



New Mexico's Experience With a Broad-Based Sales Tax

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Defining Sustainability

Index of Sustainability	Measure
Long-term adequacy	Tax base growth vs. total income/output/population growth
Stability	Tax base co-variation with income/output/population
Impacts on economic growth	Revenue or budget-neutral macroeconomic modeling
Political sustainability	Frequency & magnitude of base-eroding legislation

New Mexico's Gross Receipts Tax: Statutory Provisions

- Business privilege tax imposed on sellers:
 - “Gross receipts”: Any consideration for selling or leasing property (including intangible) or providing services
 - VERY inclusive definition, new businesses or activities are typically included unless a specific exemption or deduction is applicable
- State tax (5%) plus local option taxes (average 2%)(some requiring voter-approval)
 - State shares 25% of it's revenue with municipalities
- Compensating (Use) Tax:
 - No local options
 - Not Imposed on services
 - Estoppel on collecting from households
- Nexus/apportionment: Retail sales tax rules applied

Statutes Defining the Tax Base

- Exemptions:
 - Transactions taxed under other taxes
 - Wages and salaries
 - Sales to/by governments, non-profits (501c3's except for UBIT)
 - Financial institutions
- Deductions:
 - Sales (tangibles and services) for re-sale
 - Tangibles sold to governments
 - Manufacturer's ingredients
 - Food for home consumption;
 - Medical services; Hospitals
 - Miscellany: Agriculture; Newspapers; Racetracks; Renewable energy; Sales to Film producers

