NEW MEXICO
VOICES
FOR CHILDREN

Fiscal Policy Project

Citizen's Guide to New Mexico's Tax System

How the State Collects Money and Why it Matters

Updated 2017



Acknowledgements

The New Mexico Fiscal Policy Project is made possible by grants from the
W. K. Kellogg Foundation, the Center on Budget and Policy Priorities, the Annie E. Casey Foundation,
and the McCune Charitable Foundation.

New Mexico Voices for Children staff

James Jimenez, MPA Executive Director

Gerry Bradley, MA Senior Researcher and Policy Analyst

Stephanie Brinker, PhD Volunteer

Armelle Casau, PhD Research and Policy Analyst

Farah Council Development Director

Bill Jordan, MA Senior Policy Advisor and Government Relations Officer

Sharon Kayne Communications Director

Barbara Mike Operations Support Clerk

Raphael Pacheco, MBA Research and Policy Analyst/SPP Fellow

Brian Urban Operations Manager

Amber Wallin, MPA KIDS COUNT Director

Originally Published in October 2007

Updated September 2017

Other Citizen's Guides

Citizen's Guide to the New Mexico State Budget

Advocate's Guide to the New Mexico State Budget

Citizen's Guide to Legislative Advocacy in New Mexico

A New Mexico Citizen's Guide to Children's Issues

NEW MEXICO VOICES FOR CHILDREN

Table of Contents

Introduction

Taxes are the mechanism through which we accomplish things that benefit us collectively. Taxes are how we build the public commons like roads and bridges, electrical grids, and water lines, as well as how we educate our children, advance public health, uphold our laws, and prevent future problems. In short, we use taxes to manage many of the aspects of our complex society that we could not manage as individuals. Together, these public commons and other accomplishments form the foundation for our economy and enhance our quality of life. The things that we support with our taxes will pay dividends far into the future in much the same way that many of the roads, water lines, schools, and other infrastructure and public systems that we use today are the result of investments that were made in the past. The children we educated just a generation ago are the workforce of today just as the children we educate today will be the workforce of tomorrow.

Our elected officials are charged with drawing up the plans for what we will accomplish collectively and they do this through an annual budgeting process. But they also determine how the tax money that pays for these investments is collected. In other words, our lawmakers must decide who pays taxes and how much. How these decisions are made says a lot about our values and priorities. A tax code can spread the payments evenly among taxpayers or it can require some citizens to pay more and allow others to pay less.

This guide describes the basics of New Mexico's tax system. Two companion publications, *Citizen's Guide to the New Mexico State Budget* and *Advocate's Guide to the New Mexico State Budget*, explain the basics of the state's general fund budget, the budget formation process, and how citizens can promote their priorities within that process.

Some Tips for Using This Guide

Words that appear in boldface are defined in the *Technical Terms* and *Tax Facts* boxes. Acronyms used in this guide are written out in the box below.

Acronyms

CIT – Corporate income tax
EITC – Earned Income Tax Credit
FIR – Fiscal impact report
FY – Fiscal year
GRT – Gross receipts tax
LFC – Legislative Finance Committee
LICTR – Low-Income Comprehensive Tax Rebate
PIT – Personal income tax
TEB – Tax expenditure budget
TRD – Taxation and Revenue Department
WFTC – Working Families Tax Credit

Why Taxes Matter

People often ask why a child advocacy organization like New Mexico Voices for Children works on tax and budget issues. Wouldn't it make more sense to advocate on issues that directly affect kids—like better nutrition in schools, higher quality foster care, and more anti-gang programs?

The state and federal tax systems also directly impact kids. The vast majority of the money the state or federal governments have to spend on services like schools, health care, and public safety comes from taxes. Every time the government cuts taxes for one group of people or businesses, it either has to raise taxes elsewhere or it has to cut spending. Spending cuts generally lead to cuts in services, which can have detrimental impacts on children. Cuts can lead to more crowded classrooms, fewer caseworkers for investigating child abuse or for recovering child support payments from noncustodial parents, for example.

