NEW MEXICO TAX STRUCTURE OVERVIEW

A white paper by

New Mexico Tax Research Institute

Richard Anklam, Executive Director

612 1st St. NW.

Albuquerque, NM 87102

(505) 842-5833

In support of the

Economic Roundtable

on

The True Cost of Debt

organized by:

Greater Gallup Economic Development Corporation

Patty Lundstrom, Executive Director

PO Box 1795 / 102 W. Hill Avenue

Gallup, NM 87301

(505) 722-2980

The Lodge at Santa Fe

January 29, 2016

New Mexico Tax Structure Overview

➢ State General Fund

At over $6 billion in revenue and expenditures, New Mexico's General Fund funds most general state government operations, as well as public schools, higher education, and the State's share of Medicaid. It has numerous revenue sources (taxes), with the largest contributor being the gross receipts tax ("GRT"). The second largest contributor to the State's General Fund is the personal income tax.

The following chart depicts the sources and amounts of the State's general fund revenue sources (from the December consensus revenue forecast).

General Fund Consensus Revenue Estimate December 2015

	FY15				FY16				FY17			
	Aug 2015 Est.	Pre-liminary Actual	$ Change from FY14	% Change from FY14	Aug 2015 Est.	Dec 2015 Est.	$ Change from FY15	% Change from FY15	Aug 2015 Est.	Dec 2015 Est.	$ Change from FY16	% Change from FY16
Gross Receipts Tax	2,129.0	2,095.2	103.1	5.2%	2,233.9	2,178.0	82.8	4.0%	2,331.7	2,336.7	158.7	7.3%
Compensating Tax	82.0	71.8	(6.5)	-8.3%	68.6	65.5	(6.3)	-8.8%	68.0	65.4	(0.1)	-0.2%
TOTAL GENERAL SALES	2,211.0	2,167.0	96.6	4.7%	2,302.5	2,243.5	76.5	3.5%	2,399.7	2,402.1	158.6	7.1%
Tobacco Taxes	81.9	82.3	3.9	4.9%	82.0	82.4	0.1	0.1%	81.0	81.4	(1.0)	-1.2%
Liquor Excise	26.7	26.3	(0.1)	-0.4%	6.7	6.7	(19.6)	-74.5%	6.9	6.9	0.2	3.0%
Insurance Taxes	140.0	149.9	34.8	30.2%	183.0	188.0	38.1	25.5%	213.0	219.1	31.1	16.5%
Fire Protection Fund Reversion	15.7	15.2	(0.9)	-5.8%	14.0	13.7	(1.5)	-9.6%	12.8	12.4	(1.3)	-9.5%
Motor Vehicle Excise	143.0	138.7	5.4	4.1%	146.0	147.0	8.3	6.0%	150.0	152.0	5.0	3.4%
Gaming Excise	70.1	70.4	4.0	6.0%	68.9	70.1	(0.3)	-0.4%	67.7	70.1	-	0.0%
