MINUTES
of the
SIXTH MEETING IN 2016
of the
REVENUE STABILIZATION AND TAX POLICY COMMITTEE

December 14-16, 2016
Room 322, State Capitol
Santa Fe, New Mexico

The sixth meeting of the Revenue Stabilization and Tax Policy Committee for the 2016 interim was called to order by Representative Jason C. Harper, chair, on Wednesday, December 14, 2016, at 10:10 a.m. in Room 322 of the State Capitol in Santa Fe.

Present
Rep. Jason C. Harper, Chair
Sen. Carlos R. Cisneros, Vice Chair
Sen. Lee S. Cotter
Rep. David M. Gallegos (Dec. 14)
Rep. Antonio Maestas (Dec. 15-16)
Rep. Rod Montoya
Sen. Mark Moores
Sen. George K. Munoz (Dec. 15)
Rep. Debbie A. Rodella
Sen. Clemente Sanchez
Sen. William E. Sharer (Dec. 15-16)
Sen. John Arthur Smith
Rep. James R.J. Strickler (Dec. 14-15)
Rep. Carl Trujillo
Rep. Jim R. Trujillo
Sen. Peter Wirth

Absent
Sen. Ted Barela
Rep. Tim D. Lewis

Designees
Rep. Bealquin Bill Gomez (Dec. 14-15, attending as guest)
Rep. Idalia Lechuga-Tena (Dec. 14, attending as guest)
Rep. Bill McCamley (Dec. 15, attending as guest)
Sen. James P. White

Rep. David E. Adkins
Sen. William F. Burt
Sen. Jacob R. Candelaria
Rep. Sharon Clahchischilliage
Rep. Randal S. Crowder
Rep. Brian Egolf
Rep. Miguel P. Garcia
Rep. Stephanie Garcia Richard
Sen. Stuart Ingle
Rep. Conrad James

Sen. Gay G. Kernan
Rep. Javier Martínez
Sen. Nancy Rodriguez
Rep. Tomás E. Salazar
Sen. John M. Sapien
Rep. Jeff Steinborn
Rep. James G. Townsend
Sen. Pat Woods

Guest Legislators
Rep. Roberto "Bobby" J. Gonzales (Dec. 15-16)
Rep. Patricia A. Lundstrom (Dec. 15)
Sen. Cisco McSorley (Dec. 14-15)

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

Minutes Approval

Because the committee will not meet again this year, the minutes for this meeting have not been officially approved by the committee.

Staff
Pam Stokes, Staff Attorney, Legislative Council Service (LCS)
Jeff Eaton, Research and Fiscal Policy Analyst, LCS
Ric Gaudet, Researcher, LCS
Tessa Ryan, Staff Attorney, LCS

Handouts

Handouts and other written testimony are in the meeting file.

Guests

The guest list is in the meeting file.

<u>Wednesday, December 14</u>

Revenue Forecast

Jon Clark, economist, Legislative Finance Committee (LFC), Frank Crociata, tax policy director, Taxation and Revenue Department (TRD), and Clinton Turner, chief economist, Department of Finance and Administration, presented the December 2016 consensus revenue estimate to the committee. Mr. Crociata said that in fiscal year (FY) 2016 revenues were $36 million higher than the estimate made in August. However, the revenue estimates for the next five fiscal years were revised downward from the August estimate, even after the changes made by the special session of the legislature in October. FY 2017 revenue was revised downward by $109 million, and FY 2018 revenue is expected to fall an additional $127 million compared to the August estimate. Although overall General Fund revenues are expected to grow each fiscal year, the growth is expected to be anemic, due in significant part to the continued weakness in the extractive industries.

Gross receipts tax (GRT) revenue in FY 2017 is expected to decrease 5.4 percent from FY 2016, but will then increase 7.5 percent in FY 2018. Much of the FY 2017 GRT weakness can be explained by the decline in employment in the oil and gas sector, which in turn resulted in weaker retail sales. Another major factor in the current decline in GRT revenues is due to projected refund claims related to a loophole in statute allowing some hospitals to deduct health care services from gross receipts. The legislature fixed that problem during the recent special session.

