New Mexico Legislature

REVENUE STABILIZATION & TAX POLICY COMMITTEE

2016 INTERIM FINAL REPORT

Legislative Council Service
411 State Capitol
Santa Fe, New Mexico 87501
(505) 986-4600
www.nmlegis.gov

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Interim summary

Revenue Stabilization and Tax Policy Committee
2016 Interim Summary

The Revenue Stabilization and Tax Policy Committee held six meetings in 2016. Bill endorsements were completed on the second day of the December meeting, at which one bill under consideration was endorsed.

The committee discussed and reviewed a number of issues during the interim, including the work being done on capital outlay reform, a study on the state's tax base and updates on various tax expenditures. The committee spent a majority of its time discussing the possibility of making significant changes to the state's tax system, primarily to the Gross Receipts and Compensating Tax Act.

In September, the committee heard presentations on the structure and mechanics of the gross receipts and compensating taxes. The committee heard that, if viewed as a true sales tax, the gross receipts tax is too broad-based, which causes economic interference and inefficiency. If viewed as a true "gross receipts tax", the base is too narrow and the rate is too high. The state also has an over-reliance on ad hoc measures to balance the inequities, like credits and specialized deductions, to fix the system. At that same meeting, a demonstration was made of a tax code simulator that attempts to model certain state and local taxes so that policymakers can understand the fiscal consequences of repealing tax expenditures and other credits, deductions and exemptions.

In November, the committee heard overviews on the personal income tax (PIT) and the corporate income tax (CIT). New Mexico has a top marginal CIT rate of 6.9%, but that rate is being reduced over the next three years to 5.9%. The committee was advised that many factors affect the actual tax paid by a corporation and that, when comparing New Mexico to other states, it is more accurate to compare effective tax rates, which measure the actual taxes paid by a corporation. The complexities of the different methods of reporting, apportionment of income of multistate businesses and sourcing rules were discussed, and these complexities highlighted the difficulties of the CIT. The PIT is imposed on individuals and pass-through entities and has a top marginal rate of 4.9%, which is set at a relatively low threshold, making the tax fairly flat. While the PIT is much less complex than the CIT, there can be difficulty in determining the source of an individual's income.

At its final meeting, the committee primarily focused on proposals that were discussed during the interim and that were intended to be included in a comprehensive tax package. Those proposals included phasing out limitations on increases in value of residential property for property tax purposes; taxation of internet sales; changes to the deduction from the gross receipts on the sale of food and to the low-income comprehensive tax rebate; enacting a flat 5% PIT rate and CIT rate; and making significant changes to the gross receipts and compensating taxes, including changing the names of the taxes to the "state sales tax" and the "use tax" and basing the rates of those taxes on a formula using estimates determined by the Taxation and Revenue Department of baseline revenues and revenue projections.

WORK PLAN AND MEETING SCHEDULE

2016 APPROVED
WORK PLAN AND MEETING SCHEDULE
for the
REVENUE STABILIZATION AND TAX POLICY COMMITTEE

Members

Rep. Jason C. Harper, Chair
Sen. Carlos R. Cisneros, Vice Chair
Sen. Ted Barela
Sen. Sue Wilson Beffort
Rep. David M. Gallegos
Rep. Tim D. Lewis
Rep. Antonio Maestas
Rep. Rod Montoya
Sen. Mark Moores
Sen. George K. Munoz
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

Designees

Rep. David E. Adkins
Sen. William F. Burt
Sen. Jacob R. Candelaria
Rep. Sharon Clahchischilliage
Sen. Lee S. Cotter
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. Bill McCamley
Sen. Nancy Rodriguez
Rep. Tomás E. Salazar
Sen. John M. Sapien
Rep. Jeff Steinborn
Rep. James G. Townsend
Sen. Pat Woods

Work Plan

The Revenue Stabilization and Tax Policy Committee is a statutorily created joint interim legislative committee. Pursuant to Section 2-16-3 NMSA 1978, the committee is directed to "examine the statutes, constitutional provisions, regulations and court decisions governing revenue stabilization and tax policy in New Mexico and recommend legislation or changes if any are found to be necessary . . . ". In the 2016 interim, as time permits, the committee proposes to:

1. review the state's existing taxes and discuss possible changes and improvements to those taxes, with emphasis on the gross receipts tax, personal and corporate income taxes and property taxes;

2. hear from tax experts on tax policy trends in the country, including recent developments regarding the collection and payment of sales and use taxes on internet sales;

3. discuss possible reform of the gross receipts tax and analyze the impact such reform may have on other taxes;

4. discuss possible reform of local option gross receipts taxes to reduce the complexity and deficiencies of those taxes;

5. review tax incentives and continue to examine the state's ability to report and track the effectiveness and value of tax incentives to the state;

6. analyze the state's primary revenue sources, the state's reliance on the volatile oil and gas sector and options for revenue stabilization;

7. review the capital outlay process, proposed changes to the process and outstanding project balances; and

8. determine legislative actions necessary to implement changes identified by committee members that will improve the state's tax system and revenue stabilization.

Revenue Stabilization and Tax Policy Committee
2016 Approved Meeting Schedule

Date	Location
June 20	Santa Fe, State Capitol, Room 322
July 21-22	Santa Fe, State Capitol, Room 322
September 14-15	University of New Mexico Science and Technology Park, Albuquerque
October 13-14	Santa Fe, State Capitol, Room 322
November 28	Santa Fe Community College
December 14-16	Santa Fe, State Capitol, Room 322

AGENDAS AND MINUTES

TENTATIVE AGENDA
for the
FIRST MEETING
of the
REVENUE STABILIZATION AND TAX POLICY COMMITTEE

June 20, 2016
State Capitol, Room 322
Santa Fe

Monday, June 20

10:00 a.m.	(1)	**Post-Session Fiscal Review** —David Abbey, Director, Legislative Finance Committee (LFC) —Christina Keyes, Economist, LFC —Jon Clark, Economist, LFC
11:00 a.m.	(2)	**Gross Receipts Tax Base Study: Phase II Results** —Lee A. Reynis, Ph.D., Research Professor of Economics, Bureau of Business and Economic Research, University of New Mexico
12:00 noon	(3)	**Tax Deviation Report; Discussion of Work Plan and Meeting Schedule** —Pam Stokes, Staff Attorney, Legislative Council Service
1:00 p.m.		**Adjourn**

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

June 20, 2016
Room 322, State Capitol
Santa Fe, New Mexico

The first meeting of the Revenue Stabilization and Tax Policy Committee for the 2016 interim was called to order by Representative Jason C. Harper, chair, on Monday, June 20, 2016, at 10:02 a.m. in Room 322 of the State Capitol in Santa Fe.

Present	**Absent**
Rep. Jason C. Harper, Chair	Sen. Ted Barela
Sen. Carlos R. Cisneros, Vice Chair	Sen. Sue Wilson Beffort
Rep. Tim D. Lewis	Rep. David M. Gallegos
Rep. Antonio Maestas	Sen. Mark Moores
Rep. Rod Montoya	Sen. George K. Munoz
Rep. Debbie A. Rodella	
Sen. Clemente Sanchez	
Sen. William E. Sharer	
Sen. John Arthur Smith	
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Rep. Carl Trujillo	
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Sen. Peter Wirth	

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Sen. Lee S. Cotter	Rep. David E. Adkins
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	Rep. Bealquin Bill Gomez
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	Sen. Gay G. Kernan
	Rep. Idalia Lechuga-Tena
	Rep. Javier Martínez

Rep. Bill McCamley
Rep. Tomás E. Salazar
Sen. John M. Sapien
Rep. Jeff Steinborn
Rep. James G. Townsend
Sen. Pat Woods

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

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

Guests
The guest list is in the meeting file.

<u>**Monday, June 20**</u>

Post-Session Fiscal Review
David Abbey, director, Legislative Finance Committee (LFC), presented the committee with an analysis of the state's finances since the end of the 2016 regular legislative session. The legislative session ended with very slim margins for general fund reserves, with the operating reserve expected to be at one percent of recurring appropriations by the end of fiscal year (FY) 2016. Mr. Abbey said that the fiscal outlook is challenging, with little margin for additional declines in revenue. New Mexico has a revenue problem and a spending problem. The state has seen eight years of mostly flat budgets, with the exception of Medicaid spending, and revenues are not keeping pace with population growth. Revenues in the current fiscal year showed a cumulative 10 percent drop from the same period in FY 2015.

The base state budget is expected to run at a deficit for several years, requiring more reserves to be used to balance the budget. In FY 2018, most of that deficit can be attributed to an expected $94 million increase in Medicaid and other health spending. The state's main revenue source, gross receipts tax (GRT) revenue, has declined more than five percent since FY 2015. In the oil and gas sector, Mr. Abbey reported that production levels are flat and drilling activity has declined. However, the recent increases in the price of oil are one of the few positive factors in the financial forecast for the state. The health care and tourism sectors are the only industries that are performing well.

Mr. Abbey reviewed some appropriation highlights from the legislative session, including public school support, higher education and Medicaid. Public school funding increased only .2 percent from the FY 2016 budget. Higher education funding decreased by $15 million, a reduction of 1.8 percent from FY 2016. Medicaid funding increased $21 million from FY 2016, but the Human Services Department had still anticipated an $85 million shortfall during FY 2017. However, the department recently reported that cost-containment measures and federal rulings will reduce the shortfall to $24.5 million for the upcoming fiscal year. The department anticipates a need to increase Medicaid funding by $60 million to $80 million for FY 2018. Mr. Abbey said that health-care-related tax expenditures total more than $300 million annually. He suggested that the legislature consider changing some of those expenditures in order to pay for expected Medicaid appropriation increases.

Questions and comments from committee members included the following.

- Will the state's reserves being at such a low level affect the state's bond ratings? Mr. Abbey said that severance tax bonds were downgraded a bit recently, but that the oil and gas sector's expected recovery should mean that severance tax bonds should maintain good ratings. General obligation bonds, however, may be downgraded significantly if the state is unable to maintain sufficient reserves. He said that general obligation bonds will be issued in April or May 2017, after the legislature will have had a chance to enact a budget with adequate reserve levels. Even if general obligation bonds are downgraded, there should be sufficient capacity in the enacted law to cover the additional costs.

- Will the low reserve levels affect the ability of state agencies to receive supplemental and deficiency appropriations during the next budget cycle? Mr. Abbey said that the prospects for getting supplemental or deficiency appropriations are not good. Agencies need to live within their appropriated budgets during FY 2017. The LFC and the Department of Finance and Administration may need to develop a set of contingencies in order to keep the state's reserve levels adequate, including enacting more special fund reversions and revisiting the one percent agency budget reduction language that was vetoed by the governor.

- The legislature may need to meet in a special session to enact further reductions in agency budgets for FY 2017. New Mexico is actually in a better position financially than other states such as Oklahoma, Kansas and Alaska.

- The committee has a responsibility to look at potential revenue increases and not be locked into a dogmatic rejection of all revenue-increasing measures. For example, the legislature could enact a hospital provider fee to generate large amounts of money to provide Medicaid matching funds. This is a fee that New Mexico hospitals are actually advocating for, since the revenue generated will enable them to provide more services, but the current administration has categorically rejected any form of tax increase.

- San Juan County has recently lost 6,000 jobs, and more than 11,000 people have left the area because of the economic situation. In addition, a coal mine in the area just laid off 85 people. This kind of demographic shift will require that state and local governments further cut their expenses, since there will not be enough revenues to cover budgets.

- The administration has been unwilling to endorse legislation to increase revenue for several years, but at the same time is also unwilling to cut the number of full-time-equivalent positions in state budgets, which results in constant deficiencies in state agency budgets.

- One area in which the state should be willing to increase taxes is in the renewable energy sector. While the oil and gas and mining sectors are losing jobs, the renewable energy sector is greatly subsidized. The legislature may need to enact some kind of "tax in lieu of severance taxes" in order to offset the inevitable decline of revenues received from the extraction industries.

Gross Receipts Tax Base Study: Phase II Results

Dr. Lee A. Reynis, research professor of economics, Bureau of Business and Economic Research, University of New Mexico, presented the committee with findings of her research on the gross receipts tax base and possible alternatives to the tax. New Mexico has consistently ranked near the top in states that tax business inputs. A 2011 study found that New Mexico had the second-highest percentage of state and local sales taxes imposed on business input purchases, with about 55 percent of those purchases being taxed. The state has since improved its ranking slightly by enacting legislation to reduce GRT taxation on manufacturing consumables and construction inputs. Excessive taxation of business inputs has many negative impacts, including increasing tax pyramiding, making goods and services more expensive in export markets, reducing business profits, incentivizing the sourcing of inputs from out of state, reducing the economic multiplier of business activity and inducing businesses to locate production operations elsewhere. Taxation of business inputs is aggravated when rates are high. Since 2000, New Mexico GRT rates have slowly increased to an average rate of 7.2 percent, with some locations having a GRT rate as high as 8.9375 percent.

Dr. Reynis used the economic modeling software IMPLAN to analyze New Mexico's GRT base. The study was complicated by several factors, including the myriad exemptions and deductions from the GRT, many of which target only specific activities of a particular industry; many manufacturers do not report their export production to the state, which results in inaccurate data; much of the data being studied by businesses is self-reported and not audited; IMPLAN activity is not always correctly classified in its state databases; and data on business inputs used is not always available for each stage of production, making estimating tax pyramiding much more difficult.

Dr. Reynis provided the committee with an analysis of the GRT base and business inputs of the health care services industry. The analysis examined the role of the public sector and nonprofit entities, itemized the various kinds of business inputs made by the industry and evaluated the impact of health-care-related tax expenditures. Of the approximately $13.5 billion in total health care expenditures in the state in 2015, about 20 percent of the total is provided by public agencies. Of the remaining amount, nearly 45 percent of health care providers are nonprofit entities, which can deduct from gross receipts their business inputs and are exempt from paying the tax for their services. This can provide a large competitive advantage over for-profit entities engaged in the same industry. Finally, Dr. Reynis listed health-care-related tax expenditures allowed in statute, primarily for for-profit entities, which in 2014 totaled more than $269 million in foregone state revenue.

Questions and comments from committee members included the following.

- Senator Sharer discussed his idea from 2015 to completely restructure the GRT system by eliminating most exemptions, credits and deductions and then applying a much lower tax rate to the suddenly much larger GRT base. He had initially divided the state gross domestic product by current tax revenue and came up with a base GRT rate of 1.87 percent. The study performed by Dr. Reynis was intended to better model that idea, so that legislators could come up with a simplified tax system that was understandable and had a low rate, while keeping revenues the same. If every business paid a two percent GRT, the tax pyramiding issue would be much less of a problem than it is today. Health care, which is a huge and growing industry in the state, is largely untaxed. Applying a two percent GRT to all health care services would raise a tremendous amount of money.

- The biggest problem about reforming the tax system is that legislators do not have the political will to fix the problem. Most legislators are worried about their reelection.

- If all of the GRT credits, exemptions and deductions were repealed, what would the GRT tax rate need to be in order to stay revenue neutral? Dr. Reynis said that question is still unanswered. However, many of the exemptions would need to remain in statute, because of constitutional and federal preemption issues.

- Reforming the entire GRT system is probably not possible. But the legislature should examine the top five or 10 most expensive tax expenditures to determine if any should be modified or discontinued. The 10 costliest tax expenditures account for 75 percent of all the foregone revenue from tax expenditures.

Tax Deviation Report

Ms. Stokes presented the committee with a Tax Deviation Report, which attempts to list all of the credits, deductions, exemptions and other deviations from New Mexico's taxes. It is somewhat of a summary of the Taxation and Revenue Department's (TRD's) Tax Expenditure

Report, with some differences, including the categorization of tax expenditures and descriptions of deviations that have not been defined by the TRD. There are 313 tax deviations, of which 145 are currently identified as tax expenditures, 105 are not tax expenditures, 26 could be classified either way and 37 are still undefined. The Tax Deviation Report categorizes tax expenditures into seven general categories: citizen benefit; economic development; environment, conservation and renewable energy; extractive industries; health care industry; nonprofits; and other. The Tax Deviation Report uses the estimates reported in the Tax Expenditure Report for the costs associated with each expenditure. The total cost for all tax expenditures in FY 2014 was nearly $1.2 billion.

Discussion of Work Plan and Meeting Schedule

Representative Harper discussed with the committee his idea of how the committee could be run in the 2016 interim. Rather than hearing endless lectures about tax issues, coupled with requests from various interest groups for specific tax relief, he envisioned having educational sessions about certain tax topics, followed by roundtable discussions to identify specific problems and possible solutions to those problems. At the end of the interim, the committee would have a series of tax policy proposals that it would present to the legislature. Instead of being merely a tax loophole committee, the committee could actually come to a consensus on various tax policy issues. New Mexico needs to have a fair tax policy that does not pick winners and losers, which will in turn attract more business investment to the state. Republicans and Democrats in the New Mexico Legislature probably agree on 90 percent of tax policy issues, so the committee should work to find those agreements that can create consensus tax legislation to improve the economic climate of the state.

