



A Primer on New Mexico's Tax System

How it works, why it matters

For: Albuquerque Interfaith

Economic Summit

March 28-29, 2008



All state services are funded
by taxes

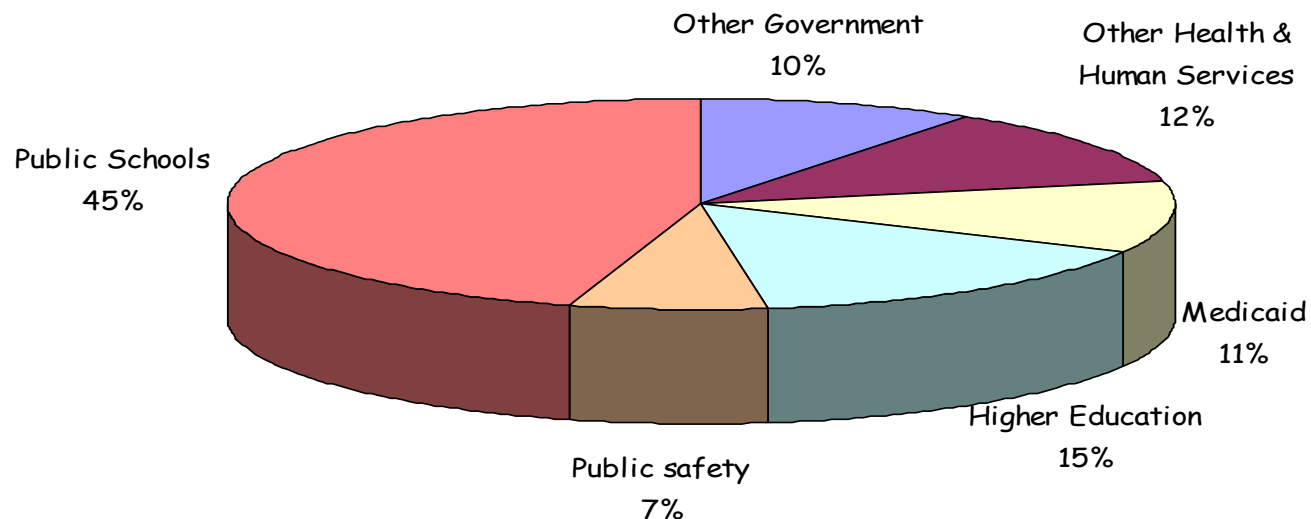
Including: K-12 Education, Higher
Education, Health Care, Public Safety





General fund spending

\$5.6 billion for FY 2008





State spending increases every year

Why must we spend an average of 7% more each year just to stay the same?

- New Mexico's population increases by about 1% per year
- Inflation - 3% per year
- Aging population – Medicaid Program
- Public priorities change
 - Pre - K
 - Universal Health Care Coverage





A \$184 million budget shortfall is expected next year

To maintain current services in FY08, NM would need \$364 million in new revenue. Because of the tax cuts, only \$168 million in new revenue is anticipated :

$$\begin{array}{r} \$308 \text{ million needed} \\ - \$180 \text{ million expected} \\ \hline = \$184 \text{ million shortfall} \end{array}$$

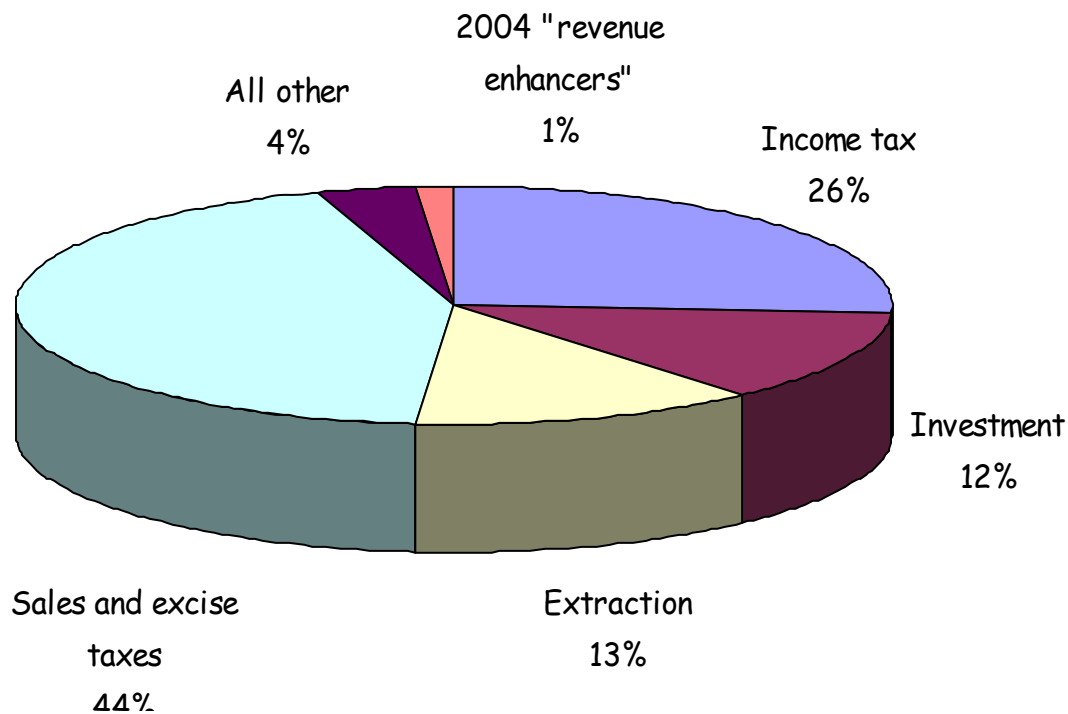
= Service cuts and/or increases in other taxes or decrease in general fund reserves





