.m. in Room 322 of the State Capitol.

Present
Rep. Jason C. Harper, Chair
Sen. Carlos R. Cisneros, Vice Chair
Sen. Ted Barela
Sen. Lee S. Cotter
Rep. Tim D. Lewis
Rep. Antonio Maestas
Rep. Rod Montoya
Rep. Debbie A. Rodella
Sen. Clemente Sanchez
Sen. William E. Sharer
Sen. John Arthur Smith
Rep. James R.J. Strickler
Rep. Carl Trujillo
Rep. Jim R. Trujillo
Sen. Peter Wirth

Absent
Rep. David M. Gallegos
Sen. Mark Moores
Sen. George K. Munoz

Designees
Sen. William F. Burt (7/22)
Rep. Bill McCamley (7/21)
Sen. Nancy Rodriguez
Sen. Pat Woods

Rep. David E. Adkins
Sen. Sue Wilson Beffort
Sen. Jacob R. Candelaria
Rep. Sharon Clahchischilliage
Rep. Randal S. Crowder
Rep. Brian Egolf
Rep. Miguel P. Garcia
Rep. Stephanie Garcia Richard
Rep. Bealquin Bill Gomez
Sen. Stuart Ingle
Rep. Conrad James
Sen. Gay G. Kernan
Rep. Idalia Lechuga-Tena

Rep. Javier Martínez
Rep. Tomás E. Salazar
Sen. John M. Sapien
Rep. Jeff Steinborn
Rep. James G. Townsend

Guest Legislators
Rep. Kelly K. Fajardo (7/21)
Rep. Luciano "Lucky" Varela

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

Staff
Pam Stokes, Staff Attorney, Legislative Council Service (LCS)
Ric Gaudet, LCS
Anna Martin, Intern, LCS
Tessa Ryan, Staff Attorney, LCS

Guests
The guest list is in the meeting file.

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

Thursday, July 21

After welcoming the committee, Representative Harper explained that the meeting would give members an overview of the state's primary tax systems and that the next meeting would provide an opportunity for members and other participants to discuss ideas for related reform.

New Mexico Tax System Overview and General Fund Revenue Sources
Information from the Legislative Finance Committee (LFC)
Christina Keyes and Jon Clark, LFC economists, presented as follows on the state's revenue sources and distributions. The presentation included a historical and future overview of revenue generated from those sources.

Overview of revenue sources and distributions. Page two of the LFC's presentation handout shows three major categories of revenue: 1) that which is funneled into two major operating funds: the General Fund and the State Road Fund; 2) that which is earned on investments, including investments of money in the Land Grant Permanent Fund and Severance Tax Permanent Fund and in state treasurer investments; and 3) that which is generated through bonding programs, including those that use property taxes and severance taxes as repayment streams. Most revenue (over 44%) in the General Fund is used for public schools, followed by health and human services (over 26%).

The General Fund. For fiscal year (FY) 2017, the LFC projects that most General Fund revenue (43%) will come from sales taxes, followed by income taxes (26%), energy-related taxes (16%), investments (11%) and other sources (4%). Pages four and five of the handout show, in bar-chart and pie-chart form, respectively, the proportion from each major source of General Fund revenue by fiscal year, from FY 2012 through FY 2016. The figures representing FY 2016 were derived partly from projections of historical data, since actual data for the last two months of that year are not yet available. The category titled "other" includes revenue from gaming and alcohol sales, among other sources. Notably, revenue levels from the gross receipts tax (GRT) have been relatively consistent over those years.

Recent revenue collection. A bar graph on page seven of the handout shows that FY 2016 revenue from most sources fell below those sources' FY 2015 levels. Though revenue from investment income exceeded the FY 2015 level, it did not compensate for losses in other categories.

GRT revenue. As shown in a graph on page six of the handout, the GRT generated more revenue in December 2015 than in December of any of the six previous years, but May 2015 GRT collections fell below May collections in each of the prior six years except 2010. Tables on pages eight and nine of the handout show changes, from July 2015 to May 2016, in matched taxable gross receipts by industry and county, respectively. The most significant change, that corresponding to the natural resource extractions industry, is consistent with the recent downturn in that sector. While gross receipts from manufacturing sales were high in early 2016, they fell by almost 28% over the measured period. Meanwhile, Bernalillo County has shown overall growth, and Dona Ana County fairly strong growth, in that period. Oil and gas sector-dependent counties, such as Lea and San Juan, on the other hand, are experiencing significant declines in their gross receipts.

<u>Information from the New Mexico Tax Research Institute (NMTRI)</u>

Richard Anklam, president and executive director, NMTRI, began his portion of the presentation with a review of the NMTRI's principles of good tax policy and stressed the importance of considering them all in relation to the state's tax system.

Principles of good tax policy. The principles of good tax policy are: 1) "adequacy", which describes sufficiency to pay for the services policymakers decide are needed; 2) "efficiency", which refers to the minimization of interference with the private economy; 3) "equity", which means vertical and horizontal fairness among taxpayers; 4) "simplicity", or reducing complexity in tax laws, forms and procedures; 5) "comprehensiveness", which means considering all taxes when evaluating a part of or the whole tax system; and 6) "accountability", which refers to the ability to measure the effectiveness of, and justify deviations from, an otherwise broad-base, low-rate tax program. Often, the principles conflict with one another.

Mr. Anklam continued his presentation by giving an FY 2017 General Fund revenue estimate by revenue source; by providing background on the state's General Fund and other revenue sources; and by comparing the rates of taxes that businesses in New Mexico pay with the national average for those taxes.