Tax systems also directly impact working families and that impacts kids. The more money a working family spends on taxes, the less money they have for necessities like nutritious food, health care, and books that help their children succeed. Surprisingly, as we will see later on, those with the lowest incomes pay the highest percentage of their income in state and local taxes.

How the State Collects Money

General Fund Revenue Sources

This guide focuses on revenues that are deposited in the state general fund, which is the state's main pot of money for operating expenses. Figure I (page 6) shows where the state gets its tax revenue, and how much is expected to be generated for **fiscal year** 2017 (FY17). The largest slice of the pie (34.3 percent) comes from general sales taxes. This includes **gross receipts taxes** (GRT) and **compensating taxes**. GRT is levied on most goods and services and is often passed along to the consumer. Including services in the tax base is good because services constitute an increasing share of economic activity while goods constitute a decreasing share. Because of this, more states are beginning to tax services. Many cities and counties in New Mexico also collect GRT to pay for municipal services, so the amount you pay will vary depending on where you are in the state.

Personal **income taxes** (PIT) make up a much larger percentage (23.8 percent) of revenue than corporate income taxes (1.2 percent). Corporate income taxes are levied on a corporation's net profits, which can fluctuate widely from year to year. Also, the Legislature has

Technical Terms

Gross Receipts Taxes – Taxes collected on the gross receipts (total money taken in) of a business or service provider. It is usually passed along to the consumer of their goods and services.

Compensating Tax – A tax on goods that are bought out-of-state for use in New Mexico. Say, for example, you open a restaurant in New Mexico but purchase your chairs and tables in Texas. You must pay compensating tax on those purchases.

Excise Taxes – Taxes levied on specific goods, such as cigarettes, alcohol, and gasoline.

Income Taxes – Taxes paid on a resident's personal income or a company's profits.

Severance Taxes – Taxes paid on natural resources such as crude oil and natural gas, so named because these resources are 'severed' from the ground.

enacted many tax breaks and significantly lowered the overall CIT rate in 2013.

Excise taxes on the sales of tobacco, liquor, motor vehicles, and telecommunications services account for 9.6 percent. People often suggest raising so-called "sin taxes"—taxes on alcohol and tobacco products—as a way to generate revenue, but as the pie chart indicates, such taxes do not amount to a significant share of revenues.

The 14 percent mineral revenues piece of the revenue pie includes **severance taxes** on crude oil, natural gas, coal, copper, and other hard minerals that are extracted from the ground, as well as rents and royalties from the sale or lease of mineral-producing land. About 90 percent of these mineral revenues comes from taxes collected on oil and natural gas extraction.