General fund revenue comes from numerous sources

FY08 general fund revenue:





What a good tax system should do:

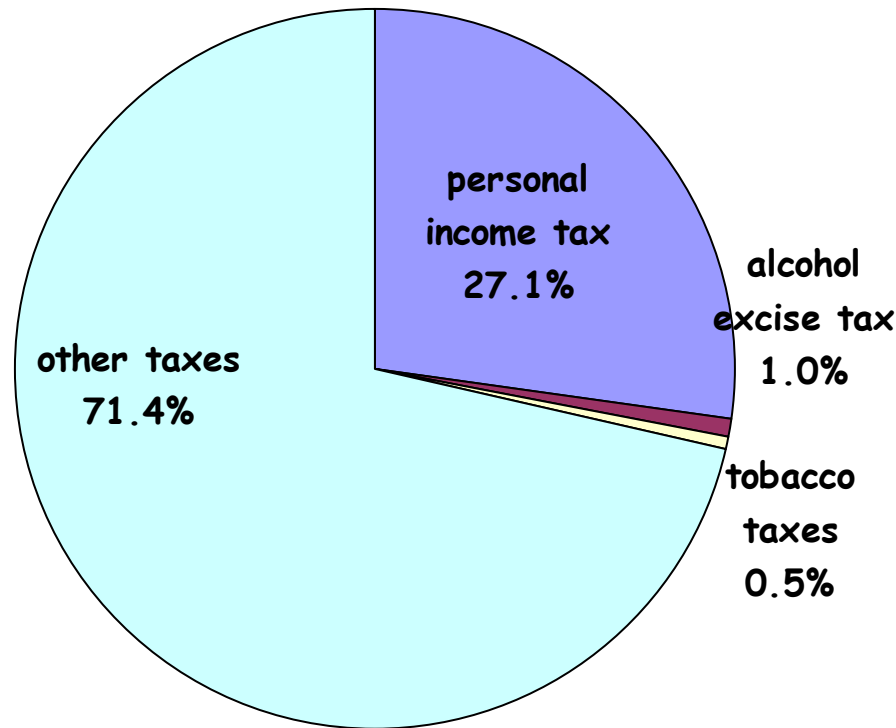
- Provide adequate, stable revenue to consistently fund state services
- In a manner that is:
 - Fair
 - Administrable and efficient
 - Accountable
 - No hidden loopholes
 - Transparent policymaking
 - Balanced
 - Promotes stability
 - Distributes the responsibility broadly





Adequacy is the first priority

Percent of general fund revenue:

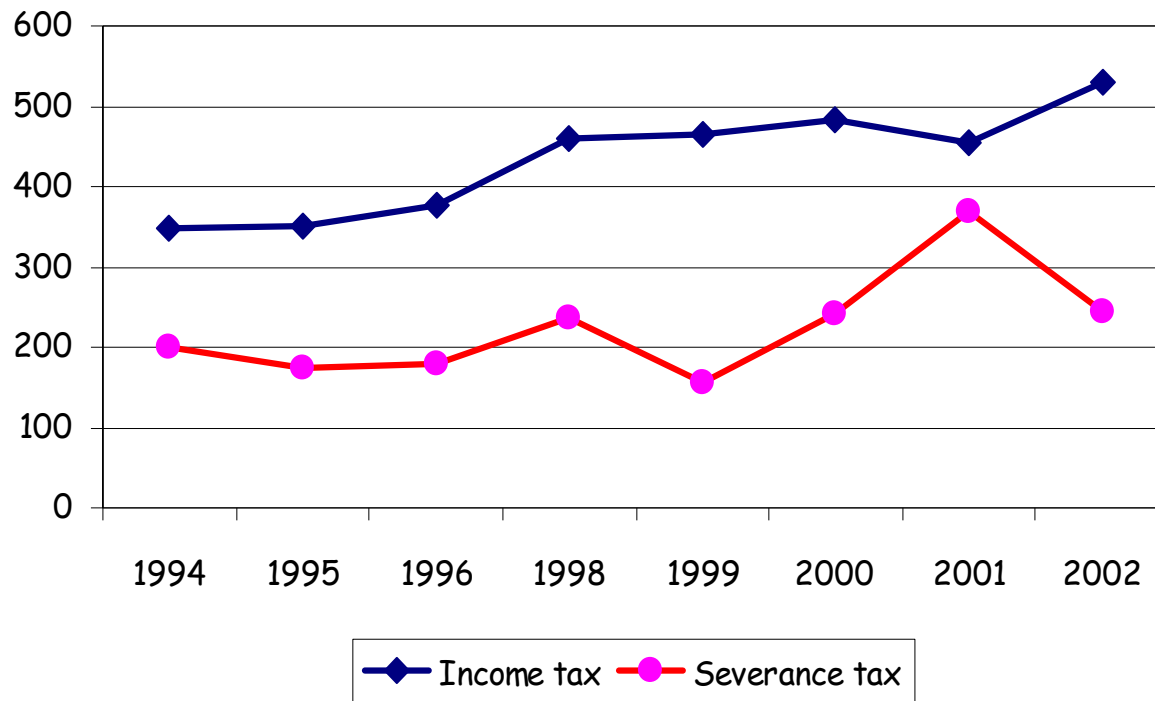


- Income taxes provide lots of revenue
- “Sin” taxes don’t



Public budgeting depends on **stable** revenue

Per capita tax collections

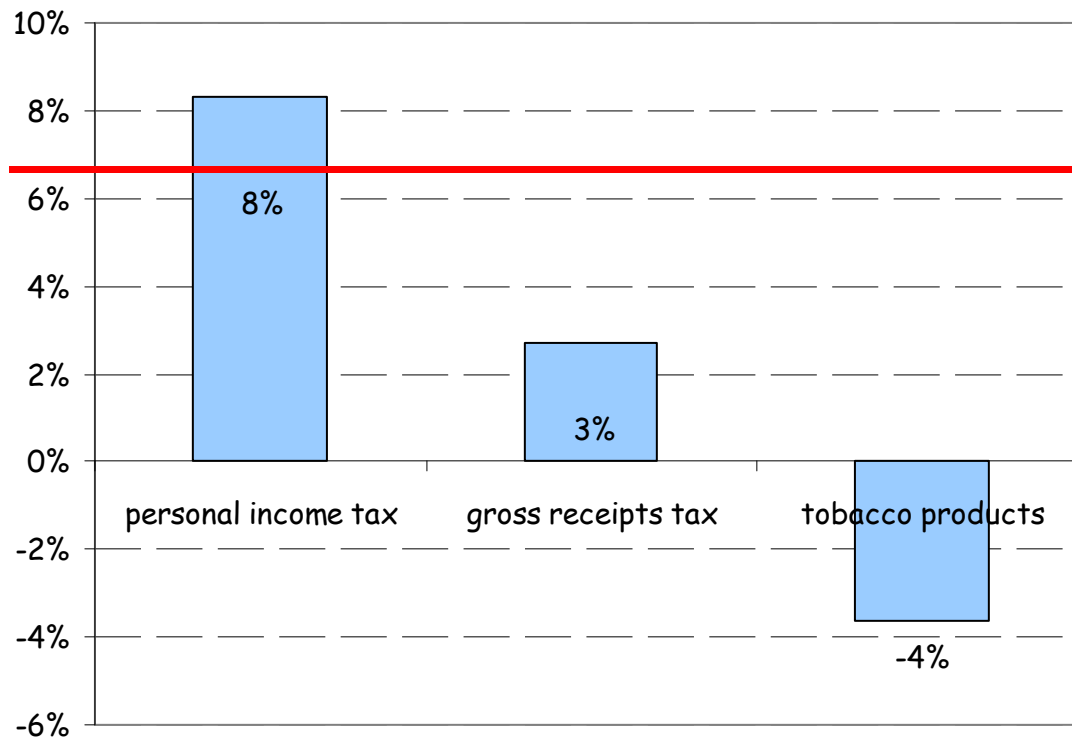


- Income taxes are stable
- Extraction taxes aren't



Revenue should **grow** at the rate of spending

Average annual growth rate (1994-2002)



Average annual spending growth

-Personal income tax do

-Some excise taxes don't





Equity

Tax burden should be based on *ability to pay*

- People in similar circumstances should be taxed similarly.
- Taxes on low-income households should be minimized.

Income taxes are the most equitable major state revenue source – the only progressive source of state revenues.





No single tax is fair to everyone; but a fair *tax system* is possible

- Most states, including NM, have both a sales tax and an income tax
 - Income tax is *progressive*
 - Sales tax is *regressive*
- Combining the two yields:
 - A more equitable **system**
 - Lower rates overall
 - Adequate, stable, consistent revenue

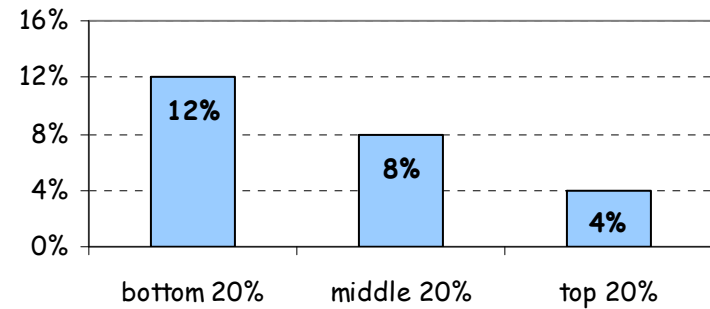




Measuring tax fairness

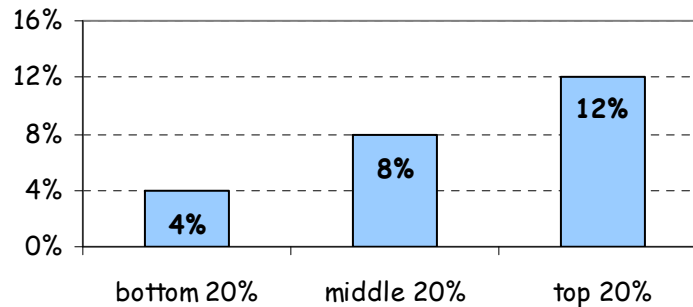
Regressive taxes

When less well-off people pay a higher percentage of their income in tax than do more well-off people the tax is called "regressive".