Personal income tax (PIT) revenue was revised downward in the December forecast by $12 million for the current fiscal year. PIT revenues are expected to grow .3 percent this fiscal year and then by 1.1 percent in FY 2018. This sluggish growth is due mostly to the loss of high-wage jobs in the extractive industries. The replacement of these jobs with lower-wage jobs diminishes PIT revenue.

Corporate income tax (CIT) revenue is always volatile, and CIT revenues are expected to decline 40 percent in FY 2017, to $70 million. In FY 2018, however, CIT revenues are expected to rebound, gaining 42 percent. TRD economists are investigating the causes of the dramatic declines in CIT revenue. One possible explanation is that many corporations overpaid taxes previously, and are currently carrying forward those overpayments to offset current CIT liability.

The oil and gas sector has seen major declines in the past two years in New Mexico, but is starting to recover. Energy-related General Fund revenues are expected to increase by $70 million in FY 2017 and by an additional $40 million in FY 2018. Expected increases in oil and gas production, coupled with higher expected prices, were the primary factors in the increased revenue estimates.

Mr. Clark said that economists have a much more pessimistic outlook for New Mexico than in previous revenue estimates. Projected revenues for FY 2017 through FY 2021 have been revised downward since the August 2016 estimate. The major factors in the forecast are due to the continued weakness in the extractive industries and lower-than-expected employment and salary growth. Total employment in New Mexico in October 2016 was 866,000, which is still below the pre-recession level of 871,000 in 2005. Average weekly wages have also declined in the past two years, as have average weekly hours worked. GRT revenues are at their lowest level in seven years, and nearly every industry has lower taxable gross receipts. The health care industry is the fastest-growing sector in the state, but that sector is largely not subject to gross receipts taxation. General Fund balances have dropped 34 percent from the same time last year, which is the largest drop ever measured.

Mr. Turner said that the state's economy is facing significant headwinds. Recent economic data have been below expectations, and declining oil and gas prices and production levels continue to directly and indirectly impact General Fund revenues. Historically low inflation in the past two fiscal years has exacerbated the nominal revenue growth rate. The continued strength of the U.S. dollar has also had a negative impact on ad valorem tax revenue and has adversely impacted the agriculture, manufacturing, energy and tourism sectors in the state. Housing starts, measured by the number of building permits issued, are still below levels found in the 1980s and are more than 60 percent below the level in 2005.

Questions and comments from committee members included the following.

- Has the state ever done a study measuring the actual economic benefits from various tax expenditures? Mr. Crociata said that the TRD has not performed such studies, except as reflected in the annual Tax Expenditure Report. Those studies are very difficult to perform because they involve dynamic modeling of behavior. Mr. Clark said that the LFC and other agencies are usually not able to study that data because much of that information is confidential and only the TRD has access to it. The legislature could require companies to disclose more information as a condition of receiving a tax expenditure.

- Arkansas has 3,000,000 residents and a state budget of $5 billion, while New Mexico has a population of 2,000,000 and a state budget of $6 billion. Mr. Turner said that New Mexico spends much more at the state level on education than most other states. Other states have a higher local share of that expense.

- New Mexico needs regulatory relief in order to encourage more oil and gas development.

- How big an impact does oil and gas production have on state revenues? Mr. Clark said that economists typically use a rule of thumb that says that for every one dollar decrease in the price of oil, General Fund revenues decrease by $9 million. However, when prices and volumes drop dramatically, that rough measure is not accurate, due to significant secondary and tertiary economic impacts. Mr. Turner said that GRT revenues are closely tied to the current rig count in the state.

- State revenues would be much higher if the TRD started collecting taxes from the largely unregulated cash economy in the state.

- Does a company that has a lease to produce oil that contracts to have an oil well drilled still pay the GRT for the creation of the well? Mr. Crociata said that, generally, the company would pay the GRT because it is the end user of the product.

- If New Mexico's state budget had grown at three percent annually since 1995, rather than the actual average four percent rate, General Fund expenditures would be around $5.2 billion, instead of today's $6.2 billion figure. David Abbey, director, LFC, said that Medicaid expenditures rapidly increased during that time period, but most other areas of the budget actually shrank.

Adoption of Minutes

The minutes from the November 28, 2016 meeting of the committee were adopted without changes.