Leased Vehicle Surcharge	5.2	5.2	0.0	0.6%	5.2	5.2	(0.0)	-0.7%	5.2	5.2	-	0.0%
Other	1.0	0.5	(2.5)	-83.5%	3.0	3.2	2.7	564.7%	2.2	2.1	(1.2)	-35.8%
TOTAL SELECTIVE SALES	483.6	488.5	44.6	10.0%	508.8	516.3	27.9	5.7%	538.8	549.2	32.8	6.4%
Personal Income Tax	1,340.0	1,339.7	84.8	6.8%	1,379.0	1,401.0	61.3	4.6%	1,440.0	1,455.0	54.0	3.9%
Corporate Income Tax	255.0	254.5	57.7	29.3%	224.7	218.0	(36.5)	-14.3%	234.7	217.0	(1.0)	-0.5%
TOTAL INCOME TAXES	1,595.0	1,594.2	142.5	9.8%	1,603.7	1,619.0	24.8	1.6%	1,674.7	1,672.0	53.0	3.3%
Oil and Gas School Tax	370.7	375.4	(125.2)	-25.0%	331.8	283.7	(91.7)	-24.4%	365.1	315.3	31.6	11.1%
Oil Conservation Tax	19.6	20.1	(7.2)	-26.3%	17.6	15.1	(5.0)	-24.8%	19.4	16.7	1.6	10.6%
Resources Excise Tax	13.0	13.3	0.3	2.5%	13.0	13.0	(0.3)	-2.6%	13.0	13.0	-	0.0%
Natural Gas Processors Tax	19.0	18.6	2.4	14.8%	18.7	19.7	1.1	5.9%	14.2	15.0	(4.7)	-23.9%
TOTAL SEVERANCE TAXES	422.3	427.5	(129.7)	-23.3%	381.1	331.5	(96.0)	-22.4%	411.7	360.0	28.5	8.6%
LICENSE FEES	55.0	55.9	4.2	8.1%	53.5	54.5	(1.4)	-2.5%	54.6	55.5	1.0	1.8%
LGPF Interest	502.8	502.8	53.4	11.9%	553.2	553.2	50.4	10.0%	547.0	548.1	(5.1)	-0.9%
STO Interest	16.8	17.0	(2.0)	-10.4%	29.9	23.4	6.4	37.5%	60.8	52.6	29.2	124.8%
STPF Interest	182.7	182.7	12.3	7.2%	193.5	193.5	10.8	5.9%	203.5	203.4	9.9	5.1%
TOTAL INTEREST	702.3	702.5	63.6	10.0%	776.6	770.1	67.6	9.6%	811.3	804.1	34.0	4.4%
Federal Mineral Leasing	541.9	542.2	(27.7)	-4.9%	420.0	421.7	(120.5)	-22.2%	430.0	407.1	(14.6)	-3.5%
State Land Office	42.2	42.2	(5.2)	-11.0%	39.3	37.6	(4.6)	-11.0%	41.4	41.2	3.6	9.6%
TOTAL RENTS & ROYALTIES	584.1	584.4	(32.9)	-5.3%	459.3	459.3	(125.1)	-21.4%	471.4	448.3	(11.0)	-2.4%
TRIBAL REVENUE SHARING	65.0	67.2	(0.4)	-0.6%	64.3	64.3	(2.9)	-4.3%	65.8	65.8	1.5	2.3%
MISCELLANEOUS RECEIPTS	52.7	56.2	11.1	24.7%	52.9	56.5	0.3	0.6%	55.0	59.4	2.9	5.1%
REVERSIONS	55.7	51.5	(45.1)	-46.7%	45.0	50.0	(1.5)	-2.8%	45.0	50.0	-	0.0%
TOTAL RECURRING	6,226.8	6,194.7	154.6	2.6%	6,247.7	6,165.0	(29.6)	-0.5%	6,528.0	6,466.3	301.3	4.9%
TOTAL NON-RECURRING	24.6	41.2	40.8	na	5.5	5.5	(35.7)	-86.7%	-	-	(5.5)	-100.0%
GRAND TOTAL	6,251.4	6,235.9	195.4	3.2%	6,253.2	6,170.5	(65.3)	-1.0%	6,528.0	6,466.3	295.8	4.8%

