



## Tax Expenditures and General Sales Taxes in New Mexico

Tax expenditures from general sales taxes, which are exemptions and deductions from New Mexico's gross receipts and compensating taxes, should be tracked on an annual basis as part of a New Mexico tax expenditure budget. That tax expenditure budget should be a section of the budget documents prepared by the executive and legislative branches of New Mexico government. Tax expenditures are exceptions to the ordinary tax code from certain types of receipts and have become a significant drag on the revenue producing capacity of the general sales tax in New Mexico. In fact, tax expenditures from general sales taxes cost as much as the value of the state general fund budget: about \$5 billion. Estimates presented by the Taxation and Revenue Department (TRD) on September 26, 2006, will be used to illustrate the problem. However, in the case of the food and medical deduction from gross receipts passed in 2004, an independent calculation has been made. The cost of the food and medical gross receipts tax deductions is about \$200 million, showing the need for regular and systematic tracking of gross receipts tax expenditures.

The general sales tax in New Mexico is composed of the Gross Receipts Tax and the Compensating Tax. The base of the general sales tax in New Mexico is comprehensive, including virtually all of the value of sales of goods and services. The tax is levied on the privilege of doing business in New Mexico, meaning that all receipts from doing business are subject to the tax unless a specific statute provides that they are not taxable. The gross

receipts tax taxes revenues generated in New Mexico, while the compensating tax is levied on the value of goods and services brought into the state that would have otherwise been subject to the gross receipts tax. The two taxes work in tandem – without the compensating tax, New Mexico businesses would be at a decided disadvantage to out of state businesses.

The gross receipts tax will yield \$1.830 billion in revenue for the state of New Mexico in state fiscal year 2007, according to the TRD. The compensating tax will yield \$60 million in fiscal year 2007. The total revenue expected this year from the general sales taxes is \$1.890 billion. Since state general fund revenues are expected to be almost \$5.7 billion in fiscal year 2007, general sales taxes are about one third of general revenues. The importance of understanding the snowballing value of exceptions from such a significant revenue source is obvious.

All receipts from doing business in New Mexico are subject to the gross receipts tax unless there is a specific statute providing that a category of receipts is not taxable. There are two ways a type of receipts can be considered nontaxable: by exemption or by deduction. 'Exemptions' are receipts which are not taxable and need not be reported to the TRD. 'Deductions' are receipts that are not taxable but must be reported to the TRD. The TRD system for collecting general sales taxes, as well as withheld income taxes, is called the Combined Reporting System or CRS. Deductible

gross receipts must be reported on the Department's Combined Reporting System's CRS-1 form. It is important to note that exempt gross receipts are not reported to the TRD, while deductions from gross receipts are published by the TRD. The cost of exemptions is unknown without special analysis, while the overall cost of deductions is available by industry code from the data publication of the TRD called the Report 80.

In testimony to the Legislative Finance Committee in September 2006, the Tax Research Unit of the TRD provided estimates of the cost of all exemptions and deductions from the general sales tax. Since there are more than 100 exemptions and deductions, this paper will group exemptions and deductions into groups for analysis. 'Exemptions' are sorted into seven groups: 1.) social policy and economic development; 2.) government; 3.) nonprofit organizations; 4.) receipts from businesses with taxes paid under other tax programs; 5.) agriculture; 6.) food stamps pre-empted by federal law; and 7.) out-of-state communications. The cost of these exemptions is shown in Table I. The largest category of exempt receipts is 'taxes paid under other programs'. This exemption for taxes paid under other programs is probably appropriate, but about \$310 million in exemptions remain after that category is excluded.

Table I - Exemptions from Gross Receipts and Compensating Tax

	General	Municipal	Total	% Share of Total
Social Policy - Economic Development	\$58.2	\$23.0	\$81.2	2.50%
Government group of exemptions	\$20.0	\$15.0	\$35.0	1.10%
Interstate Trade Group of exemptions	\$12.0	\$8.0	\$20.0	0.60%
Nonprofit Organizations group of exemptions	\$90.0	\$60.0	\$150.0	4.70%
Taxes paid under other programs	\$1,755.0	\$1,144.0	\$2,899.0	90.30%
Agricultural Group of exemptions	\$3.0	\$1.0	\$4.0	0.10%
Federal pre-emption - food stamps only	\$7.0	\$5.0	\$12.0	0.40%
Manufactured Products Group of exemptions	\$8.0	\$0.0	\$8.0	0.20%
	<b>\$1,953.2</b>	<b>\$1,256.0</b>	<b>\$3,209.2</b>	<b>100.00%</b>

*Source: Calculation by NM Voices for Children Fiscal Policy Project staff; estimates of costs of exemptions from NM TRD Tax Research Unit*

'Deductions' from gross receipts are sorted into eleven groups: 1.) social policy and economic development; 2.) government; 3.) interstate trade; 4.) nonprofit organizations; 5.) deductions for taxes paid under other state programs; 6.) agriculture; 7.) manufactured products; 8.) property for resale; 9.) property for lease or re-lease; 10.) construction materials and services; and 11.) real property. The category of deductions with the highest cost (\$760 million) is the 'property for resale' group of deductions, deductions designed to limit so called 'pyramiding'. This shows that New Mexico tax policy has already done much to correct this alleged problem.