Progressive taxes

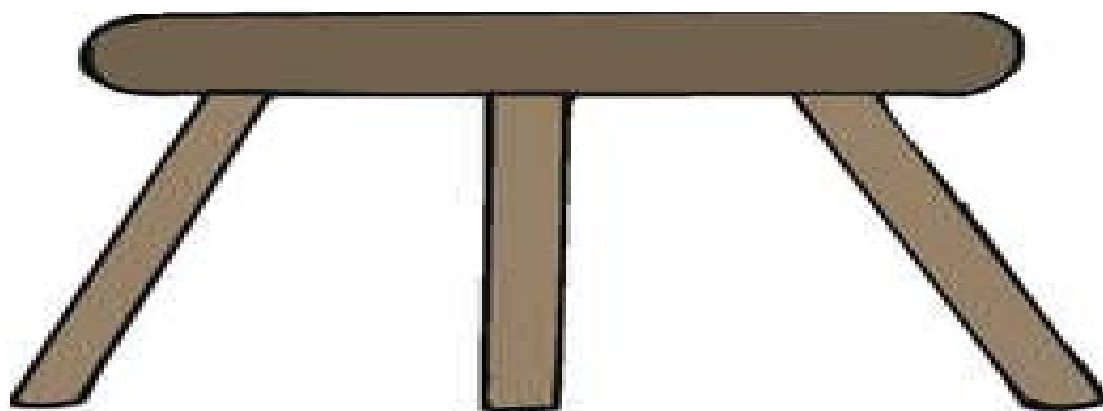
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Thirty-eight states levy three general taxes: property, sales and income taxes.

The “three-legged stool” approach to revenue policy is generally consistent with good tax policy principles.



Income tax

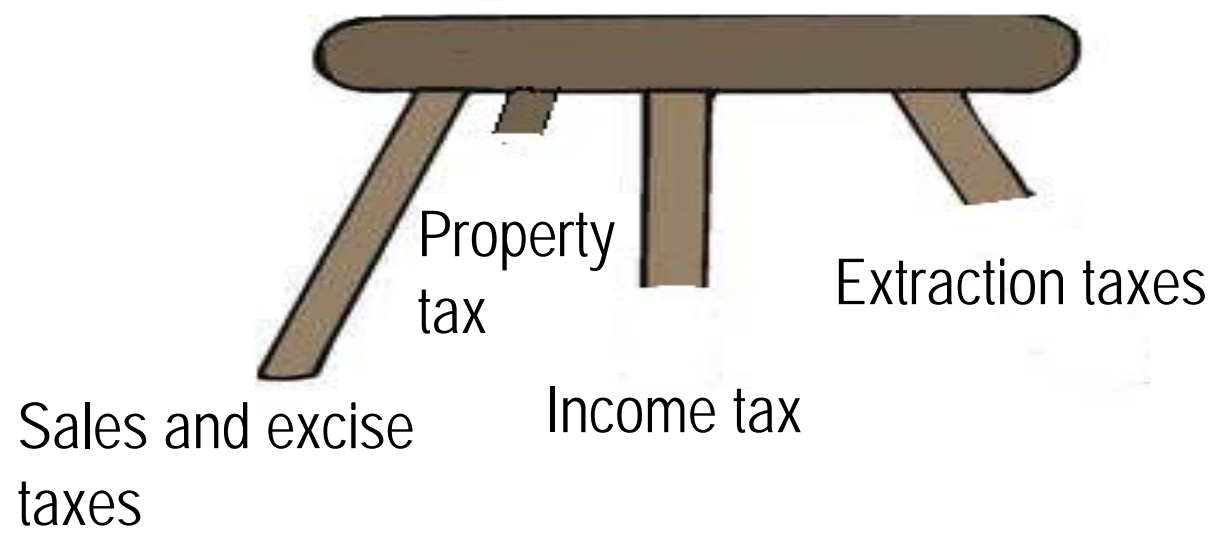
Property tax

Sales & excise tax



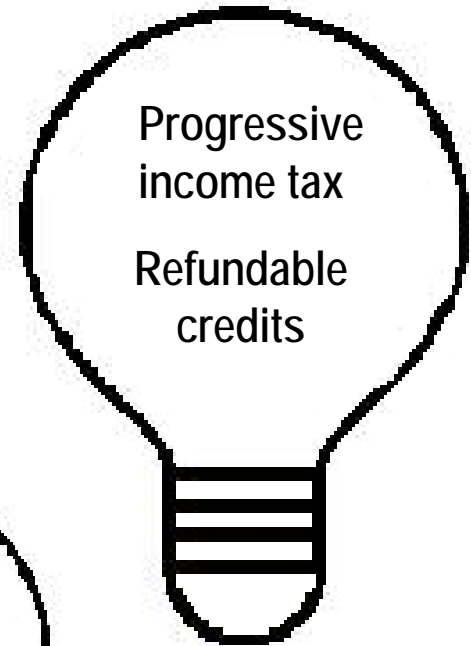
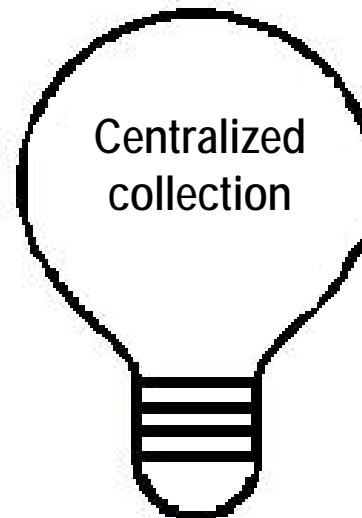
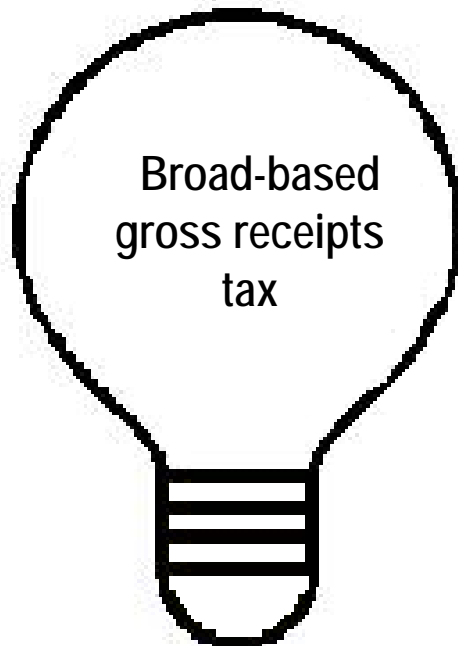
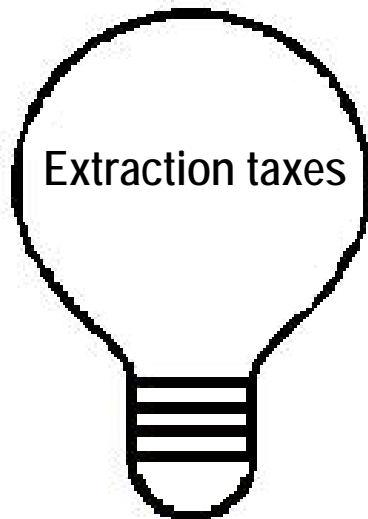


