

# **Tax Matters**

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## **RSTP Reviews Tax Policy Principles, Film Credits, Fiscal Update**

The interim Revenue Stabilization and Tax Policy Committee (“RSTP”) kicked off the 2009 legislative interim with an unusually crowded and substantive agenda at its meetings on June 11 and 12. In addition to the policy agenda, the Committee introduced several new members and also approved a work schedule for the interim.

NMTRI’s Richard Anklam and Tom Clifford were the first presenters, providing an overview of the Principles of Good Tax Policy endorsed by the Institute’s members, and using the principles to discuss several issues currently facing the Legislature. On the Adequacy principle, Richard and Tom presented information on how New Mexico’s tax burden compares with that of other states, and also on the trend in tax collections over time. New Mexico’s tax burden is about average on households, but is above average on businesses, mainly due to severance taxes. The “big three” taxes – Gross Receipts, Income and Property – have generally grown faster than the combination of inflation and population growth, which means their revenue is adequate to provide the same level of per capita public services to a growing population. On the Efficiency principle, Richard and Tom suggested the Legislature should avoid increasing the Gross Receipts Tax (“GRT”) rate so that the pyramiding of the GRT doesn’t become an even bigger problem. They also argued that the state does not appear to be losing significant amounts of corporate income tax due to avoidance by multi-state companies, and that increasing the tax is difficult to justify under the principles of good tax policy. On the Equity principle they suggested that legislators seriously consider joining the Streamlined Sales and Use Tax Agreement, as a way to reduce the tax disparity between in-state and remote vendors. They also suggested the Legislature commission a study of the property tax lightning problem, which is causing a large and increasing amount of inequity in one of the state’s most important (and unpopular) tax programs. Finally they argued for improved accountability in the state’s various tax incentive programs. A copy of Richard and Tom’s presentation can be found [here](#).

Legislators had a number of questions following the NMTRI presentation. Representative Sandoval asked if other companies were engaged in transactions like the one targeted in *N.M. Taxation and Revenue Department v. Kmart*. NM TRD Policy Director Jim Nunns responded that a significant number of companies had come to the Department after that ruling to report similar transactions. Senator Keller asked how New Mexico ranks in terms of severance taxes. Tom responded that the state is about average, some mineral-producing states are significantly higher and others significantly lower. Senator Keller also asked if we know of research indicating how responsive companies are to the tax rate? Tom noted in response that several studies have been done on the issue, including one very thorough analysis by a researcher at the University of Wyoming. A copy of that study is available [here](#). Speaker Lujan asked how New Mexico ranks relative to other states in the region with regard to our individual income taxes and motor vehicle excise tax. He also asked about the share of New Mexico’s tax revenue going to local vs. state government. The Speaker also asked about out of state businesses not paying their fair share of taxes. Representative Miguel Garcia asked if the state’s tax policies are not less responsible than they were in 2003 because the top income tax rate was lowered and the whole system is now much less progressive. Tom Clifford responded that it is important to consider the

income distribution of government spending as well as taxes when evaluating progressivity. Since spending has an overwhelmingly progressive impact, this offsets any regressivity of the tax system and makes the combined system progressive. Senator Smith asked about local governments being pitted against one another through the proliferation of local option tax impositions.

N.M. TRD's policy director Jim Nunns also spoke to the Committee about tax policy principles. He took issue with some of NMTRI's principles, arguing that NMTRI's Adequacy principle is really just a "rule of thumb," and that it confuses spending policy decisions – such as the appropriate level and mix of spending – with tax policy principles. Jim also criticized NMTRI's Efficiency "rule of thumb," stating that the emphasis on a broad base with low rates could be used to rationalize pyramiding. On the Equity principle, Jim argued that equity principles only apply to individuals, not to businesses as stated in NMTRI's version.

***NMTRI Response:** A healthy debate about tax policy principles is something to be desired in its own right, and in that spirit we welcome Jim Nunns' comments. No one should pretend to have a monopoly on the truth when it comes to tax policy, there are too many legitimate and competing perspectives that must be accommodated in the democratic process. In addition, as Jim acknowledged in his presentation, there are numerous trade-offs between desirable goals that must be accommodated. NMTRI's principles literally embody these facts. They represent a consensus of a wide variety of perspectives, they explicitly refer to some of the most important trade-offs and in addition, they are designed to provide specific, practical guidance to lawmakers. The Adequacy principle, for example, acknowledges the primary goal of tax policy – the need to fund government services -- and points to the fact that spending and taxing decisions can never be completely separated. Neither unlimited spending nor thoughtless tax cutting are responsible options. The Efficiency principle embraces the "broad-base, low-rate" principle for two reasons: it is supported by a consensus of economic theorists and it provides clear guidelines for decision makers. If the argument is that one cannot apply the rule in a mindless fashion, to justify pyramiding for example, we agree, and we would point to our determined efforts to oppose and reduce pyramiding as evidence that we are well aware of the trade-offs the principle entails. As to the application of the Equity principle to businesses, we respectfully disagree with Jim. While it is logically correct to point out that "businesses don't pay taxes, people do," it is also true that we can seldom be certain of the ultimate economic incidence of the taxes we impose on businesses. Meanwhile, the taxes we impose on businesses, if applied in an inequitable manner, can create competitive advantages and disadvantages that are completely at odds with good tax policy. We are of course not referring to broad sectors such as energy or healthcare, but similarly situated taxpayers should have a right to expect equitable treatment. Even if the state has the power otherwise create winners and losers, to do so would erode confidence in the voluntary tax system and the political process that stewards it, no good has ever come of that.*