LFC Progress Report: Select Health Care Tax Expenditures

Charles Sallee, deputy director for program evaluation, LFC, presented to the committee an update on selected health care tax expenditures. In 2011, the LFC reported on five major health care expenditures and made recommendations to increase reporting and transparency, provide revenue safeguards and increase the evaluation of the expenditures. Since 2011, more residents have gained access to health coverage via Medicaid or private health insurance, which, in turn, has increased the cost of those health care tax expenditures. Many health care tax expenditures do not have a stated purpose, and it is difficult to determine what the actual costs of the expenditures have been. For example, it is unclear whether the rural health care practitioner tax credit has actually encouraged practitioners to locate in rural areas of the state. Better results might be accomplished if the annual $6.4 million in foregone revenue were used in the Medicaid program, which would leverage much more federal money. That money could be used to pay for health care in rural areas of the state.

For-profit hospitals are able to deduct 50 percent of their receipts from gross receipts and are also able to claim a credit against their subsequent GRT liability. The apparent intent of these tax expenditures was to level the playing field between for-profit and nonprofit hospitals, but it is not clear whether that goal has been accomplished. A study comparing the profit margins of hospitals found that average New Mexico hospital profits of 9.8 percent far exceeded the national average of 2.6 percent.

Premiums collected by insurance companies are subject to a premium tax, and health and life insurers pay an additional surtax. Insurance companies are exempted from paying all other taxes, which results in a significant, but difficult to measure, tax expenditure. A recent special audit of the Office of Superintendent of Insurance (OSI) found that the OSI undercollected premium taxes by an estimated $198 million between FY 2010 and FY 2015. The legislature should consider transferring the collection of premium taxes to the TRD. Health and life insurers are also required to pay an assessment to the New Mexico Medical Insurance Pool (NMMIP) to help fund the payment of medical claims of eligible NMMIP members. Insurers can take credits against their premium taxes of 50 percent, and in some cases 75 percent, of the amount of assessment paid to the pool. It is unclear whether the NMMIP is still needed after the federal Patient Protection and Affordable Care Act of 2010 was fully implemented. The legislature should consider repealing the NMMIP credit.

Since 2004, health care providers have been able to deduct medical services from gross receipts. To offset the significant revenue loss to local governments from this deduction, "hold harmless" distributions were also enacted, which will phase out over several years. The fiscal impact of this tax expenditure is estimated to be $494 million from FY 2009 through FY 2015. In 2016, the Administrative Hearings Office issued a ruling that allowed a hospital to claim the deduction, which had previously been limited to health care practitioners. The potential fiscal impact of this ruling was large, and the legislature closed that loophole in the October 2016 special session.

Questions and comments from committee members included the following.

- Hospitals are interested in finding a solution to reductions in Medicaid funding, including some sort of new tax that would be dedicated to funding Medicaid. The amount raised would leverage a huge amount of federal funding for the program. Mr. Sallee said that the New Mexico Hospital Association is currently reaching out to the governor with its ideas.

Clarifying the Meaning of "Attest" in the 1999 Public Accountancy Act

John A. Carey, president, New Mexico Society of Certified Public Accountants, Jack Emmons, chair, New Mexico Public Accountancy Board, and Larry Horan, lobbyist, presented a proposed bill draft that would specify in statute what is meant by an attest engagement and who can perform that service. The presenters stated the draft would not, after all, be presented for endorsement consideration by the committee. Currently, New Mexico law does not completely align with national standards, which means that persons not licensed as certified public accountants (CPAs) can perform certain financial and other reviews of a company's operations. The new language would restrict attest services to CPAs, which would better protect the public. The legislation would also provide reciprocity for out-of-state CPA firms wishing to locate in the state. Currently, firms wishing to locate in New Mexico must go through a rigorous and expensive approval process or "piggyback" off the license of a New Mexico CPA. The new language would provide an easier and more accountable process for these firms to operate in the state.

Questions and comments from committee members included the following.

- Have there been problems in New Mexico with people who are not CPAs performing attest services? Mr. Carey said that there have not been any problems in New Mexico, but in other states some industries have been using national accounting standards to perform reviews on nonfinancial activities, such as greenhouse gas emissions. Companies have been hiring people who are not CPAs to perform attest engagement services for those activities. The new language would restrict all attest engagement services to CPAs.