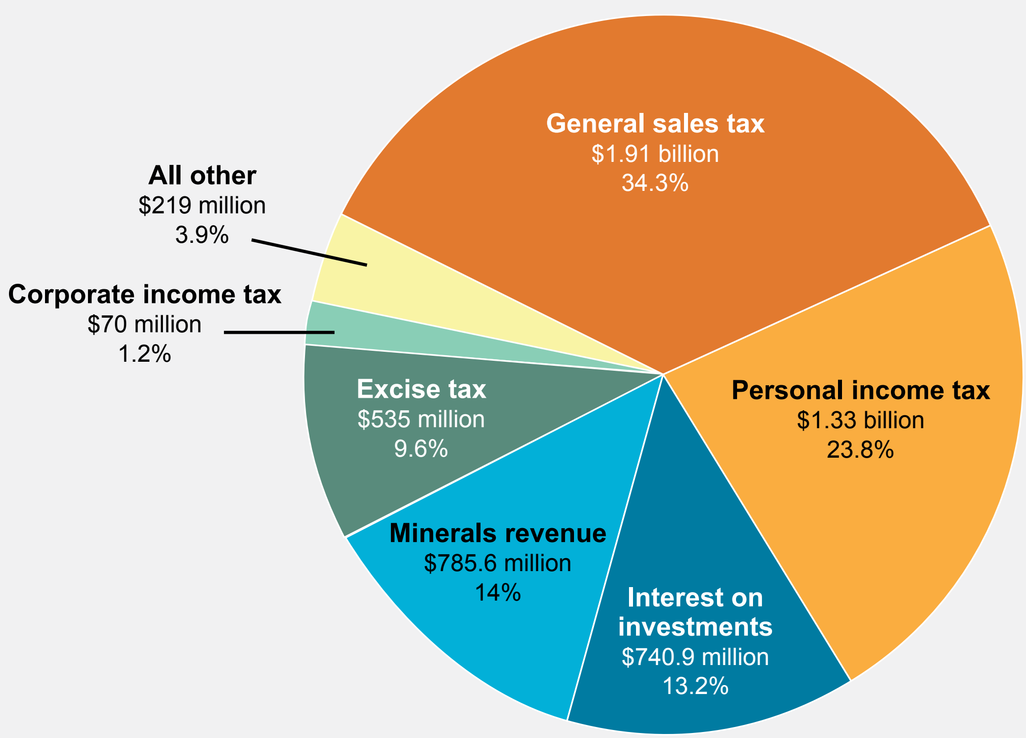
Severance taxes are a desirable revenue source because they are "exported," meaning these taxes are paid by consumers and shareholders (whether they live in New Mexico or not), as well as oil and natural gas producers, most of which are owned by out-of-state companies. However, they are based on the value of production (e.g., the price of a barrel of oil), so changes in the market prices of these commodities can have a significant effect on the amount of revenue collected by the state.

The final two categories—"interest on investments" (13.2 percent) and "all other" (3.9 percent)—include some non-tax revenues. Interest revenue is primarily income derived from investing permanent fund revenue in the stock and bond markets. New Mexico derives an unusually large share of revenue from investments, but this revenue also rises and falls with the stock market. The "all other" category includes gaming revenue from tribal casinos as well as the fees paid on things like registering your car or visiting a state park or museum.

FIGURE I

New Mexico's Tax System Relies Most Heavily on Sales and Personal Income Taxes

New Mexico's revenue sources for FY17



Source: *Post-Session Review*, Legislative Finance Committee, 2016
NEW MEXICO VOICES FOR CHILDREN

Spending Through the Tax Code

The state spends money both directly and indirectly. Direct spending takes the form of annual budgeting for programs and services such as education, public safety, and health care. Direct state spending is covered in the companion publication *Citizen's Guide to the New Mexico State Budget*. The state also spends money indirectly by choosing to forego collecting certain tax revenues. While direct spending is done through the budgeting process, indirect spending is handled by changing the tax code.

Over the years, the Legislature has enacted many tax breaks, which are called **tax expenditures**. Many tax expenditures are touted as necessary for economic development because they provide a subsidy or incentive for specific businesses. Tax credits for solar panels is an example of this. Other expenditures are intended to help groups of people. The Working Families Tax Credit, which helps low-income working families, is one example.

Tax breaks almost always result in the state collecting less revenue. Lower revenue means the state will either have to cut its direct spending or it will have to raise other taxes or fees to make up the difference. Before any legislation to enact a tax break is passed, however, the state tries to estimate how much it will cost. These estimates are contained in a fiscal impact report (FIR) prepared by the Legislative Finance Committee (LFC) staff.

Once a tax break is enacted, it is a good idea to track how much it is costing the state, and whether it is having the desired outcome. This regular accounting is called a **tax expenditure budget** (TEB). Unfortunately, for many years the state did not track the cost and benefits of the many tax breaks that have been enacted over the years.