Ms. Stokes reviewed the proposed work plan and meeting schedule for the committee. She said that the committee would need approval from the New Mexico Legislative Council for an extra meeting day in December and to meet outside of the State Capitol for its November meeting. The committee would also request $30,000 to contract with subject matter experts during the interim.

The proposed work plan and meeting schedule for the committee during the 2016 interim were adopted by the committee unanimously.

Adjournment

There being no further business, the committee adjourned at 12:30 p.m.

TENTATIVE AGENDA
for the
SECOND MEETING
of the
REVENUE STABILIZATION AND TAX POLICY COMMITTEE

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

Thursday, July 21

9:00 a.m. (1) **New Mexico Tax System Overview and General Fund Revenue Sources**
—Richard Anklam, President and Executive Director, New Mexico Tax Research Institute
—Christina Keyes, Economist, Legislative Finance Committee (LFC)
—Jon Clark, Economist, LFC

12:00 noon **Lunch**

1:00 p.m. (2) **Constitutional Constraints on Tax Policy and What States Are Doing to Tax Internet Sales**
—Frank Crociata, Tax Policy Director, Taxation and Revenue Department

5:00 p.m. **Recess**

Friday, July 22

9:00 a.m. (3) **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
—Gary Tonjes, President, Albuquerque Economic Development

10:30 a.m. (4) **Results from New Mexico First's Statewide Town Hall on Economic Development**
—Tom Taylor, Former State Representative, Co-Chair, New Mexico First (NM First) Implementation Team
—Bill Garcia, Former Secretary of Economic Development and Tourism, Co-Chair, NM First Implementation Team
—Heather Balas, President, NM First

11:30 a.m. **Adjourn**

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.

Information from the New Mexico Tax Research Institute (NMTRI)

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.

Questions and Discussion

"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.

Revised: September 16, 2016

TENTATIVE AGENDA
for the
THIRD MEETING
of the
REVENUE STABILIZATION AND TAX POLICY COMMITTEE

September 14-15, 2016
The Rotunda, University of New Mexico Science and Technology Park
Albuquerque

Wednesday, September 14

9:00 a.m. (1) **The Gross Receipts Tax: Overview, Administrative Issues and Suggestions for Improvement**
—Frank Crociata, Tax Policy Director, Taxation and Revenue Department
—Richard Anklam, President and Executive Director, New Mexico Tax Research Institute

10:30 a.m. (2) **Local Option Gross Receipts Taxes: History of the 1.225%, Impact of Hold Harmless, Unused Increments and Other Issues Affecting Local Governments**
—William Fulginiti, Executive Director, New Mexico Municipal League
—Jim O'Neill, Contractor
—Steve Kopelman, Executive Director, New Mexico Association of Counties (NMAC)

12:00 noon **Lunch**

1:00 p.m. (3) **A New Mexico Tax Code Simulator; Discussion on Tax Reform**
—Ryan Gleason, Contract Policy Analyst, New Mexico House of Representatives Majority Office

2:00 p.m. (4) **Whiteboard Session**
—Representative Jason C. Harper, Chair, Revenue Stabilization and Tax Policy Committee (RSTP)

5:00 p.m. **Recess**

Thursday, September 15

9:00 a.m.	(5)	**Property Tax Overview** —Rick Lopez, Director, Local Government Division (LGD), Department of Finance and Administration (DFA) —Susan Rodriguez, Budget and Finance Bureau Chief, LGD, DFA —Brenda Suazo-Giles, Finance Coordinator, LGD, DFA —Betty Cabber, Torrance County Assessor, NMAC Assessor Affiliate Chair —Damian Lara, Bernalillo County Deputy Assessor
10:15 a.m.	(6)	**Overview of Industrial Revenue Bonds in New Mexico** —Deirdre M. Firth, Deputy Director, Economic Development Department, City of Albuquerque
11:15 a.m.	(7)	**Whiteboard Session** —Representative Jason C. Harper, Chair, RSTP
12:00 noon		**Adjourn**

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

September 14-15, 2016
The Rotunda, University of New Mexico Science and Technology Park
Albuquerque

The third 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, September 14, 2016, at 9:07 a.m. in the Rotunda of the University of New Mexico Science and Technology Park in Albuquerque.

Present
Rep. Jason C. Harper, Chair
Sen. Carlos R. Cisneros, Vice Chair
Sen. Ted Barela
Sen. Lee S. Cotter (9/14)
Rep. Antonio Maestas
Rep. Rod Montoya
Sen. George K. Munoz (9/14)
Rep. Debbie A. Rodella
Sen. Clemente Sanchez
Sen. William E. Sharer
Sen. John Arthur Smith
Rep. James R.J. Strickler (9/14)
Rep. Carl Trujillo
Rep. Jim R. Trujillo
Sen. Peter Wirth

Absent
Rep. David M. Gallegos
Rep. Tim D. Lewis
Sen. Mark Moores

Designees
Rep. David E. Adkins
Rep. Randal S. Crowder
Rep. Bealquin Bill Gomez (attending as a guest)
Rep. Bill McCamley (attending as a guest)

Sen. William F. Burt
Sen. Jacob R. Candelaria
Rep. Sharon Clahchischilliage
Rep. Brian Egolf
Rep. Miguel P. Garcia
Rep. Stephanie Garcia Richard
Sen. Stuart Ingle
Rep. Conrad James
Sen. Gay G. Kernan
Rep. Idalia Lechuga-Tena
Rep. Javier Martínez

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

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

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

Guests
The guest list is in the meeting file.

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

<u>Wednesday, September 14</u>

The Gross Receipts Tax: Overview, Administrative Issues and Suggestions for Improvement

Demesia Padilla, secretary, Taxation and Revenue Department (TRD), Frank Crociata, TRD tax policy director, and Richard Anklam, president and executive director, New Mexico Tax Research Institute, gave a presentation to the committee about the gross receipts tax (GRT) in New Mexico. Secretary Padilla introduced the speakers and some of her key staff at the TRD before briefly discussing the upcoming publication of the tax expenditure report (TER) for 2016. The wide availability of the TER has exacerbated the issue that the TRD is calling "data mining", in which tax consultants use existing tax expenditures in new ways to benefit their clients' tax liability. Tax consultants are also advising their clients to make one refund claim covering several years in order to maximize their contingency fee. This has resulted in the TRD issuing very large refunds to companies recently.

Mr. Crociata discussed the structure and mechanics of the GRT. New Mexico does not have a true sales tax; it instead imposes the GRT for the privilege of engaging in business in New Mexico. The GRT resembles a traditional sales tax but is based on a business's receipts, and it places the legal incidence of the tax on the seller. In addition, the GRT applies to a much broader range of business activities than a sales tax. In order for the GRT to apply to a transaction, four requirements must be satisfied: that the GRT is not preempted by federal law or constitutional provision; that the person is engaged in business; that the person has gross receipts from its activities; and that the person or transactions of the person are not exempt. "Engaged in business" is defined in statute as conducting any activity with the purpose of direct or indirect benefit, with a couple of specific industry carveouts for website hosting and certain call center activities. The definition of "gross receipts" is very broad and includes selling property, leasing or licensing property, granting a right to use a franchise, performing a service and performing certain research and development services outside of New Mexico if the product of that service is initially used in New Mexico. Gross receipts include many special kinds of transactions, including receipts from consignment sales, commissions on taxable sales of property and services, cooperative dues, receipts from intrastate communications, sales by New Mexico florists to fill an order out of state and certain receipts from home service mobile telecommunications providers. The term also excludes certain items, including cash discounts and tax already paid on the same transaction.

The GRT is reported by businesses through the Combined Reporting System (CRS) at the TRD, which is also used to report compensating tax liabilities and income tax withholding for businesses' employees. Businesses that are exempt from paying the GRT do not need to file, but allowable deductions from gross receipts are reported on the CRS form by businesses. The state GRT rate is 5.125 percent, which is added to the local rates imposed at a business's location. Local governments are authorized to impose numerous rate increments that piggyback on the state rate. Combined rates currently range from 5.5 percent to 8.9375 percent, depending on the locality and which increments have been adopted by the local government.

Deductions and exemptions from the GRT apply equally to both state and local governments. Exemptions are not reported to the state, which makes it difficult to estimate their cost to state and local revenues. Deductions reduce GRT liability by eliminating certain transactions from a taxpayer's gross receipts. Many deductions were enacted to reduce the problem of business-to-business taxation, or "pyramiding", especially in the construction sector. Many deductions require the seller to be in possession of a nontaxable transaction certificate (NTTC) from a qualified purchaser in order to be allowed to claim the deduction. If a business does not have the NTTC in its possession, the TRD will disallow the deduction following an audit unless the NTTC can be produced within 60 days. The TRD has no discretion in allowing a deduction if the NTTC is not present, even if the company that should have presented the NTTC to the seller is no longer in business. However, if a company accepts an NTTC in "good faith" that the purchaser is in compliance with the law regarding paying the GRT, the TRD does allow the deduction.

Several GRT credits are also allowed in statute, making New Mexico unique in the nation. Many of these credits are business incentives that allow for a reduction of several taxes, including the GRT, for certain kinds of business activity.

Mr. Crociata also discussed the issue of data mining and how it can negatively affect state revenues. In Arizona, the car rental company Enterprise Leasing exploited a loophole in a tax credit designed to encourage pollution control activities. The company used the language to claim a $2.5 million credit for all of its motor vehicles that had catalytic converters installed, which technically met the goal of "pollution control". The Arizona legislature was forced to quickly revise its statute to close that loophole before other companies made the same credit claim. Mr. Crociata cautioned the committee to enact tax credits that are clearly written, with all operative terms defined. Secretary Padilla said that a loophole in the high-wage jobs tax credit statute was not fixed in a timely manner, resulting in more than $100 million in lost state revenue.

Mr. Anklam then discussed the history of the GRT and ways in which its structure could be reformed. The GRT is a consumption tax and is the most important funding source for state and local governments in New Mexico. However, the GRT is also regressive; it is difficult or impossible to enforce in some situations; and it can easily lead to excessive tax pyramiding. The GRT began in 1934 as an emergency school tax that was a broad-based two percent tax on goods and services. In 1966, the tax was restructured and renamed as the "gross receipts tax". The GRT put the incidence of the tax on the seller, which allowed for the taxation of services provided to the federal government at the economically significant national laboratories and military bases. The new tax was also broad-based, which meant that pyramiding of business transactions soon became a problem due to the higher rate and the ability of local governments to add their own tax increments. By the 1990s, the legislature had carved out many exceptions to the broad GRT base, but many of those deductions and exemptions tended to be based on a particular industry's needs and not on an overall tax policy perspective. The differential in taxation between New Mexico and other states also began to play a role in economic development. Because New Mexico taxed many things that other states did not, and because New Mexico had a tax structure unlike most other states, it became more difficult to attract new businesses to the state.

The compensating tax is the companion tax to the GRT and is intended to collect tax on items and services obtained outside of the state. However, it is often impossible to collect, and its lower rate, compared to the combined local and state GRT rate, acts as a disincentive for businesses to purchase in state.

Mr. Anklam said that the current GRT system is broken. Viewed as a true sales tax, the GRT is too broad-based, which causes economic interference and inefficiency. Viewed as a true "gross receipts tax", the base is too narrow and the rate is too high. New Mexico has a hybrid system, but it suffers from the worst of both worlds, with high rates and a continually shrinking base. The state also has an over-reliance on ad hoc measures to balance the inequities, like credits and specialized deductions, to fix the system. If New Mexico is to have a tax system that is more like a sales tax, it needs to eliminate pyramiding and make the tax more of a "retail" or "consumption" tax. Whether to tax federal activity, health care and digital goods will need to be considered. In addition, the GRT and compensating tax bases and rates will need to be harmonized. If the GRT is to become a true "gross receipts tax", then most exemptions and deductions will need to be eliminated and the tax rate will need to be lowered to below two percent in order to minimize the pyramiding impact. But this kind of reform would carry with it other critical considerations, such as its impact on local government financing and the regressivity of the new tax structure. Other possibilities include creating a sales tax for retail sales and some kind of business activity tax for businesses. Each would have different rates and bases, which could reduce regressivity and pyramiding.

Questions and comments from committee members included the following.

- Would it be possible to limit the time that a business credit can be claimed? Secretary Padilla said that limiting the amount of time a refund can be claimed is possible, but that would put the state out of sync with most other states and the federal government, which allow for four years to claim a refund. Mr. Anklam said that most business credits have a much shorter time limit in which the credit can be claimed but that the high-wage jobs tax credit did not have a time limitation.
- There are currently too many tax expenditures, some of which do not work as intended. This makes it difficult to craft a workable budget in the state. Secretary Padilla said that any new deductions need to be written with no ambiguity and need to be easy to administer.
- It is actually easier to do business in Arizona than in New Mexico, even for New Mexico businesses.
- Does the state really have $1.1 billion in annual tax expenditures? Secretary Padillla said that the TER reflects actual foregone revenues, but many of the expenditures are estimates only. Jon Clark, economist, Legislative Finance Committee, said that repealing one deduction or exemption may not have the same fiscal impact as listed in the TER because a different expenditure might be allowable once the first one is removed. Also, since most GRT deductions are reported in the aggregate, it is very difficult to give exact numbers on the cost of individual deductions. Exemptions are not reported at all, and the TER merely reflects an educated guess of their cost.
- The TRD was requested to provide the committee with information on whether taxable gross receipts increased or decreased as a result of an increase in tax rates.

Local Option Gross Receipts Taxes

William Fulginiti, executive director, New Mexico Municipal League (NMML); Jim O'Neill, NMML consultant; and Steve Kopelman, executive director, New Mexico Association of Counties (NMAC), discussed with the committee various issues surrounding local gross receipts taxation. Mr. Fulginiti began by discussing the history of the GRT and how municipalities ended up receiving a portion of the GRT. Before the creation of the current GRT, the legislature granted municipalities the ability to impose a one percent sales tax, which in 1969 was rolled into the GRT base rate of four percent, with the municipal share being distributed to municipalities. Over time, the legislature granted and repealed various other base GRT increments to municipalities, resulting in a base rate of 1.225 percent since 1991. This portion of the overall GRT rate, which today is about 24 percent of the state share, is distributed to municipalities. The state has also granted various local option GRT increments over the years, with total authorized municipal local option GRT increments of 2.6875 percent. Added to the

1.225 percent rate implicit in the state rate, municipalities have a total of 3.9125 percent GRT taxing authority, compared to the state's net tax rate of 3.9 percent. Some municipalities have additional taxing authority for special projects unique to their locality. Also, the state rate of 5.125 percent is allocated entirely for state purposes for businesses located outside of municipalities.

Mr. Kopelman introduced Lea County Manager Mike Gallagher to the committee and then discussed the NMAC's position on tax reform. The NMAC supports GRT tax reform, but county and municipal governments need to be at the negotiating table when that occurs. There is a huge unused GRT tax capacity for counties because many of the authorized increments are earmarked for specific purposes that counties often do not need. Whereas in the past, property tax revenues were the most important portion of county budgets, now GRT revenues play a much larger role. Mr. Kopelman said that counties would prefer a certain amount of GRT increment taxing authority to be used for general purposes. Counties should have more flexibility in determining how GRT revenue is used.

Mr. Gallagher said that Lea County's GRT revenues have plummeted in the past few years, mostly due to the oil and gas sector decline in the area. Fiscal year (FY) 2016 revenues were 32 percent lower than FY 2015, but the state mandates for health care, corrections and other areas have not been reduced at all. He said that there is much oil and gas being extracted in southeastern New Mexico, but much of the product is shipped to neighboring Texas for processing, which has a healthier regulatory and tax climate. Mr. Fulginiti said that GRT revenues have fallen 39 percent in Hobbs, 52 percent in Eunice and two percent in Albuquerque.

Questions and comments from committee members included the following.

- San Juan County has lost more than 6,000 jobs in the past several years as a result of the decline in the oil and gas sector. Compounding the problem is the fact that 85 percent of the land in the county is not privately held, resulting in much-reduced property tax revenue. In addition, the strict regulatory structure in New Mexico makes it difficult for extractive industries to compete in the state.
- What kind of GRT reforms do local governments support? Mr. Fulginiti said that it is very unusual for states to have so many earmarked local option taxing increments. The legislature has been reluctant to grant broad authority to local governments. Mr. Kopelman said that the legislature could substantially reduce the number of local options but authorize more general purpose increments. Mr. Fulginiti said that municipalities and counties would need to devise a plan to determine county area versus countywide rates so that certain joint responsibilities could be properly apportioned. He also said that the recent enactment of the hold harmless GRT authorizations pits counties against municipalities. If both a municipality and a county enact all of those GRT increments, taxpayers would see huge rate increases.