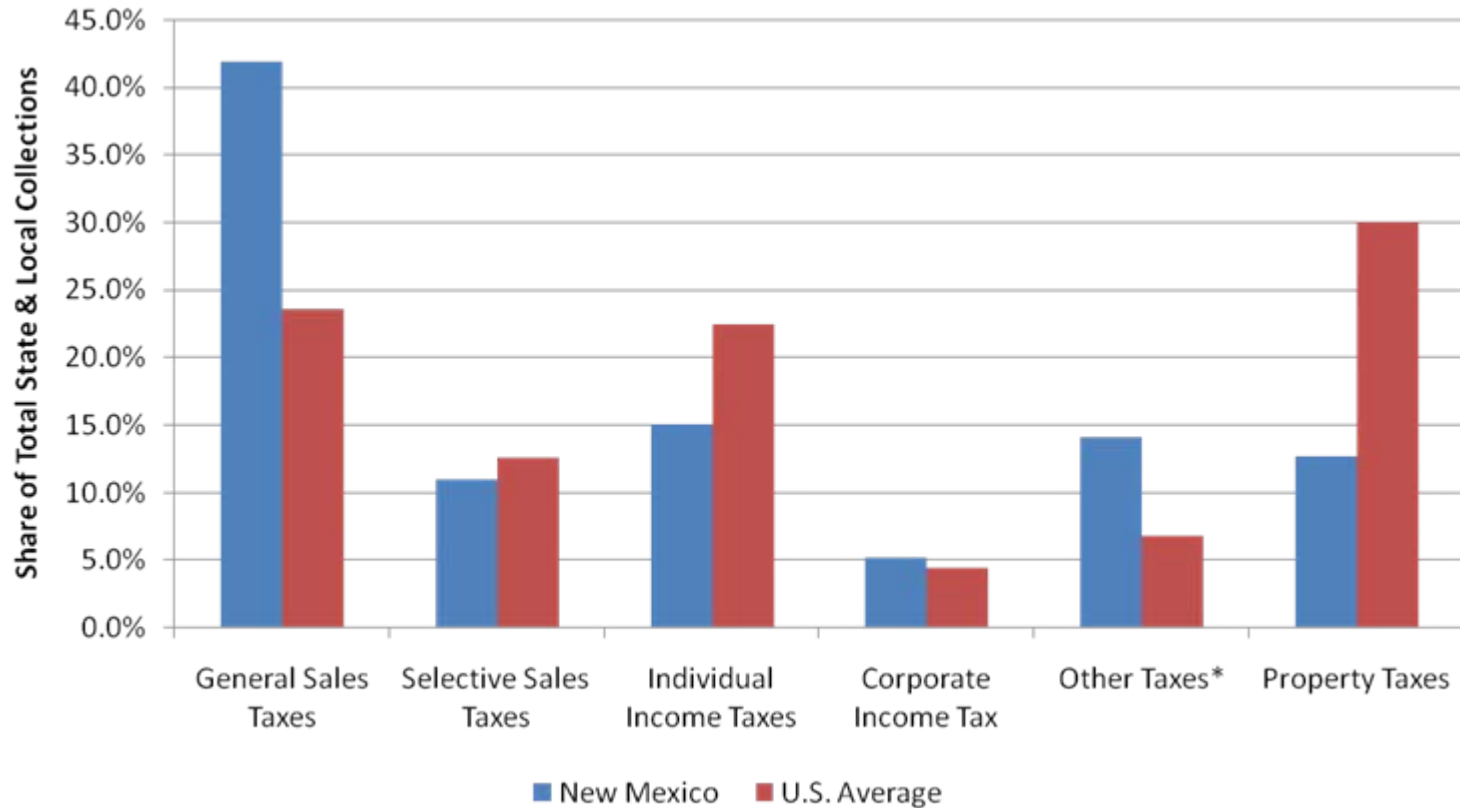
Some Implications of Broad Tax Base

- GRT on services: Deduction only for sales for resale when the next sale is taxable, primarily buyers in the same industry.
- GRT on tangibles: Narrow deductions for resale and for manufacturers' ingredients or components. Substantial portion of tangible purchases by business remain in the tax base.
- GRT on intangibles: Broadly interpreted by the Department, challenged by taxpayers (successfully in *Kmart vs. N.M.*). Tax on intangibles has caused confusion, lead to more pyramiding, and is probably not a significant source of revenue.
- Comprehensive tax base -- combined with vaguely-worded statutes -- has often lead to taxpayer uncertainty and litigation. Tax Department has alternately been seen as either aggressive or as indecisive.

Comparison With Similar Taxes

	New Mexico GRT	Washington B&O	OHIO CAT	Retail Sales Tax
Taxable transactions	All except listed exemptions & deductions	All except listed exemptions & deductions	All except listed exemptions & deductions	Specifically listed transactions. Usually sales at retail for use
Taxation of Services	Most taxable	All taxable	All taxable	Most not taxable
Consumer deductions	Health care; Food;	None	None	Food; Medicine
Business deductions	Resale; Exports; Manufacturing ingredients; Selected services sold to business	Wholesale	Small business	Resale; Exports; Manufacturing equipment and ingredients;
Average Tax Rate	7%	0.1% to 1.5%	0.26%	2.9% - 8.5%