Priority Road Construction and Public Transit Infrastructure Bonds

Anthony Mortillaro, president, New Mexico Transit Association (NMTA), Stan Cooper, board member, NMTA, and J.D. Bullington, lobbyist, presented proposed legislation that would provide a funding source for transit projects in the state. The presenters stated the draft would not, after all, be presented for endorsement consideration by the committee. The NMTA, with 56 governmental and private sector members, was founded in 1987 to be the voice of public and private transportation providers. There are dozens of public transit districts, city and county transportation systems and special needs transportation providers in the state, with no dedicated revenue source to fund these systems. There is a constant need to replace vehicles and improve infrastructure. The legislation would provide for the issuance of severance tax bonds for five consecutive years in the amount of $60 million annually. Ninety-five percent of the money would be allocated toward road construction projects statewide, and five percent, or $3 million, would be dedicated to transit districts, municipalities and counties for the acquisition of vehicles and facilities for public transportation programs. Mr. Bullington said that, given the current bleak outlook for severance tax bonding capacity, he understands that issuing $60 million in bonds for road and transit projects is unlikely. However, he said that just $3 million would be an important first step toward improving the adequacy of public transit systems in the state.

Questions and comments from committee members included the following.

- How would the new funds for public transit projects be prioritized and allocated? Mr. Mortillaro said that the Department of Transportation would prioritize projects based on critical needs of the transit systems requesting the funds. Federal transit funds have been recently cut, and the new funding source would help offset those cuts. Recently, the City of Santa Fe had to borrow money from the New Mexico Finance Authority to replace some of its aging buses.

- It is important that public transit projects be prioritized based on objective standards and not based on politics.

Determine In-State Sales of Intangibles and Services Based on Market-Based Sourcing Instead of Cost of Performance

Representative Harper and Senator Wirth presented proposed legislation for the committee's consideration that would change the way intangible property and services are apportioned for CIT purposes. Senator Wirth said that this is the same legislation that the committee endorsed in the 2014 and 2015 interims, and that passed the senate in the 2016 session. The legislation amends the Uniform Division of Income for Tax Purposes Act to change the way intangible property and services are apportioned. Current law uses an antiquated method of apportioning, commonly called the "cost-of-performance" method. Using that method, the state in which the company expended the greatest cost to produce the property or service is apportioned the entire value of the property or service. The proposed legislation changes the method of apportionment to a "market-based sourcing" method, in which each state is apportioned the value of the intangible property or service if it is used in or delivered to the state.

The changes in apportionment will encourage service-based and information technology companies to locate in the state, because they will be able to apportion the sales of their products to each state where the sales are made. Sales of tangible property are already apportioned in this way. Some industries, such as the telecommunications sector, opposed the legislation because those companies would end up paying more CIT to New Mexico based on sales of telecommunications services to residents of the state. Representative Harper said that many states have moved toward a single sales factor in apportioning CIT liability. However, the single sales factor method does not work for companies selling intangible property and services unless the state also adopts market-based sourcing.

Questions and comments from committee members included the following.

- How will this legislation affect existing companies that have a presence in the state? Senator Wirth said that telecommunications companies will end up paying more CIT to New Mexico because each sale in New Mexico will be apportioned to the state in calculating its sales ratio. However, he said that under current law, a telecommunications company based in New Mexico would have a huge CIT liability, because all of its sales in the world would be apportioned to New Mexico. The current situation is a very big disincentive for a telecommunications company to be based in the state.

- Why is the bill needed, especially if it is unclear whether it will bring in any additional revenue for the state? Senator Wirth said that market-based sourcing better reflects today's economy. The legislation would also act as an incentive for service-based companies to locate in New Mexico.

- Companies should be allowed to choose to use either the cost-of-performance or market-based sourcing method.

The committee endorsed the proposed legislation, with one member opposed to endorsement.

Recess

The committee recessed at 3:49 p.m.

<u>Thursday, December 15</u>

The committee was reconvened by Representative Harper on Thursday, December 15, at 9:08 a.m.