### **Economic Impacts of Film Credits**

The Committee heard testimony on two recent studies of the economic impacts of film production tax incentives, one by the Arrowhead Center at New Mexico State University ("AHC") and the other by Ernst & Young ("E&Y") consultants. The AHC study was commissioned by the Legislative Finance Committee ("LFC") while the E&Y study was commissioned by the New Mexico State Film Office and the State investment Council. LFC

economist Dan White summarized the two studies. Film credits have increased dramatically in the last several years, as illustrated in the following table. In addition to these credits, the industry receives several other financial incentives from the state, including funds for training activities, zero interest production loans and direct capital expenditures.

<b>Fiscal Year</b>	<b>Total Film Credits Claimed</b>
2002	\$0.8 million
2003	\$1.2 million
2004	\$1.7 million
2005	\$2.1 million
2006	\$10.8 million
2007	\$17.7 million
2008	\$46.0 million
2009*	\$48.0 million

\*Through March 2009. Source: “LFC Hearing Brief, Survey of Economic Development Incentives,” May 12, 2009.

The two studies conducted similar types of economic impact analysis, taking direct spending by the film industry and applying “multipliers” to estimate the additional economic activity resulting from the industry’s presence. The studies estimated the revenue “feedback” to state and local government by applying average effective tax rates to total estimated income and spending. Large differences between the studies were generated by different economic assumptions. The AHC study estimated that \$38 million in tax credits during the first part of FY 2008 generated \$153 million in direct spending by the industry and, when the multiplier effects are included, \$5.5 million in additional state revenue. Comparing the \$5.5 million to the \$38 million, the study concluded the state gets back only \$0.14 for every \$1 it invests in tax credits. The E&Y study concluded that \$49 million in tax credits in calendar year 2007 were associated with \$253 million in industry spending, which ultimately generated \$46 million of feedback revenue to the state and an additional \$28 million to local governments. These translate into \$0.94 and \$0.56 per dollar of tax credit respectively.

One of the biggest differences between the studies is the estimated impacts of increased tourism spending due to the film industry, which was included in the E&Y study but not in the AHC study. Tourism impacts were estimated using a set of surveys conducted for the N.M. Tourism Department last fall, both of which represented very small sample populations. Using this basis to estimate added tourist spending, and applying multipliers, the total increase in state and local revenue due to tourism alone was \$32 million, about 43 percent of the total revenue attributed to the film industry. Another important difference in the studies was the inclusion of capital expenditures related to the construction of the Albuquerque Studios, which was included in the E&Y study but not the AHC study. The presentation of the E&Y study results gives the impression that this kind of spending can be expected on a recurring basis. LFC staff concluded that the actual return on the state’s tax credit dollars is probably somewhere between the results of the two studies, and would certainly be less than \$1 per dollar of credits.

**NMTRI Comments:** A weakness of both studies is that they did not take into account the offsetting reduction in spending or increase in other taxes by the state in order to meet its

*balanced budget requirements. In addition, state incentives other than the tax credits were not included in the calculation. Both of these adjustments would reduce the benefit/cost ratio for film industry subsidies, but such adjustments are necessary when trying to understand the choices and trade-offs the state really faces when considering subsidizing any one group at a cost borne by the remaining taxpayers.*

**State’s Revenue Outlook Continues to Deteriorate**

LFC Staff Director David Abbey provided the Committee with an updated look at the state’s revenues, and the news was not good. Under the latest revenue forecast, revenue was expected to fall by 5% in FY 2009, by 4.3% in FY 2010 and to increase by about 5% per year thereafter. However, individual and corporate income tax collections have fallen well below the forecast so far this spring. Director Abbey indicated that the cumulative shortfall by the end of the fiscal year may be in the range of \$150 to \$200 million. He stated that the Legislature had made provisions to offset a portion of the shortfall by reserving a portion of the funds that otherwise would have gone to Medicaid. Thus, the state should finish FY 2009 with reserves not too far below the original target of 10%. Looking ahead, however, the lower income tax base will probably affect revenue in FY 2010 and after. Meanwhile, Abbey stated that the additional federal stimulus revenue that has been mentioned in the news will probably not flow through the state’s budget, with most of the money being distributed through various federal agencies. Thus, it is not likely the state will get another “bailout” for any revenue shortfall.

