

Tax Matters

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LFC considers role of tax incentives

At their August hearing in Cloudcroft, the Legislative Finance Committee (“LFC”) heard two sets of presentations on the role of tax incentives in New Mexico’s tax system. The first panel provided a wide spectrum of opinions on the role of incentives, while the second panel focused on the film production tax credit.

Evaluating Tax Incentives

TRD Cabinet Secretary Rick Homans argued that well designed incentives are an important element in the state’s ability to attract new investment. Homans also discussed the need to address disincentives in the state’s tax system, and the need to insure that revenues are adequate to fund public services. Homans reviewed the results of several studies of New Mexico’s tax incentives, and echoed the conclusion of one study that more information on incentives is needed. He said that TRD is currently working on several initiatives to provide more information about our current tax incentives.

A presentation co-authored by Richard Anklam and Tom Clifford of the NMTRI discussed tax incentives in light of the principles of good tax policy as endorsed by members of the organization. NMTRI’s presentation provided a list of arguments for and against economic development tax incentives, discussed the relationship between tax incentives and the broader goal of tax reform and talked about the trade-offs between increased accountability and respect for taxpayers’ need for privacy and certainty. Putting these points together, the NMTRI presentation suggested a set of guidelines for evaluating tax incentives, and included a list of specific questions that legislators might ask when a new incentive is proposed. Finally, the presentation described inconsistent language in current law governing tax credits and other incentives and suggested some ways that language could be clarified. A copy of the NMTRI presentation is available [here](#).

Chief Economist Norton Francis of the LFC staff presented a “multi-dimensional” analysis of tax incentives in which he described the layering and interactions among tax and non-tax incentives, the role of geographic targeting in some incentives and the accountability criteria that apply to different incentives. Mr. Francis expressed concern over the lack of comprehensive reporting of all incentives – including tax and non-tax incentives – awarded to a particular company or project. He concluded with a call for greater accountability, and also for applying a set of good tax policy principles to the evaluation of proposed new incentives. A copy of the LFC presentation is available [here](#).

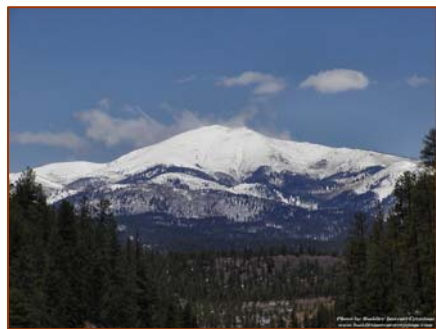
Dr. Jim Nunns, Tax Policy Director for TRD concluded the first panel by noting that, although tax incentives are at variance with good tax policy principles of “simplicity” and “economic efficiency”, they may be reconciled because the primary focus for incentives is not really tax policy, but rather the use of the tax system to provide financial incentives for certain activities. This latter function is more akin to expenditure policy, and therefore the principles of tax policy may not be directly relevant in evaluating incentives. Dr. Nunns also described ongoing work at TRD to respond to legislative requests for a “Tax Expenditure Budget.” In the current stage of

this work, TRD is working on the conceptual framework that can be used to identify which provisions give rise to tax expenditures. TRD hopes to complete that work this year. The second stage of the work will define and measure tax expenditures for a number of specific taxes, and the third stage will attempt to evaluate the effectiveness of the expenditures in achieving their desired objectives.