New Mexico lawmakers have passed bills requiring a TEB in statute, but they were all vetoed. Instead, governors have ordered the state's Taxation and Revenue Department (TRD) to issue a TEB. When the TEB is produced by executive order, the governor can instruct the TRD to leave out any pet tax breaks he or she doesn't want scrutinized. Because of that, New Mexico's TEB is incomplete and does not offer enough evaluation of tax breaks.

Technical Terms

Tax Expenditure – A way the state spends money indirectly by foregoing collecting certain taxes through tax exemptions, deductions, and credits.

Tax Expenditure Budget – An accounting (usually annually) of the cumulative cost of all tax expenditures. Such a report may also determine whether the tax expenditure had the intended economic effect.

Tax Exemptions (as applied to the gross receipts tax) – Goods and services that are not taxed. For example, the state does not collect taxes on the food we buy to eat at home because it is exempt from the GRT.

Tax Deductions (as applied to the gross receipts tax) – Expenses that can be subtracted from a business's tax return. For example, if a business rents construction equipment, the state does not collect taxes on that rental because the business has deducted the cost from their tax return.

Tax Facts

Other Revenue Sources

Some other revenue sources you may be familiar with that do not go into the state general fund are:

Fuel Taxes on gasoline, diesel, and other fuels. These are specifically designated for the Department of Transportation's use and are deposited in the state road fund, which is used to finance highway construction and maintenance, as well as debt payments for highway capital improvement bonds.

Fees are collected for services such as licensing a car or to enter a state park.

Federal Funds accounts for approximately one-third of the state's total spending. While many agencies receive federal funding, the majority goes to the departments of Health, Human Services, Transportation, and Public Education. Federal funding also goes to higher education institutions.

Property Taxes do not support the operations of state government but are used for public infrastructure. County and city governments receive more than 46 percent of taxes imposed on property. The public schools receive about 30 percent, mostly for school construction, and the remainder goes to two-year colleges, health facilities, and special districts.

Principles of a Good Tax System

New Mexico's Legislative Finance Committee evaluates tax policy on five principles:

- Adequacy
- Efficiency
- Equity
- Simplicity
- Accountability

Adequacy means that tax revenue meets state spending needs and keeps pace with inflation and population growth.

An **efficient** tax system, by the LFC's definition, is one that has a broad base to avoid excess reliance on one tax. Most states rely on three sources to create balance: income, sales, and property taxes. New Mexico also collects severance taxes, so the state has four main sources of revenue, giving it a broad base.

Equity in a tax system means that everyone pays according to their ability to pay. This means taxes on low-income households should be minimized. Personal income taxes usually incorporate this ability-to-pay principle because they:

- Adjust for family size and family type;
- Allow deductions and credits for some family expenses like child care and health care;
- Can include low-income wage subsidies such as the federal Earned Income Tax Credit and New Mexico's Working Families Tax Credit (for more on refundable tax credits, see page 11); and
- Include graduated rates.

A tax system is **simple** when the effort that goes into collection is minimal and it is easily understood. Every time the state enacts a tax exemption, deduction or credit, the system loses simplicity, making it more difficult to administer.

Accountability means that tax credits, exemptions, and deductions are easy to monitor and evaluate.

These five principles cover most aspects of a good tax system. However, we would add three more:

- Stability
- Consistency
- Transparency

A **stable** tax system is one that relies more on predictable revenue sources than on sources that fluctuate. Personal income taxes are stable because they follow personal income growth. Severance taxes are less stable because they are based on the current prices of oil and natural gas, which are set at the global level.

A tax system is **consistent** when tax revenues grow at the same rate as state personal income. Gross receipts tax growth is the most consistent because it closely follows population growth (which also impacts the need for state services).

Transparency is what makes accountability possible. A tax system is transparent when citizens have enough information about the tax code to hold government accountable.

