

New Mexico Fiscal Policy Project

Tax Effort in New Mexico – Need for a Fair State Tax System

April 2005

The issue of overall tax effort by our state’s population is important, but even more important is what sectors of the population are required to contribute and how much. A state tax system can be assessed for fairness by determining the distribution of tax payments by income class. A tax system in which lower income groups pay the same percentage as upper income groups is called a proportional tax system. The two other classification of tax distribution are: ‘regressive’, in which lower income groups pay at a higher rate than the upper income groups; and a progressive tax system, in which upper income groups contribute at a higher rate than the lower income groups. It is important to assess the New Mexico tax system for tax justice by describing who pays state taxes by income level.

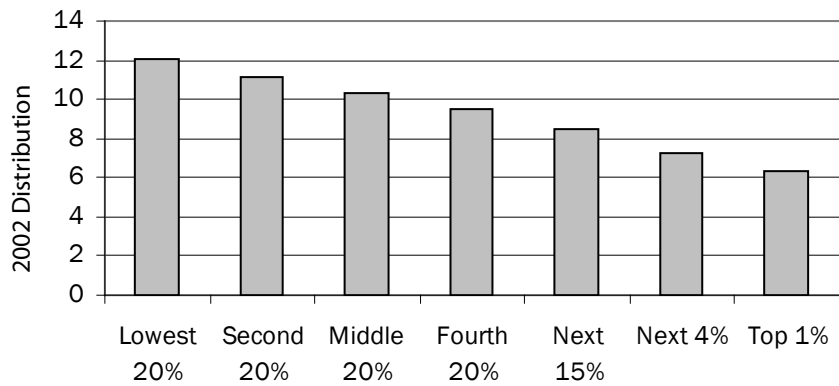
A recent study done by the Washington-based Institute for Taxation and Economic Policy (ITEP) for New Mexico Voices for Children describes who pays New Mexico taxes before and after the introduction of the 2003 personal income tax cuts. Table I shows that the New Mexico tax system was regressive in 2002, with higher income groups paying between 8.5 and 6.3 percent of their income, and lower income groups paying at 12.1 – 11.1 percent of their income. Even before the changes to the tax system enacted in the 2003 legislature, New Mexico failed the criteria of a just tax system: the principle that taxpayers should contribute to the common good in line with their ability to pay. The ITEP study is based on an established economic model that distributes tax payments from the broad categories of income taxes (personal and corporate), property taxes, and sales taxes between the income groups in accord with a documented set of tax incidence assumptions. The model also takes into account special factors such as New Mexico severance taxes on oil, natural gas, coal, and other natural resources. These taxes are allocated to other states based on national resource consumption patterns.

**Table I - New Mexico Tax System - Who Pays?
Taxes Paid in 2002 as a Percent of Income, by Income Level**

2002 Distribution	Lowest 20%	Second 20%	Middle 20%	Fourth 20%	Next 15%	Next 4%	Top 1%
Total Taxes	12.1%	11.1%	10.4%	9.7%	9.3%	8.7%	8.7%
Federal Deduction Offset	0.0%	0.0%	-0.1%	-0.3%	-0.8%	-1.4%	-2.4%
Total After Offset	12.1%	11.1%	10.3%	9.5%	8.5%	7.3%	6.3%

Source: Institute on Taxation and Economic Policy

New Mexico Tax System - Who Pays?



The New Mexico state tax system has undergone marked changes in the years since 2002. Some of the changes in the tax system, such as removing the gross receipts tax on food purchases likely had little overall impact, since the gross receipts tax on all other goods and services was raised in order to avoid a significant loss of revenue. The personal income tax cuts passed by the 2003 New Mexico Legislature, however, will continue to have a significant impact on the both the level and the distribution of tax effort in New Mexico. The 2003 income tax cuts had the effect of shifting the overall New Mexico tax effort significantly from higher to lower income taxpayers. The line labeled Federal Deduction Offset shows how much of the tax cut is going directly to the federal Internal Revenue Service as additional federal income taxes.

**Table II - New Mexico Tax System – Who Pays?
Taxes Paid after the 2003 Personal Income Tax Cuts Take Effect**

Distribution after 2003 Personal Income Tax Cuts	Lowest 20%	Second 20%	Middle 20%	Fourth 20%	Next 15%	Next 4%	Top 1%
Total Taxes	12.3%	11.2%	10.4%	9.5%	8.6%	7.2%	5.8%
Federal Deduction Offset	0.0%	0.0%	-0.1%	-0.2%	-0.7%	-1.0%	-1.2%
Total After Offset	12.3%	11.2%	10.3%	9.2%	7.9%	6.2%	4.5%

Source: Institute on Taxation and Economic Policy

New Mexico Tax System - Who Pays?

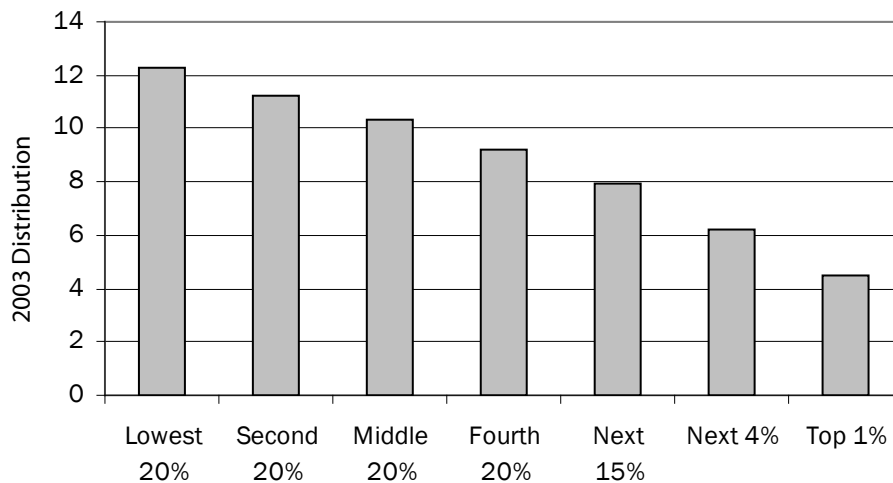


Table III presents the difference between New Mexico tax effort by income fifths in 2002 and after the personal income tax cuts proposed by the Governor and passed by the Legislature.

**Table III - New Mexico Tax System – Who Pays?
After Full Implementation of the 2003 Personal income Tax Cuts**

Total After Offset	Lowest 20%	Second 20%	Middle 20%	Fourth 20%	Next 15%	Next 4%	Top 1%
2002	12.1%	11.1%	10.3%	9.5%	8.5%	7.3%	6.3%
2003	12.3%	11.2%	10.3%	9.2%	7.9%	6.2%	4.5%
Difference (+ More or - Less Tax Burden)	+0.2%	+0.2%	0.0%	-0.3%	-0.6%	-1.1%	-1.8%

Source: Institute on Taxation and Economic Policy

New Mexico Tax System - Who Pays?

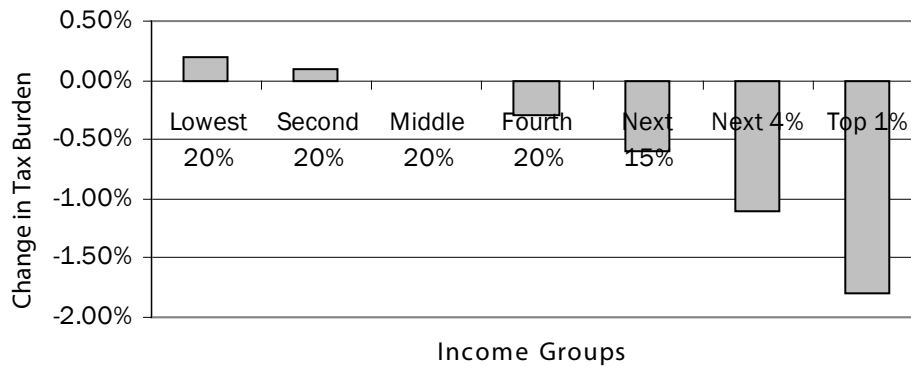


Table III clearly shows that the 2003 personal income tax cuts will make the New Mexico state tax system more regressive than it was before the tax cuts went into effect. The bottom line of Table III shows that the lowest two fifths of the income scale are shouldering more of the tax effort, while the upper two fifths are paying less.

In conclusion, New Mexico is headed in the wrong direction in terms of tax justice. New Mexico is headed away from basing its tax system on the ability to pay and towards forcing the lower income classes who are politically and economically less powerful to pay more than their share of the cost of providing government services.