Property Tax: Phasing out the Limitation on Increases in Value of Residential Property and Providing a New Limitation for Long-Term Occupants

Damian Lara, Bernalillo County deputy assessor, and Christine Humphrey, Sandoval County chief deputy assessor, presented proposed legislation for the committee's review to address the issue of what is referred to as property tax "lightning". The legislation was prepared by the Assessors Affiliate of the New Mexico Association of Counties pursuant to a request from the chair of the committee, and has not been endorsed by the affiliate or by the association. The legislation would eliminate property tax lightning for new homeowners by phasing out over three years the valuation increase limitation currently in statute, except for long-term homeowners who meet income qualifications. Currently, most residential property is subject to a three percent valuation increase limitation. When the property is sold, however, the property is required to be valued at its current and correct value, which often means that a new homeowner ends up paying significantly higher taxes than other homeowners in the neighborhood with similar properties. The valuation limitation is increased to five percent in 2018 and to seven percent in 2019 and is removed for 2020 and beyond. For those properties that are significantly under-assessed, the valuations may rise more than the stated percentages, up to a ceiling valuation of 70 percent in 2018, and 85 percent in 2019, of current and correct values. For long-term homeowners who meet income thresholds, property valuation increases would be limited to five percent annually if the property has been occupied for 10 to 24 years, and to three percent for those properties that have been occupied for 25 years or more.

The legislation will increase the values of many residential properties, but that overall increase also means that the mill rate will decrease due to operation of the yield control formula. Now is the best time to enact this legislation, because most counties have assessed values that are close to the current and correct values. As property values increase, the disparity between those values will increase, leading to another significant tax lightning problem. County assessors will need to perform much outreach if the legislation passes, because the valuation limitation for long-term homeowners is available for property owners who apply for the special assessment. Most residential property owners will pay close to the same amount of tax that they are currently paying.

Mr. Lara said that since Proposition 13 was enacted in California, which limits property taxation increases in that state until properties are sold, the result has been that low- and moderate-income property owners currently pay on average 100 percent of their burden, but that wealthy property owners pay only 70 percent. This disparity is due to the fact that expensive properties do not change ownership very often. This same situation occurred in Bernalillo County, until property values declined following the recent recession. Currently, less than seven percent of properties are valued below 70 percent of their current and correct values, but that percentage will increase as property values continue to rise. Betty Cabber, Torrance County assessor, said that Torrance County has been struggling to get all residential properties valued at their current and correct levels since the three percent valuation cap was enacted. She said that some residential properties will have higher tax rates, but, overall, most people's property tax bills should remain the same. Laura Montoya, Sandoval County treasurer, said that the provisions in the bill about long-term homeowners, when coupled with current law freezing property values for homeowners who are more than 65 years old with incomes below $32,000, will provide property tax relief to those most needing it. Raul Turrieta, Grant County assessor, said that most of Grant County is valued at current and correct values. Now is the time to enact reform legislation, before the tax lightning problem gets worse.

Questions and comments from committee members included the following.

- Property tax lightning legislation should be written to not affect elderly, long-term homeowners negatively. The valuation protest process is very confusing and cumbersome. Mr. Lara said that county assessors are prohibited by law from disclosing actual sales prices, except when a protest enters its discovery phase. Most other states require full disclosure of property sales prices.

- There are thousands of properties in northern New Mexico that are unable to be covered by title insurance because of easement issues and water settlement problems. How does this problem affect property valuations? Mr. Lara said that county assessors take into consideration easement and other issues affecting an entire community when calculating property values.

- How did county assessors handle the recent real estate valuation collapse? Ms. Humphrey said that Sandoval County reduced property values in high-foreclosure neighborhoods.

- There is no disclosure of sales prices of commercial property, which makes it very difficult to assess that sector. Small counties often do not have the sophisticated assessment tools that the larger counties use.

- If the proposed legislation is enacted, properties that are valued at under 50 percent of their current and correct value will be taxed at much higher rates.

- County assessors have too much discretion in the methods they use to value property, including determining whether a building is classified as residential.

- Why are property valuations made by county assessors often much higher than actual sales prices? Mr. Lara said that county assessors are required by law to assess a property at its market value. One sale does not make a market.