- The state has a limited private property tax base, and the only area that can see much growth is in the GRT base. Local revenues need to have an expanded base. The state never used to pay for school construction, but it now pays for nearly all of that cost.
- The state could authorize higher local government general purpose increments, but the voters should still have a voice in whether to enact those increments. Mr. Fulginiti agreed and said that most local option increments require voter approval.
- Would local governments imposing hold harmless GRT increments offset the amount of revenue currently being distributed to account for food and health care practitioner gross receipts deductions? Mr. Fulginiti said that those tax increments could offset the hold harmless distributions but that imposing the tax at the local level is causing problems.

A New Mexico Tax Code Simulator: Discussion on Tax Reform

Ryan Gleason, contract policy analyst, New Mexico House of Representatives Majority Office, demonstrated for the committee a tax code simulator that attempts to model various New Mexico tax codes so that policymakers can understand the fiscal consequences of making changes to tax expenditures. The simulator, which consists of a complex set of macros and formulas in an Excel spreadsheet, uses FY 2015 data available from the TRD and other sources to model a revenue-neutral scenario to examine the effects of various deductions, exemptions, credits and other expenditures on the GRT rate. Mr. Gleason said that he received input from state tax experts in developing the simulator, but he cautioned that it is still a work in progress. During the demonstration, Mr. Gleason ran several scenarios, based on input from committee members, to see what the effect on rates would be. He reported that the simulator calculated a .5 percent overall reduction in the GRT rate if the food and health care provider deductions were eliminated but that local rates would remain about the same.

Representative Harper said that the data on business pyramiding still need to be fully developed in order to estimate its fiscal impact. Mr. Gleason said that pyramiding of services needs to be separated from pyramiding of tangible personal property. The TRD is currently assembling those data, he said.

Questions and comments from committee members included the following.

- How is the fiscal impact of GRT exemptions calculated? Mr. Gleason said that he used the TRD's estimates when they were available. However, if there is an area in which there is no firm number, those impacts can be adjusted according to differing estimates in the simulator.
- The simulator should attempt to model the effects on removing the food deductions and how that would affect the use of Supplemental Nutrition Assistance Program (SNAP) purchases.
- What would the state GRT rate be if every deduction, exemption and credit were repealed? Mr. Gleason reported that the simulator predicted a state GRT rate of 2.125 percent.

- There are many cars sold in Farmington. Eliminating the motor vehicle excise tax on cars and imposing the GRT would probably mean that Farmington's revenue-neutral GRT rate should be close to zero percent. Mr. Gleason said that the simulator does not have the data to model tax revenue by car purchase but that the data could be included.
- Much of the data needed to yield accurate local results are not available. The simulator seems to use statewide averages, but the reality is that each locality has different economic sectors, with widely varying results for each tax expenditure. Mr. Gleason said that there are still some issues with the accuracy of local data, but the statewide averages seem reliable. He also said that the model has a built-in bias toward underestimating the GRT base so that the predictions of the simulator will tend to err on the side of less revenue rather than being too optimistic about revenues.

Whiteboard Session

Representative Harper led a discussion with the committee and audience members about reforming the GRT. They began by identifying several basic ideas and principles that would need to be followed during any reform process, including simplicity, marketability, economic activity, regressivity, stability, adequacy, competitiveness and accountability. Next, the following list of positive and negative attributes of a pure GRT and a pure sales tax was generated by the group.

	GRT	Sales
Good	Broad Simple Low rate Balanced/robust More stable than sales Downward pressure on other taxes	Understandable No business-to-business pyramiding Marketing/similar to neighboring states/not weird Fairly stable
Bad	Collection/pass-on Pyramiding Weird Less transparent	Higher rate/smaller base Consumption-driven

A participant in the session said that the GRT needs to be rebranded with "sales" in its name, regardless of whether the GRT is converted into some other type of tax. Almost nobody outside of New Mexico has any idea of what a GRT is, but nearly everyone in the nation understands the basic idea of a sales tax.

Representative Harper then briefly described one idea he wanted to explore: what would the GRT rate need to be if all deductions, exemptions and credits were eliminated, taxing essentially all activity in the state? The tax code simulator calculated a rate of about two percent, with another two percent needed to fund local governments. That combined rate of four percent would still be too high to keep pyramiding from having negative economic consequences. Expanding on that idea, but repealing and then including in the GRT base activity currently taxed by the motor vehicle excise tax, the premium tax and associated insurance taxes, the personal income tax (PIT) and the corporate income tax (CIT) would have the net result of greatly expanding the GRT base, especially for local governments, which would lower the rate some more. Mr. Crociata cautioned that converting the PIT and CIT into the GRT base would cause major problems in implementation. One difficult issue is that the PIT is based on state residency, while the GRT is based on location in the state. Similar complex issues would involve the conversion of the CIT into the GRT base, he said.

Representative Harper solicited a list of possible GRT and other tax reform ideas from the group. The group subsequently discussed each one and tried to come to consensus about what could be done.

<u>GRT Brand</u>

One group member said that just speaking the words "gross receipts tax" scares people and that the term always needs to be explained. A new name for the GRT was proposed: the "New Mexico sales tax".

<u>1.225 Percent "Shell Game"</u>

It would be more transparent and easy to understand if the 1.225 percent rate that is part of the 5.125 percent rate but distributed to municipalities were to become an actual set of GRT increments imposed by municipalities. Then the 3.9 percent effective state GRT rate would be much easier to grasp in order to understand state and municipal revenues, although the state would still get the entire 5.125 percent outside of municipalities.

<u>NTTC Reform</u>

Mr. Crociata said that the TRD does not like the current NTTC system. The TRD issues NTTCs as a compliance tool for buyers, but, in fact, it allows a deduction from the seller. This is inherently unfair. He said that the TRD could eliminate all NTTCs, except for one needed by the electric utility sector. The TRD could instead just provide a simple exemption form. However, this solution would have some initial costs. The TRD also needs to allow for businesses to provide alternative proof that they are allowed a deduction rather than the current, very strict proof required.

Mr. Crociata also suggested tightening the requirements to show good faith in accepting an NTTC, in response to recent court decisions greatly expanding the term.

Secretary Padilla said that any NTTC reform will need to provide the TRD with extra time to prepare and train its auditors in the new system.

Compensating Tax

In order to encourage New Mexico businesses to purchase goods in the state, the compensating tax rate should be the same as the average total GRT rate. As it is now, businesses have a two percent to four percent incentive not to purchase property in the state, merely from the tax differential. Mr. O'Neill said that the compensating tax is supposed to protect in-state merchants from unfair out-of-state competition, but currently it is doing just the opposite. The compensating tax is also used as a penalty if a business improperly uses NTTCs to avoid paying the GRT to a seller. Finally, it is important to note that the compensating tax is imposed on the purchaser while the GRT is imposed on the seller. A committee member said that the compensating tax also acts as a disincentive for a company to move large equipment it owns out of state into the state for testing purposes. This became an issue at the White Sands Missile Range because the company could not prove that it had already paid a sales or use tax on the equipment it wanted to relocate to New Mexico.

Internet Sales

Two reform ideas were presented. The first is that it might be time to repeal the prohibition of the TRD from enforcing the compensating tax on individuals to allow for collection of that tax for out-of-state purchases. The second reform proposal is that, eventually, internet sales from out of state need to be taxed. It may be difficult and complicated to achieve this goal, however.

Data Mining

Secretary Padilla said that the TRD is often torn between competing ideals: providing transparency to the public about tax expenditures versus divulging information to tax consultants about potentially costly loopholes in those expenditures. At the same time, the department does not want to discourage legitimate businesses from receiving the tax expenditure.

Mr. O'Neill said that tax expenditures, also known as business incentives, really do not belong in tax statutes. They ideally belong as part of the budgetary process; however, that would raise some constitutional Anti-Donation Clause issues. He said that the legislature should put caps on all tax expenditures to limit their fiscal impact. The high-wage jobs tax credit, which was enacted to entice businesses to create new high-paying jobs, instead has been used by extractive industries to claim a credit for their existing employees.

Tax Expenditures for Federal Contractors

The group did not identify any potential reforms on this issue.

Local Option GRT Reform — Earmarks Versus General Revenue

The group then discussed the desire of local governments to provide general revenue GRT increments, rather than the current plethora of increments with specific purposes for the revenue generated. Several committee members expressed support for that idea but were cautious about changing any voter approval requirements for those increments. One group member said that local governments should still be allowed to earmark revenue if so desired.

Most of the current earmarked GRT increments came into existence because they were requested by municipalities and counties over the years.

Pyramiding

There are a few kinds of tax pyramiding, each with different problems associated with them. Most states do not tax business-to-business services, but New Mexico generally does. Pyramiding of tangible personal property is generally the issue most states deal with, but New Mexico also has the issue of pyramiding on intangibles and on services. The question of whether to solve the pyramiding problem all at once or in steps was raised. Also, the scope of the issue still needs to be well-defined. Mr. O'Neill said that New Mexico does not need to eliminate pyramiding; it just needs to reduce it to make it comparable to other states.

Senator Sharer's Two Percent Tax Proposal

The whiteboard session paused briefly in order for Senator Sharer to present his tax reform proposal, introduced in the 2015 regular session, which would eliminate nearly all tax credits, expenditures and deductions in the GRT; eliminate most other taxes; tax nearly all compensable activity in the state, including income and housing; and have a single, statewide two percent GRT rate. The basic idea is to tax everything, but at a much lower rate. This would reduce the dollar value of pyramiding tremendously because of the low rate. The fact that businesses would not benefit from anti-pyramiding deductions would be more than offset by the fact that their overall taxes paid on business inputs would be reduced. This benefit would make purchasing New Mexico products much more attractive than it is today. This would in turn create more manufacturing in the state, creating more jobs and, thus, building a bigger economic pie from which everyone could benefit. More people would be working, and more people would be paying taxes.

The PIT would be eliminated, replaced by a flat two percent GRT on wages withheld and sent to the TRD on behalf of employees. Workers under a certain income threshold would receive an annual rebate to help cover expenses, such as food and housing. Housing costs would also be taxed. Property sales would be taxed at the low rate. The cost to businesses and individuals would be minimal, but the total amount generated by the state would be tremendous. All agricultural exemptions and deductions would also be eliminated, but the reduction in all other taxes for the agricultural community would more than offset the lost revenue from those exemptions and deductions. Any special deals made in the past with specific industries, such as GRT deductions for URENCO, which is a nuclear fuel company, and Union Pacific Railroad, would continue to be honored but would eventually be phased out. If the two percent tax rate raised too much or not enough money to cover current state and local revenues, there would be automatic mechanisms to change the tax rate accordingly. Finally, the compensating tax would be reformed, reduced to a two percent rate and applied to all purchases made out of state, including from individuals who purchase goods online. Senator Sharer predicted that if the state were to adopt this reform proposal, everyone in the state would benefit and the economy would grow tremendously.

"Grown Up" Tax Code

Representative Harper then discussed with the group different options the state could take to reform the GRT structure. One idea would be to have a hybrid GRT-sales tax system, which would have a regular sales tax for most consumer purchases, a low business GRT rate and no income tax. This structure is similar to Texas's tax structure. However, even with a tax rate of 3.5 percent to four percent, the pyramiding impacts would still be too high. Another idea would be to try to eliminate almost all pyramiding by providing more targeted deductions for businesses and then reducing the GRT rate to about four percent. More than one-half of current tax expenditures are already targeting pyramiding. Other deductions, credits and exemptions that are not related to pyramiding would be repealed.

The group discussed the food and health care provider deductions. Taxation of food is regressive, but it used to be the most reliable and important revenue stream for local governments. A committee member said that one common misperception about SNAP is that if the GRT were again imposed on food, poor people would not suffer because they buy food using their SNAP cards and the GRT is not imposed on those purchases. The reality, however, is that SNAP benefits only cover a portion of actual food costs for families. One idea would be to include the low-income comprehensive tax rebate, included as part of an income tax return, with the monthly SNAP benefits. This would increase those monthly benefits and ensure that they are spent for food. Another idea is to provide a deduction from gross receipts for all food purchases made by individuals who present their SNAP card to a retailer. This would ensure that the GRT would not be imposed on any food purchase made by individuals who have SNAP benefits.

Recess

The committee recessed at 5:09 p.m.

Thursday, September 15

The committee reconvened at 9:09 a.m.

Property Tax Overview

State Perspective

Rick Lopez, director, Local Government Division (LGD), Department of Finance and Administration (DFA); Susan Rodriguez, chief, Budget and Finance Bureau (BFB), LGD; and Brenda Suazo-Giles, special projects analyst, BFB, made a presentation to the committee about property tax in New Mexico. Mr. Lopez reported that the LGD had finalized the rates for the upcoming property tax year the previous week. New Mexico has a unique and complex property tax system because of constitutional rate limitations, how tax revenue is generally used and various exemptions and valuation limitations. At the local level, county assessors provide a list of valuations for each property and prepare property tax schedules. County treasurers bill, collect and distribute property taxes. Governing bodies, such as boards of county commissioners, municipal councils, school boards, public improvement districts, etc., impose the property tax rates as allowed by law and as determined by the DFA. The LGD is responsible for determining the actual tax rates for each entity based on property valuations, constitutional restraints and the yield control formula. Other state agencies, including the TRD, State Board of Finance, Public Education Department, Higher Education Department, New Mexico Livestock Board and Soil and Water Conservation Commission, provide property tax schedules to the DFA for their respective areas of interest.

The LGD takes all of the information provided and prepares a tax certificate for the upcoming property tax year with the mill levy for each entity in each county. The most confusing aspect of the rate certification involves the yield control formula, set out in statute in Section 7-37-7.1 NMSA 1978. This formula is intended to prevent extraordinary tax increases in response to increases in property values. As valuations increase or decrease, the tax rate adjusts to limit tax revenue. Revenues can increase only from inflation and the growth attributed to new construction. This formula does not affect the valuation of individual properties but affects the mill levy assessed against each property and also limits revenues collected. The formula is applied separately to residential and nonresidential properties, which has had the effect over the past decades of reducing property tax rates for residential property below those allowed by the Constitution of New Mexico and keeping those rates at or near the limits for nonresidential property. The yield control formula applies to most mill levies, except for those specifically excluded by statute and for general obligation levies.

Questions and comments from committee members included the following.

- Is it possible that the property tax on a property could double in one year? Ms. Suazo-Giles said that the annual three percent valuation limitation increase on most residential property means that once a property sells and the valuation limitation is removed for that property tax year, the taxes owed for that property could significantly increase. Damian Lara, Bernalillo County deputy assessor, said that the three percent valuation cap is authorized in the Constitution of New Mexico, but it is codified in statute based on ownership and eight other delimited exceptions. Most counties are now valued at close to the statutory mandate of "current and correct", due to the recent real estate bubble collapse and slow recovery. As property values increase, however, counties will start seeing larger discrepancies among property values due to the valuation limitation provisions.
- Why are mill levy rates so different between residential property and nonresidential property? Ms. Suazo-Giles said that the yield control formula is calculated separately for those classifications. Over time, residential property values have increased faster than nonresidential property, which has had a downward pressure on residential property tax rates.
- One big problem is that vacant lots that long-time residents own often are taxed at higher rates than the adjoining property on which they live. This problem is especially acute in Santa Fe and Taos counties, where poor neighborhoods are in the same vicinity as super-rich neighborhoods. Gary Perez, Santa Fe County chief deputy assessor, said that there is no valuation cap for vacant lots. Santa Fe County uses

comparable sales ratios, but it does not use high-priced neighborhood valuations to establish property values for poorer neighborhoods. He also commented that nonresidential property sales are not subject to disclosure to the county assessor, which makes it very difficult to assess those properties. He said that the only way for the state to eliminate the property tax "lightning" problem is to repeal the three percent valuation limitation, and now is the best time to do it. Property valuations are very close to current and correct across the state, which will tend to limit sudden tax increases.

- When the legislature enacted the three percent valuation limitation, county assessors thought it was a great idea. But it is very unfair to new homeowners.
- County assessors often get elected to office by promising to lower property taxes, something they have authority to do. The legislature should consider abolishing the elected office of county assessor and make it an appointed position to take some of the politics out of this very important professional position.
- The property tax lightning issue has been brutal in Santa Fe and Taos counties. In some cases, there have been valuation disparities of more than five to one for similar neighboring properties.
- If bond rating agencies downgrade New Mexico's status, how will that affect property tax rates? Ms. Suazo-Giles said that only future bond issuances would be affected, but taxpayers would have to either pay a higher rate or the amount authorized would be reduced.
- One possible solution to the property tax lightning problem is to raise the valuation limitation from three percent to four percent.

<u>County Assessor Perspective</u>

Several members of the NMAC Assessors Affiliate discussed with the committee the role of county assessors in the property tax system. Participants included Mr. Lara, Bernalillo County Assessor Tanya Giddings, Torrance County Assessor Betty Cabber, Santa Fe County Assessor Gus Martinez, Sandoval County Chief Deputy Assessor Christie Humphrey, Grant County Assessor Raul Torrieta, Catron County Assessor Susan Griffin and Mr. Perez. Mr. Lara said that the role of county assessors is to identify, locate and value taxable property. County assessors do not have the authority to impose taxes, but their offices receive the bulk of the complaints about property tax bills. County assessors track values for residential and nonresidential property; maintain county parcel maps reflecting ownership; determine and maintain current and correct values of property; administer property tax exemptions, valuation limitations and special methods of valuation; and notify property owners of their assessed value. Property owners have the right to protest their valuations through the county assessor's office. The TRD certifies to each county the assessed values for the special types of property the department is responsible for assessing. The county then sends total certified values to the DFA, which uses those values to set mill levy rates.