Legislators asked a number of questions of the panel. Rep. Sandoval asked how we can improve our system of incentives? Are we giving away the farm? And Are incentives available to existing firms? Senator Smith asked what is the lowest tax rate that we can promise a business over the long term? He also argued for the need for certainty. Representative Varela stated that we need to be careful not to undermine the long term goals of the tax system. He also asked if the state tried the use of dynamic analysis to evaluate these policies? Senator Beffort asked if we aren't better off economically in New Mexico thanks to personal income tax cuts and targeted tax incentives? Representative Saavedra said that he agrees with NMTRI point that geographic targeting creates inequities. As an example he noted that the Suncal development has not received same incentives that Mesa del Sol got. He also argued that incentives to Eclipse aviation were good policy because they provide high quality jobs. Representative Bratton stated that several principles should guide our policy: (1) Need level playing field; (2) Need incentives to maintain employment; (3) TID's should be used to revitalize older neighborhoods; (4) TID's are a form of earmarking which bypasses the appropriation process; (5) TID's may allow new development to erode the base for existing retailers and others; (6) Broad-based tax with low rate is the best policy, and (7) NM needs to be competitive with other states, and (8) Existing businesses need to be treated fairly.

Film Incentives:

In the second panel, the Committee heard about pros and cons of the film production credit from Professor Tony Popp of New Mexico State University and from Eric Witt, Director of Media Arts and Entertainment Development for the state. Professor Popp described results of an economic analysis of the film credits which suggest that the economic benefits to the state are unlikely to be large enough to make the state's revenues "whole" for the total amount of credits foregone. He estimated total credits in FY 2008 were approximately \$38 million, and that the state had probably recouped only about one-seventh of that amount through increased economic activity. Mr. Witt argued that the results of Dr. Popp's may be skewed by a number of assumptions that were made. He noted that New Mexico is one of over 40 states that now provide incentives to the film industry, and that those incentives have been instrumental in attracting jobs and investment to the state. Dr. Popp's slide presentation can be found [here](#), and the report of the analysis should be posted on the LFC website in the near future.



RSTP Meets in the Mountains of Ruidoso

The interim Revenue Stabilization and Tax Policy Committee ("RSTP"), met in Ruidoso on August 27th and 28th. While the agenda focused on presentations regarding local issues, equine specimen testing, and presentations by the Gaming Control Board and Racing Commission (the last Racino license (horse racing track and casino) allowable under the Indian Gaming Compacts, was awarded to Raton which will

race in the summertime concurrent with Ruidoso Downs).

The remaining agenda items included presentation of the revised consensus revenue forecast prepared the day before the Special Session. The forecast was presented by the LFC's chief economist Norton Francis, the Department of Finance and Administration's chief economist Laird Graeser, and the Taxation and Revenue Department's cabinet secretary Rick Homans and policy director Dr. Jim Nunns. The report focused on the consensus revenue estimating process, and the volatility in the oil and natural gas markets that drove the consensus estimate down immediately prior to the Special Session. It was noted that the previous estimate was prepared at the virtual peak of oil and natural gas prices in July, and revised due to the subsequently and dramatically falling leading up to the prices before the Special Session. A copy of the revised consensus estimate can be found [here](#). It was reported that the consensus revenue forecast would be revised in October. Oil and natural gas prices, driving volatility in the forecast, have remained well below those called for in the current forecast, giving some lawmakers budgetary concerns (see the recent public Albuquerque Journal article by Barry Massey [here](#) (you'll have to endure a commercial if not a subscriber) and read on to the next topic for more on this subject).

Also discussed were issues surrounding tax increment financing tax increment development districts (TIFs and TIDDs, respectively), with presentations and committee discussions from a panel of experts including Norton Francis, Laird Graeser, Mesa Del Sol's Sheila Duffy, SunCal lobbyist Dick Minzner, and Bob Hearn of the Quality Growth Alliance of Dona Ana County. The state officials described the need for more oversight and information, possibly to include state representation on tax increment district boards (which no one disagreed with). Other discussion pertained to the state's limited involvement in the process despite the potential for implications to the general fund. Laird mentioned that only Arizona and Illinois didn't have some form of tax increment financing. Some discussion ensued regarding the "no net expense" concept, which as Dick Minzner pointed out, is not in state statute but exists in local government agreements with developers. The notion involves the idea that TIDD's should be required to draw new outside investment for tax funding purposes, rather than simply cannibalizing the effected local governments' tax base. However, the ways to measure and police such a mechanism can vary and are subject to debate. Quality Growth Alliance of Dona Ana County made a presentation supporting TIDD reform, including a moratorium on "greenfield" or open space developments (as opposed to metropolitan redevelopment projects). Groups represented by Quality Growth Alliance of Dona Ana County included AFSCME, American Federation of Teachers, New Mexico AFL-CIO, and Voices for Children to mention a few. The conversation then turned when legislators from both sides of the aisle asked a number of questions about the nature of some of the supporting organizations, their interest in the subject, their funding sources and whether or not they receive state funding.



