



**Issues that May Be on the Agenda of the
2007 New Mexico Legislature**

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Compensating Tax

Individual Enforcement: New Mexico prohibits the enforcement of the compensating tax against individuals, leaving only businesses to be audited for compliance. In view of the effort by other states to step up enforcement of this tax and the effort to promote procedural uniformity for state transaction taxes through the Streamlined Sales Tax Agreement. *Should New Mexico begin enforcing this tax against individuals?*

Local Compensating Tax: Local governments in New Mexico often cite the need to diversify their revenue structure. Cities in particular are heavily dependent on the local gross receipts tax. Most states that have a local sales tax have a local compensating tax. *Should New Mexico grant this authority to the county and city governments in our state?*

Corporate Income Tax

Combined Reporting: Some states require unitary groups of companies that operate as “unitary business” to file their corporate income tax returns using a “combined report” essentially pooling the income of the corporations and dividing up the income among the states in some proportion to their operations in the taxing state compared to all of the states in which they operate. Proponents say it lessens the ability of corporations to “game” the system to reduce their tax liability. Opponents say it is a disincentive to operate in smaller markets. *Should New Mexico require this type of filing of corporate income tax returns and if so, are there relief mechanisms that should accompany such a requirement like rate reductions or apportionment factor relief?*

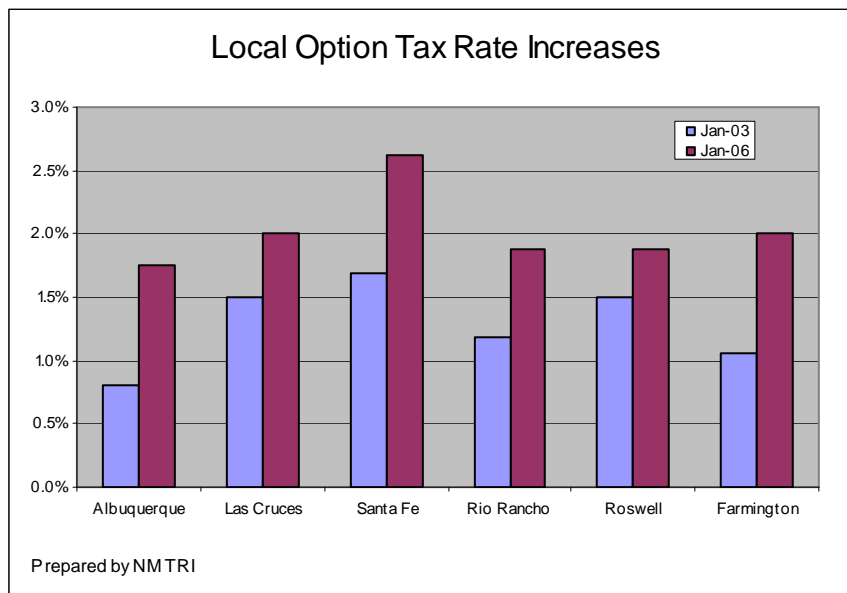
Enforcement Issues: The corporate income tax is cited by many as the most difficult of taxes to enforce. Although there are fewer taxpayers, the issues are often complex, straining the resources of the Taxation and Revenue Department to make the audits and litigate the cases. Litigation often takes years and is often a game of attrition as the cases drag on. *Should New Mexico decide that the Corporate Income Tax is not a cost effective way to raise revenue from corporations and repeal the tax in favor of a scheme of fees for government services that places the burden on those who use those services?*

Gross Receipts Tax

Pyramiding Relief: The New Mexico Tax Research Institute has estimated that the State collects about \$780 million through pyramiding, the taxation of business inputs when the business outputs are also taxed. All states that have a sales tax experience pyramiding to some degree, but in New Mexico it is more pervasive because the state has a wide tax base, which includes services. The business sector has complained for years that this is a problem that needs relief and the Legislature has responded very modestly and with a laser shot approach. Although pyramiding is perceived as a business problem as a result of the quantities of goods and services purchased by businesses, it is also a consumer problem. If the business sector faces a non-competitive market the higher taxes caused by pyramiding can be passed on to the consumer. *Should New Mexico try to address pyramiding comprehensively?*

Rate Creep: Since 1990, when the last increase of the state tax rate of GRT was enacted to a rate of 5%, the local portion of the GRT has been steadily increasing. The issue is not readily apparent because these increases take place in very small increments, in different counties and municipalities, and at different times. However, when considered in the aggregate, these increments amount to a substantial tax increase resulting in a significantly higher state average.

