# Tax Matters

*The Newsletter of the New Mexico Tax Research Institute*

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## INTO THE LEGISLATIVE SESSION – IT BEGAN SEPTEMBER 28, 2016

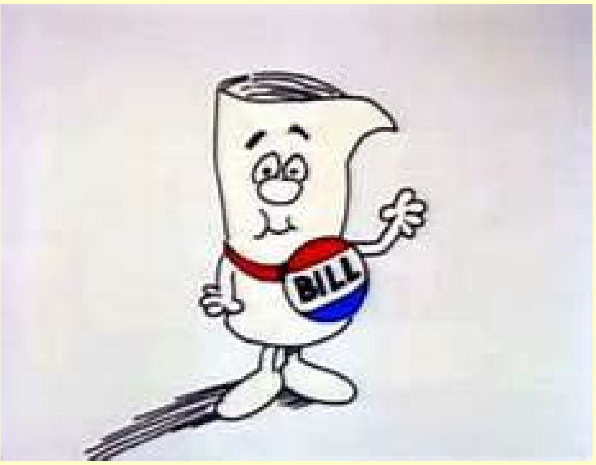
The 2016 2nd Special Session of the New Mexico Legislature convened at noon on Wednesday, September 28 after being called by Governor Martinez to address the state's solvency and other unrelated issues (see her proclamation here). The session was precipitated by the revised consensus revenue forecast (on the legislative website here), which had the state's general fund shortfall increasing $223M for the year that ended June 30, 2016, and $431M in the year ending June 2017. It was initially expected to be a very short session, perhaps four hours if a deal was cut in advance, but it didn't quite work out that way.

New Mexico has an uncompensated volunteer legislature comprised of a 70 member House of Representatives and a 42 member Senate. Legislative sessions alternate between 30-day budget related sessions in even numbered years, and unconstrained 60-day sessions in odd-numbered years.

Click here to the see the daily bill locator on the legislative website. We have our list of tax related legislation having passed both chambers below.

The Legislative Council Service maintains copies of bills, compiles locators, and publishes lists of bill conflicts during the course of the session. Most information is available in a timely and electronic fashion from their rather robust website, which can be reached at https://www.nmlegis.gov/. The site has become increasingly functional and reliable over time. Information is reasonably up to date and legislation can be easily followed from home.

**Bills with significant tax implications introduced in the 2016 Second Special Legislative Session:**




Note – in the table that follows, if no effective date is mentioned, the bill lacks one and would take effect upon enactment. Effective date for GRT and other non-income tax bills is July 1, 2016 unless otherwise noted. Income Tax bills are effective tax years beginning on or after January 1, 2016 unless otherwise noted. "TYBA" = Tax years beginning on or after. Other notes: "CS" indicates committee substitute; "a" indicates amended

| Bill Number/ Sponsor: | Title: Link to bill language: Description | Assignments-Location: |
|---|---|---|
| HB 11 McCamley /Martinez | **Cannabis Tax Act: HB 11** Provides for the legalization, regulation, and taxation (15%) of cannabis producs. | HRC-not prntd |
| HB 12 Martinez/Mc Camley | **Limit Capital Gain Deduction: HB 12** Eliminates the present law capital gain deduction of 50%, retaining the $1000 deduction. | HRPAC/HW MC-HRPAC |
| HB 15 Montoya/Gal legos/Strickl er/Townsend | **Reduce Film Production Tax Credit Cap: HB 15** Reduces the film production tax credit cap from $50M to $25M in fiscal 2017 only, whereby the credit cap returns to $50M in subsequent years. | HWMC |
| | | |
| SB 1 Wirth | **Combined Tax Reporting for Unitary Corporations: SB 1** Mandates combined filing for unitary corporations. Eliminates consolidated filing election. | SFC |
| SB 5 Smith | **Delay Tax Changes: SB 5** Delay corporate income tax rate reductions and phase in of single sale factor apportionment elections. | SFC-DP-Passed/S-HWMC |
| SB 6 Smith/Cisner os | **Tax Package: SB 6** Eliminates hold harmless distributions, narrows the High Wage Jobs Tax Credit and the healthcare practitioner gross receipts tax deduction, eliminates. *Contains an emergency clause*. | SFC-DP-Passed/S-HWMC-DP/a-fl/a-Passed/H-s/cncrd |