Ms. Humphrey said that requiring disclosure of nonresidential property sales would aid county assessors in determining those property values. Mr. Lara said that special districts in a county sometimes have the authority to impose a rate of up to 30 mills, which is in addition to the 20 mill authority granted in the Constitution of New Mexico.

Questions and comments from committee members included the following.

- Who monitors payments in lieu of taxes (PILTs) for industrial revenue bonds (IRBs)? Mr. Lara said that the governing body that issues the IRB monitors those payments. Ms. Cabber said that in Torrance County, the county gets a check once per year from companies benefiting from an IRB; the check is divided between the county and school districts. Typically, the county receives 60 percent of the PILT, and the school districts in the county negotiate with each other about how to divide the remaining 40 percent.

Overview of IRBs in New Mexico

Deirdre M. Firth, deputy director, Economic Development Department, City of Albuquerque, discussed with the committee the process that Albuquerque uses to consider and issue IRBs for companies. IRBs are a tool to encourage business expansions and relocations. They help the state to be competitive for capital-intensive projects by reducing the cost of locating in the state through various tax abatements. IRBs are commonly mistaken as some sort of loan, loan guarantee or credit enhancement given by a local government for a company seeking to locate in a community. IRBs are actually an authorization by a local government for a company to borrow money from a private loan source, and the money from that loan flows through the local government as owner of the property being developed. The property is owned by the local government for up to 30 years, after which it can be transferred to the company for a nominal amount. This arrangement exempts the new property from being subject to property tax for the term of the bond. The local government does not pledge any of its revenues to pay off the bonds; it merely acts as the fiscal agent and temporary owner of the property. Since the local government is the owner of the property, tangible personal property for use in the property can be deducted from gross receipts or exempted from the compensating tax. However, the construction of any real property for the project is still subject to GRT taxation. The company that borrowed the money for the project is responsible for paying off the loan. The local government has no responsibility for the loan, and if a company defaults, there is no negative consequence for the community, except for the loss of the business there.

Local governments can also issue IRBs for tax-exempt nonprofit entities. These entities are typically already exempt from paying property tax, GRT and compensating tax, but they use the IRB process to allow them to access financing for their projects, according to federal law.

Albuquerque has an extensive application and review process before an IRB is issued. Staff scores each application based on more than 40 criteria, and if an application has merit, the proposal has a fiscal impact analysis prepared by the University of New Mexico Bureau of Business and Economic Research. Projects that do not have a net positive fiscal impact are not submitted to the city council for approval. Before any approval, a series of at least three public hearings is held. Typical fees include an application fee of $2,500, a fiscal impact analysis fee of about $2,000 and the substantial costs incurred by the city's legal counsel and staff. The total cost for the issuance of an IRB is between $35,000 and $70,000. For this reason, IRBs in Albuquerque are not recommended for projects costing under $2 million. The city also requires that the company make PILT payments to the city to offset some of the city, county and school district revenue that would otherwise be collected as property tax revenue. All IRB contracts also provide clawback provisions if the company does not fulfill its employment or investment obligations.

Questions and comments from committee members included the following.

- Albuquerque seems to do a good job of reviewing applications for IRBs, but many small local governments do not have the ability to perform that kind of review. Smaller school districts end up relying on PILTs for operating revenue, but when the IRB ends, the school district may get into fiscal trouble.
- How is it possible that a county can issue an IRB for a retail store? Ms. Firth said that the legislature amended the statutes to allow counties to issue IRBs for a retail store, but it did not make that change for municipalities. The assumption was that this would allow for the location of retail stores in rural areas that do not have access to retail shopping sites.

Whiteboard Session — Property Tax

Representative Harper led a discussion with the committee and audience members about how to fix problems within the property tax system. He posited that by enacting the three percent valuation limitation, the legislature created a new problem of property tax lightning, in which adjacent, similar properties can have vastly different valuations. The cap was enacted to solve a problem that occurred in Santa Fe and Taos counties, in which residential property values were increasing very quickly and long-time homeowners were unable to pay their tax bills. The cap protected those owners from huge increases in assessments but created a new problem in urban areas. In those areas, a new homeowner would have a property assessed much higher than a neighbor in a similar house merely because the house was sold to the new owner. There were several attempts to remedy the situation, including legislation proposing to:

- remove the three percent valuation cap permanently once a property is sold;
- phase in an annual higher valuation cap to seven percent or 10 percent over three years; and
- remove the valuation cap immediately, forcing all residential property to be valued at its current and correct level.

A committee member asked whether a few counties could be exempted from legislation removing the valuation cap or if that would violate constitutional provisions requiring all property to be assessed similarly.

Mr. Lara suggested that legislation could provide a valuation cap only to long-time homeowners and remove the cap for everyone else in the state. This would protect those people, but it would not have much of an impact on the rest of the properties in a county. Now is the best time to enact property tax reform because in a few years, tax lightning will be a much bigger problem than it is now. Property valuations are starting to increase, which means that the difference between assessed values and the current and correct values will also increase.

A committee member suggested that the state enact a 15-year period in which property values are subject to a seven percent annual valuation increase cap, except for long-term owner-occupants of homes, who would be subject to the current three percent limitation. While a seven percent increase in value seems like a big increase, the yield control formula would tend to reduce actual tax rates, so people on average would not pay more property tax. A committee member said that even if this idea could work, there needs to be agreement from the governor on the proposal.

Adjournment

There being no further business, the committee adjourned at 12:58 p.m.

TENTATIVE AGENDA
for the
FOURTH MEETING
of the
REVENUE STABILIZATION AND TAX POLICY COMMITTEE

October 13-14, 2016
State Capitol, Room 322
Santa Fe

<u>Thursday, October 13</u>

10:00 a.m.	(1)	**Capital Outlay Overview and Discussion** —Stephanie Schardin Clarke, Deputy Cabinet Secretary, Department of Finance and Administration (DFA) —Rick Lopez, Division Director, Local Government Division, DFA —Linda M. Kehoe, Principal Analyst, Legislative Finance Committee —William Fulginiti, Executive Director, New Mexico Municipal League —Steve Kopelman, Executive Director, New Mexico Association of Counties
12:00 noon		**Lunch**
1:00 p.m.	(2)	**Job Trends and Status of the Unemployment Compensation Fund** —Celina C. Bussey, Cabinet Secretary, Workforce Solutions Department
2:15 p.m.	(3)	**New Mexico's Economic Base — A Study Performed by the Office of Policy Analysis at Arrowhead Center** —Jim Peach, Ph.D., Regents Professor, Department of Economics, Applied Statistics and International Business, New Mexico State University (NMSU)
3:30 p.m.	(4)	**Proposal to Tax All Contractors Equally That Operate National Laboratories** —Andrea Romero, Executive Director, Regional Coalition of LANL Communities
4:00 p.m.	(5)	**Status Update of the Committee: Gross Receipts Tax and Property Tax** —Representative Jason C. Harper, Chair, Revenue Stabilization and Tax Policy Committee
5:00 p.m.		**Recess**

Friday, October 14

9:00 a.m.	(6)	**Discussing the Cost and Benefits of a Next Generation Energy Company** —Sayuri Yamada, Director of New Mexico Governmental Affairs, Public Service Company of New Mexico (PNM) —Matthew Jaramillo, Federal and State Government Affairs, PNM
9:45 a.m.	(7)	**Annual Report — Laboratory Partnership with Small Business Tax Credit** —Mariann Johnston, Communications Director, Richard P. Feynman Center for Innovation, Los Alamos National Laboratory —Genaro Montoya, Program Leader, New Mexico Small Business Assistance Program, Sandia National Laboratories
10:30 a.m.	(8)	**Annual Report — Locomotive Fuel Gross Receipts and Compensating Tax Deductions** —Hector Dorbecker, Senior Economist, Taxation and Revenue Department —Ndem Tazifor, Economist, Economic Development Department
11:00 a.m.	(9)	**Economic Benefits of the Gross Receipts Tax Deduction for Nonathletic Special Events** —Scott Breckner, Director, Special Events, NMSU
11:30 a.m.	(10)	**Economic Benefits of the Renewable Energy Production Tax Credit and Cost-Saving Opportunities from Reforming the Credit** —Ward Marshall, Director of Business Development, Pattern Energy Group LP —Jim Shandalov, Executive Director, NextEra Energy Resources, LLC
12:00 noon		**Adjourn**

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

October 13-14, 2016
Room 322, State Capitol
Santa Fe

The fourth meeting of the Revenue Stabilization and Tax Policy Committee was called to order by Representative Jason C. Harper, chair, on October 13, 2016 at 10:05 a.m. in Room 322 of the State Capitol.

Present	**Absent**
Rep. Jason C. Harper, Chair	Rep. David M. Gallegos
Sen. Carlos R. Cisneros, Vice Chair	Rep. Tim D. Lewis
Sen. Ted Barela (10/13)	Sen. Mark Moores
Sen. Lee S. Cotter	Sen. William E. Sharer
Rep. Antonio Maestas	Sen. John Arthur Smith
Rep. Rod Montoya	
Sen. George K. Munoz (10/13)	
Rep. Debbie A. Rodella	
Sen. Clemente Sanchez	
Rep. James R.J. Strickler	
Rep. Carl Trujillo	
Rep. Jim R. Trujillo	
Sen. Peter Wirth (10/13)	

Designees

Rep. Randal S. Crowder	Rep. David E. Adkins
Rep. Bill McCamley	Sen. William F. Burt
Sen. Nancy Rodriguez	Sen. Jacob R. Candelaria
Sen. James P. White	Rep. Sharon Clahchischilliage
Sen. Pat Woods	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

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

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

Guests
The guest list is in the meeting file.

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

Thursday, October 13

Approval of Minutes
On a motion made and seconded, the minutes from the September meeting were adopted without objection.

Capital Outlay Overview and Discussion
Stephanie Schardin Clarke, deputy cabinet secretary, Department of Finance and Administration (DFA), Rick Lopez, division director, Local Government Division (LGD), DFA, Linda M. Kehoe, principal analyst, Legislative Finance Committee (LFC), William Fulginiti, executive director, New Mexico Municipal League (NMML), and Steve Kopelman, executive director, New Mexico Association of Counties (NMAC), gave a joint presentation on the state's capital outlay system and on efforts to reform it.

Ms. Kehoe introduced the panel and gave background for the presentation. A group of system administrators has been meeting regularly to discuss problems with, and recommend improvements to, the capital outlay system. The group has concluded that, considering the large amount of unspent, earmarked capital outlay money, the system falls short of its potential to improve health, safety and economic development. Some of the group's recommendations have been implemented. As part of its efforts, the group has conducted surveys of city and county officials. Cognizant of the widespread resistance to legislative reform of the system and the need to preserve the legislature's power of appropriation, the group has explored administrative changes to streamline and improve the system.

The capital outlay system; issues. Mr. Lopez summarized the capital outlay system and described some of its salient issues. The system is intended to: improve health, safety and quality of life; create and retain jobs; and provide other critical government services. It is estimated that $2.6 billion will be spent in the next five years on state and local capital outlay projects, but flaws in the system compromise the state's ability to achieve the highest possible return on that investment. Too often, funding is directed at low-priority projects that are insufficiently funded and unready to begin. As a result, hundreds of millions of dollars in bond proceeds earmarked for projects sit idle.

The capital outlay funding process is convoluted. It involves many steps related to planning, requesting, vetting, authorizing, procuring, reimbursing and fiscal exchange.

Several of the entities that play a role in administering the capital outlay system operate within the DFA. Generally, the department's role in this context is to promote accountability in the system's use of public money by ensuring compliance with applicable state and federal laws and policies. Often, issues in project funding arise while the DFA is performing its role in the project funding process. Frequently, issues are attributable to breakdowns in communication between a local administrator and a state agency. Those wishing to resolve such an issue are encouraged to contact Mr. Lopez or Ms. Schardin Clarke.

Municipal perspective. Mr. Fulginiti reported the results of a survey of municipal representatives and articulated the NMML's perspectives on the capital outlay system. The system is cumbersome. Local representatives frequently have to submit the same information on different forms to more than one agency. This duplication could be cured by instituting a universal form. Meanwhile, the four-year time frame in which project money must be spent is too restrictive: instead of the period beginning when the authorization bill is signed, it should begin when the state approves the grant for a project. There is also a need for providing written guidelines or a checklist for completing necessary documentation to local officials. The turnover in local offices often compounds the problems stemming from these flaws in the system.

County perspective. Mr. Kopelman reported the results of the survey that the NMAC conducted of its members and on the NMAC's perspectives on the capital outlay system. The survey results were virtually identical to those of the NMML's survey. In sum, the system: 1) is cumbersome — time-consuming and difficult — particularly for small counties; 2) allows for partial funding of projects for which full funding is unavailable or too difficult to secure; 3) allows for nonprofit or quasi-governmental agencies to propose, and get legislative authorization for, projects that require local government participation but that local governments do not agree beforehand to take on; and 4) demands much in these cases from the local governments, which often lack the resources and expertise to fulfill their responsibilities in this context.

Communication and cooperation among those who otherwise operate independently of one another could mitigate some of the system's problems, including many that could be solved without legislative action. Many problems could be further tempered by: 1) instituting a uniform, comprehensive, project database for agency use; 2) prioritizing projects with the highest needs; 3) requiring local government preapproval of a project proposed by an external entity and involving that government; 4) taking into account project time lines in developing grant agreements; 5) educating legislators annually on the process; 6) encouraging legislators from the same regions to collaborate with their local officials to address capital outlay concerns and needs; and 7) involving councils of governments (COGs) more in the process.

State agency perspective. Ms. Schardin Clarke spoke about problems with, and suggested improvements to, the capital outlay system. She also spoke about recent administrative changes and steps legislators can take to improve the system.

The system could be improved by reducing the proliferation of authorized projects. The multitude of projects dilutes spending efficiency since each project, regardless of its size, carries fixed costs. Graphs on page 18 of the presentation handout illustrate the dilution: the 2016 median project cost is $85,000, and of the 680 projects outstanding in that period, 427 cost less than $100,000.

Potential improvements to the system include: 1) prioritizing critical infrastructure over nonessential projects; 2) coordinating project funding streams; 3) streamlining and standardizing forms; 4) limiting projects for nonprofit organizations, which heavily consume legal resources and for which the cost of bonds rises by one-third; and 5) ensuring that projects are ready to begin when they are authorized.

Steps that have been taken to improve the system include the following: 1) the State Board of Finance (SBOF) has moved to a web-based, streamlined questionnaire to aid local government grantees and state reviewers; 2) the governor issued Executive Order 2013-006, which improved compliance with the Audit Act; 3) the SBOF began publishing on its website a list of authorized, but unissued, projects; 4) agreements for projects with potential anti-donation issues are formed only after those issues are resolved; 5) the deadline for completed bond questionnaires has been moved to before the governor's bill-signing deadline; 6) the LGD managed to generate 2016 grant agreements more quickly than in the past; and 7) the DFA plans to survey grantor agencies on their practices, identify those that are most effective and prescribe a best-practice standard.

Steps that can be taken to potentially improve the system include the following: 1) creating a capital outlay planning council to increase prioritization and reduce proliferation and piecemeal funding; 2) as individual legislators, considering the priorities identified in local infrastructure capital improvement plans (ICIPs); 3) as legislators from a region, collaborating to fully fund large, region-wide, critical projects; 4) ensuring that a funded asset's useful life exceeds the average maturity period of the state's long-term bonds; 5) establishing a minimum project size of $50,000 for all but the most critical projects; 6) avoiding funding privately operated projects unless necessary; 7) instituting unwavering time-related requirements; 8) limiting the number of outstanding projects associated with a given local entity; 9) except for critical projects, requiring matching funding from local governments; and 10) requesting that the LCS work with the DFA on project data sharing. Concerning the last step, which seems like low-hanging fruit, the DFA has consulted with the LCS, which in turn is seeking related guidance from legislative leaders.

Ms. Kehoe added that the proposed collaborative database would not reveal sponsor names, but would help expedite the process, prevent capital outlay money from sitting idle and prevent project de-authorizations. She enumerated the criteria applied in recently identifying projects to de-authorize for budget solvency and closed by underscoring the value of educating legislators and others on the capital outlay system.

Questions and Discussion

Term definition. Ms. Kehoe clarified that, as used in the presentation: "critical" refers to projects that, for example, treat wastewater; bring buildings into compliance with federal disability law; repair cracked sidewalks, leaky roofs or roads; relate to health and safety concerns; or prevent tunnels from collapse; and "nonessential" projects satisfy wants, not needs. Ms. Schardin Clarke clarified that the need to ensure that projects are "ready when authorized" refers to the bond-sale prerequisite that a project be certified in writing as ready to begin within a certain time frame and be one for which 85% of its cost can be spent within three years. She said that delays often arise despite such certification.