Taxation of Internet Sales

Richard Anklam, president and executive director, New Mexico Tax Research Institute, presented proposed legislation for the committee's review to encourage out-of-state retailers to pay the New Mexico GRT for sales made to New Mexico residents. The legislation would specify that sales made to residents by a company without physical presence in the state are taxable if the company or its affiliates has sales of more than $100,000 annually in the state. The definition of "engaging in business" for purposes of the Gross Receipts and Compensating Tax Act is actually narrowed from current law, but the state has never attempted to collect the GRT from out-of-state sellers. The bill is designed to encourage Amazon and other large online retailers to voluntarily pay the state's GRT. Other states have enacted similar legislation and have seen significant revenue increases due to voluntary compliance.

Mr. Anklam said that the proposed legislation does not currently have provisions to provide GRT revenue to local governments based on the destination of the sale. That language could easily be included, but he cautioned that there is a slight risk that such a provision could be held to be unconstitutional. There are situations in which an out-of-state seller could be charged a higher tax rate than an in-state seller, which could be an unconstitutional restraint of interstate commerce. However, destination-based taxation provisions in other states have never been challenged in court. Collection of sales taxes is now part of Amazon's business model, because the company is developing tax collection software platforms that third-party vendors will eventually be required to use and pay for. In addition, the company does not want to be eventually subject to a tax liability for sales it made and for which it did not collect tax. It is easier in the long-run to collect sales taxes from customers at the point of sale than to risk a huge tax liability in the future.

Questions and comments from committee members included the following.

- Are call centers based in New Mexico required to pay the GRT? Mr. Anklam said that a specific exemption from the definition of "engaging in business" was enacted so that call centers would not be subject to the tax. Under some scenarios, a call center that made sales on behalf of an out-of-state company would have been subject to the GRT.

- There is a price incentive to purchase goods from out of state because of the lack of obligation to pay the GRT. This hurts local businesses and local governments. Many local businesses have closed around the state because of this tax differential.

- The governor has said that this legislation is a tax increase, and, therefore, she would oppose it. Representative Harper said that he hopes this legislation can be included in a larger tax reform bill that can be supported by the governor.

- The legislation should include destination-based tax collection, so that local governments benefit. In addition, third-party consignment sellers that use a marketplace platform should be required to pay the GRT.

Nontaxable Transaction Certificates (NTTCs): Allowing Evidence Other Than an NTTC to Prove That Proceeds from a Transaction Are Deductible from Gross Receipts

Mr. Crociata presented proposed legislation for the committee's review that would allow other forms of evidence to be presented to allow for a deduction from gross receipts. Current law requires that a seller be in possession of an NTTC to allow a deduction from gross receipts within 60 days of an audit by the TRD. This poses many "gotcha" situations in which a business, in good faith, did not charge GRT to another business, but the NTTC proving the deduction was allowable was never presented to the seller. The legislation would allow the seller to present other evidence that the transaction was deductible. The burden of proof would be on the seller to show that the transaction was deductible. The legislation would also define what is meant by "good faith" related to the acceptance of NTTCs by sellers, because New Mexico courts have recently weakened the common definition of that term. Mr. Crociata said that he is unaware of any other state that requires possession of a piece of paper to prove that a transaction is not subject to sales tax. It is inherently unfair to deny a deduction merely because a form is missing.

Questions and comments from committee members included the following.

- The current system of NTTCs encourages cheating on the GRT. It is too difficult for the TRD to track down improper transactions.

Addressing Regressivity: Allowing a Deduction for All Food Purchased by Supplemental Nutrition Assistance Program (SNAP) Beneficiaries and Adjusting Low-Income Comprehensive Tax Rebate (LICTR) Amounts

Representatives Harper and McCamley presented proposed legislation for the committee's review that would provide a deduction from gross receipts for all food purchased by SNAP recipients. This legislation would be part of a larger tax reform package that would include the repeal of the current deduction from gross receipts from the purchase of food and would attempt to reduce the regressivity of that tax. If a SNAP recipient presented an electronic benefits transfer (EBT) card to a retailer, all food purchases made, regardless of whether the EBT card was used to purchase the food, would be deductible from gross receipts. The bill would also increase the income threshold to be eligible for and the amount of the LICTR, as well as providing for yearly cost-of-living allowances for the rebate.