The six most populous cities in New Mexico comprise about half of the population of the state and the increases in those cities are fairly significant from January 2003 to January 2006. If these tax increases in the major cities are representative of the increases in the rest of cities and counties a state rate increase can be estimated, by averaging and weighting by population. Using this method, the local portion of the tax has increased about 0.84% of the total GRT tax rate, from January 2003 to January 2006. Considering that the tax base for the GRT in New Mexico is about \$33 billion, the tax increase comes to about \$280 million in the last three years. *Is it time to coordinate local taxes more, especially if the Streamlined Sales Tax Agreement is implemented in New Mexico?*

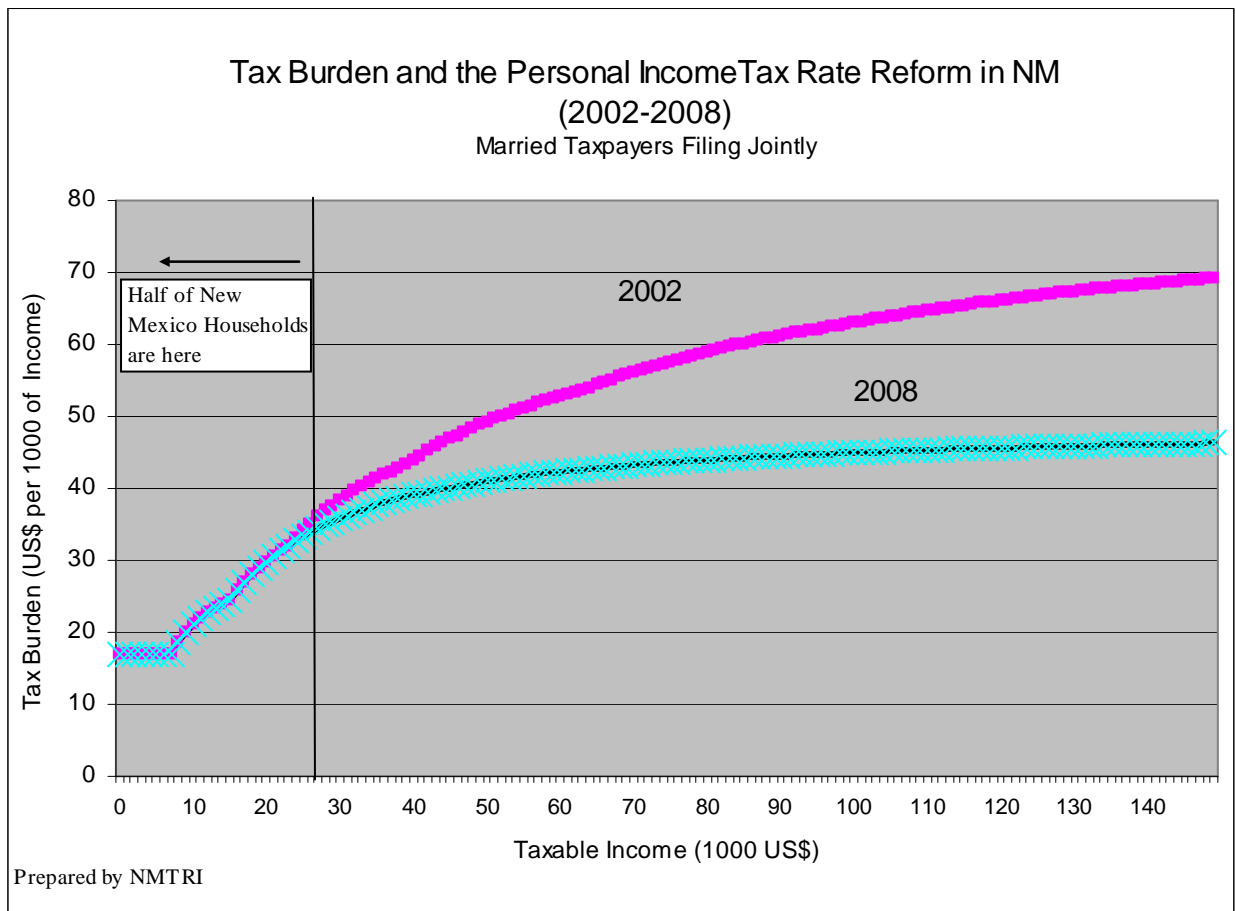


Personal Income Tax

Rate Progressivity: New Mexico's revenue stream relies heavily on the Gross Receipts Tax, which, to the extent it taxes necessities, is perceived as regressive. Before the income tax reduction 2003-2008, the regressivity of the GRT was neutralized by a modestly progressive personal income tax rate schedule, which had eight brackets. The income tax rate reduction of 2003-2008 reduced the tax brackets to four.

The rate reductions were applied mostly to the half of households with higher incomes, while the tax rate applied to the half of lower income households was unchanged, thus decreasing the progressivity of the income tax.

The Food and Medical Services exemption from the GRT, which was designed to induce some progressivity in the gross receipts tax system, will have some diminished results due to the extensive use of Food Stamps in the state, which were already exempt from the GRT. For example, in one county in NM about 28% of the population receives food stamps and they will not be directly benefited by the new exemption. *In the interest of restoring some progressivity, should New Mexico consider an expansion or indexation of the Low Income Comprehensive Tax Rebate program or the application of a greater Earned Income Tax Credit at the state level?*



Independent Tax Appeals

Taxpayers sometimes complain that there is a perception, if not a real, unfairness to a tax appeals system that begins with a hearing before employees of the agency that made the assessment of additional tax. If the auditor and the lawyer and the judge all work for the same agency, is a taxpayer going to receive a fair hearing of a disputed matter? No one suggests that the people involved are intellectually dishonest, but in a trial of fact and law should not the process both be fair look fair? *Should the Legislature establish a system of independent hearing officers apart from the New Mexico Taxation and Revenue Department or even a separate Tax Court?*