Project eligibility; Anti-Donation Clause; nonprofit entities; local government fiscal agents. Members expressed their concerns about the limitation on funding for projects that benefit nonprofit entities: 1) each administration, it seems, interprets the Constitution of New Mexico's Anti-Donation Clause differently and for its political advantage; but the capital outlay system should not be politicized — rather, it should impartially meet legitimate infrastructure needs; 2) often, local governments do not wish to act as fiscal agents for nonprofit entity-sponsored projects; in those cases, perhaps a central agency like the LGD could perform that function; 3) in some cases, nonprofit entities that perform functions otherwise assumed by the government or that the government is unwilling to assume ought to benefit more equally from the system; and 4) COGs can be helpful in acting as fiscal agents for certain projects. Lastly, a member asked whether any local government is charging a fee for acting as a fiscal agent.

The presenters responded as follows. Ms. Kehoe said that: 1) the Public School Facilities Authority and the Facilities Management Division of the General Services Department charge fees for acting as fiscal agents; 2) previously, some local governments charged administrative fees to nonprofit entity recipients, but the practice ceased because of concerns about fee ranges and accountability and because those governments often indirectly benefit from the project grants; 3) previously, nonprofit entities received more capital outlay benefits because more General Fund money, which is not subject to bond-sale tax laws, was available for capital expenditures and because some of that nonprofit entity work fell within Anti-Donation Clause exceptions; and 4) recently, some nonprofit entities benefiting from project grants received a letter from the SBOF notifying them that they were out of compliance with grant agreements; many of those entities can reach compliance by reporting statistics on their services. Ms.

Schardin Clarke said that capital outlay improvements to buildings occupied by nonprofit entities are allowed if the buildings are publicly owned and if the owners lease them at fair-market value. Mr. Lopez said that: 1) under Executive Order 2013-006, grantees out of compliance with the Audit Act must have a local government act as the fiscal agent for a project; 2) the DFA has worked with COGs in their role as fiscal agents; and 3) those relationships are improving, but they have room to grow.

Project size; system efficiency; acequia projects. Responding to the suggestion that funding be concentrated in larger-scale projects and projects identified as priorities in ICIPs, members commented that: 1) recent low-capacity trends, combined with the valid policy of equalizing the division of funding among legislators, lead to the proliferation of small-scale projects; 2) legislators not knowing ICIP-listed priorities and the general lack of communication among the entities with a role in the process also influence project selection; 3) the situation can at times be averted when lobbyists for local governments coordinate project selection with legislators; 4) many worthwhile projects can be funded for less than $50,000; 5) not all worthwhile projects are listed as priorities in ICIPs; and 6) it is better to fully fund a small project than to insufficiently fund a large project.

Members criticized the system for presenting difficulty in securing funding for acequias, a difficulty made worse by the governor's having vetoed all acequia projects in the most recent capital outlay authorization bill. A member characterized the vetoes as politically motivated and retaliatory and contended that the action mostly hurt the people who would have benefited from the projects, not legislators. Another member pointed out that the prerequisite for an engineering study, which acequias often cannot afford, is an impediment to their getting project funding and that the planning grants available to pay for such a study are sometimes unavailing.

In response, Ms. Kehoe reported that: 1) the governor categorically vetoed all projects under a certain amount, which included every acequia project; 2) ICIP-listed projects are reported at LFC hearings each December; 3) the DFA puts instructions on accessing those lists in legislators' mailboxes on the first day of session; 4) she maintains copies of ICIP descriptions; 5) one reason legislators generally do not select ICIP priority projects is that their individual allotments usually fall short of those projects' costs; 6) in the 1970s, the only local projects funded were critical projects; and 7) local projects reduce the resources available for state projects, which serve more people.

Recent project de-authorizations. A member requested a list of projects de-authorized during the special session and the corresponding reasons for their de-authorization. Mr. Lopez stressed the importance of working collaboratively to avoid such "sweeps", and he said that the governor, when considering vetoes, often considers whether a given project is listed in an ICIP. He remarked that long-term, critical, infrastructure-oriented projects should be favored and said that staff strictly follows the rule-based guidelines for funding. Ms. Kehoe stated that projects in the de-authorization bill are being reviewed for readiness to proceed. Projects not ready to proceed would call for a line-item veto.

Proposed project-vetting body. Responding to the idea of creating a statewide capital outlay committee or board, members commented that such a body would probably: 1) favor funding for Albuquerque and Santa Fe projects; 2) be a costly, extra layer of bureaucracy; 3) like the Water Trust Board and Colonias Infrastructure Board, usurp some of the legislature's appropriation power; and 4) not solve the problem of earmarked, but idle, funding. Another member added that: 1) a legislative attempt was made to add staff to facilitate the process, but that effort failed; 2) policymakers should focus not on the question of the size of government, but rather its effectiveness; and 3) the governor, it seems, is trying to shrink government.

In response, Ms. Schardin Clarke pointed out that: 1) to allay the first concern about the suggestion of creating a project-vetting body, the legislature could enact safeguards for equity; 2) the legislature could further protect funding equity by modeling the capital outlay system on the public school capital outlay system, which incorporates surveys and ranking; 3) New Mexico has a funding-scarcity problem; 4) the move to per-legislator allocations improved equity but made the system less workable; 5) the budget process is sensible because most of the work is accomplished through committees that would make recommendations to the full legislative body, which would not dilute the legislature's appropriation power; and 6) under the proposal for a project-vetting body, staff would review projects and provide relevant information to that body, which would then make recommendations to the legislature.

Information sharing for efficiency; other proposed system changes. Responding to the suggestion that agencies collaborate more to streamline the system for the sake of project applicants and grantees, members expressed support for greater agency collaboration and for the use of a standardized form.

Members articulated the following additional suggestions for improving the system: 1) produce a one-page sheet listing steps in the process for reference by applicants; 2) impose a match requirement, particularly for projects for which other funding channels are reasonably available; 3) exempt from the requirement small entities that cannot afford such funding; 4) differentiate between large and small entities in establishing funding criteria and require a greater match from large entities; 5) include in the application a prompt for applicants to list other funding sources secured, validate that information and share it with legislators; 6) require that applicants ready their proposed projects before the legislature is approached with the request to fund them; however, applicants face many up-front costs in readying projects; and 7) to avoid the problem of excessive enrichment, require local governments to disclose, and then inform the appropriate legislators of, projects pursued by the governments through the state-funded project channel.

In response, Ms. Kehoe said that a multi-agency-produced guidelines sheet, as described in the first comment above, already exists; Mr. Lopez added that it could be modified to include anti-donation rules.

Special Session LFC Summary; New LFC Economist

Summaries of legislation passed in the special session were distributed to the committee, and Representative Harper recognized the new LFC economist, Dawn Iglesias, who was in the audience.

Job Trends and Status of the Unemployment Compensation Fund

Celina C. Bussey, secretary of workforce solutions, gave an update as follows on the state's economy and its unemployment insurance system.

New Mexico's economy. Statewide, as of August: 1) the unemployment rate was 6.6%; 2) the year-over-year non-farm job growth was .2%; 3) 1,800 jobs were added; 4) also in that period, employment increased by 10,400 jobs in private service-providing industries and decreased by 8,700 jobs in goods-producing industries; 5) the job loss was concentrated in industries connected to energy extraction, and the job gain was concentrated in education, health services and the leisure and hospitality industries; and 6) on the whole, the breakdown of employment by sector has not changed much since 2011.

Unemployment insurance. Concerning the state's unemployment insurance system: 1) approximately 11,000 individuals are certifying for benefits each week; 2) about 950 claims are filed each week; 3) the weekly claims rate tends not to fluctuate; 4) the rate of exhaustion of benefits is 38.4%, the seventeenth-highest in the nation; 5) New Mexico's previous rankings among all states for that measure were even higher, but the current measure places it low in a rank among states in the region, in part due to concerted efforts of the Workforce Solutions Department (WSD) to pursue re-employment strategies; 6) the average duration of benefits is 17.3 weeks, the thirteenth-highest in the nation — a figure the WSD will soon strive to reduce; 7) over the past 12 months, $188.5 million has been paid in benefits; 8) the WSD's initiatives to improve the re-employment rate include an active engagement with, and the empowerment of, workforce centers to pursue re-employment strategies, such as one-on-one case management and improved work-search planning; and 9) these efforts are paying off.

Unemployment Trust Fund. The health of the Unemployment Trust Fund is improving, and employer rates are decreasing. The approximately $377.6 million in the fund falls slightly below the fund's ideal balance of between $400 million and $440 million, a level believed sufficient to withstand an economic downturn. If the fund is depleted, the state would have to turn to borrowing money or selling bonds to make up the difference between its payment obligations and the fund's balance.

Meanwhile, to maintain fund health, a "reserve factor" is determined and used in the calculation of unemployment insurance taxes owed by employers. If the fund balance is low, the reserve factor — and, in turn, taxes — increase. Calendar year 2017's reserve factor, which will be reported in notices to employers, is 2.5264, a decrease from the 4.0 reserve factor used to calculate rates in calendar years 2015 and 2016, the period during which the fund hit an all-time low of $20 million. Constituents of legislators who receive the notices and have questions about them are encouraged to contact the WSD.

Questions and Discussion

Employment data. Secretary Bussey commented that: 1) unemployment reports distinguish farm employment from non-farm employment to present information not influenced by seasonal trends; 2) in general, agriculture-related employment in New Mexico is strong; 3) the agricultural industry has, in the past 10 years, experienced changes caused by automation; and 4) variable weather patterns have also affected the industry. Secretary Bussey agreed to provide the number of unemployed people represented by the state's 6.6% unemployment rate.

Benefit determination. Secretary Bussey clarified that: 1) in a given case, a computation based on work history determines a claimant's allowable duration of benefits; 2) the rate-of-exhaustion figure indicates that 38.4% of claimants collect unemployment benefits for their individual maximum duration; 3) an applicant is ineligible for benefits if the applicant drove the separation from employment; and 4) when an employee is laid off from one position but offered a different position, the determination of whether that employee is eligible for benefits hinges on factors that include the degree of change in location, work conditions and work shift of the new job. Secretary Bussey agreed to provide the number of applicants deemed ineligible for benefits.

Employer rates; practices affecting experience in the program. Secretary Bussey clarified that: 1) the reserve factor is calculated based on many factors; 2) the rate cap results in a system in which some employers subsidize others; 3) most employers are not subsidized; 4) subsidized employers are not concentrated in any particular industry classification, business size or location; 5) federal law requires that the system, which is an insurance program, provide for subsidization; 6) the cap was raised in 2013 for "high-risk" employers; 7) the legislature can further raise the cap; and 8) a relatively small number of employers pay an excess claims premium.

Secretary Bussey went on to explain that: 1) to avoid classification as "high-risk", an employer should be selective in hiring and proactive in responding to employee misbehavior; 2) the WSD considers potential liability of all of an applicant's employers during the previous 18 months; 3) the determination of liability is based on whether the reason for separation was voluntary or for cause; 4) to help avoid a determination of liability, an employer should always respond completely and timely to related, department-initiated inquiries, which solicit the reason for separation and evidence of that reason; 5) in making the determination of liability, the WSD impartially rules on the two parties' testimony and evidence; 6) each party has a right of appeal within the WSD and to the courts; 7) those appeals, while potentially cumbersome, afford due-process protections; and 8) an employer receives an inquiry-based notice only if its former employee applies for benefits. Responding to a member's suggestion that, to accommodate their needs, employers submit quarterly reports to the department, Secretary Bussey said that she would consider ways to improve the collection of related information from employers, but she also noted that the cost to the department of handling that volume of paperwork, considering the relatively small number of applicants, would probably outweigh the benefit of the approach.

Chronic unemployment. Responding to a member's question about whether the unemployment insurance system promotes unemployment, Secretary Bussey remarked on the importance of keeping people employed for as long as possible, saying that long-term unemployment can be devastating. She expressed the desire to institute policies that promote the value of work, in cooperation with other benefits-providing agencies.

New Mexico's Economic Base — A Study Performed by the Office of Policy Analysis at Arrowhead Center

Jim Peach, Ph.D., regents professor, Department of Economics, Applied Statistics and International Business, New Mexico State University (NMSU), read from a prepared statement reflecting his personal perspectives. The statement was distributed to the committee and is summarized as follows.

New Mexico's under-performing economy. Compared with other states, New Mexico's economy has performed poorly for long-term, structural reasons unrelated to the downturn in oil and gas prices. In the period starting in December 2007, the beginning of the national recession, to August 2016, New Mexico ranked forty-ninth among states for positive change in non-farm employment. In the period from June 2009, when national recovery from the recession began, to August 2016, it ranked forty-eighth among states in that measure. During the first period, the state lost 21,600 jobs. It is unlikely that the state will have made up that loss by the point marking a decade after the recession began.

That outcome, however, is not inevitable. If the state's job-growth rate since the beginning of the national recession were 1% — a plausible and, relative to the state's own past performance, low rate — the current fiscal crisis could have been averted. Were jobs added at that rate, fiscal year (FY) 2016 and FY 2017 gross receipts tax (GRT) and personal income tax (PIT) revenues would have been substantially higher and expenditures lower.

Other economic indicators point to trouble in the state's economy. New Mexico's unemployment rate is considerably higher than that of the nation and neighboring states, and its real gross domestic product recently decreased. And for the first time in five decades, the state's population is decreasing.

Analyzing the state's current economic structure and potential economic growth. It is important, given these troubling economic trends, to analyze the state's economic structure and its industry-specific potential for growth. The legislature's interim Jobs Council has made one such attempt: the council has striven to identify economic-base industries and define the need for economic-base jobs.

One way of conducting such an analysis is through an economic-base study. NMSU's Arrowhead Center has, for several years, conducted such studies for the state and subdivisions of the state. In general, an economic-base study can be used as a tool to guide local economic development activities, direct officials in their efforts to attract firms to a local area and improve local businesses' understanding of their local and export product markets.

Economic-base studies rely on the theory that a local economy has "basic" and "non-basic" industries, i.e., those that bring jobs and income into the local economy and those that do not, and that basic industries promote economic growth. Commonly, a local economy's basic activity is identified by determining its location quotient, or the proportion of a given industry's local employment to that industry's employment in the state or nation. The location quotient tells the relative importance of that industry, in a measure of employment, to the local economy. Economic-base studies often go on to identify an export-base employment multiplier. That figure is calculated by dividing the total employment of a given location to the location's total, basic-industry employment.

NMSU's most recent economic-base study for New Mexico shows that in 2014, the state's basic industries, or those whose location quotient exceeded 1.0 were: 1) mining; 2) utilities; 3) agriculture and related industries — forestry, fishing and related activities; 4) accommodation and food services; 5) federal government, including military and civilian jobs; and 6) state government. For several reasons, it is important that when using the results of such a study to guide policymaking, one should consider factors that undermine the results' integrity.

Often, policymakers — including, recently, those in New Mexico — use the results of economic-base studies to target industry clusters in economic development plans. But the state's most recent strategic plan, developed by the Economic Development Department (EDD), does not. Rather, it focuses on supporting businesses and creating a favorable business climate. Regardless of a state's economic development strategy, economic-base studies and other economic analyses can aid policymakers in their efforts to improve the economy.

Looking forward. Restoring New Mexico's economy would require a substantial amount of work and investment and changes to law. If that work is not undertaken and those investments and changes are not made, the state's economic troubles will worsen.

<u>Questions and Discussion</u>

Future economic outlook; steps toward improvement. Responding to a member's question about the state's economic future — specifically, its ability to function and to promote the economy — considering the conditions that forced a special session and the measures taken during that session to shore up revenue for solvency, Dr. Peach remarked that: 1) it appears that FY 2018 revenue will be flat; 2) a rise in oil and gas prices, which is possible, would boost those revenues; 3) the continued in-state production of oil and gas is probable, given the advances in related technology and investments already made; 4) factors such as international events affecting oil markets, possible cutbacks in global production and the exhaustion of stored oil will influence oil prices; 5) it appears that further drops in GRT revenue levels are improbable; 6) the state's long-term dependence on the volatile stream of revenue from oil and gas production is deleterious; 7) copper and coal mining activity is not likely to resume to prior levels, but uranium mining might; 8) long-term, structural problems afflict the national economy, too; and 9) to alleviate some of its current fiscal problems, the state should address its basic tax structure and, when oil and gas prices are high, make investments in infrastructure and education. When asked by a member what New Mexico would look like if it had taken those steps beginning in 1980, Dr. Peach responded that without the Richardson-era tax cuts and changes to the GRT, the state would have a steadier revenue stream.