Representative McCamley said that the GRT is a regressive tax and, if the legislature repeals the deduction for the purchase of food, it will be even more regressive. The legislation would reduce some of that regressivity by ensuring that all food purchases for SNAP-eligible residents are not subject to the GRT and by increasing the LICTR. Representative McCamley said that if the legislature is considering repealing the food deduction, it also needs to provide tax relief to low-income residents. Representative Harper said that the original reason to remove GRT taxation on food was to assist some low-income residents, but the unintended result of that change was a significant revenue loss to local governments and an increase of the GRT in all others items that has impacted all New Mexicans.

Questions and comments from committee members included the following.

- Linking the amount of the LICTR to inflation is not sound tax policy, but there should be a one-time increase in the income thresholds to qualify for the rebate.

- Fred Nathan, executive director, Think New Mexico, said that only about 75 percent of people eligible for SNAP benefits actually receive them. Many low-income residents earn too much to qualify for benefits, but still spend a significant percentage of their income on food. Reimposing the GRT on the purchase of food would put a large burden on that population.

PIT and CIT: A Flat Five Percent Rate

Representative Harper presented proposed legislation for the committee's review that would set a single tax rate of five percent for both the CIT and PIT. He said that there is no reason to have progressive tax rates for the CIT. The rate for the PIT and CIT should be the same, because it is not fair to tax corporations at one rate and other pass-through entity businesses at a different rate. Finally, Representative Harper said that the low tax brackets in the PIT could be eliminated without causing harm, because those brackets only apply to very poor people who probably do not pay any income tax.

Questions and comments from committee members included the following.

- Janet Peacock, consultant, LFC, said that the PIT rates are marginal rates, meaning that each level of income is taxed at the corresponding rate, and amounts above that threshold are taxed at a higher rate. She pointed out that a family with a modified gross income of $24,000 would see a $470 tax increase from the proposal.

- Colorado has a single PIT and CIT rate of 4.63 percent.

- Almost all of the progressivity of the PIT was removed in 2003 when the top marginal rate was set at 4.9 percent, with an estimated $450 million annual cost to the state. The PIT system needs to become progressive again to be fair to low-income residents.

Distributing a Portion of the Motor Vehicle Excise Tax (MVET) to the State Road Fund and the Local Governments Road Fund

Representative Harper presented proposed legislation for the committee's review that would distribute 30 percent of the receipts attributable to the MVET to the State Road Fund and 30 percent to the Local Governments Road Fund. Currently, all of the proceeds are distributed to the General Fund. The legislation is to be considered as part of the larger tax reform package being prepared. Both road funds are in dire need of new funding, and this would improve the funding stream a bit.

Questions and comments from committee members included the following.

- Instead of reducing the distribution to the General Fund, why not increase the MVET to four or five percent and distribute the increased revenue to the road funds? Other states have much higher rates for that tax. Mr. Clark said that most surrounding states charge more than three percent, and some combined state and local tax rates are as high as eight percent.

- All of the revenue raised from the MVET should eventually be distributed to the road funds.

Liquor Excise Tax Distribution Changes: An Increase to the Local DWI Grant Fund and New Distributions to the Magistrate Drug Court and County-Supported Medicaid Funds

Representative Harper presented proposed legislation for the committee's review that would increase distributions from the liquor excise tax for prevention and treatment programs. The liquor industry originally supported the tax because the revenues were to be dedicated to those programs. Today, much of the revenue is distributed to the General Fund and the Lottery Tuition Fund. The legislation would distribute all of the revenues from the tax to the Local DWI Grant Fund, the Magistrate Drug Court Fund and the County-Supported Medicaid Fund and to fund the ongoing provision of services to street inebriates in Gallup. The legislation is to be considered as part of the larger tax reform package being prepared.

Questions and comments from committee members included the following.

- All of the revenue generated from the liquor excise tax should be distributed back to local governments.

- The Local DWI Grant Fund needs a more equitable distribution formula, so that money is distributed evenly across the state.

- How will lottery tuition scholarships be fully funded if the Lottery Tuition Fund no longer receives a distribution of liquor excise tax revenues? Representative Harper said that state revenues should not be used to pay tuition for college students. When the lottery tuition scholarships were implemented, universities and colleges began to increase tuition rates.

Recess

The committee recessed at 4:07 p.m.

Friday, December 16

The committee was reconvened by Representative Harper on Friday, December 16, at 9:13 a.m.