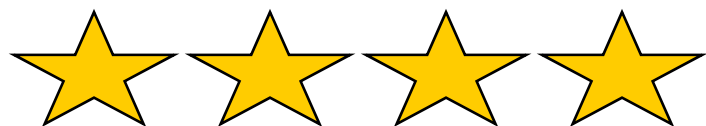
New Mexico's stool has four legs





New Mexico's tax system had a lot to recommend it.





Revenue adequacy



Fairness to taxpayers

"It seems a fair assumption that poor states would have the hardest time bringing in adequate revenue to support their array of responsibilities. But that's not always the case. Take a look at New Mexico. It has more working poor than any other state, and its overall poverty rate is among the highest in the country. Yet its diverse tax structure serves it remarkably well."

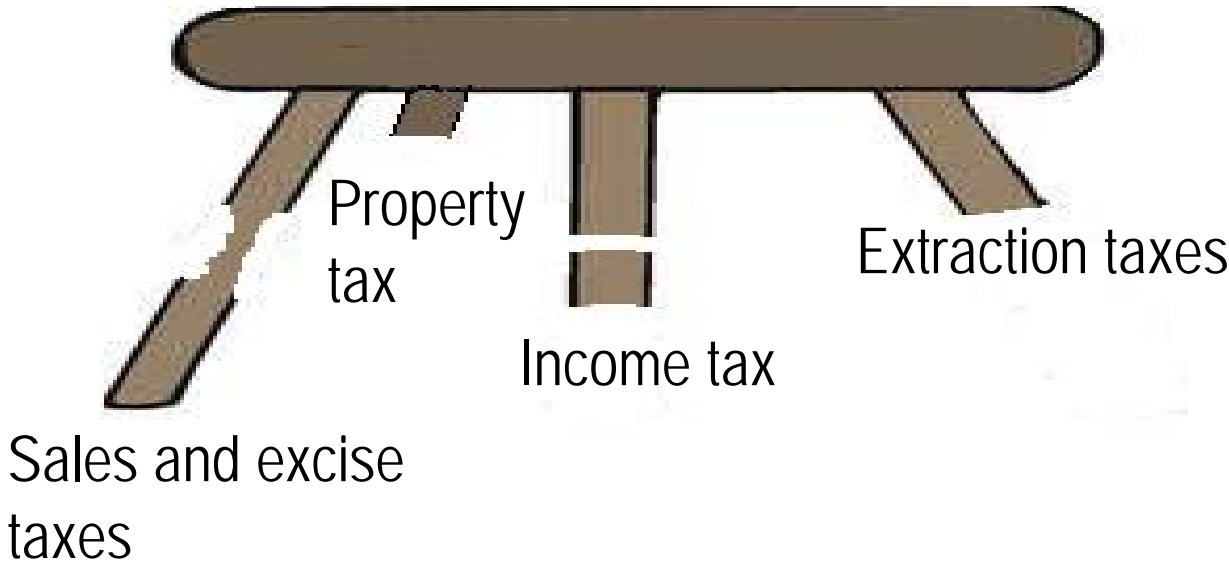
-- *Governing* magazine,

"The Way We Tax," February 2003





The last few years have not been good for NM's stool



Damage to the income tax

- No longer adequate (\$360 million less)

	2004	2005	2006	2007	2008
Rate reduction	-17,110	-72,210	-151,058	-254,352	-332,377
Capital gains	-4176	-10,297	-15,622	-20,336	-27,442
Total cost	-21,286	-82,507	-166,680	-274,688	-359,819