The GRT was created in the early 1930's (it was the "Emergency School Tax" then), and in the 1960's it became what it resembles today as a result of a tax reform effort (the last successful one in New Mexico – the "Franklin Jones Commission"). It is the only tax that's broadly shared with local governments, who possess the ability to impose their own tax increments above the State's rate of 5.125% - but with some limitations. The State also shares 1.225% of its 5.125% with municipal governments on transactions that occur within their boundaries. The gross receipts tax is somewhat misnamed, as it is a hybrid at best and is really structured more like a sales tax than a true gross receipts tax. However, relative to most states' sales taxes, it is more broadly imposed in that it taxes most services. This broad taxation includes business-to-business services, not just final consumption (the ideal for consumption taxes), so it "pyramids". This means business inputs through the chain of commerce can be taxed multiple times, resulting in a much higher effective tax rate than the stated rate, since the tax can become embedded in the cost of business inputs and then taxed and embedded again - potentially multiple times. This "hides" the tax from consumers and voters, and creates inequities (i.e., it tends to disfavor small businesses and those who cannot vertically integrate).

Consumption taxes like sales taxes and value added taxes are broadly considered to be the most efficient. Ideally, they only tax final consumption so as not to distort markets, making them less fair and efficient (the aforementioned "pyramiding" problem). Most states tax some business inputs – typically consumed tangible personal property. New Mexico stands out for its taxation of business service and intangible inputs that few other states tax at all, much less so broadly.

Properly designed or not, consumption taxes can also raise lots of revenue. All but five states impose a sales-type tax and those that don't still impose other consumption taxes. It is often the largest funding mechanism for state and local governments. As a revenue source, sales taxes are more stable than income taxes but more volatile than property taxes.

One downside to consumption taxes, and really all taxes except progressive income taxes, is that they are regressive. As a percentage of income, they fall harder on families as incomes go down.

Rates also matter - as you increase rates, not only is the pyramiding problem exacerbated, but the burden on households – particularly poor households – is increased. Households feel the hidden effects of pyramiding also.

- **<u>Local Governments and the Gross Receipts Tax (GRT)</u>**

Local Governments, as previously mentioned, share in the gross receipts tax along with a few special districts that can also share in the tax base (i.e. water districts, spaceport, etc). In most cases, the GRT is the largest source of funds for municipal governments, followed by property taxes. The reverse is generally true for property taxes. Since the state and local governments share the same tax base, meaning they can't pick and choose what they tax – they have to tax the same things the state does and nothing more. There are Taxation and Revenue Department rules and deadlines for notifying the department of new local tax increment ordinances, and local GRT rates can only change on January or July 1.

Local governments have the ability to impose various tax increments authorized by the Legislature. Some require voter approval, while others do not. They vary in terms of the rate or rates of the increments, as well in their use (some are for limited specific purpose, while others are general purpose). Some increments have never been used. The New Mexico Association of Counties has recently undertaken efforts to reduce tax authority and the number of increments available to counties in general, in exchange for broader flexibility by counties over their remaining increments. Some county increments are only applicable to transactions that occur within county boundaries but outside of municipal boundaries, while others apply within and outside municipal boundaries**.**

- **Property Taxes**

Unlike the State's other taxes, property taxes in New Mexico are provided for in the State Constitution. Unlike the GRT, the State itself gets almost no money from property taxes, which are generally administered by county assessors, whose work is overseen by the Taxation and Revenue Department's Property Tax Division. In addition to municipal and county governments, there are other beneficiaries that share in the property tax. It depends upon location, but they tend to be beneficiaries such as hospitals, community colleges, and irrigation districts. New Mexico is generally viewed as having fairly low property tax rates, however Bernalillo County is the highest and closer to the national average. New Mexico taxes business and personal real property, as well as business personal property (but not individual personal property). The last feature is not as common among states, gets mentioned as a negative factor in state tax comparisons, and like the GRT, effectively contributes to the business pyramiding problem the GRT presents, rendering our local businesses less competitive relative to out-of-state competitors.

Like consumption taxes, property taxes are regressive, and tax increases tend to disproportionately hurt low income household. Property tax "incidence", that is, who is really paying the tax regardless of who is assessed, can vary. However, renters can and do bear the incidence of property tax also. As previously mentioned, New Mexico does not rely on the property tax as much as many other states do, for a host of reasons. However, one upside to property tax is that it is one of the most stable revenue sources available to local governments.

New Mexico's history with the property tax is long. There was a property tax revolt, so to speak, which in part gave rise to the GRT. New Mexico suffers from the loss of property tax revenues due to the vast amounts of public, military, and tribal land, which simply can't be taxed. That means New Mexico doesn't have the funding flexibility that many other states enjoy with their property tax base (Texas for example has virtually no public or tribal land and relies on its property tax to a much greater extent than New Mexico does).

- **Recent history/issues**

Since the early 2000's, and for a variety of reasons, there has been a steady trend in increasing GRT rates, both at the state and local level. From January 2000 to January 2016, the GRT rate in Albuquerque has increased 24%, while Santa Fe's has risen 29%, and in Gallup the rate has risen by 32%. Those are highly significant increases, which serve to exacerbate the downsides of the sales-type tax as a revenue tool.