FY 2017 General Fund revenue estimate and sources. It is projected that approximately $6.26 billion will flow to the General Fund in FY 2017. Each year, most General Fund revenue comes from sales taxes, especially the GRT. New Mexico, unlike many states, is somewhat heavily reliant on severance taxes and earnings from permanent fund investments, but not very reliant on property taxes, which primarily benefit local governments.

Business tax rate comparison. The table on page five of Mr. Anklam's handout shows 2009 figures that represent: 1) the rates of taxes imposed on in-state businesses as those rates compare with national averages; and 2) the difference in revenue generated by each of those taxes in New Mexico and the corresponding national average. The figures underscore the state's relatively low reliance on its property tax, its relatively heavy reliance on sales taxes and its comparability to the nation in its excise tax, its corporate income tax (CIT) and its individual income tax on business income. (The unemployment insurance tax figures are outdated.)

State and local GRT; compensating tax. In 1935, New Mexico imposed what is now known as the GRT. Originally called the "emergency school tax", the state imposed the tax to generate revenue needed for schools, preferring to tax sales over property due to the relative scarcity of taxable property. Unlike many other states' sales taxes, the GRT: 1) is imposed on the seller, not the buyer; 2) originally featured a very broad base; 3) applies to the sales of intangibles and services (in addition to goods), a feature other states are considering in light of developments in the modern economy; 4) has been the subject of a court challenge in which the federal government argued that it should not have to indirectly pay the GRT; and 5) is indirectly paid by the federal government, which lost that challenge.

The GRT system also includes several "special" state taxes, like the governmental GRT, the interstate telecommunications GRT, the lease vehicle GRT and surtax and the telecommunications relay service surcharge.

The GRT features many "local options", in which the state allows its political subdivisions to impose (sometimes only with voter consent) their own GRT increments on the same tax base. Allowing local governments to alter the tax base, as some states do, would enhance flexibility but also complicate administration. Because the increments are optional, the overall GRT rate, which depends on the location of the seller, varies across the state. The state remits a portion of its 5.125% GRT revenues to local governments. When the state removed certain food and medical sales from gross receipts taxation several years ago, it provided for compensation to local governments through its "hold harmless" distributions; since then, it has begun to phase out most of those distributions. A member pointed out the results of a study on the food and medical deductions from the GRT: it showed that the cuts have not reduced gross receipts taxpayers' net spending, since many governments raised their GRT rates to compensate for the revenue lost from those deductions.

States have taken a variety of approaches to address the problem of tax pyramiding in business-to-business transactions. Some impose a turnover, or business-to-business, tax at a low rate, and others impose a consumption tax on finished products. Economists generally disfavor turnover taxes because they unfairly advantage vertically integrated businesses.

In response to a member's question about industrial revenue bond (IRBs) and GRT exemption, Mr. Anklam explained that an IRB is a tool used by cities and counties to expand private enterprise. With revenue from the sale of IRBs, a local government pursues a project, such as the acquisition of a building or tangible property. The government becomes the owner of that property. A private enterprise leasing the property then enjoys the government's exemptions from property tax and the GRT. The largest issuers of IRBs have been Albuquerque and Bernalillo and Curry counties; a prominent recipient of IRBs is Intel Corporation.

The state's compensating, or "use", tax is a companion to the GRT. It is intended to compensate the state for the non-remission of GRT inherent in certain sales, namely, those for which the tax would be collected if the seller were liable to pay it. As such, the compensating tax is imposed on the buyer. Generally, it applies to sales of tangible goods and services bought out of state. Taxpayers may claim a credit against the tax for taxes paid on a purchase to another state, a feature that guards against double taxation. Whereas most other states' compensating tax rates equal their sales tax rates, New Mexico's compensating tax on services (5%) falls slightly below its GRT rate (5.125%). That differential and the statute barring enforcement of the compensating tax owed by individuals constitute an incentive for buyers to purchase goods and services from out-of-state sellers — a result considered undesirable in tax policy.

Most large businesses are familiar with and pay the compensating tax, but many small businesses lack awareness of their obligation to pay it. One option for potentially increasing individuals' compliance with the tax is to prompt its payment through personal income tax (PIT) forms. In response to a member's question, Mr. Clark noted that the LFC estimates the compensating tax will have generated $47 million in revenue in FY 2016. In response to a member's question about the amount of revenue lost to noncompliance with the tax, Frank Crociata, tax policy director, Taxation and Revenue Department (TRD), who was in the audience, said he was unsure whether the TRD's tax-gap analysis included a look at that tax. He added that the department's audits of businesses' tax filings improve compliance with it. Asked by a member about best practices for improving compensating tax compliance, Mr. Anklam replied that the no-enforcement statute and constitutional and jurisdiction-related constraints limit the state's ability to enhance collection. The member suggested that the committee explore the topic of enforcement at the next meeting and also consider eliminating the tax because it is difficult to enforce. Another member remarked that audits cannot force compliance by those who evade the tax by transacting in cash or by those not registered with the TRD. Mr. Anklam commented that enforcing the payment of taxes is a perennial problem for states.

Mr. Anklam continued and stated that many exemptions and deductions apply to the GRT and the compensating tax, including transactions that were never intended to be subject to the tax, such as those based on most wages and the sale and lease of property. Some exemptions and deductions apply to types of products, like insurance and gas, that are taxed under different schemes. Elsewhere, certain types of sales, like those for resale, are exempted to reduce the problem of tax pyramiding. Increasingly, lawmakers have removed other categories of sales from the base to promote social welfare, economic development and other causes. In many cases, that base-narrowing has driven up GRT rates and caused a trend that has spurred many special interest groups to seek new exemptions. This cycle of raising rates and carving out portions of the base is considered bad tax policy and has recently driven lawmakers to introduce tax-overhaul proposals that would return the GRT to a broad base and a low rate.