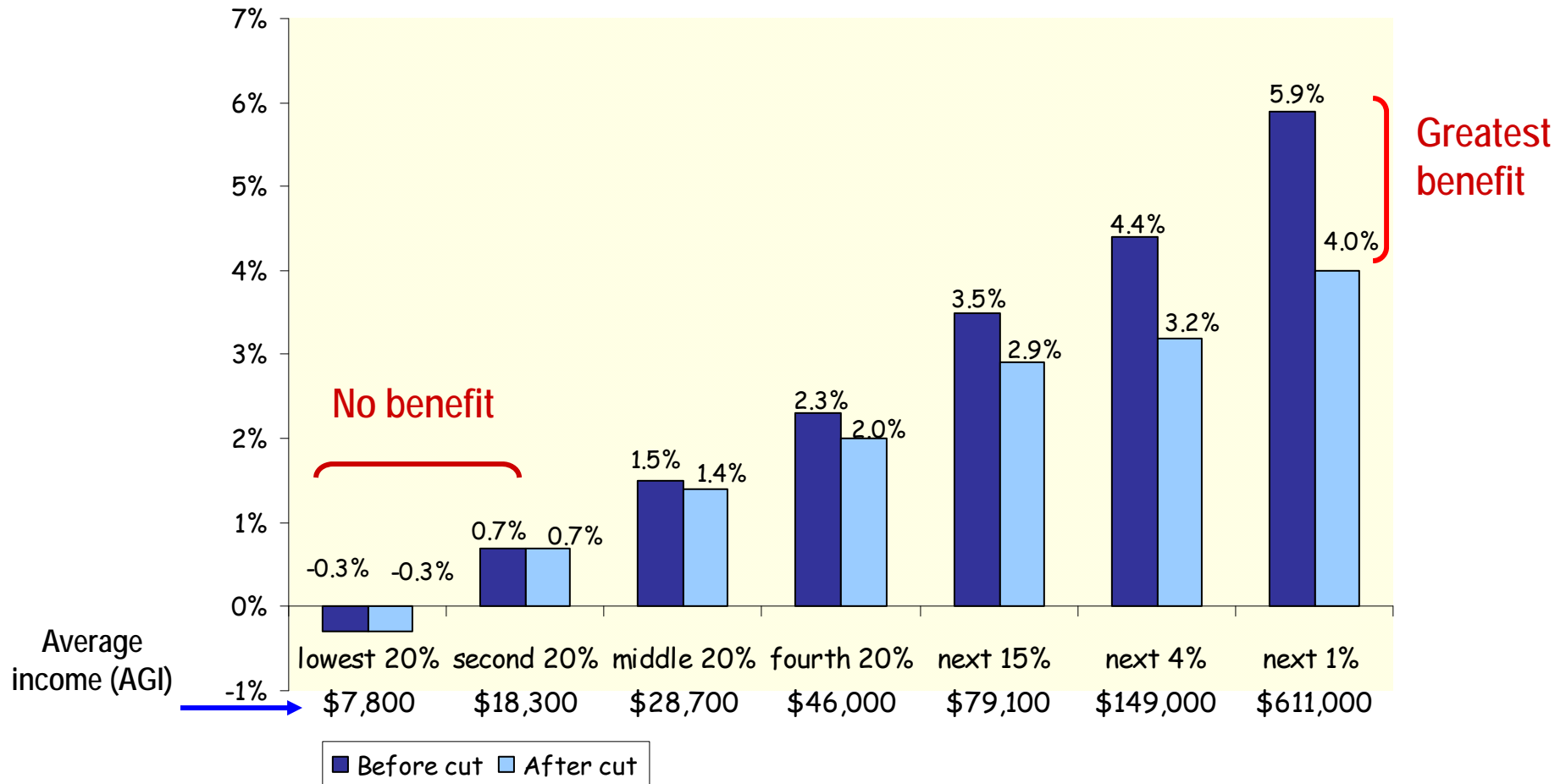
- Far less progressive

In 2008, when the income tax cut is fully phased in, a family with taxable income of \$22,000 will pay the *same tax rate* as a family with taxable income of \$600,000



State income taxes as a percent of family income by income class

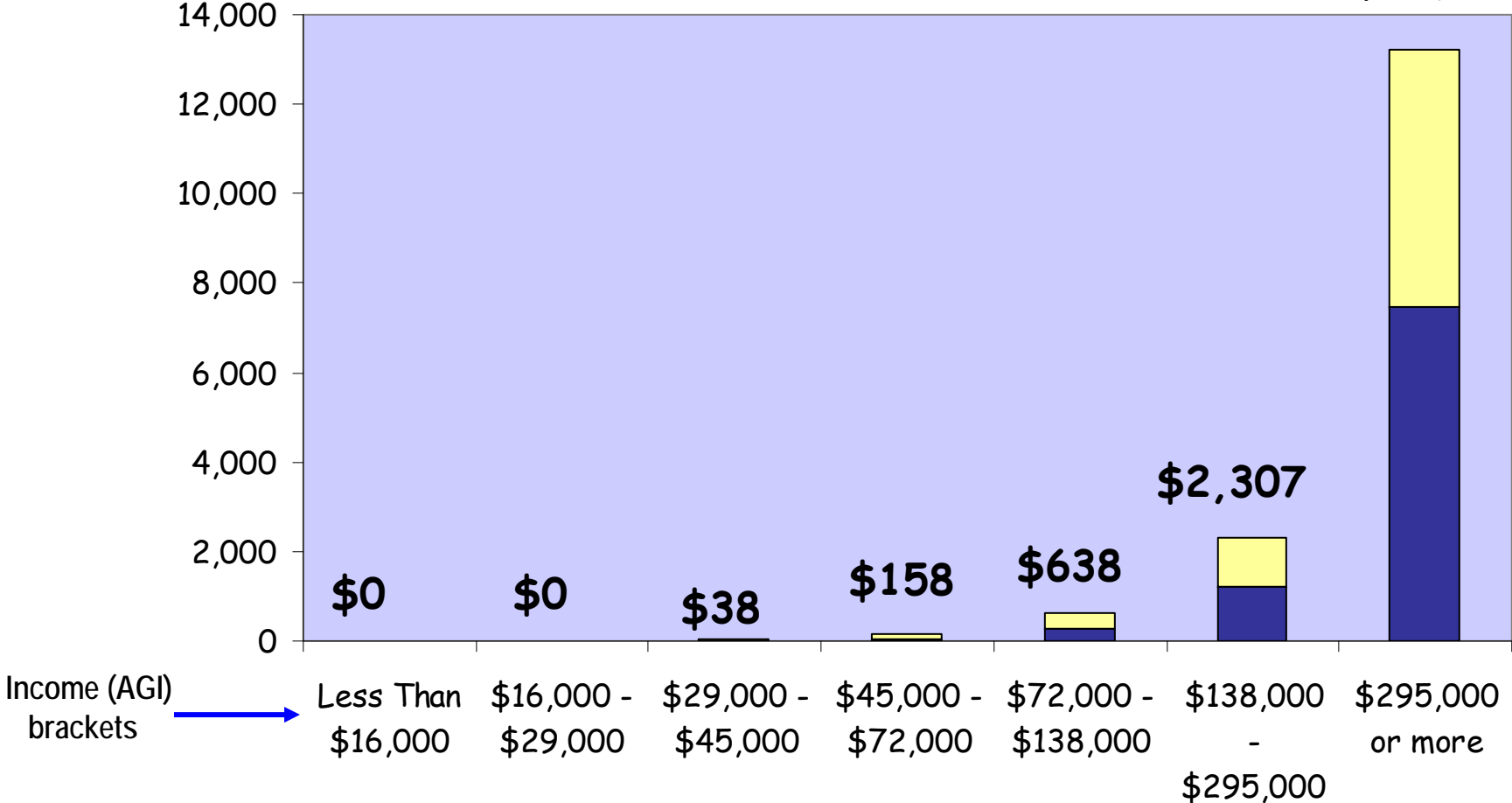
Before and after full phase-in of state income tax cuts