Table II - Deductions from Gross Receipts and Compensating Tax

	General Fund	Municipal	Total	% Share of Total
Social Policy - Economic Development	\$126.4	\$34.6	\$161.0	9.30%
Government Group of deductions	\$25.0	\$15.0	\$40.0	2.30%
Interstate Trade Group of deductions	\$11.0	\$3.0	\$14.0	0.80%
Nonprofit Organizations Group of deductions	\$24.3	\$16.5	\$40.8	2.40%
Deductions for Taxes paid under other programs	\$4.0	\$2.0	\$6.0	0.30%
Agricultural Group of Deductions	\$14.0	\$6.0	\$20.0	1.20%
Manufactured Products Group of deductions	\$99.0	\$46.0	\$145.0	8.40%
Property for resale Group of deductions	\$463.3	\$300.0	\$763.3	44.30%
Lease for re-sale or lease Group or deductions	\$13.0	\$4.0	\$17.0	1.00%
Construction Materials and Services Group of deductions	\$48.0	\$32.0	\$80.0	4.60%
Real Property Group of deductions	\$266.0	\$171.0	\$437.0	25.30%
	<b>\$1,094.0</b>	<b>\$630.1</b>	<b>\$1,724.1</b>	<b>100.00%</b>

Source: Calculation by New Mexico Voices for Children Fiscal Policy project staff; estimates of costs of exemptions from NM TRD Tax Research unit.

The total cost of tax expenditures under the general sales tax is the sum of exemptions and deductions. That sum is presented in Table III.

Table III – Total Exemptions and Deductions from GRT

	General Fund	Municipal	Total	% Share of Total
Social Policy - Economic Development	\$184.6	\$57.6	\$242.2	4.90%
Government Group of exemptions and deductions	\$45.0	\$30.0	\$75.0	1.50%
Interstate Trade Group of exemptions and deductions	\$23.0	\$12.0	\$35.0	0.70%
Nonprofit Organizations Group of exemptions and deductions	\$114.3	\$76.5	\$190.8	3.90%
Exemptions and Deductions for Taxes paid under other programs	\$1,759.0	\$1,146.0	\$2,905.0	58.90%
Agricultural Family of exemptions and deductions	\$17.0	\$7.0	\$24.0	0.50%
Federal Pre-emption - Food Stamps only	\$7.0	\$5.0	\$12.0	0.20%
Manufactured Products Group of exemptions and deductions	\$107.0	\$46.0	\$153.0	3.10%
Property for Resale Group of deductions	\$463.3	\$300.0	\$763.3	15.50%
Lease for re-sale or lease Group or deductions	\$13.0	\$4.0	\$17.0	0.30%
Construction Materials and Services Group of deductions	\$48.0	\$32.0	\$80.0	1.60%
Real Property Group of deductions	\$266.0	\$171.0	\$437.0	8.90%
	<b>\$3,047.2</b>	<b>\$1,557.1</b>	<b>\$4,934.3</b>	<b>100.00%</b>

Source: Calculation by New Mexico Voices for Children Fiscal Policy Project staff; estimates of the costs of exemptions by statute from NM TRD Tax Research Unit.

Table III shows that the cost of tax expenditures from the general sales tax in New Mexico is almost \$5 billion, approaching the total general fund budget in the current fiscal year. There is a clear case for tracking tax expenditures on an annual basis.

There is also reason to think that the estimate of the TRD for one significant deduction should be higher. That is the deduction for receipts from the sale of food and some medical services passed by the legislature in 2004. The cost of this deduction is presented as \$22 million in the testimony presented by Tax Research to the Legislative Finance Committee in 2006. The state gross receipts tax rate was increased by half of a percentage point (0.5 percentage point) when the food and medical tax deduction was enacted in order to compensate for the loss in revenue from the deductions. However, the loss in revenue remains the amount lost through the deduction for food and medical services itself. The Report 80 published by the TRD shows that this statute resulted in a far higher loss of revenue than reported in the testimony. The most recently available Report 80, showed a deduction of \$781.7 million in the third quarter of 2006. This would represent a gross receipts tax loss of about \$51.9 million in that quarter alone. The deduction reduced taxable gross receipts \$740.7 million in the second quarter of 2006, resulting in a tax loss of

\$48.8 million in the second quarter of 2006. The deduction reduced receipts by \$725.6 million in the first quarter of 2006, representing a tax loss of \$48 million. The deduction was valued at \$796.1 million in the fourth quarter of 2005, representing a tax loss of \$52.4 million.

The tax loss from the deduction for food and medical services is costing about \$200 million per year, according to the figures computed from the TRD's Report 80. This would add the significant amount of roughly \$200 million to the total for tax expenditures and bring the total for tax expenditures from general sales to about \$5.1 billion.

Table VI - Gross Receipts loss from the 2004 Food and Medical Care Deduction

Quarter	Deduction	Tax Loss
3rd Quarter 2006	\$781.6 M	\$51.9M
2nd Quarter 2005	\$740.7 M	\$48.8M
1st Quarter 2006	\$725.6 M	\$48M
4th Quarter 2005	\$796.1 M	\$52.4M
Four Quarter Total	\$3.044B	\$201.1M

Source: Compiled by NM Voices Fiscal Policy Project Staff from Report 80, New Mexico Taxation and Revenue Dept., various issues.

TRD to track the cost of exemptions and deductions from the gross receipts tax, along with all other exceptions from New Mexico revenue sources. The time has come for New Mexico to join the other two dozen states and the federal government that produce such tax expenditure reports on a regular basis.

The New Mexico Legislature has the opportunity to enact tax expenditure budgeting. This would require the

This report, as well as other reports by the New Mexico Fiscal Policy Project, is available online at [www.nmfiscalspolicyproject.org](http://www.nmfiscalspolicyproject.org). The New Mexico Fiscal Policy Project is a program of New Mexico Voices for Children - [www.nmvoices.org](http://www.nmvoices.org)