Taxation and investments. Dr. Peach noted that relatively high taxes and burdensome regulation have not driven energy producers from the state, and he noted that California, an example of a non-low-tax state, has had robust non-farm employment largely because of its strong labor force. He further recommended that New Mexico: 1) reduce its reliance on the oil and gas industry for General Fund revenue; 2) prepare its youth for the labor force; and 3) strive to make its K-12 education and workforce training programs as good as or better than those of surrounding states.

Energy sector slump; population loss. Responding to a member's statements that high energy taxes and a restrictive regulatory regime have exacerbated the dramatic job loss and economic collapse in energy-sector-dependent San Juan County, Dr. Peach noted that cause for optimism lies in the fact that the county's workforce is highly skilled and that, though the county is experiencing an out-migration, many who leave will return after oil and gas prices rebound. He said also that: 1) the recent statewide population loss is due in part to the state of the economy and to the death rate outpacing the birth rate; 2) to attract those who have left, the state should repair its economy; and 3) it is not necessarily regrettable when a New Mexican leaves the state to fill an esteemed professional role.

Public and private sector cooperation. Dr. Peach disputed the notion that the private sector necessarily performs more efficiently than the public sector and pointed out that some of the greatest historical accomplishments, such as the construction of canals and railroads and many technological innovations, were either borne of public-private partnerships or were publicly funded.

Proposal to Tax All Contractors Equally That Operate National Laboratories

Andrea Romero, executive director, Regional Coalition of LANL Communities, described her organization and argued for the elimination of a GRT exemption as follows.

The Regional Coalition of LANL Communities. The Regional Coalition of LANL Communities consists of nine entities, including cities, towns, counties and pueblos, that surround Los Alamos National Laboratory (LANL). The coalition is a nonpartisan organization founded in 2011 to advocate for its members' interests in the context of national decisions relating to LANL. Specifically, the coalition focuses on the topics of regional economic development and site employment, environmental remediation and adequate funding for LANL.

Requested changes to law. The coalition asks the legislature to consider eliminating the GRT exemption for nonprofit entities insofar as it applies to contractors that manage and operate the national laboratories. As shown in tables in the presentation handout, the state has collected from those contractors many millions of dollars in GRT revenue in at least the past 10 years. Recently, that amount, combined with the amount collected by laboratory-area local governments, has approximated $200 million each year.

With the upcoming selection of a new contractor to manage and operate the laboratories, the coalition is concerned about the prospect that the selected contractor will qualify as a nonprofit entity under current law and, thus, have no GRT obligation on the sales of its services to the United States. Were that the case, the communities surrounding LANL and Sandia National Laboratories (SNL) would, along with the state, suffer a loss of revenue otherwise used to improve infrastructure and provide services that benefit the laboratories.

Page two of the handout lists several options for amending the existing law to ensure that in both the near and long term, regardless of whether the contractor selected to manage and operate the laboratories is a for-profit or nonprofit entity, the revenues from those laboratories' activities that the state and certain local governments have come to depend on will continue without interruption.

Questions and Discussion

Prospect of a contract award to a nonprofit organization. Ms. Romero testified that: 1) the National Security Agency (NSA) has assured the coalition that the state's law, even as that law might be changed, will be complied with; and 2) the coalition has been tracking acquisitions in other states and noticing the growing trend, which fuels the coalition's concern in this context, of contract awards to nonprofit entities. Ms. Romero summarized certain trends observed in the NSA's recent contracting practices in other states.

Prospect of amending the GRT exemption for nonprofit entities. Ms. Romero indicated that the coalition is currently exploring different options for potential statutory change.

A member expressed concern about making such a narrow exception to the GRT exemption at issue. Janet Peacock, a legislative contractor who was in the audience, amplified the member's concern. She cautioned that singling out national laboratories in this way might invite a federal challenge to the law and pointed out that other institutions — such as nonprofit hospitals — for which the exemption would presumably continue, also resemble for-profit businesses. Several members expressed worry about a potential action in this context resulting in the loss of the national laboratories in the state.

Representative Harper raised the possibility that under tax reform measures the committee is considering, the GRT exemption for nonprofit organizations be eliminated altogether or be changed to incorporate income-based, graduated tiers of exemption.

Status Update of the Committee: GRT and Property Tax

Representative Harper outlined his ideas for enacting GRT- and property-tax-reforming measures, details of which are in a handout distributed to the committee, as follows.

Under the proposed plan, the law would: 1) be enacted in 2017; 2) take effect on January 1, 2018; 3) temporarily bar local governments from adjusting their sales tax rates; 4) for its first year in effect: set new state, municipal and county sales tax rates (to be determined using estimated data) with a revenue-neutral result; expand the sales tax base; require that any revenue in excess of a revenue-neutral baseline amount be deposited into a tax stabilization fund; and require that money in that fund be distributed to certain local governments with low revenue levels; 5) for its second year in effect, provide for sales tax rate adjustments to more precisely generate revenue at target levels; and 6) for its third year in effect, transfer excess revenues from the tax stabilization fund and remove the temporary moratorium on local government adjustments to sales tax rates.

<u>Questions and Discussion</u>

Proposed plan. Representative Harper clarified that under the proposed plan: 1) the rate would be determined using information stored in a database, which was presented at the last meeting, and be based on a very broad base; 2) the LFC, Taxation and Revenue Department (TRD) and DFA will help develop the rate-setting methodology; 3) local governments' hold harmless enacted tax increments would not factor into the rate-setting calculation; 4) the new, re-branded sales tax would be imposed on sellers, include services in its base and include a use tax component; 5) local governments would be allowed to spend revenue from the tax as they wish; 6) the first year's revenue-neutral baseline amount would be based on the highest of the past three years' GRT revenue levels; 7) the goals of the reform are to normalize and simplify the sales tax and to encourage business development and fairness; and 8) the repeals of selected exemptions, deductions and credits would take effect at the beginning of tax years. Representative Harper indicated that he is talking with the governor's staff about the proposal but has not yet received executive endorsement of it.

Members commented on: 1) the value of some exemptions, deductions and credits in making the state more competitive in attracting outside capital and businesses to the state; and 2) the probability that, once the plan is fully implemented and the sales tax "reset", lobbyists would begin appealing for new tax incentives.

Recess

The committee recessed at 4:45 p.m.

<u>Friday, October 14</u>

The committee reconvened at 9:15 a.m. on Friday, October 14, with Representative Harper chairing the meeting.

The Cost and Benefits of a Next Generation Energy Company

Sayuri Yamada, director of New Mexico governmental affairs, Public Service Company of New Mexico (PNM), and Matthew Jaramillo, federal and state government affairs, PNM, discussed as follows PNM and some of its contributions to the state, some consumer protection-related concerns of PNM and a recent regulatory rate case to which PNM was a party.

Overview of PNM; contributions to the state. For about 100 years, PNM has provided electricity in New Mexico; it is one of the state's top state and local taxpayers. It has spent millions of dollars in investments in, and has charitably served, the state. Those activities have benefited small businesses, the solar power industry, local communities, nonprofit entities and low-income families. Each year, PNM sponsors a volunteer fair in which its employees offer different types of assistance to low-income residents.

PNM works toward the goals of transmitting power more reliably, improving meter technology and increasing its investments. The company was instrumental in attracting Facebook to New Mexico and in enacting a special economic development rate for electric service. It is working on replacing its meters with "smart" meters, which feature advanced capabilities.

Another of PNM's goals is to provide more clean energy. PNM has invested in more than one million solar panels, has 15 solar sites across the state and is working with partners to improve battery storage to make solar power generation more advantageous. More than 7,400 customers that use private solar systems are part of the PNM system, and it is projected that 2016 will mark a dramatic spike in the amount of solar power generated in the state. Federal and state tax subsidies drove much of that recent increase.

Consumer protection concerns. Although PNM is generally supportive of the trend toward clean energy power generation, the company is concerned about some of the practices engaged in by out-of-state companies exploiting the trend and tainting the reputation of the utility industry. Some of these companies are misleading people, many of whom are on low or fixed incomes, in the companies' efforts to finance, lease or sell private solar energy systems. Specifically, company representatives show prospective customers electric utility bills along with quotes for solar power that falsely depict the differences in the costs of each type of power. In truth, when considering all of the costs of each choice, the difference between them is only marginally significant. To respond to this deceptive practice, PNM has been working with other stakeholders to develop and promote a legislative initiative to require certain disclosures, impose a grace period during which such contracts could be rescinded and implement other consumer protection measures.

Another consumer-related issue resides in the sale or lease of solar panels to homeowners who later wish to sell their solar-panel-enhanced homes. Often, the contractual obligations that homeowners assume in these transactions put undesirable encumbrances on the homes or reduce the homes' marketability. In this context, too, PNM would like there to be requirements that help inform potential solar energy system buyers.

A third issue associated with the increased prevalence of solar energy system sales relates to hazardous meter installation practices potentially causing explosions, damage to humans or damage to property. PNM wishes to promote legislation to standardize the interconnection process and otherwise promote safety in this context.

Regulatory rate review final order. PNM is displeased with the result of a recent rate case, whose final order the Public Regulation Commission (PRC) issued on September 28. The order will decrease the amount of PNM investments that PNM may recover through customer assessments. Tables on page three of the presentation handout enumerate the costs of key investments and the recoverable portions of those investments. The order will potentially discourage PNM from making new investments, which help promote economic development.

Questions and Discussion

On questioning, Carlos Lucero, government affairs manager, PNM, and Anthony Bueno, senior technical account manager, PNM, who were in the audience, the presenters and the committee addressed the following topics.

Solar energy system sales and leases. Members expressed support for consumer protection in solar energy system transactions, particularly considering the current and anticipated growth in that industry. A member noted that these issues also affect real estate agents. Mr. Jaramillo stated that there is model legislation to address related issues; he also said that PNM would pursue a policy that does not impede buyers from acquiring such systems but, rather, helps them make informed decisions. Ms. Yamada added that PNM would also pursue provisions that allow the attorney general to prosecute offenders or create a civil right of action.

Hazardous meter installation practices. Mr. Bueno clarified that the illustration on page 11 of the handout shows an illegal, disconnected production meter on a functioning solar energy system. The setup creates a safety hazard and an offset on the bill, he said.

Rate case. Mr. Jaramillo cited as the PRC's reasons for denying PNM's cost recovery on its investments in balanced draft technology (pollution control equipment) that: 1) the equipment was an imprudent investment; and 2) such recovery would burden customers. He noted that PNM purchased the equipment to comply with an environmental law mandate. Ms. Yamada added that: 1) the PRC approved the federal Environmental Protection Agency's (EPA's) promulgated regulation as a way to curtail emissions from PNM's San Juan Generating Station; 2) PNM made the purchase three years before the rate case at what was believed to be fair market value; and 3) in rate cases such as this, strictures on communications between PNM and the PRC limit PNM's ability to plead its case.

Several members articulated the challenge inherent in PNM's having to comply with the EPA's regulatory mandate, on the one hand, and the limitation on recovery of costs associated with mandate compliance, on the other. They further commented that: 1) the circumstance seems unfair; 2) the widespread desire for inexpensive, reliable and low-carbon-emission electricity transmission cannot be easily satisfied when rulings like this discourage PNM investments, stymie the company's planning efforts and interfere with its ability to promote power stability and to expand quickly; and 3) that the stability and ability to expand are important for economic development.

Economic development rate. Ms. Yamada explained that the relatively newly implemented economic development utility rate provision in state law will help attract businesses to the state, thereby spreading out the fixed costs among PNM customers. The provision, she said, helped attract Facebook and entice other companies considering locating here.

PRC reorganization. Some members expressed support for the idea of reorganizing the PRC, through a constitutional amendment, from an elected to an appointed body. They remarked that: 1) in its current form, the PRC is politically influenced; and 2) it should instead make decisions based not on underlying bias but, rather, on scientific objectivity. It was recommended that such a re-formed commission include legislative appointees and treat fairly both its utilities and its consumers.

Annual Report — Laboratory Partnership with Small Business Tax Credit

Genaro Montoya, program leader, New Mexico Small Business Assistance (SBA) Program, SNL, reported as follows on the laboratory partnership with small business tax credit.

The SBA Program, funding for which is made available through GRT credits claimed by the laboratories, is a catalyst for the transfer of cutting-edge technologies developed at the laboratories to fill small businesses' needs. The credits provide up to $2.4 million per laboratory each year to support small business projects in urban and rural areas. The TRD primarily administers the program, and the EDD offers advice on improving program operations.

Each year, an outside party conducts economic impact and customer satisfaction surveys and otherwise analyzes the program. Those analyses show that in the period from the program's inception in 2000 through 2015, the program has: 1) assisted 2,495 small businesses — 65% of which are in rural New Mexico — in all 33 counties; 2) provided $48.5 million in assistance to those businesses; 3) created or retained 5,734 jobs; 4) resulted in other cost savings and increased revenues for businesses; and 5) had other positive economic effects. For 2016, it is estimated that $4.5 million to $4.8 million will be used by the program to help over 300 small businesses in 28 to 30 counties.

The 2015 annual report, copies of which were distributed to the committee, features more statistics on the program and highlights some examples of successful projects.

Mariann Johnston, communications director, Richard P. Feynman Center for Innovation, LANL, outlined the program's strategies and focus as follows. The program strives to: 1) expand the types of businesses that receive program assistance and expand to more underserved rural counties; and 2) continue to help the state grow its economy. The program's focus industries are: agriculture; oil and gas; mining; renewable energy; manufacturing; and high technology.

Ms. Johnston highlighted some of the businesses served and the technologies applied in their businesses in 2015.

Eugene C. Hudson, chief executive officer, Emerging Technology Ventures, Inc., testified on the help he received through the program to expand his unmanned vehicles business, which is headquartered in Alamogordo. The company partnered with SNL to develop smart battery management technology and a resulting product. That product assesses the health of an unmanned vehicle's battery pack before and during the vehicle's mission. The partnership has helped create high-paying full-time jobs for a relatively small investment.

Mr. Montoya and Ms. Johnston commented that the program allows for the leveraging of resources and involves the participation of several of the state's higher education institutions.

Questions and Discussion

Value of deduction. Mr. Montoya indicated that the SBA Program is not asking for any additional benefit from the state. A member noted that the committee is considering tax reform that would do away with many — but not all — GRT exemptions, deductions and credits. The member argued that, because of its effectiveness and its value in helping people and small businesses, this credit should not be among those eliminated under that reform.

Annual Report — Locomotive Fuel Gross Receipts and Compensating Tax Deductions

Demesia Padilla, secretary of taxation and revenue, noted that the report on the locomotive fuel deductions is statutorily required.

Hector Dorbecker, senior economist, TRD, and Ndem Tazifor, economist, EDD, presented the following information on the locomotive fuels deduction for FY 2016. The deduction, which can be taken against the compensating tax and the GRT, was reported by Union Pacific Railroad (UP) as providing $9.5 million in compensating tax relief and no GRT relief. BNSF Railway reported $4.6 million in GRT relief and $1.9 million in compensating tax relief. A TRD PIT analyst estimated (using a conservative 3% rate) that the construction jobs resulting from those companies' presence in the state generated $1.7 million in PIT revenue; from permanent jobs, it generated $1.2 million. That analysis is continually being refined.

Questions and Discussion

Rail fuel vending. The committee discussed the topic of where UP and BNSF buy fuel for their trains that run through the state.

Value of deduction. Some members praised the economic success experienced recently in the Santa Teresa region, stimulated in part by the enactment of the locomotive fuel deduction. Others raised the possibility that the railroads would have made the capital investments they did without the deduction. Ivan Jaime, director of public affairs, UP, commented that before UP's partnership with New Mexico, it had two tracks and no jobs in the state. Now, the railroad employs about 435 people in the state and has invested about $550 million in infrastructure, and it directs a lot of freight traffic through New Mexico. He added that many UP employees who work in New Mexico but who live in El Paso would move to New Mexico if not for housing shortages. John Thompson, lobbyist for BNSF, commented that the railroad, which buys millions of dollars of fuel from New Mexico vendors, would not be buying it without the deduction; he agreed to provide the names of those vendors.

Secretary Padilla noted that the law providing for the deduction does not require claimants to hire local contractors in building the requisite infrastructure.

Economic development promotion; project idea. A member suggested that to grow its economy, New Mexico identify and promote its advantages — such as its proximity to Mexico and its intersection between train routes — as compared with other states. The member argued for the creation, possibly using Local Economic Development Act funding, of an industrial transloading facility in Bernalillo County. Such a facility, the member suggested, could be located at the end of a one-mile spur, connect to truck-freight corridors and freight rail lines, help transport to market goods manufactured in the state and benefit the entire state.

Economic Benefits of the GRT for Nonathletic Special Events

Scott Breckner, director, special events, NMSU, reported as follows on the GRT deduction for nonathletic special events. The deduction was enacted in 2007 and was extended in 2012. It is scheduled to sunset on June 30, 2017. NMSU requests that the legislature extend the deduction through June 30, 2022. If it does not, there will be drastic reductions in NMSU's concert business; its student employment, internships and scholarships; tax revenues; New Mexicans' quality of life; and revenue for area businesses. Conversely, if the legislature does extend the deduction, its benefits, including the economic boost corresponding to ticket sales made to Texas residents, which constitute about one-third of all sales, will continue. These circumstances result from the hosting by nearby University of Texas at El Paso of comparable events whose revenues are tax exempt.