Tax Facts

Why the GRT is Not a Sales Tax

The GRT differs from a more traditional sales tax in a number of ways. In general, a sales tax is a tax levied by the government on the sale of products to customers. The business selling the product is simply the go-between—collecting the tax from the customer and passing it along to the state (or city or county). The GRT is a tax on the business's total receipts—or the money it takes in. While it is generally passed along to the customer, it doesn't have to be—but it still has to be paid to the government. Gross receipts are not the same as profits, which is the money the business makes from the transaction minus the deduction of allowable expenses.

Measuring Tax Fairness

A state tax system can either be regressive, proportional or progressive.

Sales and excise taxes tend to be **regressive**, meaning those with the lowest incomes pay the highest share of their income in these taxes. That is because the lower a person's income, the higher the share that must be spent on day-to-day necessities—such as gas, utilities, and non-food groceries—most of which are taxed. This means they spend a greater proportion of their income on sales taxes than do upper-income people, who can save or invest some of their earnings because they do not need to spend it all to make ends meet.

A **proportional** system in one in which everyone pays the same percentage of their income in taxes. This may sound like the most equitable option, but it does not take into account one's ability to pay or minimize taxes on low-income households.

Income taxes are generally **progressive**, meaning those who earn the least pay the lowest rates, with rates increasing as income increases. The federal income tax was designed this way to help make up for the fact that state and local taxes tend to be regressive.

Taxing Poverty

Most people agree that the poor shouldn't pay a higher percentage of their income in taxes than the rich. However, the truth is that poor people pay a much higher share of their income in taxes.

When we look at taxes as a share of income, the ideas of regressivity and progressivity become clearer. Figure II (below) illustrates what percentage of their income non-elderly New Mexicans pay in taxes. The chart is organized by income levels, from the lowest 20 percent to the highest 1 percent, in order to show how the impact of taxes varies depending on one's income.

FIGURE II

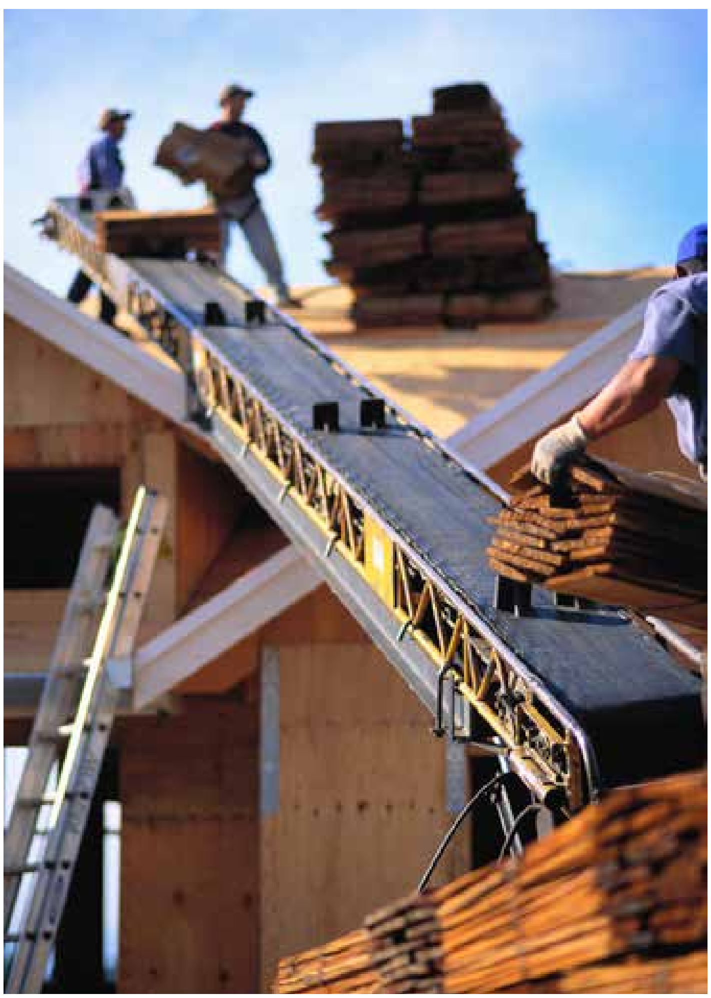
New Mexicans with the Lowest Incomes Pay The Highest Share of Their Income in State and Local Taxes

