

# ***Tax Matters***

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## **IN THIS “SPECIAL SESSION” ISSUE OF *TAX MATTERS*:**

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## **I can't Believe It's Over – What Did They Do In the New Mexico Special Session and What Does it Mean for Taxes??**

The Special Session started off without an advance “deal” between the legislators and executive on how to address the budget shortfall, which grew when the revenue forecast was revised just before the Special Session convened (see it [here](#)). The revisions increased the deficit for the 2009 fiscal year by \$98 million from the August estimate, and had recurring revenue down by \$219 million in the current year with 2011 revenue revised downward by \$224 million. That means the 2009 deficit is up to \$214 and \$653 million in savings or new revenue are needed in order to end the year in with a 6% reserve.

After the arm twisting, pandering to constituents, and gnashing of teeth, the legislature sent bills to the Governor authorizing the necessary transfers from reserves to cover the 2009 shortfall, and almost patching the current year anticipated deficit with a mixture of measures that include state account sweeps, sponge bond diversion, budget reductions, and federal stimulus money. Real cuts to recurring spending represented only a third of the proposal, with schools and entitlement programs left largely unaffected. Also unaffected was capital outlay, although there were discussions of voiding stalled or “never going to happen” projects and putting that money into the general fund. That approach will be back on the table in January, where realistically there’s probably \$200M in projects ripe for picking, but the politically palatable number will be something less. The most pain from real cuts will be felt by general state agencies, with a little over half a year remaining to swallow the new budget cuts. The remaining deficit will be left to the regular thirty day session to deal with, along with any adjustments to the revenue forecasts between now and then. A list of the House and Senate bills passing both houses with links to the text can be found [here](#) on the LCS website.

Although the Governor’s proclamation directed that taxes not be considered, several tax measures were introduced by House and Senate members. Ultimately they were found to not be germane, although there was plenty of early controversy over whether the Governor could limit the agenda. A table of the tax bills is listed below. Why did we list them if none of them were introduced? Because you’ll see them (and many more) again in three months when the 2010 Regular Session convenes in January.

There were nine House and eleven Senate bills that related to taxation (although not all of their bill titles reflected that in an apparent attempt to tip toe around the Governor’s instruction). While there was nothing introduced that one would find unexpected as tax increases go in NM – personal income tax increases, mandatory combined filing, alcohol, tobacco, and motor vehicle excise tax increases – there was evidence of creativity. Rep. Garcia’s income tax proposal varied from the “repeal Richardson’s tax cuts” theme by restoring the old rate structure (up to 8.2%) but with dramatically expanded brackets (top single bracket reached at \$667K) increasing progressivity and ensuring the working poor don’t end up in the top bracket as they did under prior law. There were proposals to add another bracket, add back itemized state taxes to taxable income, and to create a \$200K taxable income cliff for those who could take the 50% capital

gain deduction, whereby earning a dollar more would eliminate the deduction completely. Also proposed was the franchise tax proposal from last year, eliminating soft drinks from the gross receipts tax deduction for food, and making certain administrative services performed by insurance companies subject to the gross receipts tax. The income tax increase proposals were to have been effective for tax year 2009, which would have come as an unpleasant surprise to taxpayers three quarters of the way into the year, and could have resulted in estimated payment penalties for some (some proposals directly addressed the penalty issue while others did not).

While there were variations on many tax increase proposals like the rates of liquor, tobacco, and personal income taxes, there did appear to be some common thinking on the capital gain deduction limitation proposals. All proposals introduced created a benefit cliff whereby current law (deduction = the greater of \$1000 or 50% of actual gain) applies until taxable income of \$200,000 is exceeded, and which point the deduction is up to \$1000.

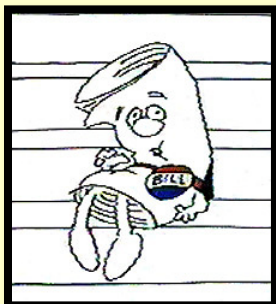
*{NMTRI note: historic arguments in NM for preferential capital gains treatment usually relate to encouraging investment or not forcing small business owners to leave the state upon sale of their businesses, and in this light, these proposals make no sense. Also, benefit “cliffs” tend to encourage tax planning and distort normal behavior, which is why gradual phase-in’s and phase-out’s are so common. If the intent is to raise revenue by limiting the current deduction, other approaches in keeping with the deductions intent could be considered.}*

Another proposal, Senator Griego’s SB 7, created three surtaxes that applied to taxable incomes above certain levels for three years. For singles, the proposal creates a 1% surtax on incomes above \$100K, another 2% tax on incomes above \$133K, and 3% on incomes above \$166,000. The proposal distributed half of the new revenue to the public education fund, and the other half to the Human Services Department.