Another trend is that the GRT tax base has been steadily eroded through tax deductions and credits. The largest example was the deduction created for food and medical services in 2004. Not only was it notable for how large a swath it cut in our consumption tax base, but for the unique mechanism that had to be designed to keep local governments from going bankrupt. That mechanism is referred to as "Hold Harmless", and was simply a mechanism by which taxpayers selling now-deductible food or medical services were required to report those deductions separately from other deductions (which are generally all lumped together on the tax return). Subsequently, the Taxation and Revenue Department would then distribute money to the local governments as if the tax had been paid to begin with. This mechanism allowed the deductions to pass the Legislature, but it also cost the General Fund almost double what it would otherwise incur (since the State is distributing money it isn't taking in).

More recently, the Hold Harmless rule was altered such that the State's payments to most local governments were to be reduced over 15 years. In exchange, counties and municipalities, regardless of whether they were subject to the phase-out, were all given the authority to impose three 1/8% tax increments that could be imposed immediately and without voter approval, and for any purpose. The new county increments are not limited to transactions outside municipal boundaries, so as with property taxes, people in the county could now effectively tax the people in the municipality, and the municipality in this case is subject to the possibility of a 6/8% overall increase from this measure (i.e., three 1/8% increments by the county plus three 1/8% increments by the city). Accordingly, in some places there appears to be a perverse tax competition, where some local governments are imposing the new taxes before the other local government does, even though it is long before they need to. Around the same time that the Hold Harmless phase-out was enacted, the State also intercepted revenues that some counties had been receiving (Sole Community Provider Act funds), in return for which it authorized those counties to enact an additional ¼% local tax increment. Meanwhile, however, these jurisdictions already have other unused increments on the books and are facing budget pressures of their own.

At the State level, in 2009 the statewide GRT rate was raised from 5% to 5.125%. In addition to "normal" tax increases and decreases by various local authorities, GRT was also raised in two of three counties near the Spaceport for its support (Otero County voters said no).

Property tax has seen some activity around the State, but it is more specific to jurisdictions, since the array of beneficiaries and their interest in mill rate increases can vary extensively. There was some controversy around "tax lightning" when a 3% residential valuation increase was passed and subsequently litigated. That issue, however, impacted who paid how much, but not overall property tax collections.

➢ **Policy questions and tradeoffs - Analysis**

"Tax cost versus public benefit" is an important question. Not all tax structures are created equal, so unless you have more resources than you need, a poorly designed system will cause you to "get less and pay more." On the other hand, a more thoughtful approach can minimize adverse effects on economic development and local businesses, which might otherwise be rendered uncompetitive without even realizing it, as well as avoiding unintended consequences to more vulnerable households. Still, the impacts of increasing tax rates can be difficult to analyze, and the process can often be further muddied by the vagaries of the political process.

The first rule, however, is that one needs to look at a tax structure comprehensively. Few voters have the ability to do that. Whether looking at impacts on businesses or households, the analysis is meaningless without such a comprehensive treatment. Low turnouts for special elections can be another barrier to public understanding and engagement of and on tax issues. Another problem is that those public institutions/tax users seeking to raise revenues, for whatever purpose, tend to think of their own needs rather than those of the community-at-large, just like the voters often do (e.g., "It's only a penny, and don't you love the animals at the zoo?"); such self-interested parties might understandably prefer low turnout for elections as it may increase the chances of success in achieving passage of new tax measures. Every reason may sound good, as there are certainly legitimate, real and challenging needs in our communities that need to be addressed. The fact that we - both taxing authorities and voters - analyze these public tax questions in a vacuum, rather than from a big picture community perspective, can lead to fragmentation of our revenue power, neglect of community-wide priorities, excessive tax burden on businesses and taxpayers and poor decision making in general.

So, how do we break this cycle? It's not easy, but the formula is "Education, Education, Education." Informed voters who understand the tradeoffs and issues make better comprehensive decisions for themselves and their community (not that they'll always agree). Evaluation of options is also easier when they are considered at the same time and in the big-picture context. Ideally, all voter-decided taxes would be on the same ballot at the same time, allowing for better analysis of what is being proposed comprehensively. Structural changes can also help, but may be harder to do. Should we have county GRT imposed in cities by people who don't live in the city? There are two sides to that argument, but it's not clear in the case of the recent new increments if they were considered by the Legislature. Still, whether improving the tax and administrative structure, educating voters and tax users, or trying to get elections to occur at the same time – none is easy but all should be done.