GRT's Role in New Mexico's Tax System



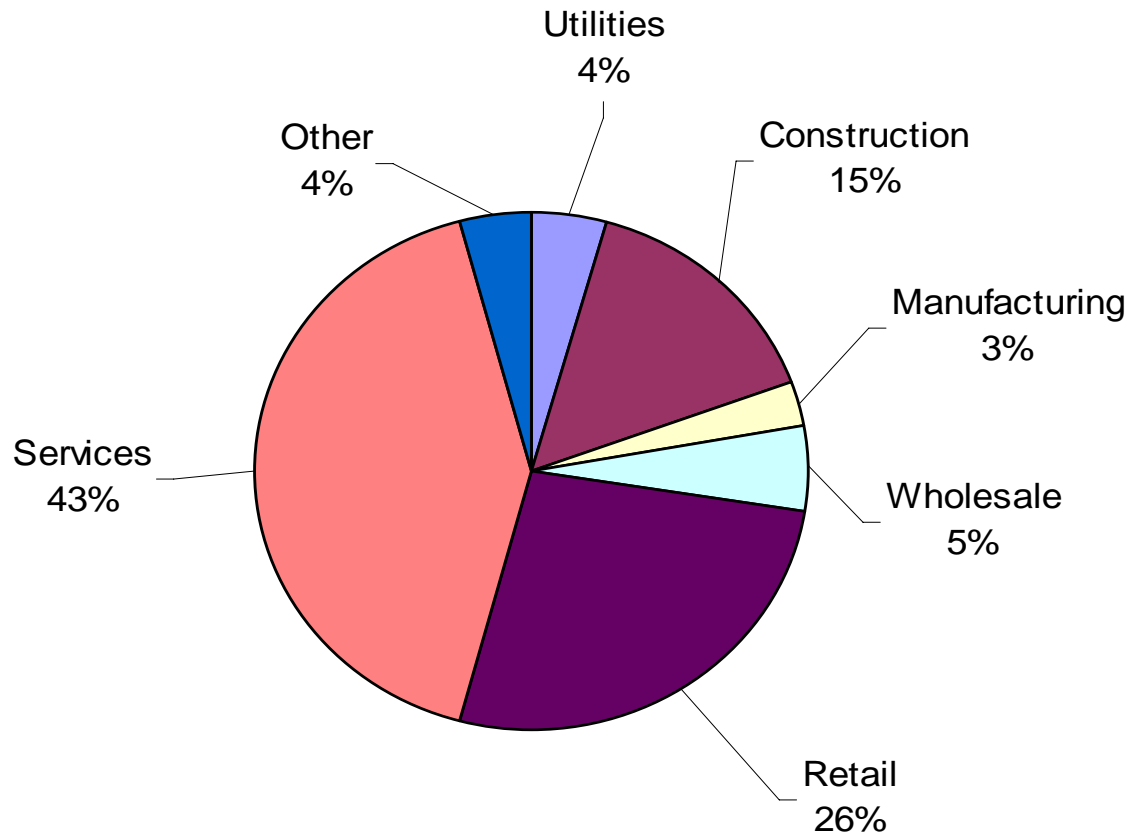
- *Higher NM Sales Tax offsets lower Property Tax than U.S. Average.*
- *Property tax base constrained by public land; “Land rich, cash poor” population*
- *NM Individual Income Tax is lower, Oil & Gas production Taxes make up the difference.*

Role in New Mexico Economy

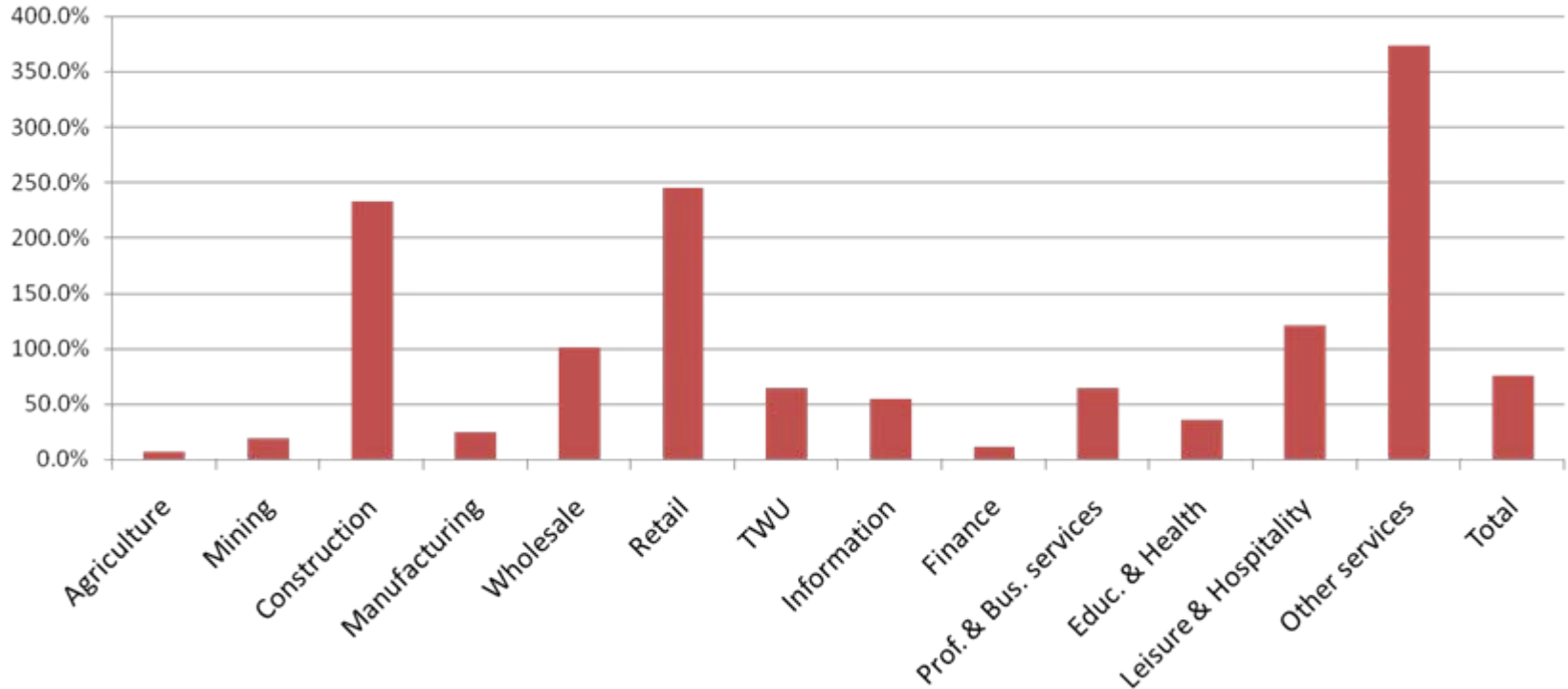
- Minimal role of cross-border transactions so little tax competition at retail level.
- Large role of government facilities: Seller-imposed GRT brings government contractors into tax base.
- Large role of resource extraction industries: GRT on services brings their contractors into the base.
- Relative isolation of N.M. economy is changing. Newly-locating businesses are putting pressure on the GRT, seeking relief on inputs and outputs. Also using GRT credits to offset other liabilities like withholding.