NMTRI Reviews State Revenue Outlook

NMTRI Research Director Tom Clifford received two invitations in the past month to discuss the revenue outlook for New Mexico. As a former Chief Economist for both Taxation and Revenue and the Department of Finance and Administration, Tom has considerable experience to draw on when considering the revenue forecast. The first invitation came from the Council of University

Presidents, who held a planning conference at the Tamaya Resort on July 28. At this meeting, Dr. Clifford reviewed estimates prepared by the consensus revenue estimating group in early July. In addition to reviewing the current outlook, Dr. Clifford was asked by the Council to discuss the process by which the estimates are derived. The second invitation came from members of the Senate Democratic caucus during the recent Legislative Special Session. Some caucus members were concerned about the uncertainty in the current revenue forecast due to volatility of crude oil and natural gas prices. The revenue forecast had been revised immediately prior to the Special Session, to reflect sharply lower crude oil and natural gas prices.

Revenue estimating process:

By agreement between the executive and legislative branches, the estimating process is largely insulated from political influence. Economists from both the legislative and executive branches form their best estimate for each revenue source through a consensus process. The total revenue forecast is simply the sum of these individual revenue forecasts. Revenue forecasts are published with a five-year time horizon, but the most important figures for decision making are those for the current year and the immediately following year. A variety of statistical methods and data sources are used to prepare the individual revenue forecasts. Uncertainty varies significantly, with the largest revenue source, the Gross Receipts Tax, typically being one of the easier revenues to predict since its broad revenue base provides some insulation against volatility in particular sectors of the economy. Other revenues, like the corporate income tax, are much harder to predict, because they depend on net income rather than gross revenue, and they are highly sensitive to cyclical fluctuations in the economy, which are almost impossible to predict. The greatest forecast challenge is dealing with high and volatile crude oil and natural gas prices. Revenues from production taxes and royalties are now at their highest level ever and comprise almost one quarter of total General Fund revenue. General Fund revenue changes by almost \$4 million for each \$1 per barrel change in the annual average price of oil, and by almost \$11 million for each 10 cent change in natural gas prices. In the past, the estimating group, after reviewing information from the futures market and from economic forecasting services, would often reduce their oil and gas price forecasts to a modest extent as a hedge against the risk of a sudden downturn in prices. This approach led to criticism that the group was being overly conservative, a criticism that was borne out during the last four years by steadily rising energy prices. Perhaps in response to this criticism, the estimating group seems to have changed their approach. The oil and gas price forecasts in July and August were close to or even above the price outlook as reflected in the futures market. Thus, the forecast does not appear to include any explicit adjustment for risk. This is an important change in approach, and leaves the task of managing the risk in the forecast to the Legislative appropriating and tax-writing committees.

Current revenue outlook:

The current revenue forecast can be thought of as a “soft landing”, in which the slowdown of broad-based revenues due to a softening economy is more than offset by unusually high revenue from crude oil and natural gas production. Gross receipts tax collections were essentially flat in FY 2008, but are expected to resume growth of 4% to 5% per year in FY 2009 and beyond. Personal income taxes fell by almost 2% in FY 2008, and will fall again slightly in FY 2009 before resuming growth in 2010. These trends are influenced by recent legislative changes, including the new Working Families Tax Credit and the final year of phase-in of top tax rate reductions first passed in 2003. Corporate income taxes fell by 3% in 2008, but this appears to be primarily due to a sharp increase in film production credit claims, which reached \$46 million

for the year. Crude oil prices are expected to average \$122 per barrel in 2009 and \$116 in 2010. Natural gas prices will average \$9.60 this year and \$9.20 next year.