*{NMTRI note: whether the bill was intended to create a graduated rate structure is unknown, but as drafted the bill creates three cumulative surtaxes for a combined rate of 10.9% on taxable income above \$166K on individual returns/\$250K on married filing joint returns.}*

In addition to our table below, the Legislative Council Service maintains copies of bills, compiles locators, and publishes lists of bill conflicts during the session. Most information, to include Legislative Finance Committee (“LFC”) fiscal impact reports (“FIR’s”), is available in a reasonably timely and electronic fashion from their rather robust website, which can be reached at <http://legis.state.nm.us/lcs/>. If you’re curious what the New Mexico Taxation and Revenue Department thinks about proposed legislation, you can find out from the list of their own FIR’s that they maintain on their website here: <https://ec3.state.nm.us/pdflists09/pdfindex.asp>. The NMTRD maintains a group of analysts dedicated to tax related issues, and their work often serves as a basis or source for other agencies and analysts such as the LFC.

**Bills with significant tax or revenue implications introduced in 2009 First Special Legislative Session:**



<b>Bill Number/ Sponsor:</b>	<b>Title: Link to bill language: Description</b>	<b>Assignments -Location:</b>
HB 2 M. Garcia	<b>Omnibus Tax Bill: <a href="#">HB 2</a></b> Restore 2002 rate structure with expanded brackets, eliminate capital gain deduction for those earning more than \$200K, add-back itemized state taxes to state taxable income, require mandatory combined filing for corporate income tax filers, increase cigarette taxes from \$.91 to \$1.41/pack, and increases tobacco products tax from 25% to 40% of the product value, increase all alcohol taxes.	not prntd- HRC
HB 4 E. Chavez	<b>Develop Tax Expenditure Budget: <a href="#">HB 4</a></b> Require TRD to publish annual tax expenditure budget.	not prntd- HRC
HB 7 Begaye	<b>Adjust Capital Gains Tax in Certain Income: <a href="#">HB 7</a></b> Eliminate 50% capital gain deduction for those with NM taxable income in excess of \$200K.	not prntd- HRC
HB 8 Begaye	<b>Create Higher Income Tax Bracket: <a href="#">HB 8</a></b> Creates new 6% personal income tax bracket at \$100K for singles/\$200K for married filing jointly.	not prntd- HRC
HB 9 Begaye	<b>Corporate Income Tax Definitions &amp; Rates: <a href="#">HB 9</a></b> Phase in corporate income tax rate reduction to 4.9% while phasing in franchise tax (calculated as percentages of a taxpayers combined NM property payroll and sales factors beyond certain thresholds).	not prntd- HRC
HB 12 Egolf	<b>Increase Cigarette Tax: <a href="#">HB 12</a></b> Increases cigarette tax from \$0.91/pack to \$1.91/pack; increase tobacco products tax from 25% to 40% of the product value; changes distributions.	not prntd- HRC
HB 13 Egolf	<b>Liquor Excise Tax Rate and Distribution: <a href="#">HB 13</a></b> Increases tax on all alcoholic beverage categories with beer more than tripling from \$.41 to \$1.48/gal; wine from \$.45 to \$.85/liter; spirituous liquors from \$1.60 to \$2.40/liter; fortified wine from \$1.50 to \$2.30/liter; microbrewer beer from \$.08 to \$.15/gallon; small winegrowers from \$.10 to \$.50/gallon on the first eighty thousand liters – from \$.20 to \$.60/gallon on amounts over eighty thousand liters up to 950 thousand liters.	not prntd- HRC
HB 14	<b>Increase Motor Vehicle Excise Tax Rate: <a href="#">HB 14</a></b>	not prntd-