GRT Tax Base by Industry

New Mexico Gross Receipts Tax by Industry Group: FY 2007



Taxable Gross Receipts as Percent of GSP



Total Taxable Gross Receipts = 75% of Gross State Product:

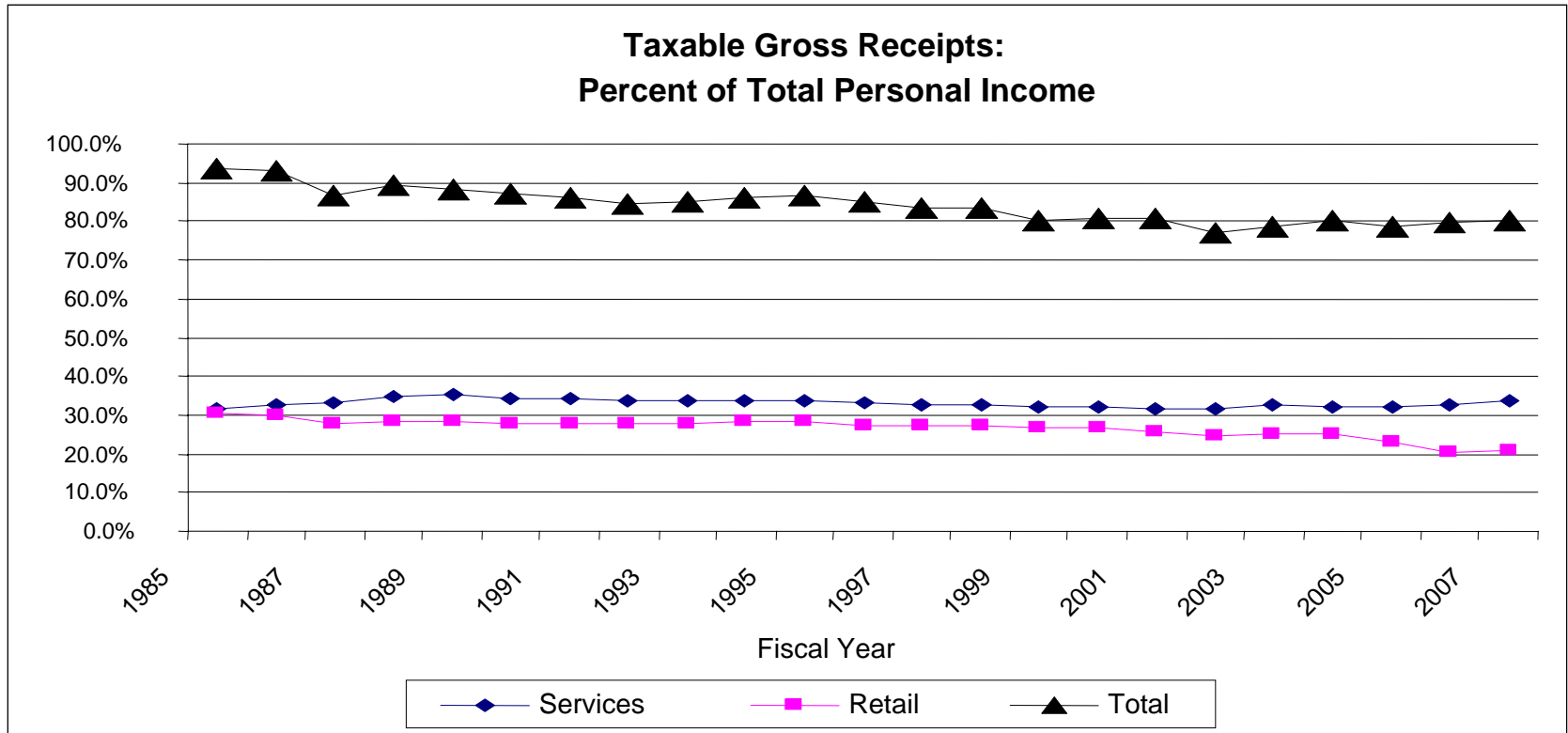
- Mining output is taxed under other taxes – Most is exported
- Construction includes value of new buildings – treatment under GSP accounting?
- Most manufacturing output is exported (deductible)
- Statutory deductions reduce Health sector relative to GSP
- Other Services tax base significantly exceeds GSP due to “pyramiding”