After appropriations and the tax credit authorized in the Special Session, General Fund balances are projected to be about 12% of recurring appropriations at the end of FY 2009. Although these reserves would appear to be adequate under most circumstances, their vulnerability to energy prices cannot be overstated. Oil and gas prices on the futures market have already fallen by enough that, if the current prices were to persist, reserves would fall below the 10% goal that has been set in recent legislative sessions.

A copy of Dr. Clifford's presentation is available on the NMTRI website [here](#) (keeping in mind the report was created in the context of the earlier July consensus revenue forecast rather than the revised forecast linked in the previous article).



WELCOME NEW MEMBERS: The New Mexico Tax Research Institute is delighted to welcome these new members and thank them for their support of good tax policy in New Mexico.

*REDW LLC The Rogoff Firm
CCH, a Wolters Kluwer business*

A very special thank you goes out to Eric Herrera, Jimmy Trujillo, and Jake Meuli for making the membership happen and for their individual help, support and interest in good New Mexico tax policy.

KNICK KNACKS

Legislative Committees Staying Busy

The interim Revenue Stabilization and Tax Policy Committee ("RSTP") is holding its September meeting in Farmington September 10-12th. Agenda items include a panel presentation of local government tax bases including member representatives Bill Fulginiti of the Municipal League and Tasha Young of the Association of Counties. Taxation and Revenue Department Secretary Rick Homans and Tax Policy Director Jim Nunns will be presenting possible legislative proposals to be forthcoming from their agency. Last but not least, our own Tom Clifford will be present on the subject of managing oil and natural gas price volatility. The agenda can be found on the LCS website [here](#).

The Legislative Finance Committee ("LFC") is scheduled to meet September 24-26 at the Capitol building in Santa Fe. The meeting is oriented towards budgets and review of LFC reports, as well as previews of appropriation requests for Medicaid and the Children Youth and Families Department and a report on the fiscal condition of county and municipal governments by DFA's Local Government Division. The agenda can be found on the LCS website [here](#).

Ron Loyd Retires

Ron Loyd of Holly Corporation has retired and left the NMTRI Board of Directors. Ron has been with NMTRI as founding member Holly Corporation's representative since the inception of

the organization. He served NMTRI, as well as other organizations such as the Association of Commerce and Industry, tirelessly. Ron was on the Executive Committee and contributed a great deal to human resource issues, as they were his responsibility at Holly. Although an HR guy most recently, Ron served as the Deputy Secretary of the New Mexico Taxation and Revenue Department during its zenith. The Board and staff wish to thank Ron for all his help, and wish him many happy days at the lake... and wherever else his retirement may take him.

COST's 39th Annual Meeting

The Center on State Taxation ("COST") is holding its 39th annual meeting October 22-24th in Orlando Florida. Topics under discussion are broad and diverse, including current tax and litigation issues, deteriorating state fiscal conditions, incentives best practices, sales and use taxes in an M&A environment, and state tax reform efforts (boom or bust?), to name a few. The agenda and registration information can be found on the COST website [here](#).

TAX QUOTABLE:

"The same prudence which in private life would forbid our paying our own money for unexplained projects, forbids it in the dispensation of the public monies."

~Thomas Jefferson



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. You may also e-mail them to tom.clifford@nmtri.org or call him at 505-228-7129. We genuinely solicit your input and thank you for your support.



"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" Campaña General de Tabacos v. Collector, 275 U.S. 87, 100 (1927), Justice Oliver

Wendell Holmes, dissenting.

Join NMTRI today.