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.

Wednesday, September 14

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.

GRT Brand

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".

1.225 Percent "Shell Game"

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.

NTTC Reform

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.

County Assessor Perspective

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.