State and local taxes paid by New Mexicans as a portion of their incomes (by quintile, 2015)

Source: *Who Pays?*, The Institute on Taxation and Economic Policy, 2015
Note: Table shows permanent law in New Mexico enacted through December 31, 2014 at 2012 income levels
NEW MEXICO VOICES FOR CHILDREN

The light orange bars show the total share of income paid in state and local taxes. The bars decrease as income increases—meaning the overall system is regressive. The colored bars within the light orange bars show how each individual tax contributes to the overall rate. As the blue bars indicate, sales and excise taxes are the most regressive—hitting the lowest 20 percent the hardest. The same is true for property taxes (the yellow bars), which doesn't just hit homeowners, because it is also passed along to renters. The opposite trend can be observed for income taxes (the green bars) because these taxes are progressive. The lowest 20 percent of earners receive an income tax credit (shown by the green bars that dip below the 0 percent line) and as the amount earned increases, the percentage paid to income taxes also increases (except for the top 1 percent, where it decreases slightly).

In addition, there is a federal offset (the dark orange bars). State income taxes paid are deducted from the amount owed in federal income taxes, thereby decreasing the amount of federal income taxes due. The higher the income group, the more valuable the offset.



Overall, Figure II shows that income earners in the lowest 20 percent pay nearly 11 percent of their income in taxes, while the top 1 percent pays less than 5 percent—meaning the tax rate paid by the poorest New Mexicans is more than twice the tax rate paid by the richest.

Refundable Tax Credits

One progressive aspect of New Mexico's income tax is the existence of four refundable tax credits for very low-income New Mexicans:

- Low-Income Comprehensive Tax Rebate (LICTR);
- Property Tax Rebate for seniors;
- Child Care Credit for low-income working parents; and
- Working Families Tax Credit (WFTC).

Refundable tax credits help low-income families by reducing their overall tax bill if they owe taxes or refunding them money they've already spent (for example, on child care) if they do not owe taxes. The WFTC, a state-level Earned Income Tax Credit (EITC), rewards work because the credit amount is based on income earned. Unfortunately, millions of dollars in federal and state refundable tax credits go unclaimed every year by New Mexicans[1] because they either do not file tax returns or they (or their tax preparer) are unaware of the credits.

Technical Terms

Regressive Taxes – Those with lower incomes pay a higher percentage of their income in tax than do those with higher incomes.

Proportional Taxes – Everyone pays the same percentage of their income in tax.

Progressive Taxes – Those with lower incomes pay a smaller percentage of their income in tax than do those with higher incomes.

Tax Cuts and “Job Creators”

A Less Adequate, Equitable and Stable System

In 2003, at then-Governor Richardson’s request, the New Mexico Legislature cut the personal income tax rate for the top income earners by almost half—from 8.2 percent to 4.9 percent. New Mexicans earning the median income ($29,001–$45,000) received a small cut. Those earning the least—the bottom 40 percent of tax filers—received no benefit at all.