Average NM income tax cut (2008)

by income class

\$13,227



■ phased in 2003 -- 2005 ■ phased in 2006 -- 2007

New Mexico's tax cuts mirror recent federal cuts

Bush CUTS

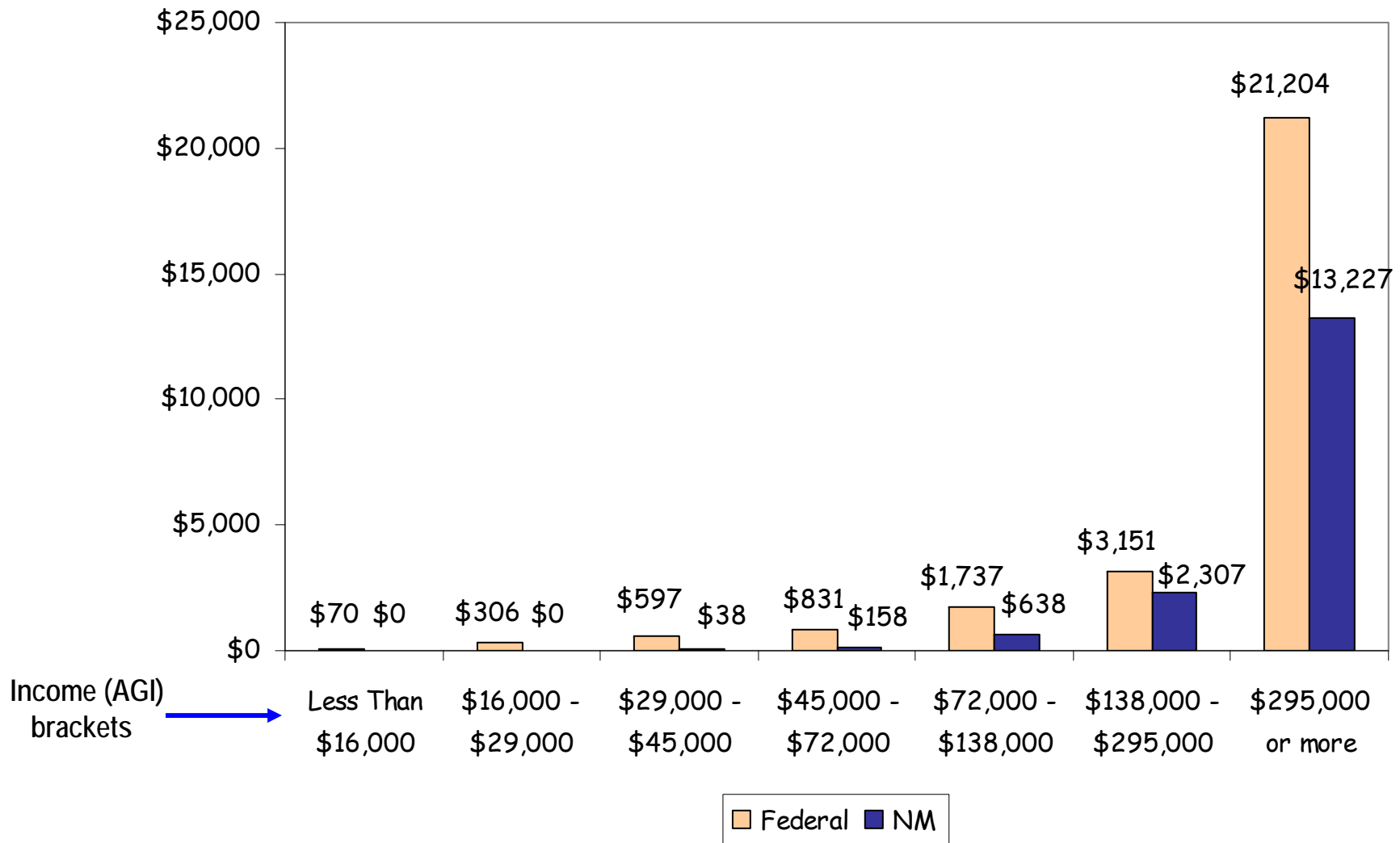
- Reduces the overall tax responsibility on the richest 1% of Americans by more than 12%
- While the bottom 20% of Americans receive only a 3% tax reduction.