Summary of GRT Tax Base

- GRT is a hybrid of a Retail Sales Tax and a Business Privilege Tax
- Tax rate and deductions for resale are similar to RST
- Comprehensive taxation of sales to businesses are similar to BPT
- GRT on services sold to non-profits, government is more like BPT, broader than most RST's.
- B-t-B sales extend the GRT base well beyond consumption, but large parts of the consumption base are excluded.*

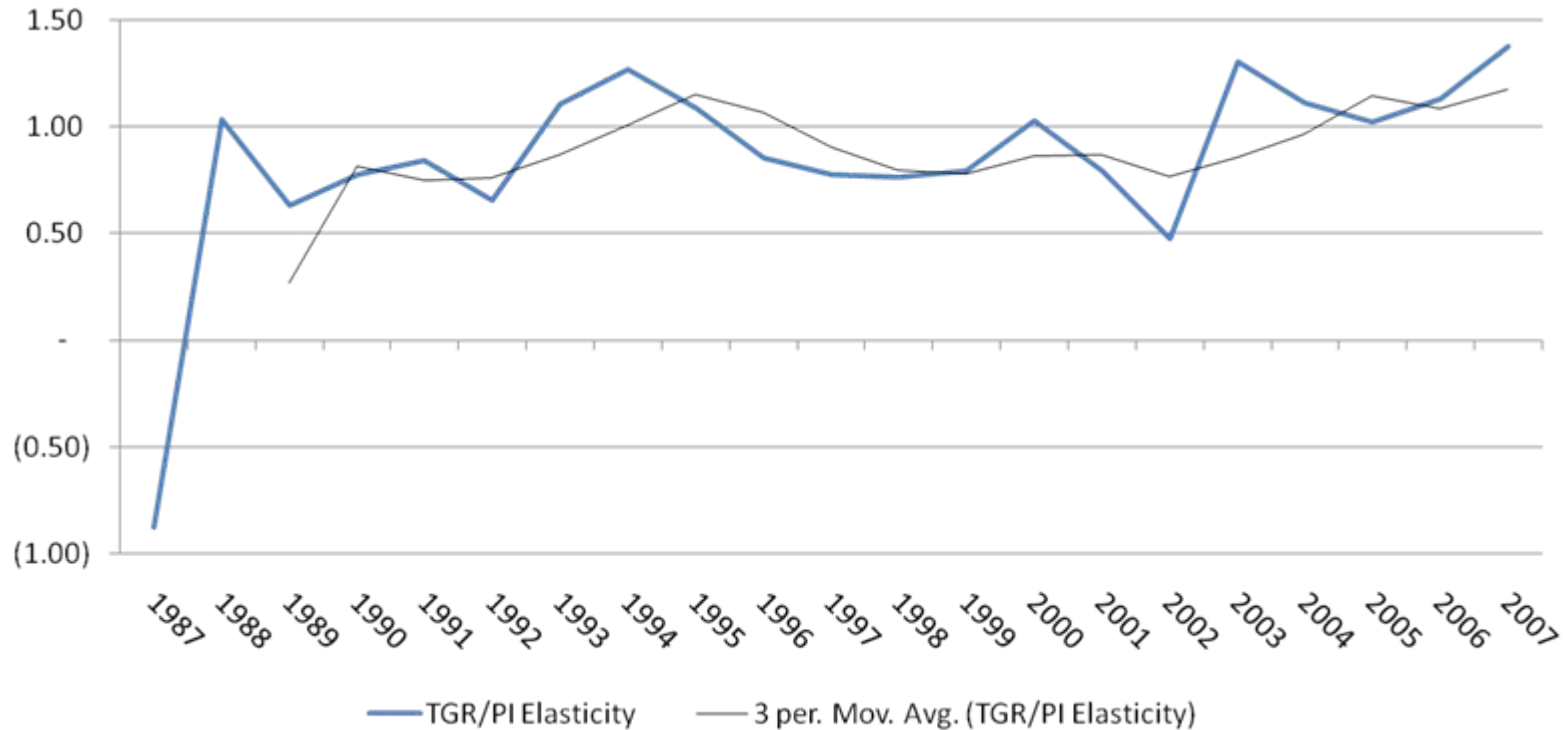
Thomas F. Pogue, *"Tax Expenditure Budget: Defining the Benchmark GRT Base,"* Prepared under contract to the New Mexico Taxation and Revenue Department, April 2008.