Ricardo Rel, senior director, NMSU Government Affairs, who was in the audience, testified that the deduction does not affect General Fund revenue levels but, rather, the amount of money accruing to the recipients of the governmental GRT. He added that the annual amount in tax revenue resulting from the events and their associated effects, approximately $344,000, exceeds the approximately $80,000 per year in tax that would have been paid on NMSU's nonathletic event ticket sales, had those sales occurred.

There were no questions or comments from members.

Economic Benefits of the Renewable Energy Production Tax Credit and Cost-Saving Opportunities from Reforming the Credit

Ward Marshall, director of business development, Pattern Energy Group LP, Jim Shandalov, executive director, NextEra Energy Resources, LLC, and Kari Smith, director of business development and regulatory affairs, SunPower Corporation, presented on the proposed extension of a modified renewable energy production tax credit. Each presenter read from prepared statements, which were distributed to the committee and are summarized as follows.

NextEra Energy Resources testimony. Extending the renewable energy production tax credit will economically benefit the state despite the state's current fiscal challenges. The credit was created in 2002. Since then, it has attracted renewable energy-related investment to rural parts of the state, made the state competitive in the market for that investment and financially enriched school districts.

If extended, the credit should be modified to continue to attract renewable energy-related investment. Specifically, the credit limit should be reduced to more closely align with market conditions, which have changed since 2007, when the statute providing for the credit was last amended. The credit should also be modified to reduce the backlog of applicants for it. Lastly, the credit should gradually phase out. These changes would increase the value of the credit to the state.

Pattern Energy Development testimony. Pattern Energy, which develops and constructs renewable energy and transmission projects, including three wind projects in Curry County that were initiated because of the credit, also supports the reforms as outlined in the NextEra Energy Resources testimony.

Extending the credit is important for New Mexico because of the credit's potential to increase renewable energy-related investment and grow the state's economy. A recent economic impact analysis found that the value of the credit outweighs its costs by eight to one. Renewable energy projects create economic value in the form of landowner royalties and major investments in infrastructure.

Furthermore, New Mexico is poised to become a leading exporter of renewable energy, and the continuation of the credit will promote that outcome. New Mexico has an advantage over other states because of its excellent wind resource. Its disadvantage, on the other hand, lies in its location: it is relatively far from active markets, and the transmission wheeling costs associated with projects in the state are comparatively high. Meanwhile, a sharp future increase in renewable-energy demand from California will increase competition among companies hoping to capitalize on that demand and, thus, will reduce the cost of that energy. Continuing the credit would help New Mexico stay competitive in that race.

If extended, the credit would have major long-term effects on the state's economy. It does not exist to increase renewable energy companies' profit margins but, rather, to bring those companies' projects to the state, where they otherwise would not be.

SunPower Corporation testimony. SunPower Corporation, which is a solar manufacturer and systems developer that has several projects in the state, also supports the continuation, with modifications, of a renewable energy production tax credit. The company's projects enrich the state through state land lease payments, payments to counties and school districts and job creation.

Reducing the credit now is feasible and smart and would allow the state to capture the economic benefits from solar projects on the credit waiting list. Without the credit, new projects might not materialize. The prospect for new projects is especially great given the strong interest by many commercial and industrial customers to locate in renewable energy-supportive states and to meet corporate sustainability goals.

Questions and Discussion

Nonrenewable energy industry; movement toward renewable energy production. A member expressed concern about: 1) the rapid rate at which traditional energy sources are being replaced by renewable energy sources; 2) energy storage issues associated with renewable energy production and corresponding power supply disruptions; 3) the policy preference for renewable energy activity over coal mining activity; 4) the renewable energy industry's heavy reliance on government subsidies; and 5) the disadvantages faced by the coal industry, which not only does not receive subsidies but must pay severance taxes.

Mr. Ward commented that it is prudent for states to rely on a wide array of energy sources and that the tax credit, if extended, can mean the difference between a company deciding to invest in infrastructure in New Mexico or not.

Adjournment

There being no further business before the committee, the committee adjourned at 12:30 p.m.

TENTATIVE AGENDA
for the
FIFTH MEETING
of the
REVENUE STABILIZATION AND TAX POLICY COMMITTEE

November 28, 2016
Jemez Rooms, Santa Fe Community College
Santa Fe

Monday, November 28

9:00 a.m.	(1)	**Overview of the Income Tax Act and the Corporate Income and Franchise Tax Act** —Demesia Padilla, Secretary, Taxation and Revenue Department (TRD) —Frank Crociata, Tax Policy Director, TRD —James Kaminsky, Senior Economist, TRD
12:00 noon		**Working Lunch**
12:15 p.m.	(2)	**National Trends in Personal and Corporate Income Tax Policy and an Update from the Council on State Taxation's Forty-Seventh Annual Meeting** —Helen Hecht, General Counsel, Multistate Tax Commission —Richard Anklam, President and Executive Director, New Mexico Tax Research Institute
2:00 p.m.	(3)	**Legislative Proposal: Determine In-State Sales of Intangibles and Services Based on Market Sourcing Instead of Cost of Performance** —Representative Jason C. Harper, Chair, Revenue Stabilization and Tax Policy Committee (RSTP) —Senator Peter Wirth —Mark Johnson, Co-Founder and Chief Executive Officer, Descartes Labs
3:00 p.m.	(4)	**Tax Policy Package Update and Whiteboard Session** —Representative Jason C. Harper, Chair, RSTP
6:00 p.m.		**Adjourn**

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

November 28, 2016
Jemez Rooms, Santa Fe Community College
Santa Fe

The fifth meeting of the Revenue Stabilization and Tax Policy Committee for the 2016 interim was called to order by Representative Jason C. Harper, chair, on Monday, November 28, 2016 at 9:15 a.m. in the Jemez Rooms of Santa Fe Community College in Santa Fe.

Present
Rep. Jason C. Harper, Chair
Sen. Carlos R. Cisneros, Vice Chair
Sen. Lee S. Cotter
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
Sen. Ted Barela
Rep. David M. Gallegos
Rep. Tim D. Lewis
Sen. Mark Moores
Sen. George K. Munoz

Designees
Rep. Bill McCamley (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
Rep. Bealquin Bill Gomez
Sen. Stuart Ingle
Rep. Conrad James
Sen. Gay G. Kernan
Rep. Idalia Lechuga-Tena
Rep. Javier Martínez
Sen. Nancy Rodriguez

Rep. Tomás E. Salazar
Sen. John M. Sapien
Rep. Jeff Steinborn
Rep. James G. Townsend
Sen. Pat Woods

Minutes Approval

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

Guest Legislator

Sen. Linda M. Lopez

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>Monday, November 28</u>

Overview of the Income Tax Act and the Corporate Income and Franchise Tax Act

Frank Crociata, tax policy director, Taxation and Revenue Department (TRD), and James Kaminsky, senior economist, TRD, discussed with the committee the structure and mechanics of the personal income tax (PIT) and corporate income tax (CIT) in New Mexico. Mr. Crociata began by discussing the CIT program, which mostly parallels the federal income tax program. The CIT is imposed on the net income of every corporation that transacts business in or derives income from New Mexico. "Net income" is defined as federal base income, with a few caveats. New Mexico has a slightly different definition for net operating loss (NOL) than the Internal Revenue Service (IRS), but as long as a corporation's federal NOL meet the state's definition, the NOLs are treated the same way. New Mexico has a top marginal tax rate of 6.9 percent, but that rate is being reduced over the next three years to 5.9 percent. He cautioned against comparing CIT rates across the country because many factors affect the actual tax paid by a corporation, including whether the company is filing a combined tax return and the staggered tax rates at different income levels. It is more accurate to compare effective tax rates, which measure the actual taxes paid by a corporation on its pre-tax profits.

New Mexico has three levels of income reporting, and most corporations are not required to use any particular method. Separate reporting is when each company transacting business in the state files its own state CIT return, regardless of the total corporate structure and ownership. Only the profit and loss from the entity doing business in the state is reported. Combined reporting, sometimes called "unitary reporting", is when a group of commonly owned corporations that engage in a unitary business file one CIT return that includes all unitary members, if at least one of the members transacts business in the state. Combined reporting is optional, except for New Mexico retailers selling goods from facilities that exceed 30,000 square feet. Those entities must file combined returns in New Mexico. Combined returns include New Mexico's proportionate share of profits and losses for the entire business entity. Finally, corporations that have unrelated business entities have the option of filing a consolidated return, which otherwise mirrors the combined return system. Although combined and consolidated reporting uses the entire company as the basis for computing tax liability, many more factors are also included. It is very difficult for the TRD to estimate the fiscal impact of requiring combined reporting because the situation in each company is unique. Mr. Crociata said that 25 states require combined reporting. In states that allow separate reporting, such as New Mexico, some corporations have been able to shift much of their in-state income to a holding company located in another state that does not impose a CIT or in which it files a combined return. This enables a corporation to greatly reduce its tax burden to New Mexico and also to reduce its overall tax burden.

The process of dividing income of multistate businesses is governed by the Uniform Division of Income for Tax Purposes Act (UDITPA), which was enacted by New Mexico in 1965. Business income of a corporation, consisting of transactional income, liquidations and sales of integral property related to the business, is apportioned according to a formula that assigns a certain amount of income to each state in which the company is operating. Nonbusiness income is typically allocated to one state, usually where the property is located or where the business is domiciled. When the UDITPA was formulated in 1957, it established a three-factor formula to apportion business income, which New Mexico still uses for most businesses. The proportion of property owned and payroll expenses and sales made in New Mexico compared to a business's total in each of those categories are added and then divided by three to get the business income apportioned for the state. The sales factor is calculated using different methods, depending on whether the property is tangible or intangible. Sales of tangible personal property are sourced based on the destination of the property being sold, but sales of intangible property, including services, are sourced to the state where the business expends the greatest "cost of performance". The payroll factor in New Mexico is calculated only using actual employees and does not include contractors.

Recently, New Mexico added optional apportionment formulas for manufacturers and headquarters operations to allow for just the sales factor to be used in computing the state's business income apportionment. These special apportionment factors were enacted to entice those sectors to locate in or remain in New Mexico, since the formula usually results in a reduction in New Mexico CIT liability for the company. The UDITPA also allows for deviations from the standard three-factor formula when the results do not fairly reflect the extent of a taxpayer's business activities in the state. Over the years, the Multistate Tax Commission (MTC) has developed rules for certain industries, such as construction contractors, railroads, airlines, trucking companies, financial institutions and broadcasting and publishing companies, and the TRD has adopted most of those special rules. Nineteen states have changed their apportionment laws to allow for a single sales factor for most or all businesses; 22 states use market-based sourcing, rather than cost-of-performance sourcing, for sales of services; and 19 states also use market-based sourcing for sales of other intangible property.

Mr. Crociata then discussed the mechanics of how the CIT is calculated for a business in New Mexico. First, the company's total income is reported, based on its federal reported base income, and then any New Mexico-specific NOLs are subtracted. The tax is calculated, using the CIT tax rates. Next, the company's income is allocated and apportioned to reach a percentage for the state, and that percentage is applied to the total theoretical CIT liability. Finally, any New Mexico tax credits are applied to the state CIT liability.

Finally, Mr. Crociata discussed the PIT program in New Mexico, which is structurally much less complex than the CIT program. The PIT program imposes a net income tax on New Mexico residents and nonresidents who derive income from New Mexico sources. The program also imposes tax liability on individuals who receive distributive shares of various kinds of pass-through entities (PTEs), including S-corporations, partnerships and certain kinds of limited liability companies. The top marginal PIT rate is 4.9 percent, set at a relatively low threshold, which makes New Mexico's income tax fairly flat. Mr. Crociata said that the TRD has been attempting to quantify the impact on PIT revenue from PTEs. However, it is difficult to determine exactly what source an individual's income is attributed to because the taxable event only occurs when a PTE makes an earnings distribution to its owners. PTEs typically only file federal informational returns, and it is not always possible to follow distributions to a liable individual or corporation.

Questions and comments from committee members included the following.

- What needs to change in the CIT structure to encourage businesses to relocate in New Mexico? Mr. Crociata said he does not think that New Mexico's overall CIT structure is out of sync with other states. He said that the state could allow companies to use a single sales factor and allow market-based sourcing of intangibles. He said that the gross receipts tax (GRT) is more of an economic disincentive than the CIT.
- Adopting a single sales factor for manufacturing companies did not do much to entice Intel, which instead chose Chandler, Arizona for a new chip manufacturing plant, to expand its operations in the state. Mr. Crociata said that people always look to Arizona and wonder how it succeeds when New Mexico keeps falling behind. However, Arizona's tax structure is not an ideal economic development tool, and it has been ranked poorly in some nationwide surveys. Arizona's economic development success has to be attributed to other factors than its tax structure.

- What is the rationale for adopting single sales factors and market-based sourcing? Mr. Crociata said that single sales factors are typically adopted to encourage businesses to locate or stay in a state. However, without adopting market-based sourcing for intangibles in calculating the sales factor, service-based companies would be discouraged from engaging in business in the state. For example, if a software company located in New Mexico is required to use cost-of-performance sourcing for its sales, all sales of the company would be attributed to New Mexico because that is where the majority of the costs would have been incurred. That would mean that the company would have a very distorted CIT liability in New Mexico.
- The reduction of the PIT rates in 2003 has cost the state more than $450 million annually. As the state continues to struggle to find revenue to pay for basic services, the legislature needs to reconsider those rate cuts. The state needs to have a more progressive PIT structure.
- The more progressive the tax code, the more volatile state revenues will be. However, paying 4.9 percent of net income is much more difficult for a low-income person than for a rich person. There is also no good reason for progressivity in the CIT rates.
- How can a state encourage businesses to locate in the state by offering a favorable tax climate and still accurately capture the economic base in its tax program? Mr. Crociata said that it is probably impossible to both. Single sales factors are really tools to encourage business activity and do not accurately reflect economic realities. However, requiring the use of a single sales factor will end up punishing other industries.
- Could the TRD do a better job of collecting premium taxes than the Office of Superintendent of Insurance (OSI)? Recent audits revealed that the OSI has more than $190 million in uncollected taxes that were due over the past several years. Mr. Crociata said that he does not know very much about the tax collection structure at the OSI and that the TRD would be hard pressed to take over that responsibility given current staffing levels. However, he said that there could be some administrative and regulatory benefits in having one agency administer different tax programs.
- The huge cash economy in New Mexico means that many businesses never pay GRT to the state. The TRD needs to make GRT collection a priority.

Adoption of Minutes

The minutes from the October 13-14 committee meeting were adopted without changes.

National Trends in PIT and CIT Policy and an Update from the Council on State Taxation's (CST's) Forty-Seventh Annual Meeting

Helen Hecht, general counsel, MTC, and Richard Anklam, president and executive director, New Mexico Tax Research Institute, discussed with the committee national trends relating to the PIT and CIT. Ms. Hecht said that in 2015, income taxes accounted for 42 percent of state-level taxes in the nation. State income taxes are generally tied to federal income taxes, and many states do not audit the numbers reported to the IRS, making adjustments only if a taxpayer is audited by that agency.

Ms. Hecht next discussed national trends related to the PIT. Some states have increased the top marginal PIT rate recently, and a few states imposed a "millionaire tax" on high-income individuals. Other states have reduced PIT rates or have begun phasing out the CIT. Many states increased their version of the earned income tax credit (EITC) to address tax regressivity issues that negatively affect low-income households. She cautioned that states are seeing increased levels of tax filing fraud, partly because EITCs are generally refundable, which makes that kind of fraud more attractive.

The U.S. Supreme Court recently ruled that if a state taxes income on both a residency and source basis, it must give a credit to residents for taxes paid in another state on a source basis. The court established a test to determine if the state tax laws violate the ruling: if every state had the same tax system as the home state, would that income be subject to double taxation? Ms. Hecht said that there may be future challenges to multistate taxation of income, including whether states must give credit for local income taxes paid.

Ms. Hecht discussed issues surrounding the collection and tracking of PTE income. More business income is now reported by PTEs than by corporations. Many PTEs have complex structures with multiple layers of partnerships, of other PTEs and of corporations. The IRS has had trouble auditing and enforcing income tax on partnership income because of the lack of transparency in those business entities. States may have separate issues in collecting tax from income reported by PTEs, including the ability to collect taxes from nonresident owners of PTEs. Ms. Hecht said that it is very difficult for taxing entities to determine if PTE income is being correctly reported by individuals who have some ownership interest in the company. Partnerships get to decide how to divide up their income, and there used to be no way to determine if that division was actually legitimate. In 2015, a new federal law was enacted to allow the IRS to compel partnerships either to pay taxes due or to assign that tax liability to individuals who are part of the partnership. The MTC is currently developing model legislation for states to have similar authority to collect state income tax due. Mr. Anklam said that the complex structure of many PTEs makes it impossible for states to match an individual or trust with a PTE tax liability.

Congress is considering other income tax reform, including proposals to lower rates and broaden the tax base, which would also expand the state income tax base. Ms. Hecht said that most proposals also eliminate the ability for individuals to deduct state income taxes paid on their federal tax return. This would have the net effect of increasing the cost of state income taxes because taxpayers would no longer be receiving an offsetting tax benefit.

Ms. Hecht then discussed national trends related to the CIT. Many states now require combined filing for most types of corporations, and many states allow the use of a single sales factor to apportion their income. Another major trend is to use market-based sourcing in the apportionment of intangible property. The courts have been weighing in on many state efforts to capture corporate income, especially regarding inter-company transactions that are used to avoid paying the CIT. This issue mostly affects states such as New Mexico that have the option of separate entity filing, but it also affects combined-entity-filing states because of the many multinational corporations in the world today. States have attempted many solutions to fix this problem, including: asserting that certain out-of-state affiliates have economic nexus in the state; requiring that inter-company transactions must have real substance in order to be legitimate; requiring that deductions for inter-company transactions be added back into the net income of a corporation; requiring that affiliates in overseas tax havens be included in the combined group of a company; and enacting anti-distortion transfer pricing remedies. The MTC has a special program to train and provide information to states on this issue. Some states are considering replacing their CIT with some version of a GRT, targeted exclusively at companies. Finally, Ms. Hecht said that there is proposed federal legislation to reduce or eliminate temporarily the imposition of income tax on assets held overseas by companies to stimulate investment in U.S. economic infrastructure.

Mr. Anklam reported to the committee topics discussed at the recent Council on State Taxation conference. Many state-level tax reform ballot initiatives failed at the general election, including a ballot measure in Oregon that would have imposed a 2.5 percent GRT on corporations. However, there were dozens of municipal tax proposals that were approved, many of which imposed higher taxes on their residents. Four states legalized the recreational use of marijuana, which is a huge potential revenue source for those states. Taxation of business-to-business transactions was also a major issue discussed at the conference. States are attempting to expand their sales tax base by imposing taxes on more such transactions, but the business sector tends to view these expansions as increasing the problem of tax pyramiding, which leads to economic distortions and stagnation.

Questions and comments from committee members included the following.

- Has there been any progress on the issue of internet sales taxation? Mr. Anklam said that federal legislation on that issue is still stalled. Most of the business community is in favor of collecting sales tax from online transactions, but would prefer a uniform nationwide standard.
- The legislature should consider sharing a portion of the CIT and PIT with local governments. There has been much erosion of the local tax base over the past two decades, and that erosion was made worse when the deduction from gross receipts for the sale of food was enacted. The state has imposed many mandates on local governments but did not provide a method to pay for those mandates.
- Are there any special apportionment rules for the telecommunications industry? Ms. Hecht said that the MTC adopted apportionment rules for that industry in 2008. The MTC recommends that if a state begins using market-based sourcing for all services and intangible property, it also adopt the current MTC special rules for various industries. She said that telecommunications companies are already required by federal law to track the locations of customers, so it would not be a big burden for them to start calculating their sales based on location. The TRD has the authority to adopt the MTC telecommunications special apportionment rule, but it has not yet done so.

- The CIT is by far the most complex tax program New Mexico has, yet its revenues are only about the same as the motor vehicle excise tax.

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

Senator Wirth and Mark Johnson, co-founder and chief executive officer, Descartes Labs, presented proposed legislation for the committee's consideration that would provide for the apportionment of the sales of intangible property and services for the purpose of calculating the CIT using a market-based sourcing method, rather than the cost-of-performance method currently required. When the UDITPA was enacted almost 60 years ago, its apportionment rules were designed to reflect the major economic industries of the time. The allocation rules for intangible property and services no longer reflect the current economy and can act as a deterrent for companies to locate in the state. The current cost-of-performance methodology can create situations in which a company that sells intangible property or services would be forced to pay its entire CIT liability in the state in which it is located, even though most of its sales are outside of the state. The cost-of-performance method apportions all sales of intangible property to the state that accounts for the most of the cost in creating the property. This model does not make sense in a service economy.

Senator Wirth said that he introduced legislation to allow for market-based sourcing of intangibles in 2014, 2015 and 2016. The legislation passed the senate in 2015 with little opposition but did not make it through the house of representatives before the session ended. In 2016, however, several industry groups suddenly opposed the legislation. Many out-of-state companies were concerned that they would have to start paying CIT to New Mexico. Senator Wirth said that perhaps the MTC special apportionment rules could provide a solution for the telecommunications industry.

Mr. Johnson discussed Descartes Labs with the committee. The company was founded in Los Alamos in 2014 and is expected to earn a profit in 2017. Descartes Labs uses "cloud"-based supercomputers to model complex planetary systems, including weather and agriculture. It currently has 25 employees and is looking to expand its operations soon. Its average employee salary is $131,000. Its modeling of worldwide corn and soybean production is the most accurate model in the world, which is of extreme value to investors and others in the agricultural sector. Mr. Johnson said that he expects to expand the company in the next few years, and a more favorable tax climate for companies like Descartes Labs would be one factor in the decision of where to locate the expanded company.

Questions and comments from committee members and the public included the following.

- What could New Mexico do to encourage more technology companies to locate in the state? Mr. Johnson said that there is not very much available commercial property in Santa Fe and Los Alamos that is suitable for a technology start-up. He said that technology infrastructure is woefully inadequate. It is incredibly expensive to get fast internet service in Los Alamos, the location of the premier scientific research laboratory in the nation. He also said that a seemingly simple thing, like having uninterrupted cell phone service between Santa Fe and Los Alamos, is currently not available. He said that getting venture capital companies to fund a start-up in New Mexico is very challenging because the state has very little history of such ventures. Finally, he suggested that the Job Training Investment Program be adjusted to allow training funds to be used for employees who recently moved to the state. The current one-year residency requirements are posing problems with Descartes Labs because of the difficulty in recruiting qualified New Mexico residents for jobs.

- Why did the market-based sourcing bill face opposition in the 2016 legislative session? Terri Nikole Baca, director of external affairs, AT&T, said that AT&T has concerns that the legislation would have a disproportionate negative impact on wireless telecommunications providers. She said the industry does not favor a mandatory market-based sourcing approach. She said that if the TRD adopts the MTC special apportionment rule for the telecommunications industry, her company would no longer oppose the legislation. Bob Barberousse, representing the Motion Picture Association of America, said that the film industry has concerns with the 2016 legislation because it could negatively affect New Mexico's film industry. He said the industry is not opposed to the bill per se, but it needs protection from unwarranted tax liabilities.
- The current cost-of-performance apportionment rule for intangible property punishes service-based companies in the state.
- There might be too much subjectivity in special apportionment rules for each industry. Ms. Hecht said that the MTC has developed uniform rules for several industries, and most states have adopted them. The 25 states that have enacted market-based sourcing rules have also adopted the special industry rules.

Tax Policy Package Update and Whiteboard Session

Representative Harper moderated a discussion with the committee about the committee's work on a tax reform package for the legislature's consideration in the next session.

<u>PIT/CIT Reforms</u>

Ideas and proposals discussed by committee members included the following.

- The more complex a tax system is, the more difficult it is for companies to decide whether to locate in the state.
- The legislature has been shrinking the state government, rather than finding the means to fund it.
- The state's tax structure has picked winners and losers. It might be better to have some sort of flat tax system that does not favor any industry or population segment.
- If the GRT system were less regressive, the PIT structure could be flat, without harming the low-income population overall.

- The capital gains deduction for individuals is a very regressive tax policy that, if repealed or reduced, would be a huge revenue source for the state.
- Tax reform will have to proceed incrementally because nobody knows what state revenues will be in the next few years.

Remote Sales Tax Collection

Mr. Anklam discussed several developments regarding remote sales tax collection. He said that President-Elect Donald Trump's position on the imposition of sales taxes on online retailers is still unclear, but it appears that there is a general agreement that online sales should be taxed. Amazon has been open to paying sales taxes in several states that have enacted legislation encouraging agreements for the company to remit sales taxes, and it has begun requiring third-party sellers on its platform to collect and remit sales taxes in some states. Several members of the committee expressed a desire to have local governments receive a share of any tax collected from online retailers. Mr. Anklam said that could be possible but that there are some complicated factors to consider before that could happen.

Compensating Tax

The committee discussed aligning the compensating tax rate with the actual GRT rate in order to eliminate the disincentive for businesses to purchase from in-state vendors. However, there could be significant opposition from some industries, which will not like the idea of paying a higher tax rate.

Business-to-Business Pyramiding

Former Secretary of Finance and Administration Tom Clifford discussed various aspects to consider when trying to eliminate business-to-business pyramiding. He divided the pyramiding issue into three categories: tangible personal property, services and inputs. It is difficult to determine the revenue impact to the state from the elimination or reduction of pyramiding in each category. There are currently a few dozen anti-pyramiding statutes, mostly designed for specific industries. Trying to determine how to replace those deductions with more general deductions is very difficult. Another issue to resolve is what to do with the credit that manufacturers get from the purchase of equipment, which is intended to reduce the burden of the compensating tax for that industry. Policymakers will also have to determine which kinds of services should be eliminated from business-to-business taxation. Finally, it will be very difficult to calculate the fiscal impact of these changes because many of them are interconnected and operate in a dynamic economic model.

Representative Harper suggested that the legislature consider a list of services to be excluded from business-to-business taxation, based on what other states have enacted.

Nontaxable Transaction Certificates (NTTCs)

The committee discussed a proposal to modify the current statute and TRD rule that disallows a GRT deduction if a seller is unable to produce an NTTC from a purchaser within 60 days of a TRD audit. The proposal would allow for other types of evidence to demonstrate that the transaction was deductible from gross receipts.

New Mexico Sales Tax

The committee discussed the proposal to significantly restructure the GRT program and rename it the "New Mexico sales tax". Representative Harper said that the idea for this legislation is to simplify the GRT, rename it and, most importantly, reduce rates imposed by the state and by local governments by significantly expanding the tax base through the repeal of many deductions, credits and exemptions. Local governments would be free to impose new increments of the sales tax for general purposes, including for bonding. Local referenda would still be required for increments above a certain level. In addition, the current distribution of the 1.225 percent portion of the state's 5.125 percent GRT rate would be converted into an equivalent municipal increment of the new sales tax.

Ideas and proposals discussed by committee members included the following.

- If local governments no longer have dedicated GRT increments, how will bonds issued to them be protected? Representative Harper said that the bill being drafted will include provisions requiring local governments to continue paying bonds from the new undedicated sales tax revenue source.
- How reliable are the anti-pyramiding estimates used in creating the proposal? Representative Harper said that estimating the fiscal impact from changing those provisions is very difficult. However, the proposal will be ready for a professional fiscal impact report by the Legislative Finance Committee and TRD soon.
- Is there enough political will to enact legislation to encourage internet sales tax collection by online retailers? Representative Harper stated there was support if it is part of a comprehensive tax package. Representative Harper also said that the state should only enact an expanded nexus bill, which has proven successful in bringing Amazon to the negotiating table, and not attempt legislation challenging the U.S. Supreme Court *Quill* decision, which established rules for when a state can tax out-of-state businesses.

Adjournment

There being no further business, the committee adjourned at 4:31 p.m.

Revised: December 7, 2016

TENTATIVE AGENDA
for the
SIXTH MEETING
of the
REVENUE STABILIZATION AND TAX POLICY COMMITTEE

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

Wednesday, December 14

10:00 a.m. (1) **Revenue Forecast**
—Jon Clark, Economist, Legislative Finance Committee (LFC)
—Demesia Padilla, Secretary, Taxation and Revenue Department (TRD)
—Elisa Walker-Moran, Chief Economist, TRD
—Clinton Turner, Chief Economist, Department of Finance and Administration (DFA)
—Robert McGrail, Economist, DFA

12:00 noon **Lunch**

1:00 p.m. (2) **LFC Progress Report: Select Health Care Tax Expenditures**
—Maria Griego, Program Evaluator, LFC

Proposals for Committee Endorsement:

2:00 p.m. (3) **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

3:00 p.m. (4) **Priority Road Construction and Public Transit Infrastructure Bonds**
—Anthony Mortillaro, President, New Mexico Transit Association (NMTA)
—J.D. Bullington, Lobbyist, NMTA

4:00 p.m. (5) **Determine In-State Sales of Intangibles and Services Based on Market Sourcing Instead of Cost of Performance**
—Representative Jason C. Harper, Chair, Revenue Stabilization and Tax Policy Committee (RSTP)
—Senator Peter Wirth, Member, RSTP

5:00 p.m. **Recess**

Thursday, December 15

Proposals for Committee Discussion and Review:

9:00 a.m. (6) **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; Vice Chair, Assessors Affiliate, New Mexico Association of Counties (NMAC)
—Christie Humphrey, Sandoval County Chief Deputy Assessor; Secretary, Assessors Affiliate, NMAC

11:00 a.m. (7) **Taxation of Internet Sales**
—Richard Anklam, President and Executive Director, New Mexico Tax Research Institute

12:00 noon **Lunch**

1:00 p.m. (8) **Nontaxable Transaction Certificates (NTTCs): Allowing Evidence Other Than an NTTC to Prove That Proceeds from a Transaction Are Deductible from Gross Receipts**
—Frank Crociata, Tax Policy Director, TRD

2:00 p.m. (9) **Addressing Regressivity: Allowing a Deduction for All Food Purchased by Supplemental Nutrition Assistance Program Beneficiaries and Adjusting Low-Income Comprehensive Tax Rebate Amounts**
—Representative Jason C. Harper, Chair, RSTP
—Representative Bill McCamley, Designee, RSTP

3:00 p.m. (10) **Personal Income Tax and Corporate Income Tax: A Flat 5% Rate**
—Representative Jason C. Harper, Chair, RSTP

4:00 p.m. (11) **Distributing a Portion of the Motor Vehicle Excise Tax to the State Road Fund and the Local Governments Road Fund**
—Representative Jason C. Harper, Chair, RSTP

4:30 p.m. (12) **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 Jason C. Harper, Chair, RSTP

5:00 p.m. **Recess**

<u>Friday, December 16</u>

Proposals for Committee Discussion and Review (continued):

9:00 a.m. (13) **The New Mexico Sales and Use Tax Act**
—Representative Jason C. Harper, Chair, RSTP

12:00 noon **Adjourn**

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.

Wednesday, December 14

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.

<u>Friday, December 16</u>

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.

ENDORSED LEGISLATION

SENATE BILL

53RD LEGISLATURE - STATE OF NEW MEXICO - FIRST SESSION, 2017

INTRODUCED BY

FOR THE REVENUE STABILIZATION AND TAX POLICY COMMITTEE

AN ACT

RELATING TO TAXATION; AMENDING THE UNIFORM DIVISION OF INCOME FOR TAX PURPOSES ACT TO DETERMINE IN-STATE SALES OF INTANGIBLES AND SERVICES BASED ON MARKET SOURCING RATHER THAN COST OF PERFORMANCE.

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF NEW MEXICO:

SECTION 1. Section 7-4-18 NMSA 1978 (being Laws 1965, Chapter 203, Section 18) is amended to read:

"7-4-18. DETERMINATION OF SALES IN THIS STATE OF SERVICES AND OTHER [~~THAN TANGIBLE PERSONAL~~] PROPERTY FOR INCLUSION IN SALES FACTOR.--

A. Sales, other than sales [~~of tangible personal property~~] described in Section 7-4-17 NMSA 1978, are in this state [~~if~~

~~A. the income-producing activity is performed in~~

underscored material = new
[bracketed material] = delete

~~this state; or~~

~~B. the income-producing activity is performed both in and outside this state and a greater proportion of the income-producing activity is performed in this state than in any other state based on costs of performance~~]:

(1) in the case of sale, rental, lease or license of real property, if and to the extent the real property is located in this state;

(2) in the case of rental, lease or license of tangible personal property, if and to the extent the tangible personal property is located in this state;

(3) in the case of sale of a service, if and to the extent the service is delivered to a location in this state; and

(4) in the case of sale, rental, lease or license of intangible property, if and to the extent the intangible property is used in this state.

B. If the state or states of assignment under Subsection A of this section cannot be determined, the state or states of assignment shall be reasonably approximated.

C. If the taxpayer is not taxable in a state to which a sale is assigned pursuant to Subsection A of this section or if the state of assignment cannot be determined or reasonably approximated pursuant to Subsection B of this section, that sale shall be excluded from the numerator and

underscored material = new
[bracketed material] = delete

denominator of the sales factor.

D. The department may promulgate rules as necessary or appropriate to carry out the purposes of this section."

SECTION 2. APPLICABILITY.--The provisions of this act apply to taxable years beginning on or after January 1, 2018.

LEGISLATIVE COUNCIL SERVICE
SANTA FE, NEW MEXICO