Richardson CUTS

- Reduces state income taxes for New Mexicans in the top tax bracket by more than 30%
- Provides no tax relief at all for the bottom 20% of taxpayers.



NM and federal tax cuts in 2008






Reductions in state taxes mean higher federal taxes

State income taxes are deductible. When state taxes go down, itemized deductions go down.

State tax reductions mean federal income tax increases.

One third of the state tax break goes straight to the IRS





Income tax cuts *damage* New Mexico's economy

- State government cannot run a deficit. Tax cuts must be paid for with other tax increases and/or service cuts.
- Consultant to the Blue Ribbon Tax Reform Commission testified that the tax cut would *cost* NM jobs.
- Businesses value a skilled workforce more than tax breaks.
 - Labor = 40% of business costs
 - State taxes = 1% of business costs
- Retirees care more about health care than taxes.





Damage to the tax system

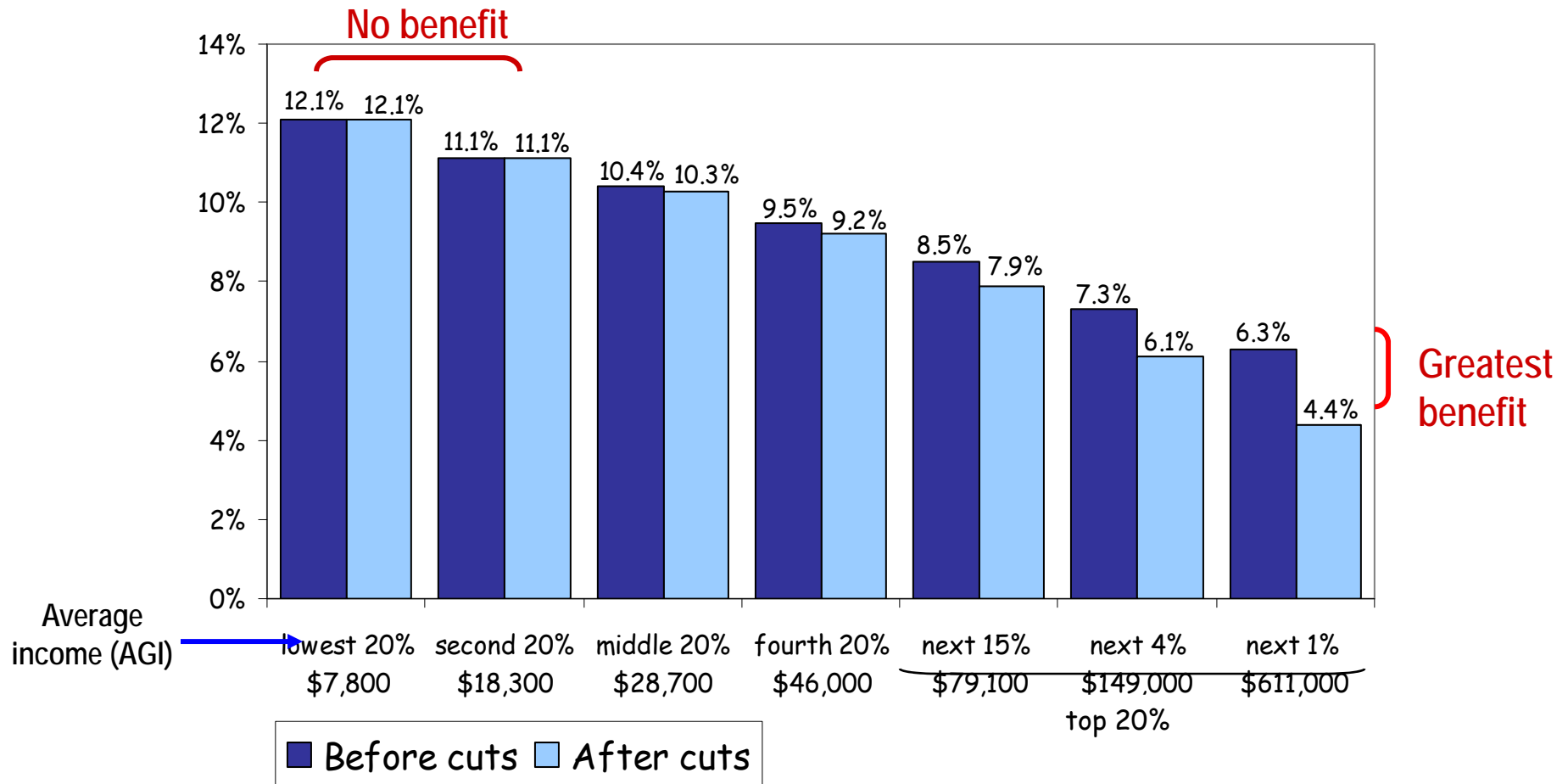
- Less balanced
- Less adequate
- More complicated
- Less transparent



State and local taxes as a percent of family income

by income class

Before and after full phase-in of state income tax cuts





Next year...

Possible service cuts

Tax increases for some

More tax cuts for others