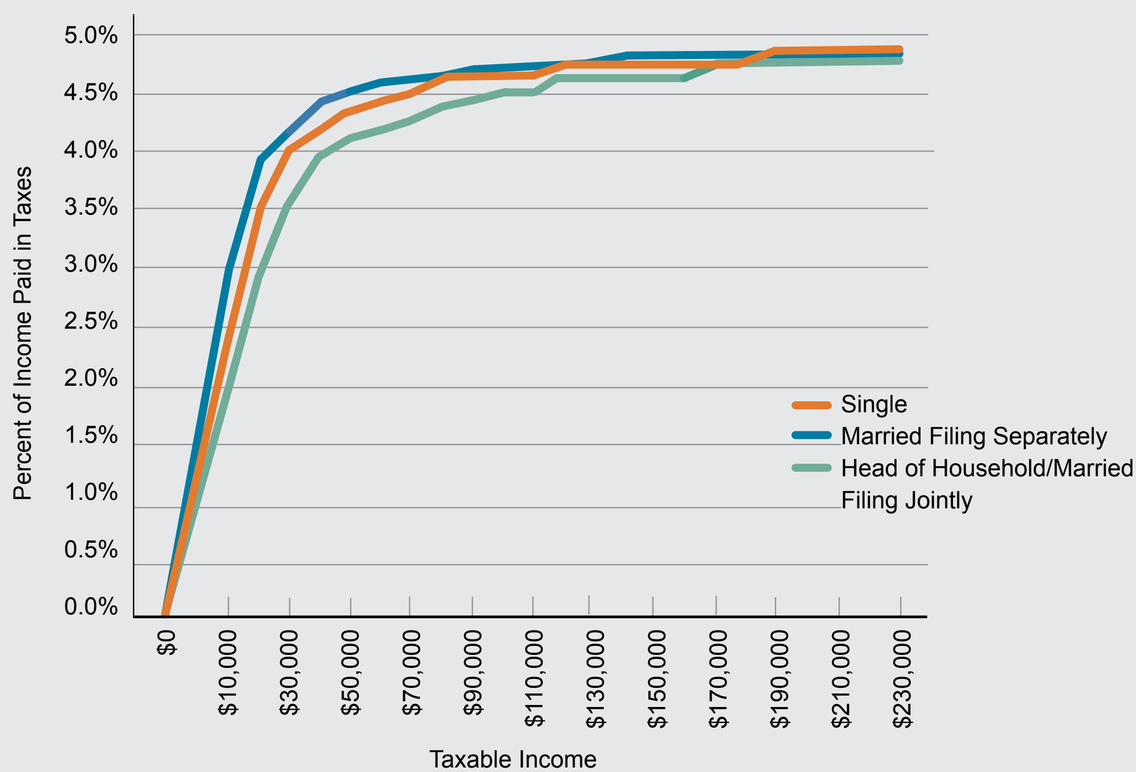
As Figure III (below) shows, this has made state income taxes considerably less progressive. The tax rate climbs rapidly in the lower-income brackets ($0 to $30,000), then begins to level out at about $70,000, and is completely flat by the time it reaches $250,000. To be truly progressive, tax rates should climb more rapidly in the highest income levels, not at the lowest. In other words, the curve below should start out flat and rise most rapidly at the end of the income scale instead of the beginning.

Also in 2003, those receiving capital gains income were given a big break. Capital gains is income realized when something of value—stocks, bonds, real estate, etc.—is sold at a profit. Because it does not come from wages or salaries, capital gains is called “unearned income” by economists. New Mexico allows those with capital gains to deduct half of that income from their state taxes. This deduction overwhelmingly goes to the highest-income earners.

FIGURE III

The 2003 Cuts Made New Mexico’s Personal Income Tax Code Much Less Progressive

New Mexico personal income tax rates (by percent)



Source: Tax Table for Taxes due April 17, 2012

Note: Taxable Income is after the Low- and Medium-Income Exemption but before the Working Families Tax Credit.

NEW MEXICO VOICES FOR CHILDREN

In 2013, without an FIR and with very little debate, the Legislature passed an omnibus tax bill. Two of the most expensive provisions in the **omnibus bill** were changes to the state's corporate income tax. The bill reduced the overall CIT rate and it also essentially eliminated CIT for the manufacturers operating in the state. Like the PIT cuts before it, the public was told that the 2013 bill would encourage job growth. There is no evidence that these tax cuts produced jobs. What the cuts did do, however, was make the state more reliant on revenue from other sources—namely severance taxes, which are not a particularly consistent revenue source, as we have seen. In fact, when oil and natural gas prices fell sharply in early 2016, the state was unable to bring in enough revenue to cover the programs and services that had already been budgeted. The Legislature had to meet in a special session in October 2016 to make sharp spending cuts to both the FY16 and FY17 budgets. As revenue collections continued to lag, more cuts had to be made to the FY17 budget during the 2017 regular legislative session.