N.M. Department of Finance and Administration (“DFA”) Cabinet Secretary Katherine Miller reviewed the state’s budget as amended by the 2009 legislative session. A summary of the budget changes by spending category is provided in the following table.

**FY 2009 – 2010 Budget Comparison After All Action Related to the 2009 Legislative Session  
(Million Dollars)**

	<b>FY 2009*</b>	<b>FY 2010</b>	<b>Change</b>
Public Education	\$2,608	\$2,539	(\$70)
Higher Education	\$885	\$853	(\$32)
Medicaid	\$799	\$778	(\$21)
Other Health & Human Services	\$728	\$711	(\$17)
Public Safety	\$412	\$393	(\$18)
Rest of State Government	\$358	\$339	(\$18)
Judicial	\$218	\$210	(\$8)
Legislature	\$20	\$20	(0.2)
<b>Total</b>	<b>\$6,027</b>	<b>\$5,843</b>	<b>(\$184)</b>

\*Prior to budget reductions.

Source: “Post 2009 Session Review,” Katherine Miller, Cabinet Secretary, Department of Finance and Administration, June 12, 2009.

Within the FY 2010 budget, federal stimulus funds were used to provide \$165 million to public education, \$153 million to Medicaid and \$14 million to other health care. Not reflected in the table is an estimated \$43 million of savings due to increasing public employee retirement premiums (which according to recent reports is falling under legal challenge). The extent of the state’s fiscal challenge can be seen by comparing the FY 2010 appropriation level, \$5,843

million, with projected state revenues in FY 2010 of \$5,473 million, leaving a deficit of \$370 million. This deficit indicates the increase in annual state funding that will be needed to maintain current spending when federal stimulus funds are no longer available. In addition, based on the information provided by LFC Director Abbey, it appears that this deficit has grown by about \$150 to \$200 million per year due to lower income tax revenue collections.

### **LFC Questions Effectiveness of Economic Development Policies**

Legislative Finance Committee analysts Susan Fleischman and David Lucero presented results of an evaluation of the state's economic development programs. They described a variety of programs including equity investment, loans, capital outlay, grants, tax credits and direct appropriations. Many different agencies are involved, and significant funding is provided, but the lack of coordination among programs means effort is duplicated and fragmented, and credible performance measures are lacking. The result is a waste of administrative resources and a lack of efficiency. In contrast to New Mexico's practices, a best practices approach would include a statewide strategic plan, incentive agreements, incentives linked to performance, minimum wage standards for job creation, job retention requirements and incentive clawbacks for non-performance. House Bill 118 from the 2009 session requires the state to review and evaluate economic development incentives, including tax incentives. A copy of the LFC survey can be found on our website [here](#).

### **RSTP Work Plan and Meeting Schedule**

The committee approved a work plan for the interim that included the following items:

- Examine the property tax, including yield control and possible changes to the limitations on property tax;
- Compare/contrast economic development financing including tax increment financing, public improvement districts, industrial revenue bonds, etc.
- Review the effect on the property tax of the use of industrial revenue bonds;
- Determine and compare the ability of counties to assess property;
- Discuss opportunities for revenue enhancement and review the State's revenue outlook;
- Examine each major tax, review trends and the share of revenue provided by each;
- Discuss revenue losses from exemptions and determine where collections could be improved cost-effectively;
- Review the effectiveness of incentives;
- Review the personal income tax amendments and corporate income tax proposals;
- Review findings of the pension and investment committees;
- Review the impacts of holding local governments harmless for GRT reductions;
- Review status of the national effort to streamline sales and use tax administration and collection;
- Review implementation of new weight distance tax collection initiatives, and the status of gasoline and other fuels tax collections;
- Collect information on tax reform;
- Review local GRT collections and distributions.