Tribal taxes. As sovereign entities, tribal governments may establish their own tax systems that need not align with the state's. As a matter of convenience, 15 tribal governments have entered into cooperative agreements with New Mexico for it to administer the GRT on the tribal government's land.

PIT. After the GRT, the PIT generates the most General Fund revenue. It is a relatively flat tax imposed on residents and nonresidents who derive income from New Mexico sources. Taxpayers' calculation of PIT owed is based on federal adjusted gross income, a feature that helps simplify the tax. Then certain exemptions, deductions, mostly nonrefundable credits and withholding and estimated payments are factored in. The top PIT rate is 4.9%.

CIT. Corporations and other entities taxed as corporations under federal tax laws pay the CIT if those entities have constitutional nexus with New Mexico, which can be established with even "the slightest" physical presence. Federal and state treatment of businesses' net operating losses varies somewhat. Increasingly, many non-C corporation businesses — those organized as pass-through entities — pay tax on business income through the PIT instead of the CIT. Responding to a member's request for the percentage of PIT taxpayers that are pass-through entities, Mr. Crociata agreed to try to retrieve that information.

A corporation may report its income for CIT purposes using one of three methods: 1) separate (the default method); 2) combined (for "unitary", or related, entities); or 3) consolidated (a classification defined by federal regulation; similar to combined). Once a corporation elects one of the two latter methods, it needs the seldom-granted permission of the secretary of taxation and revenue to subsequently file under the first or, if applicable, second method.

Unlike most states, New Mexico has tiered CIT rates; its three tiers apply to a taxpayer's worldwide, net income, which is then allocated and apportioned in accordance with New Mexico's Uniform Division of Income for Tax Purposes Act. "Non-business" income is allocated to a source state. "Business" income is apportioned to New Mexico based on, in general, the percentage of the taxpayer's property, payroll and sales attributable to the state. However, certain types of taxpayers, including manufacturers and corporate headquarters, may apportion their income based only on what percentage of their sales is attributable to New Mexico — that is, they may use a "single sales factor" formula. The CIT tiers and rates are gradually shifting toward two tiers with a 5.9% top rate, which approximates the average of surrounding states. The CIT also features credits and a $50.00 annual franchise tax.

In response to a member's question, Mr. Anklam explained that special tax status applies to nonprofit organizations. Generally, they pay certain taxes and are subject to full or partial tax exemptions on others.

Oil and gas taxes. Several taxes, including the oil and gas emergency school tax, the oil and gas severance tax, the oil and gas conservation tax, the production ad valorem tax and the production equipment ad valorem tax, apply to the extraction of oil and natural gas, though at different rates for each resource type. New Mexico's rates, which have not recently changed, fall roughly in the middle in a comparison with other states' corresponding tax rates. Moreover, the overall tax burden on natural resource extraction taxpayers in New Mexico approximates that in states such as Colorado and Texas.

The revenue from these taxes, together with other tax revenue generated from those industries' activities, constitutes a substantial fiscal benefit to the state. Like other states with high natural resource extraction activity, New Mexico is experiencing revenue declines from the slump in that sector.

Selective sales taxes: tobacco; liquor; insurance; gaming. The tax rate on cigarettes, which the state has raised more than once, is $1.66 per pack of 20. Certain exemptions, namely, those related to the federal government and tribes, apply. For products like snuff and cigars, a tobacco products tax of 25% of the product value applies. Elsewhere, states like New York that have high tobacco tax rates experience distortions in the form of an active underground tobacco economy. For New Mexico, meanwhile, issues around tobacco taxes arise largely in the context of tribal taxation and the growing prominence of e-cigarettes.

A range of rates, which have been adjusted over time, apply to different types of liquor. The legislature recently increased the volume at which a lower rate applies to microbrewer beer.

The state also imposes taxes on insurance premiums and gaming, distinguished because the TRD does not administer them. The state taxes insurance premiums at 3.003% and, for health insurance premiums, at an additional 1%. Several exemptions apply to insurance taxpayers. Meanwhile, the Gaming Control Board and the State Racing Commission control gaming taxes on transactions like the transfer of a gaming device, the net take of a gaming operator and the net take to purses.

Questions and Discussion

Tax policy and economic development. A member recommended that the committee explore the experiences of other states, such as Arizona and Colorado, that have enacted tax measures intended to improve the economy; the member then asked if any data-driven studies have revealed best practices in this context. Mr. Anklam responded that other states can act like laboratories in that way, and generalizations can be drawn. However, he said, analysis of that experimentation is limited, and the differences among states make drawing firm, universal conclusions difficult. Mr. Clark made some related points: 1) despite having been named by Ernst and Young as the best western state in tax treatment for manufacturing businesses, New Mexico has been losing jobs in that sector; and 2) many studies have concluded that tax incentives factor weakly into most businesses' relocation decisions; rather, those businesses care more about factors like quality of infrastructure and labor. A member expressed support for raising revenue through taxes to pay for high-quality infrastructure and education, as do states like California and New York, which maintain strong economies. The opposite approach, he said, could have grim consequences, like those facing Kansas, which has had to borrow millions to finance its education system after having drastically cut taxes. Another member pointed out the limitations surrounding a government's control over the economy, observable in the Federal Reserve's inability to decisively stimulate the economy by lowering the interest rate. Similarly, the member asserted, the state's lowering CIT rates would not guarantee business relocation to the state, but the state's raising those rates probably would deter that activity.

Tax expenditures. Responding to a member's comment that the widespread elimination of tax exemptions, deductions and credits would improve revenues, Mr. Anklam stressed that policymakers wishing to overhaul the tax system should first choose their overarching design goals and then decide which of tax expenditures comport with those goals. He asserted that the state's tax system depends too much on exemptions, deductions and credits, which function largely as bandages; while they help make the state competitive, they also compromise simplicity in the system. Mr. Clark asserted that there is too little reporting in the tax expenditure arena, which results in revenue loss and in a poor understanding of the cost of the state's tax expenditures. A member pointed out that the state's system of tax exemptions, deductions and credits creates big winners and losers.