Those Elusive 'Job Creators'

Over the past 40 years, Americans have been told that tax cuts for the wealthy will create jobs. We were also told that the new jobs created by these tax cuts would generate enough new tax revenue that the cuts would "pay for themselves." While tax cuts for the so-called "job creators" can spur job growth, they have not been proven to pay for themselves,[2] so that means states lose money on them.

When tax cuts result in spending cuts, both public- and private-sector jobs are lost. Cities and states not only cut back on employees, they also cut back on contracts with the private businesses, vendors, and non-profits that provide services. The jobs lost can range from teachers and technical advisors to health care providers. In short, a million dollars spent providing education or health care creates far more jobs than a million dollars sent back to shareholders or high-income consumers in the form of tax cuts. Leading economists say that cutting public-sector jobs in order to pay for private-sector tax breaks does more harm to the economy than good.[3]

Tax cuts for businesses are also said to encourage job growth by luring new companies to the state. While no company will turn down a tax incentive, research shows that business owners weigh a very broad range of factors that are associated with the quality of living—such as the quality of the public education system and the local workforce, proximity to highway, rail, and airline routes, and even the weather—when considering new business locations.

In the last decade, New Mexico has cut personal and corporate taxes by billions of dollars in an attempt to lure companies to the state. Our job growth rate, however, continues to be sluggish.

Technical Terms

Fiscal Year – The revenue and budget year for the state. New Mexico's fiscal year starts on July 1 and ends the following June 30. The fiscal year is named for the calendar year in which the fiscal year ends. For example, fiscal year 2017 (which began July 1, 2016) ends on June 30, 2017. Fiscal year 2017 is abbreviated as FY17.

Omnibus bill – A bill consisting of many different smaller bills.

Tax Facts

What Business Wants

Business values a skilled workforce more than tax cuts because:

- Labor = 40% of business costs.
- State taxes = 1% of business costs.

Conclusion

Most government services and programs are paid for with taxes, as is the infrastructure that makes our way of life and modern economy possible. How we collect taxes says a great deal about our values and priorities—whether we want a progressive tax system that allows low-income families to pay less, or whether we think everyone should pay the same rate no matter their income level.

Because of our broad-based gross receipts tax, New Mexico's tax system has always leaned rather heavily on our low-income families. The income tax cuts of 2003 and corporate tax cuts of 2013 made our system even less progressive and also significantly decreased the state's revenue.

Endnotes

1. "The Earned Income Tax Credit—A Fact Sheet," Center on Budget and Policy Priorities, http://www.cbpp.org/eitc-partnership/eitcfactsheet.htm
2. "Tax Cuts: Myths and Realities," Center on Budget and Policy Priorities, Washington, DC, Revised May 9, 2008; http://www.cbpp.org/cms/?fa=view&id=692
3. "The Ultimate Burden Of The Tax Cuts: Once the Tax Cuts are Paid for, Low– and Middle–Income Households Likely To Be Net Losers, on Average," William G. Gale, Peter R. Orszag, and Isaac Shapiro, Center on Budget and Policy Priorities, Washington, DC, 2004; http://www.cbpp.org/cms/index.cfm?fa=view&id=1971

Follow us online

www.nmvoices.org

New Mexico Voices for Children
625 Silver Ave. SW, Suite 195 • Albuquerque, New Mexico 87102
505-244-9505 • www.nmvoices.org

NM Voices for Children is a proud member of the following networks: