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Raising GRT Bad Idea Now

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There has been a lot of talk about the financial crisis and what it has done to state and local government revenues. In addition to spending cuts, it may be necessary to raise taxes. Other states have raised taxes recently, including their sales taxes.

In New Mexico, our sales tax is called the gross receipts tax (GRT). But the GRT is different from a typical sales tax in an important way. It applies much more broadly to a lot of things, services in particular, that most sales taxes do not.

What does having a broader tax mean? It means an average consumer will pay more total "passed on" tax in the cost of what they buy than they would elsewhere, even if the rate is the same.

First, consumers pay on more types of purchases. Things like attorney and accountant services, construction services, computer and IT consulting, maintenance and repairs.

But, there is also more tax in everything you buy because business inputs are also taxed. This increases the cost of what businesses buy, as well as the prices they must charge for their own products and services. The tax compounds with each business-to-business transaction, making New Mexico businesses less competitive in an entirely untransparent way.

It also punishes some business based on how they buy things, who they buy them from, and how big they are.

The problem is generally worse for small businesses because they are not large enough to hire in-house marketing, accounting, legal or other services and must, instead, buy those services in taxable transactions.

We call this phenomenon "pyramiding" because of the compounding effect the GRT can have on the chain of transactions before the final sale.

So, raising the GRT tax rate just 1 percentage point means consumers pay much more than that on many purchases.

Another problem is that sales taxes, including the GRT, are particularly "regressive" by nature. The term "regressive" means people at lower income levels pay a higher share of their incomes in tax. The tax was taken off food in 2003, it's true, but what many don't remember is that tax rates went up on everything else at the same time in order to balance the food tax cuts.

While the GRT is a little less regressive than some sales taxes because of its breadth (meaning it applies to goods and services bought by those at higher income levels), it is highly regressive nevertheless.

These two problems — pyramiding and regressivity — are made much worse when the rate is increased: something we have been doing a lot of lately.

It is not talked about much, but in the last few years we have increased GRT rates tremendously within New Mexico.

Albuquerque's GRT rate, now at 6.625 percent, has increased by 14 percent since 2003 (18 percent higher before its transportation infrastructure tax expired at the end of 2009), and Santa Fe's tax rate now at 8.0625 percent is up a whopping 28 percent from 2003.

A third problem is that local governments rely on the GRT as well and have far fewer taxing alternatives than the state.

Increases in the state GRT rate makes it harder for local governments to raise their rates, even though that might be their only option to balance their budgets.

Nevertheless, raising the GRT rate polls well, something politicians like, especially in an election year. Why does the idea poll well? Probably because raising sales tax rates is generally perceived as fair. Other states have done it. Special interests like the idea because it has the potential to take them out of the crosshairs of potential targeted tax increases. It can be sold as a seemingly small tax increase (it's just a penny.).

All that said, raising the GRT rate is a profoundly bad idea.

To put it bluntly, if you want to hurt job creation — particularly in small businesses — and increase the tax burden on the poor at the same time, then this is how you do it.

You may have heard the phrase "broad base, low rate." It is something to aspire to, and something the GRT was for many years.

Narrowing of the base of the tax has and will lead to pressure to raise rates. And raising the rate will inevitably lead to greater efforts by special interests to carve out activities from the tax. Ultimately this leads to a less stable, less fair tax.

Let's hope we don't make a real problem worse when there are much less damaging alternatives.