The Committee approved the following meeting schedule:

July 14, 15	Farmington
August 27, 28	Raton
September 21, 22	Cloudcroft
October 14, 15	Santa Teresa/Deming
November 23, 24	Santa Fe, State Capitol Room 322
December 14, 15	Santa Fe, State Capitol Room 307



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### **NMTRI Research Director Tom Clifford Announces Move to LFC**

NMTRI Research Director Tom Clifford has announced his decision to accept a position as Chief Economist for the Legislative Finance Committee effective July 13, 2009. Tom described this as an extraordinarily difficult decision, saying that he has thoroughly enjoyed his experience with the NMTRI. He mentioned in particular his strong support the goals of the organization, and also that he appreciated the opportunity to do objective research on tax policies affecting the state. He also expressed his deep appreciation of the close working relationship he shared with NMTRI

Executive Director Richard Anklam. Tom said he continues to believe the NMTRI is playing a vitally important role in the development of tax policy in the state. His goal in moving to the LFC is to bring a balanced, principled perspective on tax policy to the inner workings of the government decision-making process. Tom hopes that he can maintain positive working relationships with NMTRI and its members in the ongoing work of developing the state's tax policy. We have no doubt that he can and will. Please join the NMTRI staff and officers in congratulating Tom on his new and important role. The Legislative Finance Committee is fortunate to have Tom, particularly after the recent loss of Norton Francis and the upcoming challenges of possible special sessions, budget shortfalls, education wants, and the possibility of the largest tax increases since the post "Big-Mac" early 1980's.

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### **National Activity Implicating States**



#### **Supreme Court Holds Tanker Tax Unconstitutional**

The U.S. Supreme Court struck down a property tax on tankers as unconstitutional on the less than common grounds of violating the tonnage clause, rather than the more familiar due process or commerce clauses. The tax was imposed on tankers that made port at Valdez, Alaska. The court's 7-2 decision in *Polar Tanker's Inc. v. City of Valdez, Alaska* was apparently based on two different points

of view of the tonnages clause's implications to the tax. Justice Breyer's lead opinion, found the tax was unconstitutional because it did not apply to similar property. The vessels subject to the city tax are "not taxed in the same manner as other personal property". Chief Justice Roberts said that the Constitution prohibits states from assessing tonnage charges on ships unless approved by Congress. The tonnage clause, which bars states from declaring war or from

entering into treaties with foreign countries, in essence bans local ports from assessing taxes on vessels entering the port, based on their tonnage. The tax was also challenged on due process and commerce clause grounds, but was not decided on those challenges. A copy of the decision can be found [here](#).

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## **Knick Knacks**

### **The NCCUSL Committee Holds Annual Meeting in Santa Fe**

The National Conference of Commissioners on Uniform State Laws (“NCCUSL”) is holding its annual conference in Santa Fe next month on July 9-16<sup>th</sup>. Often referred to now in the abbreviated form “UCL”, the commission works on issues where there is a need and ability to create model uniform legislation, and is most known for its work product Uniform Commercial Code (“UCC”). The NCCUSL is also responsible for the Uniform Division of Income for Tax Purposes Act (“UDITPA”). As we focused on at last years’ conference and in several newsletters, NCCUSL formed a drafting committee for purposes of re-writing 50 year old model UDITPA. Concerns arose from some that uniformity was either not achievable or that there was not enough consensus on scope and objective, so the committee was transformed into a study committee to determine whether a drafting committee should move forward with the re-write project. The UDITPA study committee is asking the planning and scope committee to be allowed to continue. The answer should be forthcoming in Santa Fe. A copy of their agenda can be found [here](#).

### **Legislative Education Study Committee Meets Tomorrow on Taxes**

The LESC is meeting in Santa Fe June 23-24<sup>th</sup>. The high profile issue of reviewing previously proposed revenue raisers for the purpose of funding the proposed education funding formula is on the agenda and will be presented by LFC staff. Also on the agenda is a business perspective by the Association of Commerce and Industry’s Dr. Beverlee McClure. We’ve noted in newsletters and in legislative presentations our concerns about the lack of tax policy discussion, particularly with sensitive and significant issues like education funding. If policy makers decide we have inadequate revenues for any reason (declining budget forecasts, education spending increases, etc.), serious tax policy discussion should follow. The agenda can be found on the Legislative Council Services website by clicking [here](#).

### **Legislative Finance Committee Meets in Gallup in July**

The Legislative Finance Committee will meet in Gallup for three days from July 8 – 10<sup>th</sup>. The agenda does not contain any tax specific topics with the exception of a weight distance tax enforcement update, and otherwise appears to focus on behavioral health, capital outlay, and workforce training and development. The agenda for the hearing can be found on the Legislative Council Service website by clicking [here](#).

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**TAX QUOTABLE:**

***"Where is the politician who has not promised to fight to the death for lower taxes- and who has not proceeded to vote for the very spending projects that make tax cuts impossible?"***

~Barry Goldwater, US Senator and presidential candidate

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**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](mailto: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](mailto:tom.clifford@nmtri.org) or call him at 505-228-7129. We genuinely solicit your input and thank you for your support.

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"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!