Tax Expenditure Budgets

A Tax Expenditure Budget consists of an organized list of departures from the “normal” tax structure. The departures; which are designed to favor a particular industry, activity or class of persons; take different forms, such as deductions, deferrals, exclusions, credits or special rates. The preparation of a document that quantifies these “costs”, a Tax Expenditure Budget is a document that is intended to be a useful source of information that will allow the Legislature to subject indirect “expenditures” of public resources to the same degree of scrutiny as direct expenditures of public funds. As of 2002, only Idaho, New York, Ohio, Oregon, Pennsylvania, Tennessee and Wisconsin as well as the Federal Government actually published the expenditure report as a part of the budget document. Some reasons as to why a tax expenditure budget could be useful are as follows:

- 1) It introduces a useful systematic way of looking at the “departures” from “standard” tax policy. These “departures”—exemptions, deductions, deferrals credits, reductions of the tax base or selective tax rates—are in a way government expenditures, and arguably should be subject to the same transparency standards as more explicit expenditures.
- 2) It is an organized listing of all the “departures” from normal taxes, and as such is an important source of public information.
- 3) In times of fiscal constraint the TEB can be used to select the “departures” that could be subject to reduction or elimination.
- 4) Questions regarding the citizenry can be quickly answered, referring to a TEB. For example, how much is the State forgoing revenues with a specific exemption?
- 5) It is a dynamic document that each year includes the tax policy packages enacted by the legislature.

Some of the issues that would need to be considered if the preparation and publication of a tax expenditure budget were to be institutionalized are as follows:

- 1) The decision as to who should prepare the document needs to be made. Executive branch, Legislative branch, both, academic institution, non-partisan consultant are all options.
- 2) In times of fiscal constraint the tax expenditure budget can become a “shopping list that can be used to select the “departures” that could be subject to reduction or elimination, sometimes without remembering the underlying policy.
- 3) The expertise and data for an initial preparation can be a costly and employee intensive task.
- 4) The policy reasons as to the “departures” can become lost in the numerical calculation of the “costs”.

Should New Mexico have a Tax Expenditure Budget?