Stability and simplicity in the tax system. Concerning stability in the tax system, Mr. Anklam noted that the CIT and the PIT are relatively responsive to economic tides, unlike the more stable property tax. A member commented on the compromise to stability that corresponded to the deduction from gross receipts of certain food and medicine sales. Another member argued that the state should strive for balance over simplicity in its tax system. As it stands, said the member, the state's tax "stool" is faulty and lopsided.

Concerning simplicity in the tax system, a member criticized the system as being too complicated. In 1915, the state's tax code could fit on 12 pages; that figure has since ballooned to 1,200 pages. The member argued that more people would comply with tax laws if they were not so complicated and that greater compliance would afford taxation at lower rates. Another member observed that the system is so complicated that even Ernst and Young, in its initial study of tax burden in New Mexico, could not develop accurate conclusions.

Taxes on the oil and gas industries. A member opined that the oil and gas industries pay high tax rates in New Mexico compared with its neighboring states; the state relies too heavily for its revenues on those industries; those industries have recently laid off many workers who had high-paying jobs; the entire state is affected by those losses; the industry needs a high-quality workforce; and that need is satisfied in part by San Juan College's School of Energy.

Constitutional Constraints on Tax Policy and What States Are Doing to Tax Internet Sales

Mr. Crociata educated the committee on the constitutional limits of state taxation, including the taxation of internet sales. He noted that constitutional issues perennially loom around many legislatively proposed tax measures and that the TRD often notes constitutional "risks" in the fiscal impact reports on those measures. The department prefers to make reference to "risk" over unconstitutionality because: 1) it generally cannot be known in advance how a court would decide the issue of unconstitutionality; and 2) a court would only decide that issue if a party formally challenged the measure in court.

Relevant constitutional doctrines. Aside from the less-salient Privileges and Immunities Clause and clauses related to exportation and importation of goods, four federal constitutional doctrines help define the legal parameters of state taxation: 1) the Supremacy Clause; 2) the Fourteenth Amendment's Due Process Clause; 3) the Equal Protection Clause; and 4) the "dormant" Commerce Clause, which, of the four, has been most actively litigated in this context.

Supremacy Clause. The Supremacy Clause, which provides that the U.S. Constitution and federal laws have higher authority than state constitutions and laws, has been interpreted as disallowing states from directly taxing the federal government and as meaning that certain valid federal laws and federal jurisprudence can limit states' power to legislate in areas of taxation. For example, under its power to regulate interstate commerce, Congress has enacted a law that, for the time being, prohibits states from taxing internet access. Under the supremacy doctrine, courts have said that states may tax intrastate commerce, but not interstate commerce to the extent that commerce occurs outside the state. Also, after the U.S. Supreme Court held that a state may impose an income tax on an out-of-state company that sells, in-state, products manufactured out of state, Congress passed Public Law 86-272, which prohibits a state from taxing the net income of a company whose sole activity in the state is soliciting orders for tangible personal property.

Due Process Clause. The U.S. Constitution further provides that a state may not deprive anyone of property without "due process of law". Tax payments are property. Primarily, the requirement for "due process" relates to fairness and notice and, in the context of taxation, is generally satisfied if a taxpayer has purposefully availed itself of the state's economic market, i.e., is economically exploiting that market. Physical presence in the state is not required. Furthermore, the notion of fairness has to do with a state's giving something in exchange for the tax and the connection between the state and the person, property or transaction subject to the tax.

Equal Protection Clause. In the context of taxation, the Equal Protection Clause stands for the proposition that states cannot, through either the enactment or the implementation of its laws, irrationally or arbitrarily discriminate among taxpayers who are similarly situated. The clause, however, does not prohibit states from offering tax exemptions, deductions or credits. A member asked why more taxpayers who seemingly are situated similarly to their business competitors but not entitled to the same tax incentives as those competitors have not challenged those laws under the equal protection doctrine. Mr. Crociata replied that such challenges are possible, but relatively uncommon because of two deterrents: 1) the cost of litigation usually outweighs the value of a favorable result; and 2) establishing that the two different taxpayers are similarly situated, and that there was no legitimate policy reason to enact the incentive, proves difficult.

Commerce Clause; test for constitutionality of state taxation. The Commerce Clause is an affirmative grant of power to Congress to regulate commerce. The U.S. Supreme Court has construed the Commerce Clause as also limiting states in their actions insofar as those actions affect commerce. Specifically, a state may not unduly impede the operation of the national economy. But a state may impose a tax on an interstate commerce activity if the measure passes a four-pronged test: 1) there is substantial nexus, or connection, between the state and the activity; 2) the tax is fairly apportioned; 3) the tax does not discriminate against interstate commerce; and 4) the tax is fairly related to the services provided by the state.

Following are some details of the four prongs in the test for lawful taxation of interstate commerce, listed in reverse order. Prong 4: Historically, parties defending Commerce Clause challenges have not had difficulty meeting the relatively low standard of fair relation to services. Prong 3: This prong prohibits tax laws, on their face or in effect, from burdening out-of-state taxpayers more than their in-state counterparts. When considered in isolation, compensating taxes do just that; however, they are permissible because they equalize the burden of in-state sales taxpayers. Prong 2: To meet the "fair apportionment" standard of this prong, a tax must have internal and external consistency. That is, the tax would not result in multiple taxation if more than one state imposed it; and the tax does not reach beyond the value fairly attributable to economic activity within the state. New Mexico's credit in its compensating tax for taxes paid to other states is an example of a measure that addresses this constitutional concern.