Long-term Adequacy



- *GRT base is declining relative to personal income*
- *Services share is stable at about 1/3*
- *Retail share is falling – Food deduction adopted in 2004*

GRT Base Elasticity With Personal Income



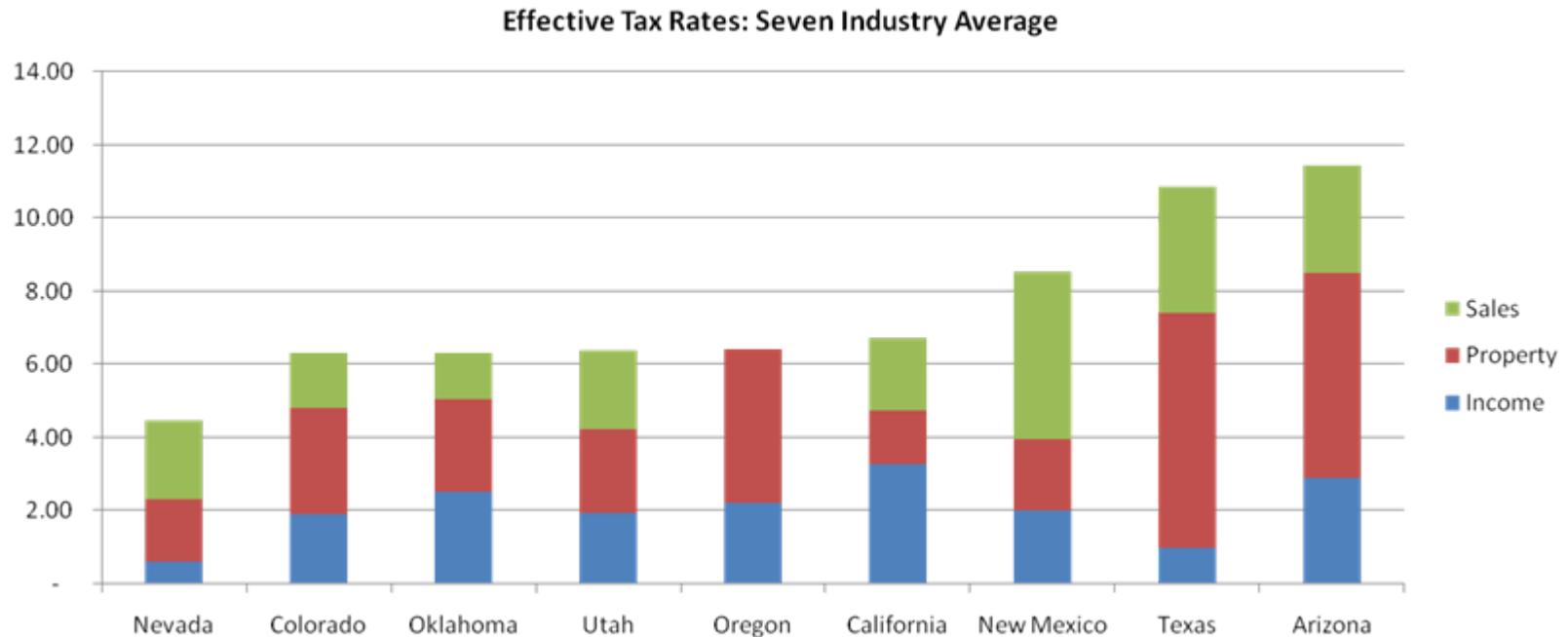
- *Elasticity is pro-cyclical; Increase in mid-1990's and early 2000's reflect strong economic growth*
- *Negative tax base changes include Indian gaming (1996); Food & medical deductions (2005);*
- *Positive base changes: Los Alamos National Laboratory contract revision (2007)*
- *Long-term average elasticity = 0.9*