Egolf	Increase motor vehicle excise tax rate to 5% from current 3%.	HRC
HB 23 McCoy	<b>Optional Income Tax Contribution to Schools: <a href="#">HB 23</a></b> Adds schools as recipients to which personal income tax filers can direct refunds to be contributed.	not prntd- HRC
SB 1 Dede Feldman	<b>Insurance Service Gross Receipts: <a href="#">SB 1</a></b> Adds administrative services only contracts to the exceptions to the in lieu provision of the insurance tax act, effectively subjecting such receipts to the gross receipts tax.	SCC/SCW- SCC-nt germane
SB 2 Ortiz y Pino	<b>Eliminate Soft Drink Gross Receipts Deduction: <a href="#">SB 2</a></b> Exclude soft drinks from the “food” deduction at Section 7-9-92.	SCC/SCW- SCC-nt germane
SB 3 Ortiz y Pino	<b>Federal Deductions as State Taxable: <a href="#">SB 3</a></b> Effectively adds back itemized state taxes by defining itemized deductions as the federal itemized deduction plus deducted state taxes.	SCC/SCW- SCC-nt germane
SB 5 Keller	<b>Develop Tax Expenditure Budget: <a href="#">SB 5</a></b> Require TRD to publish annual tax expenditure budget.	SCC/SCW- SCC-nt germane
SB 7 Griego	<b>Graduated Surtax &amp; Tax Distribution: <a href="#">SB 7</a></b> Creates three surtaxes applying above different income levels for 2010-2012 and distributes half the money to the public school fund and half to the human services department.	SCC/SCW- SCC-nt germane
SB 8 Wirth	<b>Corporate Income Tax To Public School Fund: <a href="#">SB 8</a></b> Require mandatory combined filing for corporate income taxes – does not impact public school funding.	SCC/SCW- SCC-nt germane
SB 9 Lopez	<b>Restore Pre-2004 Income Tax Rates: <a href="#">SB 9</a></b> Restores rates rates/bracket structure to 2003 law (8.2% for single filers over \$65K of taxable income/over \$100K married filing jointly).	SCC/SCW- SCC-nt germane
SB 11 B. Sanchez	<b>High-Income Taxpayer Surtax: <a href="#">SB 11</a></b> Creates 1% surtax on taxable income in excess of \$100K for single and \$160 married filing joint income taxpayers.	SCC/SCW- SCC-nt germane
SB 12 B. Sanchez	<b>Increase Cigarette Tax: <a href="#">SB 12</a></b> Increases cigarette tax from \$0.91/pack to \$1.41/pack; changes tax distributions.	SCC/SCW- SCC-nt germane

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## Tax Lightning Strikes Again – and District Court Judge Nash Say It’s Unconstitutional



For the second time in weeks, another district court judge in Albuquerque, Judge Nan Nash, has found that property revalued according to statutory requirements upon transfer in excess of the 3% limit is unconstitutional (see the decision in *Wang v. Montoya* [here](#)). Bernalillo County Assessor Karen Montoya has recently stated her hands are tied and she’s required to follow current statute. That means homeowners, who recently purchased property only to see the taxable value of their property increase more than three percent of the prior year, will have to claim a refund via suit in district court after their first tax payments are made in November. It is too late to protest the most recent notice of value.

The fact that now two district court judges have ruled the application of the current statute unconstitutional would suggest that continuing the current valuation practice and forcing those negatively implicated to file suit in court is nonsensical. At the same time, Ms. Montoya’s hands are somewhat tied in the sense that district court decisions are not precedential and do not have the effect of overturning statute. Since Ms. Montoya did not appeal her first adverse decision and will presumably not appeal the latest, there is no chance that a decision binding on all New Mexico homeowners and property tax assessors will be forthcoming anytime soon. That’s not to say she should have appealed, as even if she had, a decision would take time and still necessitate the Assessor’s granting of claims contrary to current statute, or the continuing process we have today whereby taxpayers must file claim for refund of overpaid taxes by filing suit in district court. Following the mailing of notice of values next year, afflicted taxpayers may protest the notice of value and have their concerns heard by a protest board like that which heard Dzur. It is unclear how future protest boards will react to similar claims in the future, however the remedy to an adverse board decision would be to appeal to the district court.