**Bills with significant fiscal implications introduced in the 2016 Second Special Legislative Session:**

| Bill Number/ Sponsor: | Title: Link to bill language: Description | Assignments-Location: |
|---|---|---|
| SB 2 Smith/Neville | **Transfer & Distribute Tobacco Settlement Fund: SB 2** Transfers approximately $131M from the tobacco settlement permanent fund and various other accounts to the general fund to cover FY16 and 17 appropriations. | SFC-DP-Passed/S-HAFC-DP/a-fl/a-Passed/H-s/cncrd |
| SB 4 Smith/Ingle | **Public School Capital Outlay Changes: SB 4** Authorizes the legislature to appropriate $25M in supplemental severance tax bond notes to the instructional material fund, allowing the general fund retain $25M it would otherwise send to the instructional material fund. | SFC-DP-Passed/S-HAFC-DP-Passed/H-sgnd by Gov |
| SB 7 Smith/Ingle | **Public Fund Distribution Changes: SB 7** Eliminates a $250K distribution from the general fund to the retiree health care authority and, until 6/2019, eliminates a 12% increase in | SFC-DP-Passed/S-HWMC-DP- |

| | | |
|---|---|---|
| | transfers to the fund. It also ends scheduled increases in distributions to the fire protection fund. | Passed/H-sgnd by Gov |
| SB 8<br>Cisneros/Ingle | **Capital Outlay Project Changes: SB 8**<br>Increases general fund reserves and restores funding for general fund capital expenditures by reverting GF appropriations for capital expenditures, reduces water, tribal and colonias earmarks from senior STB capacity. | SFC-DP-Passed/S-HWMC/HAFC-DP-HAFC-DP-Passed/H |
| SB 9<br>Smith/Neville | **Reduce Certain Legislative Appropriations: SB 9**<br>Reduces 2017 appropriations of many state agencies and programs by up to 5.5%, with some more "critical" areas receiving lesser cuts for a total reduction of $176M in FY2017. | SFC-DP-Passed/S-HAFC-DP-fl/a-Passed/H-s/cncrd |

Passed both houses

## Legislative Overview…

*What Happened?*

While many enjoyed the Albuquerque International Balloon Fiesta last week, New Mexico lawmakers did not. The first 2016 Special Session of the New Mexico Legislature was not unexpected; however, the severity of the declines in the August revised budget forecast has made everything harder. Low oil and natural gas prices continue to ripple through system as production volume declines are becoming visible. While that sector gets the blame, the reality is that there isn't great news anywhere. A lack of revenues has squeezed Medicaid spending, and the associated federal matching dollars "triple-down" on that system-wide impact. Federal spending has been limited for years. Permanent fund interest earnings are reaching highs in their percentage contribution to the general fund – but that's only because that revenue source is fortunate enough to be *flat* (almost everything else that matters is down year-over-year). So, while oil and gas gets the blame, nothing is booming and there's no obvious reason to expect any quick fiscal turnarounds (from a glass half full perspective, there's also no reason to expect things to get worse than we already know/anticipate in the short run).

*[NMTRI note: balloon photos in this edition are in the public domain, taken from NMTRI's receptionist's yard this year]*

Making the deal of the "fix" harder still was the political timing, with nationwide November elections looming large and every single state legislative seat up for election to (although most seats are "safe"). So nerves are raw and tensions high. Another feature of the timing is the fact that fundraising by legislators during a legislative session is prohibited—not a welcome thing for most legislators. Lots of fundraisers have been cancelled (but the attendees of the New Mexico Oil and Gas Association's annual conference worried less about their wallets last week at their annual conference).

The "norm" in such circumstances is for leadership to decide on a package of measures to achieve the objective, and then to convene very quickly (and inexpensively) to get the deal done. This year, the governor added crime legislation to a broadly worded proclamation. Combine that with an apparent slowness or absence of communications amongst the decision makers and we went into the session without a deal and left ten days later. The session convened on Wednesday September 28 and adjourned on Thursday, October 6. The Senate passed its tax and budget recommendations and first adjourned Friday the 30th (they could only stay away for three days without concurrence of the House). The House finished up its debate on the Senate's proposals and its own tax and crime bills, after which the Senate returned, concurred, and went home.

*Spending and Other Austerity Measures*

Most of the budget balancing efforts were accomplished through cuts and sweeps, with very little being done through tax increases.  There are five bills designed to raise revenue and reduce expenditures outside the scope of raising taxes (see below from the table above).

| | |
|---|---|
| SB 2<br>Smith/Neville | **Transfer & Distribute Tobacco Settlement Fund: SB 2** |
| SB 4<br>Smith/Ingle | **Public School Capital Outlay Changes: SB 4** |
| SB 7<br>Smith/Ingle | **Public Fund Distribution Changes: SB 7** |
| SB 8<br>Cisneros/Ingle | **Capital Outlay Project Changes: SB 8** |
| SB 9<br>Smith/Neville | **Reduce Certain Legislative Appropriations: SB 9** |

In combination, the proposals make available $131M from tobacco settlement funds for 2016 and 2017 appropriation; free up $25M in general fund (2018) by displacing those funds with $25 in supplemental severance tax bond notes for the schools; reduce transfers to the retiree health care authority and halt increases to the fire protection grant fund; de-authorize certain existing general and severance tax fund capital expenditures (but provide for re-authorization), sweep existing fund balances and "sponge" money that would go to the severance tax permanent fund; and reduce FY 2017 appropriations (5.5% or less depending on the agency/program) to the tune of $176M. Economic developers can rest easy that GF Local Economic Development Act ("LEDA") funds were swapped/covered with severance bonds.

*Taxes*

While revenue is the reason for the session, tax increases were not that popular. We only followed six tax proposals—three in each house. In the House, Rep. McCamley and Martinez introduced a measure to regulate and tax cannabis (15% like CO). Their proposal in **HB 11** never made it out of House Rules and wasn't printed, so it likely wasn't germane. Rep. Martinez and McCamley proposed in their **HB 12** (both Democratic House Ways and Means members) to eliminate the 50% deduction from capital gains (it did not eliminate the $1000 deduction). According to the LFC it should raise $35-45M/yr, but TRD scores it as only worth $14M or so per year. Lastly, Rep. Montoya, Gallegos, Strickler, and Townsend proposed in their **HB 15** propose to limit the film production cap in 2017 only to $25 million dollars. That was later amended in the House Ways and Means Committee to $30M before being passed to the floor.

In the Senate, Conservation Committee Chairman Peter Wirth has another proposal to mandate combined reporting. His **SB 1**, identical or virtually identical to his 2015 proposal, is a fairly vanilla mandate that unitary corporations file as a combined group. It does not maintain the election for consolidated filing, and it does not address transition issues. Senate Finance Committee Chair John Arthur Smith proposed freezing the phasing-in corporate rate reductions and single sales factor elections at 2015 levels for two years. Such a move could save the state/cost taxpayers $11.7-23.4 million depending on which agency you choose to believe (**SB 5**).

Lastly, Chairman Smith and Vice-Chairman Cisneros introduced their other tax proposals in an omnibus bill creatively titled "Tax Package" found in **SB 6** (the only one to pass both houses). That proposal initially:

- Accelerated the food and medical hold harmless phase-out provisions;
- Narrowed the scope of Section 7-9-77.1 (Medicare receipts) and 7-9-93 (healthcare) practitioners services) and made some technical changes; adding a penalty;
- Created an exception to "engaging in business" in the GRT for persons without physical presence in NM who has receipts less than $100K/yr and clarified and extended an exception to the tax collection limitation on the NMTRD to include unregistered remote sellers until 4/1/16 (pseudo-expanded nexus)
- Narrowed and tightened High Wage Jobs Tax Credit ("HWJTC") rules, imposing a $24M cap per year, and eliminating payment of interest on it and film production tax credit claims

Senate Bill 6 was amended twice. The pseudo-expanded gross receipts tax nexus provisions, the hold harmless phase out acceleration, and the cap on the HWJTC were removed in the House

Ways and Means Committee. The first provision was intended to raise voluntary compliance by remote sellers as is becoming common in other states, while the latter provisions were designed to limit general fund payouts. Replacing the hold harmless language in the first part of the bill was a provision reducing the appropriation from the general fund to the legislative retirement fund from $200K to $75K per month (or more if necessary).

On the House floor, the bill was amended to include an appropriation of $1.5M to the Children Youth and Families Department for the purpose of reducing child abuse. That provision should have had the bill stopping in House Appropriations and opened the bill up to line item veto; however, if anyone noticed, they were unconcerned. The bill contained an emergency clause (meaning its effective when signed by the Governor). The effective date has the tax and penalty provisions taking effect the first day of the month following its enactment (presumably November 1 if the Governor signs the bill this month), and the applicability provision has the credit and interest provisions taking effect on January 1, 2016.

The primary focus of the changes in the healthcare gross receipts tax provisions were intended to do several things. First, the provision unwinds a decision and order of the Hearing Officer, which overturned portions of overbroad regulations issued during the Richardson administration; and to create an ordering of the deductions. (Section 7-9-93 deductions, the one for medical practitioners, must be taken last, which was done because 7-9-93 is the deduction that requires a hold harmless distribution from the general fund to the local governments—meaning they're the most expensive kind to the general fund). A penalty was also created for the *incorrect* reporting of the 7-9-93 healthcare practitioner deduction (which results in incorrect distributions from the general fund). That penalty is also extended to the food deduction found in *Section 7-9-92 NMSA 1978*, and is an amount equal to 20% of the hold harmless distribution resulting from the incorrect deduction.

The HWJTC was significantly altered from its present state. Payout of portions of old claims in dispute under previous law were paid out in the current fiscal year, giving the appearance and fanning initial concerns that the credit was still "bleeding.' This added to concerns that the credit would become costly in the future when the natural resource industries employment turns around and prompted a change to ensure the latter wouldn't be the case, also providing opportunity for clarifications and other changes. The base upon which the credit is computed is reduced through the dis-inclusion of benefits in addition to salary in the credit calculation. Methods are changed as are definitions impacting eligibility of employers (narrowed such that certain economic base jobs are excluded relative to present law). The bill contains a provision that precludes the payment of interest on HWJTC claims and film production tax credit claims – presumably because both were to have been subject to caps. The proposal to reduce the film production tax credit cap failed, however the present law cap of $50M is still in place. The proposed HWJTC cap was removed from the bill, however the interest preclusion provision remains, leaving it – and film credits – unique in regard to interest payment.

*What Happens Next?*

The governor has acted on two of the fiscal measures by signing Senate Bills 4 and 7 (public school capital outlay and retiree health/fire protection proposals). To our knowledge she has not yet acted on Senate Bills 2 (transfer & distribute tobacco settlement funds), 8 (capital outlay changes), 9 (reduce general appropriations), or the "tax package" in Senate Bill 6. Of course, the session ended Thursday and Monday is a holiday. Stay tuned as we'll know how it all ends soon.

*[NMTRI note: it is rare that good tax or spending policy can be crafted in the haste of panic, and this special session was no exception. Tax changes were more motivated by some regrettable timing of events and expenses rather than need to raise revenue (given the options they elected), although some of the changes are necessary ultimately. A somewhat mallet fisted approach to the budget was used – exempting the predictable agencies and programs (although it was amusing to find Cultural Affairs on the de facto list of critical agencies for a time). It's hard to take any other approach under the circumstances. It was fortunate we had tobacco settlement money and other funds to sweep and capital outlay to claw back; however, when we get together again in January those options will be all gone. That's when the conversation about taxes might get real, although easy options like "freezing" reductions will start falling off the table. We might decide what didn't pass was as good as or better than what did.*

*So, what about SB 6? Is it a tax increase? If encouraging out of state sellers to respect present law is a tax increase, then yes this certainly is, but that's all semantics that clouds the conversation of good tax policy. It was expected that natural resources would be carved out of the HWJTC in 2013 (prior to that the promoters didn't realize that industry could benefit as it wasn't their target) and the fact that they weren't presents real risks when the mining sector turns around at some point in the future. For a variety of reasons it's not an effective incentive in that space anyway. That doesn't mean that beneficiaries want to see it go or reduced and their taxes will go up. The narrowing of the credit base and interest elimination are policy calls, some of the structural changes may provide clarification, the application rules appear tougher, and the new rule that the Department determines completeness is where there's opportunity for real general fund savings – when it occurs to them that no claim is sufficient - for at least a year or so anyway (this is a flashback to Y2K when laws had to be changed).*

*The healthcare provisions were also a mixed bag. The proposal reinstates a Richardson era interpretation of the law that was found to be too narrow. The interpretation was bad in that it had the potential to create meaningful economic distortion—big brother's regulations making you do business in certain forms whether the market would have it otherwise. That distortion was not intended by the legislature in 2003 and the administration had no legitimate policy interest in creating or exacerbating it. All that said, the industry has long since adjusted, the most impacted being hospitals which created other remedies, and the rest like Healthsouth (at issue in a recent Decision and Order) will simply be forced to do business differently (and never pay tax again). In any case, the definitional clean-up in the two healthcare sections and the addressing of the stacking order (requiring 7-9-93 – the healthcare practitioner deduction that requires a hold harmless distribution – the most expensive deduction – to be taken last) were positive* *changes. Restoration of the penalty for incorrect reporting of the food and medical deductions was also a good thing given the impact on distributions (although it's ironic what a big deal was made to remove it a decade ago and no one noticed it going back…).*

*All in all it was a painful way to solve the short term portion of a longer term problem. The remaining fiscal bills will almost certainly be signed as they are necessary for solvency. The tax bill isn't really all that necessary from a fiscal perspective (relative to waiting until the regular session) and it may be open to line item veto as previously noted. However, we suspect the Governor will sign it, and practically speaking, problems found or changes desired can be effected in a few short months when we get to do this all again.]*

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## HOLD THE DATE AND MARK YOUR CALENDARS NOW – 12TH ANNUAL NMTRI LEGISLATIVE OUTLOOK CONFERENCE IS COMING!

NEW MEXICO
TAX RESEARCH
INSTITUTE

The <u>Twelfth</u> (can you believe it?) Annual NMTRI Legislative Outlook Conference will be held at the Hotel Albuquerque December 20th. You will be inundated with details shortly! We look forward to seeing you there!

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**TAX QUOTABLES**

"We stand today at a crossroads:
One path leads to despair and utter hopelessness.
The other leads to total extinction.
Let us hope we have the wisdom to make the right choice."

*~Woody Allen*

"The nation should have a tax system that looks like someone designed it on purpose."

*~ William Simon*
*[NMTRI note: the same is true of the states…]*

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## DON'T FORGET THE PRINCIPLES

It's important, particularly when dealing with tough economies, tough decisions, and the emotionally charged subject of taxes, to view the world in the context of principles. Taxes are good in that they raise the money we need to pay for the services we need. They can also be bad if they create inefficiencies, distortions, or inequities. It's a more rational approach to look at our entire tax system rather than getting lost in the weeds focusing only on a particular rate or some item we choose to tax or not tax. We must raise the revenue we need for government (putting aside the debate over how much) while doing the least harm to the economy and to those things we need most (e.g. job creation) while being fair and protecting the most vulnerable in our communities. Accordingly, we've taken the opportunity to reprint our principles of good tax policy here:

- State and local taxes should be adequate to provide an appropriate level of those goods and services best provided by the public sector, such as education, public safety, law enforcement, streets and highways, and the courts.

- State and local tax policy should do the least harm to the private economy. Therefore, tax bases should be as broad as possible so that tax rates can be as low as possible in order to raise the necessary revenues.

- State and local tax policy should be fair and equitable towards individuals and businesses similarly situated. Individuals with the same income level should be taxed the same. Businesses engaged in similar commercial activities should be subject to the same level of taxation.

- State and local tax policy should not be costly to administer and should be easily understood by taxpayers so as to minimize taxpayer compliance costs.

- The state and local tax burden should be evaluated on the basis of the impact of all taxes levied on a given taxpayer, not just a single tax or tax rate.

- Deviations from established tax policy in pursuit of economic development, social or other goals should be well-reasoned and pursued only when established tax policies are not significantly undermined and the results of such deviations can subsequently be measured and evaluated.

**COMMENTS**: Your suggestions and comments on this newsletter, the conferences (past or future), the Distinguished Lectures Series, our research or any aspect of NMTRI's operation and programs are welcome. Please send them to richard.anklam@nmtri.org, call 505-269-6791 or mail them to P.O. Box 91657, Albuquerque, New Mexico 87199-1657. We genuinely solicit your input and thank you for your support.

NEW MEXICO TAX RESEARCH INSTITUTE

"The power to tax involves the power to destroy" - McCulloch v. Maryland, 17 U.S. 316 (1819), Chief Justice John Marshall.

"Taxes are what we pay for civilized society" Campañía General de Tabacos v. Collector, 275 U.S. 87, 100 (1927), Justice Oliver Wendell Holmes, dissenting.

Join NMTRI today!