Summary: Volatility and Adequacy of GRT

- The GRT base has eroded from 90% to 80% of Personal Income over a 20-year period.
- A significant portion of the erosion appears to be due to deliberate policy decisions (e.g. food & medical deduction).
- The Services component of the GRT has been stable as a percent of Personal Income.
- Elasticity of the GRT with Personal Income fluctuates in a pro-cyclical manner from 0.75 to 1.25.
- Tax base fluctuations at the local level are much more significant.

Pyramiding

- B-t-b deductions are limited to resale and targeted industry-specific relief.
- Estimates of pyramided share of tax base range from 1/3 to 50%*
- Barents Group estimates include GRT on business purchases, not sales.



“New Mexico Business Tax Competitiveness Study,” Policy Economics Practice, Barents Group, LLC, May 1997

*Pyramiding Transaction Taxes in New Mexico,” M. Del Valle, N.M. Tax Research Institute, Sept. 2005. www.nmtri.org

GRT and Regressivity

- Greater reliance on Sales tax contributes to regressivity of NM system
- Greater reliance on taxing business-to-business sales reduces impacts on households
- Reliance on services taxation reduces regressivity
- Deductions for food, medical services, prescription drugs reduces regressivity
- Targeted income tax credits reduce overall regressivity

GRT and Remote Commerce

- Broad base makes the GRT less vulnerable than Retail Sales Tax to erosion by E-commerce.
- Legislative provisions limit the reach of the Compensating (Use) Tax:
 - Tax does not apply to services or intangibles
 - No tax is collected on household purchases
 - Local option taxes are not added to the use tax
- Broad GRT base may increase confusion among remote sellers because they are not familiar with paying tax on intermediate sales.
- Generally no major hurdles for NM to joining SSUTA provided that recent changes allowing origin-based sourcing for in-state sales are sustained.

Political Tax Base Erosion

- Using tax code for social policy:
 - Health sector exclusions reducing growth
 - Food and medical deduction reduced consumption base, increased pyramided share. Accompanying tax rate increase further exacerbated pyramiding.
- Incentives targeted at economic development:
 - Refundable GRT credits being used to target businesses that are not really affected by the GRT.
- Piecemeal approach to pyramiding reform:
 - Poor comprehension of consequences of pyramiding
 - High cost of comprehensive reform
 - Exploiting special interest politics
- Tax rates have increased while base has eroded, increasing the impacts of pyramiding and making the cost of fixing it even greater.

Conclusions

- New Mexico's GRT is a hybrid between a retail sales tax and a business privilege tax.
- GRT elasticity with Personal Income is about 0.9 in the long run, from 0.75 to 1.25 in the short run.
- Lack of deductions for b-t-b sales causes a significant amount of pyramiding – as much as 2.5% of GSP.
- Comprehensive tax base and exclusions for consumer items reduces regressivity of the tax.
- Comprehensive tax base has so far insulated the tax from e-commerce base erosion.
- Comprehensive base leads to frequent proposals for targeted tax relief, but little appetite for comprehensive reform.