Below are some salient points related to Prong 1:

- Although the concept of nexus arises in the contexts of the Due Process and Commerce clauses, the tests for measuring it in each of those contexts differ.
- In the Commerce Clause context, the inquiry into whether the "substantial nexus" standard is met relies heavily on the facts of a particular case and differs depending on whether an income or a sales tax is at issue.

- In the last quarter century, courts have diluted the physical presence requirement.
- The requirement does not apply to the imposition of an income tax; rather, "economic presence" or "intangible presence" suffices in the income tax context.
- Maintaining a higher presence-related standard for sales taxes is rooted in the logic that those taxes would have to be paid more frequently and to more entities than income taxes — enough to create an undue burden.
- Consequently, for a state to impose a sales or use tax collection obligation on an out-of-state, or remote, vendor for a sale within its borders, the vendor must have "actual physical presence" in the state. The 1992 *Quill* case stands for that proposition.
- That physical presence, or nexus, can be characterized as either independent (taxpayer nexus) or attributional (nexus through others).
- For independent nexus, "actual physical presence" means, in the state: having any kind of office, storehouse or warehouse; owning or leasing real or tangible property; or having permanent or temporary employees. The inquiry into whether that requirement is met is heavily fact-dependent, and no bright-line rule guides decision-making.
- For attributional nexus, "actual physical presence" can be satisfied if related or unrelated third parties conduct activities in the taxing state that help the vendor establish and maintain a market for its goods or services. Since 1967, courts have thinned the nexus thread. Still, mere affiliation, such as common ownership, is not enough. But the activities of a brick-and-mortar store that help the store's affiliate make online, in-state sales constitute attributional nexus with the state.

Responding to committee members' questions, Mr. Crociata clarified certain points as follows.

- Most likely, states may not constitutionally force vendors without actual physical presence in the state to collect and remit taxes on their online sales to in-state residents.
- Concerning the growing proportion of online to brick-and-mortar retailer transactions, states can: 1) continue to collect sales taxes on the ever-present portion of sales made in the local economy; and 2) in order to replace otherwise lost revenue, enact more aggressive laws.
- The TRD has been: 1) actively researching the tax status of businesses like Uber; and 2) developing its position concerning those businesses' tax obligations.
- Many states' pursuits to enhance tax collection on e-commerce sales involve use, not sales, taxes because it is generally undisputed that a state may impose a use tax on its residents.

Nexus and e-commerce. States and federal lawmakers have variously attempted to change laws to allow broader state taxation in the widening e-commerce landscape. States and other policymakers have coalesced around efforts, such as the Streamlined Sales Tax Project and the introduction in Congress of the Marketplace Fairness Act, to enable more taxation of online sales. Moreover, several legislatures have pursued diluting the physical presence requirement by passing "click-through" nexus, attributional nexus and affiliate nexus laws. Some states have ventured even further by requiring remote vendors to report their in-state sales.

For example, in 2010, Colorado enacted requirements that remote vendors: 1) notify Colorado residents who transact with the vendor that they might owe Colorado use tax on those transactions; 2) provide annual transactions statements to those purchasers; and 3) provide related informational reports to the Colorado taxation department or face a penalty. A legal challenge to the law wound through several courts. That litigation has involved questions of whether the law violated the Commerce Clause and whether the federal district court could, under federal law, enjoin the state from enforcing it. Ultimately, Justice Anthony Kennedy of the U.S. Supreme Court invited a challenge to *Quill*, and the Tenth Circuit Court held that the law does not violate the Commerce Clause because, rather than a tax, the state is imposing reporting requirements. New Mexico's no-enforcement provision for individuals would stand in the way of New Mexico's enacting a similar law and increasing compensating tax collections.

Elsewhere, Alabama and South Dakota have pursued aggressive attempts to increase tax collection on remote sales. Alabama's tax department promulgated a regulation requiring remote vendors without physical presence in the state to remit the state's use tax for sales to in-state buyers if: 1) those sales exceed $250,000 in a calendar year; and 2) one of several nexus-related requirements, one of which raises an issue under *Quill*, is met. A company without physical presence in the state recently challenged the law in court. One consideration in that case is whether the department acted outside its authority in promulgating the regulation.

Meanwhile, South Dakota recently enacted a law along these lines that disregards the concept of physical presence altogether in imposing the state's sales tax on remote vendors. Among other provisions, the statute includes signals marking the legislature's awareness of the likely unconstitutionality of its action and directing the route of a challenge to the law. That is, the law seems to seek final resolution by the U.S. Supreme Court of whether *Quill* remains good law. Litigation on that matter has begun, and the state has been enjoined from enforcing the law.

Were the challenge to South Dakota's law to reach the U.S. Supreme Court, the outcome of the case might help states by clarifying the constitutionality of broader taxation of e-commerce. But a ruling in states' favor is not guaranteed; there is reason to doubt that the court would overrule *Quill* or that it would even address the constitutional issue, resolving the case instead on other grounds.

Responding to committee members' questions, Mr. Crociata clarified certain points as follows.

- In the Streamlined Sales Tax Project, states could elect to adopt criteria for easing compliance with their sales tax laws. The goal was to make it easier for Congress to pass a bill allowing member states to impose sales tax collection requirements on remote vendors otherwise not required to collect the tax. That bill has stalled in Congress.

- Since 2008, states have been more active in their efforts to impose sales tax collection requirements on remote vendors, and those proposals have become more aggressive.
- "Click-through" laws generally establish that nexus is presumed in the case of a remote vendor that pays a commission to an in-state business whose website features banners that users can click on to access the remote vendor's website. In the approximately 20 states in which Amazon paid those commissions and that enacted those laws, Amazon canceled its contracts with those in-state businesses after the laws' enactment.

Questions and Discussion

On questioning, the committee, Mr. Crociata, Mr. Anklam and members of the audience addressed the following topics.

Remote vendor sales tax collection obligations; imposition by New Mexico. Mr. Crociata indicated that: 1) if New Mexico imposed sales tax collection obligations on remote vendors otherwise not obligated to collect those taxes, it could base the rate on the destination of the object of the sale; and 2) the state already has a streamlined process for administering its sales tax that way, in contrast to states like Arizona with a multitude of local tax systems. In response, members commented on: 1) the availability of software that can help out-of-state retailers calculate in-state rates and know the subjects of taxation; 2) the revenue benefit to rural local governments that would result from the state's expanding remote vendor sales tax collection, given that rural areas have little retail base and that rural residents increasingly shop online instead of outside their communities; 3) the possibility of directing some of the revenue that would result from the state's enhanced tax collection to rural local governments; and 4) the prominence, as a reason to pursue enhanced tax collection, of improving fairness between online retailers and small, brick-and-mortar retailers, since many of those brick-and-mortar retailers are exploited by information-gathering shoppers who ultimately make their purchases online.

Mr. Crociata summarized New Mexico's position in the movement to enhance remote vendor sales tax collection as follows: the state does not have a "click-through" or "mere affiliation" nexus law, but it does have a relatively broad statute concerning who must collect the GRT, and it may rely on favorable case law decided by New Mexico courts. He then described other aspects of potential attempts to enhance remote vendor sales tax collection: 1) imposing a law like Colorado's, or those of other states, that seeks greater compliance with use tax obligations might work in New Mexico; 2) generally in this arena, New Mexico is waiting to see the outcomes of other states' pursuits; and 3) it has been suggested that states could impose a law requiring employers to withhold a certain amount of use tax from their employees' pay and allowing taxpayers, on their PIT returns, to adjust the amount of the use tax owed. In response to a member's question, Mr. Crociata also clarified that, most likely, the soonest the U.S. Supreme Court could issue an opinion in the South Dakota case is 2018; and, were the state to enact similar legislation, the effectiveness of that legislation could be conditioned on the court's holding that South Dakota's law is constitutional.

Tax on internet access charges. Mr. Crociata clarified that the TRD has preliminarily determined that if states were not enjoined from imposing a tax on internet access charges, New Mexico could raise about $46 million in revenue from such a tax. However, the department is still working on its analysis, which Mr. Crociata said was, so far, unsophisticated.

Rural local governments' assistance program. In response to committee members' questions, members of the audience testified as follows. Mr. Anklam noted that the state makes distributions to small cities and counties that meet certain population requirements. William F. Fulginiti, executive director, New Mexico Municipal League, explained that the purpose of those annual distributions is to help local governments that have low retail tax bases provide necessary services. Tasia Young, lobbyist, New Mexico Association of Counties, added that small local governments may also impose GRT increments to boost their revenues.

Recess

The committee recessed at 3:48 p.m.

Friday, July 22

The committee reconvened at 9:00 a.m. on Friday, July 22, with Representative Harper chairing the meeting.

Approval of Minutes

On a motion made and seconded, the minutes from the June meeting were adopted without objection.

Discussion of Good Jobs First's Report: "Slicing the Budget Pie for Big Business: How Three States Allocate Economic Development Dollars, Large Companies Versus Small"

Greg LeRoy, executive director, Good Jobs First, which is a nonprofit, nonpartisan, Washington, D.C.-based research organization that Mr. LeRoy founded in 1998, and Gary Tonjes, president, Albuquerque Economic Development (AED), formed a panel to explore the state's tax incentive programs and those programs' implementation.

Testimony from Mr. LeRoy. Mr. LeRoy read from his prepared remarks, copies of which were distributed to the committee. In them, he summarized the conclusions of a recent Good Jobs First report, titled "Slicing the Budget Pie for Big Business", that explored whether state economic development incentives are fair to businesses characterized as small, local or entrepreneurial. Copies of that report were also distributed to the committee.

The report concluded that New Mexico's economic development incentives demonstrate the state's bias toward large businesses. Specifically, 12% of the state's economic development subsidies benefits companies of no particular size; 18% of that spending benefits small companies; and 70% benefits large companies. Although many of these programs are not designed specifically for large companies, they effectively benefit from them more than others; about two-thirds of the state's "agnostic" programs' costs are associated with large businesses.

This bias is problematic because: 1) it disfavors small businesses, in which case the rationale for government intervention is most compelling; 2) small businesses are less likely to leave the region; 3) small businesses often face difficulty accessing credit; 4) small businesses invest more in their local economies; and 5) small businesses are more likely to hire locally than to import out-of-state workers.

Mr. LeRoy presented Good Jobs First's policy recommendations to redress the issue of this bias: 1) *Disaggregated Disclosure*, or subsidy reporting by size of business recipient; 2) *Improving Small Business Access to Credit*, which is a need many small businesses articulate; 3) *Small Business Support Budget*, in which states do work similar to that done in the Good Jobs First report; 4) *Program Sunsets*; 5) *Reform Program Eligibility Rules* to disqualify big businesses; and 6) *Spend Less by Capping*, or using safeguards such as caps per deal, caps per job, caps on "aid intensity" and caps per company.

In response to a committee member's question, Mr. LeRoy clarified that Good Jobs First defines a small business as one that has 10 or fewer establishments and 100 or fewer employees.

Testimony from Mr. Tonjes. Mr. Tonjes summarized and expanded on points made in a column he wrote that was published in the *Albuquerque Journal*, copies of which were distributed to the committee. He expressed gratitude to the governor and the legislature for having enacted the 2013 tax package that, he said, improved the state's competitiveness in retaining, expanding and attracting businesses in and to the state. He noted that the package's measures are working and that there is broad public support for the legislature's having recently boosted funding for Local Economic Development Act (LEDA) projects.

Incentives play a big role in business relocation decision-making. Companies start with a list of possible locations, then go through a process of elimination. After they have narrowed the list to a few options, even the wealthiest companies look at which option makes the most economic sense. To create jobs, particularly those of high quality that are suitable for residents whom the state spends a lot on to educate, New Mexico should make the most of its investment by maintaining a competitive environment for business expansion and relocation in and to the state.

Several recently enacted tax and funding measures, including the 2013 tax package, have made the state more competitive in attracting, expanding and retaining businesses. AED advocated for the 2013 package because of the organization's having previously been eliminated from the running for many businesses' expansion and relocation in and to the state. Mr. Tonjes's presentation handout includes economic impact analyses on two projects for which LEDA funding made the difference between their considering New Mexico for relocation or not.

Mr. Tonjes stated that contrary to many assertions made in the Good Jobs First report and in Mr. LeRoy's testimony: 1) as seen on pages 3 and 4 of the handout, many of the recipients of LEDA and Job Training Incentive Program funding are small businesses, which indeed are valuable to the economy; 2) every incentive program that large businesses may qualify for is also open to small businesses; 3) directing incentives to large businesses is important because they have more potential to fill the gap created by recent job loss, a gap that could not be filled through small business job creation alone; 4) directing program funding to small businesses only would require more resources than are available; and 5) the distinction between ordinary jobs and economic-base jobs, or those jobs for which more than half the goods or services produced by the jobs are shipped outside the state, is noteworthy, since economic-base job creation is critical to the strength and vibrancy of the economy. Furthermore, any disparity between the receipt of incentive program funding by small and large businesses might be attributable to: 1) small businesses' lack of awareness of that funding availability; and 2) the scale of large business receipt of program money, which skews the perception of what type of businesses benefit most.

Questions and Discussion

Good Jobs First's position on business incentives. When asked for a response to Mr. Tonjes's testimony, Mr. LeRoy acknowledged that consideration of economic-base jobs was not part of the Good Jobs First study. He added that the organization does not recommend that states eliminate their incentives, but rather that they lessen their aggression in pursuits to attract and retain businesses, since that behavior: 1) encourages companies to pit states against one another; 2) allows companies to take advantage of states, in part by virtue of confidentiality requirements in deal-making; and 3) causes overspending by states.

LEDA funding; 2013 tax package. Several committee members expressed support for the recent boost in LEDA funding and for the 2013 tax package. Many stressed that policymakers should wait to see the measure's complete outcomes before deciding whether to alter it. Mr. Tonjes commented that: 1) the package will further improve the state's business environment when it is fully phased in; 2) plugging the budget hole with money previously appropriated for LEDA projects sends the message that the state cannot be relied upon; 3) if the state experiences success with its current project prospects, a large portion of what has been appropriated to the LEDA program will have been spent; and 4) telling companies that LEDA money can be requested in an upcoming session is generally ineffectual.

Appealing to small versus large businesses. A member commented that small businesses are valuable in part because of their limited mobility and that the departure of a large company can economically devastate a place, particularly a small community. Mr. Tonjes pointed out that small businesses do sometimes leave the state, such as when they are acquired by larger, out-of-state companies. In contrast, he said, big companies that invest a lot to relocate are often reluctant to walk away from their investment.

Comparison of New Mexico with Texas. Mr. Tonjes noted that Texas has an exceptional reputation for business-friendliness, partly because it lacks a CIT and it maintains a regulatory environment favorable to business. He remarked that AED clients tend to be much more familiar with Texas's business environment than New Mexico's and that, though New Mexico has a lot to offer, it is stymied by a lack of resources to advertise itself to companies considering relocation. A member commented that Texas managed to build that positive reputation by: 1) enacting tort reform; 2) making the regulatory system more business-friendly; and 3) removing obstacles interfering with the energy sector's productivity. The member remarked that New Mexico tends to inhibit such productivity. Another member asserted that New Mexico more closely resembles Colorado in area and demography than it does Texas.

Tesla. Committee members and Mr. Tonjes expressed mixed views about New Mexico having not been selected by Tesla for location of its "gigafactory". Mr. Tonjes remarked that New Mexico's having been in the running for that project boosted the state's reputation; as underscored by a consultant, the state needs significant wins, such as those from having attracted Intel, Fidelity and HP, to drive new interest in it.

Factors in job creation; issues facing the state. Committee members named the following as key factors in job creation: regulatory policy; water supply; crime; education; housing; broadband; roads and bridges; incentives; small businesses' access to credit; and workforce. Regarding regulatory policy, a member noted that local governments are also responsible for influencing it, and Mr. Tonjes said that, when local businesses call and need related help, AED can usually intervene and resolve the issue. He also stated that, in this context, predictability and certainty are important. Regarding water supply, Mr. Tonjes noted that Albuquerque has taken steps to address the issue by making worthwhile investments; however, other communities are facing water challenges needing attention. Regarding crime, several members decried that the topic gets too much media attention in New Mexico. Mr. Tonjes said that: 1) he has heard that the high crime rate in Albuquerque was a factor in the cases of only a couple of prospective projects, one of which AED lost; 2) crime might have been an unvoiced consideration of other AED clients; and 3) issues like crime factor into various degrees in companies' consideration of their location options. A member noted that the state has relatively little direct control over reducing crime, in contrast to its more concrete ability to improve transportation infrastructure and education.

Members discussed the following other issues facing the state: complaints from small businesses about their interactions with state government; high unemployment in rural areas, despite the presence in those areas of large economic-base employers; struggles faced by small communities and local governments; limited budgetary resources; and the steep loss of high-quality jobs in oil- and gas-producing parts of the state like San Juan County.

New Mexico's assets for job creation. Members articulated as some of the state's assets for job creation: 1) natural resources; 2) agricultural output; 3) quality of life; 4) relative lack of threat from natural disasters; 5) attraction to tourists; 6) trade opportunity; 7) railroads; 8) cultural resources; and 9) heavy concentration of bilingual residents. Mr. Tonjes added that many businesses are lauding the state's recent improvement of its business environment.

Recommendations for job creation. Members made the following recommendations for job creation: 1) the state should develop a plan, not a deal; 2) the state should rely less on the oil and gas industry; 3) agreements with companies receiving incentives should include clawbacks to recoup the state's investment in case of default; 4) the state should be marketed better; 5) the state should look at its comparative advantages and market them; 6) the state should implement some of the key initiatives that Colorado has implemented because Colorado has experienced remarkable economic growth recently; 7) the state should explore what measures, such as criminal expungement for nonviolent offenders, will have an immediate, low-cost effect; and 8) the state should support its existing industries, such as defense, agriculture, aviation, energy and alien-sighting, by taking steps to make their growth more promising. Many members underscored the state's need for both small and large businesses; strong public and private sectors; and a variety of strategies to support those businesses and sectors. Mr. Tonjes urged that the state welcome businesses, treat them well and instill in them confidence that New Mexico warrants their investment.

Public comment. Myra Pancrazio, executive director, Estancia Valley Economic Development Association, who was in the audience, highlighted and briefly described three topics related to the discussion: 1) New Mexico IDEA, a statewide economic development organization; 2) the New Mexico Rural Economic Development Council and FUNDIT, a group of state and federal funding agencies that meet to collaboratively identify resources for public infrastructure projects; and 3) rural economic development organizations, which can help rural economic developers connect small businesses to incentives and resources.

Results from the New Mexico First (NM First) Statewide Town Hall on Economic Development

Heather Balas, president, NM First; Bill Garcia, former secretary of economic development and tourism and co-chair, NM First implementation team; and Tom Taylor, former state representative and co-chair, NM First implementation team, presented the results of the May 19-20 statewide town hall event sponsored by NM First that focused on economic security and vitality for New Mexico, a topic pursued to address the state's widespread poverty. Ms. Balas gave an overview of NM First, the town hall process and the results from the event. She also offered to provide members with copies of the background report distributed before the town hall to its participants.

NM First. NM First is a nonpartisan organization whose mission is to engage people in public policy and identify possible solutions to public issues. The organization convenes town halls, or deliberative sessions at which participants strive to reach consensus on ideas to overcome those issues. Over its approximately 30-year history, the process has yielded many recommendations, some of which lawmakers have pursued. The May town hall drew on a wide cross-section of New Mexicans representative of the state's regions, sectors and occupations.

Town hall results. The town hall's participants reached consensus on 11 final recommendations, each consisting of an action and strategies to accomplish that action. Classified by theme, those recommendations are: 1) *actively support small businesses* by creating a small business "toolbox" and by funding innovation and quality; 2) *create thriving rural and tribal economies* by investing in those communities and by investing in youth; 3) *further diversify the economy* by restructuring the tax code and by advancing a culture of economic development; 4) *advance effective roles of government* by building results-driven government and by improving technology transfer; 5) *focus on family economies* by advancing family-friendly policies (which include elimination of "cliffs", or the systemic disincentive to leave public assistance programs, by streamlining aid qualification thresholds); and 6) *strengthen the workforce through education* by aligning the workforce with a purpose-driven economy. One of the leading recommendations was to form a commission to study and recommend tax reforms; meanwhile, the recommendation to build a results-driven government received more support than any other. Three strategies in particular relate to legislative action: 1) reforming the tax code; 2) eliminating "cliff effects"; and 3) removing regulatory barriers to economic development.

Mr. Taylor then stressed the particular importance of four pursuits: 1) GRT reform through simplification, which is integral to the goal of helping relieve the tax burden of low-income taxpayers, and adopting a positive attitude toward accomplishing that reform; 2) increasing economic development program funding and restructuring the council of governments (COG) regions into economic regions to more accurately align with the COGs' work; 3) minimizing "cliffs", which serve as incentives to stay in poverty; and 4) educating and training the workforce.

Mr. Garcia, in turn, underscored the validity of the town hall process and the feasibility of implementing the town hall's recommendations, and he commented on some of the points raised in the presentation. He highlighted two strategies as potentially bringing tremendous economic benefit to the state: 1) to expand the manufacture of products by businesses throughout the state for distribution to border-area industries; and 2) to strategically restructure the tax code by building a model that would evaluate proposed changes to it.

<u>Questions and Discussion</u>

"Cliff" effects. A member commented that the "cliff" disincentive to getting off public assistance programs is attributable to financial and cultural forces and the lack of opportunity. The member expressed intent to introduce legislation that would curb the disincentive and listed as benefits of that initiative a boost in people's sense of pride and financial security, better communities and an improved tax base. Mr. Taylor expressed support for striking a balance between providing needed aid and making people overly dependent on that aid. Ms. Balas noted that, though town hall participants generated a broad range of ideas for addressing the "cliff" issue, all agreed that policymakers should remove the disincentive for people to reduce their dependence on public assistance programs.

A member remarked that legislators struggle to resolve many challenging problems and that some doubt those problems can be overcome in a short time frame, but, as in the case of workers' compensation reform, the legislature is capable of accomplishing much, and, quickly, if necessary.

Adjournment

There being no further business before the committee, the committee adjourned at 12:10 p.m.