New Mexico VOICES for Children

Taking a closer look at tax and budget policies affecting New Mexico's quality of life

New Mexico Fiscal Policy Project

Tax Expenditures, General Sales Taxes, and the Need for Transparency in New Mexico

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Introduction

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 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.

General Sales Taxes

The general sales tax in New Mexico is composed of the gross receipts tax (GRT) 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 GRT 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 GRT. The two taxes work in tandem – without the compensating tax, New Mexico businesses would be at a decided disadvantage against out -of-state businesses.

The GRT 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 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 Report 80.

Exemptions and Deductions

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 preempted 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 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	2.5%
Government Group of Exemptions	$20.0	$15.0	$35.0	1.1%
Interstate Trade Group of Exemptions	$12.0	$8.0	$20.0	0.6%
Nonprofit Organizations Group of Exemptions	$90.0	$60.0	$150.0	4.7%
Taxes Paid Under Other Programs	$1,755.0	$1,144.0	$2,899.0	90.3%
Agricultural Group of exemptions	$3.0	$1.0	$4.0	0.1%
Federal Preemption (Food Stamps Only)	$7.0	$5.0	$12.0	0.4%
Manufactured Products Group of Exemptions	$8.0	$0.0	$8.0	0.2%
	$1,953.2.0	$1,256.0	$3,209.2	100.0%

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 (see Table II) 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	9.3%
Government Group of Deductions	$25.0	$15.0	$40.0	2.3%
Interstate Trade Group of Deductions	$11.0	$3.0	$14.0	0.8%
Nonprofit Organizations Group of Deductions	$24.3	$16.5	$40.0.8	2.4%
Deductions for Taxes Paid Under Other Programs	$4.0	$2.0	$6.0	0.3%
Agricultural Group of Deductions	$14.0	$6.0	$20.0	1.2%
Manufactured Products Group of Deductions	$99.0	$46.0	$145.0	8.4%
Property for Resale Group of Deductions	$463.3	$300.0	$763.3	44.3%
Lease for Resale or Lease Group of Deductions	$13.0	$4.0	$17.0	1.0%
Construction Materials and Services Group of Deductions	$48.0	$32.0	$80.0	4.6%
Real Property Group of Deductions	$266.0	$171.0	$437.0	25.3%
	$1,094.00	$630.1	$1,724.1	100.0%

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. 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. While direct spending is reviewed every year by the governor, Legislature and each agency that submits budgetary requests, this form of indirect spending is never revisited once the expenditures are passed into law. The cumulative effect of past tax expenditures is also not taken into consideration when new expenditures are proposed.

Table III
Total Exemptions and Deductions from GRT

	Fund	Municipal	Total	% Share of Total
Social Policy/Economic Development	$184.6	$57.6	$2,42.2.0	4.9%
Government Group of Exemptions and Deductions	$45.0	$30.0	$75.0	1.5%
Interstate Trade Group of Exemptions and Deductions	$23.0	$12.0	$35.0	0.7%
Nonprofit Organizations Group of Exemptions and Deductions	$114.3	$76.5	$190.8	3.9%
Exemptions and Deductions for Taxes Paid Under Other Programs	$1,759.0	$1,146.0	$2,905.0	58.9%
Agricultural Family of Exemptions and Deductions	$17.0	$7.0	$24.0	0.5%
Federal Preemption (Food Stamps Only)	$7.0	$5.0	$12.0	0.2%
Manufactured Products Group of Exemptions and Deductions	$107.0	$46.0	$153.0	3.1%
Property for Resale Group of Deductions	$463.3	$300.0	$763.3	15.5%
Lease for Resale or Lease Group of Deductions	$13.0	$4.0	$17.0	0.3%
Construction Materials and Services Group of Deductions	$48.0	$32.0	$80.0	1.6%
Real Property Group of Deductions	$266.0	$171.0	$437.0	8.9%
	$3,047.2	$1,887.1	$4,934.3	100.0%

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.

Deductions for Food and Some Medical Services

There is also reason to think that the TRD's estimate 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 GRT rate was increased by half of a percentage point (0.5 percent) 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 (see Table VI). This would represent a GRT loss of about $51.9 million in that quarter alone. The deduction reduced taxable gross receipts by $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 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 Deductions

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

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

Conclusion

The New Mexico Legislature could enact tax expenditure reporting. This would require the TRD to track the cost of exemptions and deductions from the gross receipts tax, along with all other exceptions from New Mexico revenue sources. Then this indirect spending would come under the same level of scrutiny as the state's direct spending. The time has come for New Mexico to join the two dozen other states and the federal government that produce such tax expenditure reports on a regular basis.

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