The New Mexico Sales and Use Tax Act

Representative Harper presented proposed legislation for the committee's review that would restructure the GRT. The legislation still had some unfinished parts, but the general structure of the reform package was intact enough to discuss with the committee. The primary goal of the legislation is to significantly reduce the GRT rate by expanding the tax base through the repeal of most of the deductions, exemptions and credits currently in statute. Business-to-business pyramiding would also be reduced. A new tax rate would be established by the TRD that is designed to be revenue neutral, with some safeguards built in. The lower tax rate would offset the impacts of the repeal of most of the GRT tax expenditures currently in law and would provide a level playing field for all New Mexico residents and businesses. Proposed legislation includes the following.

Change Names to "State Sales Tax" and "Use Tax"

Changing the name of the gross receipts tax to the "state sales tax" would be an important recruitment tool for businesses considering relocating to New Mexico. People generally understand what a sales tax is, but almost nobody knows what is meant by a gross receipts tax. Although the legislation changes the name of the tax to a more friendly term, the tax is still technically a GRT. Similar confusion surrounds the compensating tax, which would be renamed as the "use tax".

Remove Local Option Tax Revenue Dedications

The legislation would allow municipalities and counties to adopt a certain amount of sales tax increments that could be used for general purposes, without requiring voter approval. After that level is reached, another set of increments could be adopted if the voters of the local government approved the increments. Local governments would have more flexibility in deciding how their tax revenue could be spent. Current dedicated revenue streams that are being used to pay off revenue bonds would continue to be paid.

1.225 Percent Municipal Share As Part of Municipal Sales Tax

Under current law, the 1.225 percent portion of the 5.125 percent GRT rate is distributed to municipalities, meaning the effective state GRT rate is actually 3.9 percent. The legislation would transform that "municipal share" into a municipal sales tax increment equivalent to a rate that would bring in the same amount of revenue each municipality is currently receiving. The state sales tax rate would be lowered to its equivalent revenue-producing rate.

Reduce Business-to-Business Pyramiding

Economists have estimated that 40 to 50 percent of the New Mexico GRT base is from business-to-business pyramiding. Some studies have shown that the effective tax rate for goods produced in the state is as high as 15 percent of the total price. This pyramiding is a big part of the economic development problem New Mexico faces. With the recent trends of increasing GRT rates, this problem is further magnified. Although most tax expenditures are being proposed for elimination in the legislation, a comprehensive package to eliminate the most problematic pyramiding is still needed if the legislation is to have any positive economic impact.

Representative Harper said that the anti-pyramiding piece of the legislation is still being developed; however, in general, it will eliminate taxation of business-to-business services and most manufacturing inputs. Purchases of tangible personal property for other business uses will continue to be taxed.

Elimination of Most GRT Deductions, Exemptions and Credits

The elimination of most GRT deductions, exemptions and credits is a key part of the legislation and could vastly expand the tax base with a correspondingly lower sales tax rate. Certain economic development promises made to industries would continue, but would be phased out after 20 years. Using economic modeling, the TRD would initially set a state sales tax rate and a rate for each municipality and county that would provide the same revenue that is currently being generated. Representative Harper estimated the state sales tax rate would be around 2.5 percent, with an average total local and state rate of around five percent.

Questions and comments from committee members included the following.

- Many current local government GRT increments are dedicated for specific purposes and are used to pay off bonds. Representative Harper said that local governments will still be able to dedicate revenue for specific purposes, but they will have more flexibility in adopting sales tax increments. Bill Fulginiti, executive director, New Mexico Municipal League, said that language would need to be added to the legislation clarifying that local governments must pledge the new revenue to existing debts.

- Given the current state of New Mexico's economy, might it be best to delay the GRT reform package? Representative Harper said that the pyramiding problem is part of the reason why the state's economy is not developing. If an industry does not have a special deduction in law, that industry is heavily taxed. There should be broad business-to-business deductions to reduce pyramiding, and all other special treatment should be eliminated. Now is actually the best time to enact a GRT reform package.

- The artificially low minimum wage impacts the ability of residents to purchase goods and services, which impacts the entire state economy.

Adjournment

There being no further business, the committee adjourned at 10:27 a.m.