A recent article in the Albuquerque Journal ([here](#)) describing the most recent property tax case, *Wang v. Montoya*, seems to suggest that only homeowners whose homes turned over and were revalued in 2008 can file a suit for refund. However, that may be misleading. While taxpayers are barred from securing refunds of taxes in prior years, claims could be filed on current year valuations where an asserted over-valuation was the result of an unconstitutional revaluation in *prior years*. If successful, the fiscal implications to tax beneficiaries (counties, school district, etc.) of taxpayers claiming and securing refunds would be larger than currently thought by those who assume the it’s only 2008 purchases currently at issue. Still, those fiscal impacts are limited by the counter-balancing effect of the yield-control formula, which changes some operating tax rates to achieve the necessary revenue targets even when values are held artificially low by limits, so that bonds cannot be impaired. Additionally, only a handful of counties experienced significant enough residential property value appreciation to experience much of the tax lightening effect and the fiscal impacts that could follow. Still, that would be of little comfort to those tax beneficiaries who have reached their constitutional debt ceilings where yield control would offer no relief and revenue therefore potentially constrained. Even the state’s general obligation bonding capacity has the potential to be slightly impacted.

A higher court ruling is not likely, so a legislative remedy is necessary to prevent some taxpayers from seeing their properties unconstitutionally assessed, forcing them to take legal action, and keeping the counties and courts tied up with the associated and pointless administrative burden. Still, it will be difficult to get legislative priority in light of other issues, and no perfect or victimless solutions have yet been proposed. Let's hope they can get close and soon.

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## **Knick Knacks**

### **Workers Compensation Rates to Go Down in New Mexico**

For the fourth year in a row, the Workers' Compensation Administration has approved rate reductions in workers' compensation premiums, meaning employers should be able to purchase insurance a little cheaper than previously. With reductions taking effect on January 1, the National Council on Compensation Insurance has requested a rate reduction of 4.5 percent in the voluntary market and an overall decrease for the Assigned Risk Pool of 0.9 percent.

### **Tax Policy Center Issues More Interesting One-Pagers**

The Tax Policy Center, a joint venture of the Urban and Brookings Institutes, continues to issue short papers on topics of current interest. In a paper titled "[\*The Incredible Shrinking Estate Tax\*](#)" the author describes the past and future of the estate tax, given EGTRRA, the recent devastation of assets as a result of the recession, and political expectations of the near future. A short piece on the future and fiscal implications of the Alternative Minimum Tax ("AMT") patch titled "[\*The Doc Fix and the AMT Patch: Add a Trillion to the Debt and Call Me in the Morning\*](#)" was thought provoking and frightening (as many fiscal issues tend to be these days). Another one-pager, titled "[\*Will the Real Marginal Tax Rate Please Stand Up?\*](#)" does a good job of pointing out that your effective tax rate, the computation of which is complicated by phase-in's and out's, may not be what you think it is, and behaviors and decision making could suffer as a result.

*{NMTRI note: economic theory is fundamentally based on informed choice, and most models and theories assume rational choices are made. Eliminating or altering the ability for informed choices to be made can create unintended and unexpected outcomes.}*

### **Personal Income Levels Rise in Majority of States**

New data from the U.S. Bureau of Economic Analysis show personal income levels rising in 36 states in the second quarter of 2009. According to the data, North Dakota grew fastest with 1.5% growth, with Iowa second at 1.2%. New Mexico fared better than its neighbors coming in with the twelfth fastest growth with a gain of .6%. Wyoming had the worst ranking with a negative growth rate of 1.0%, followed by Nevada with a negative .5% rate of growth. The tables are interesting and can be found on the BEA website [here](#).

*{NMTRI note: personal income is not the same as taxable income, and includes things such as social security and "transfer payments," or payments from unemployment or worker's compensation insurance and other entitlement programs. A review of the data by industry in NM show every sector to be down (negative personal income growth) with the exception of increases in the healthcare and federal civilian, military, and state and local government sectors, and break-even/zero growth in the education services sector.}*

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## TAX QUOTABLE:

Taxes, after all, are dues that we pay for the privileges of membership in an organized society.  
~*Franklin D. Roosevelt*

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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. 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.

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