



ISSUE PRIMER

A Guide to New Mexico's Tax System

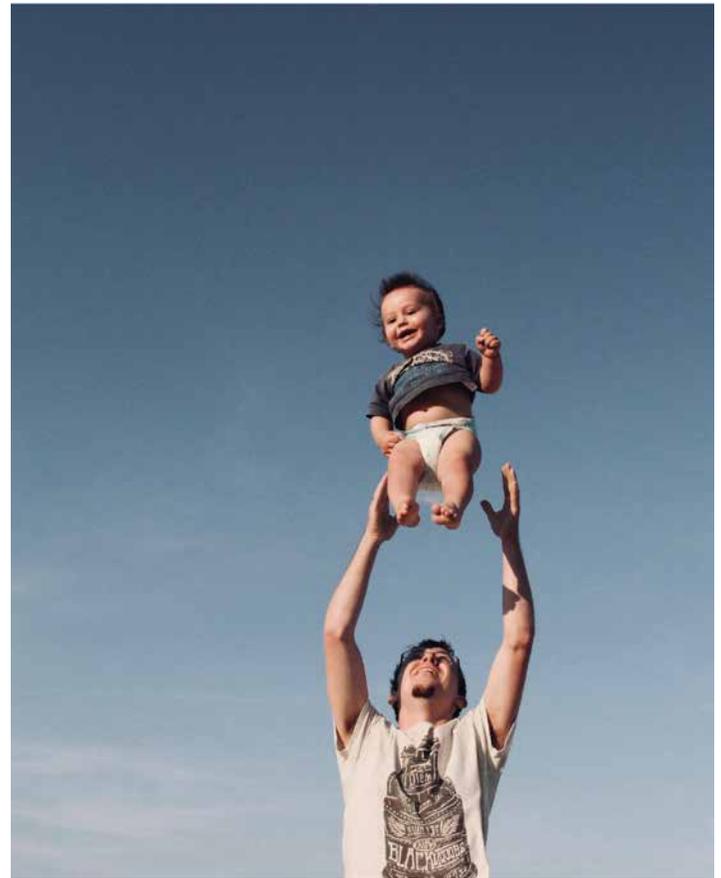
Executive Summary



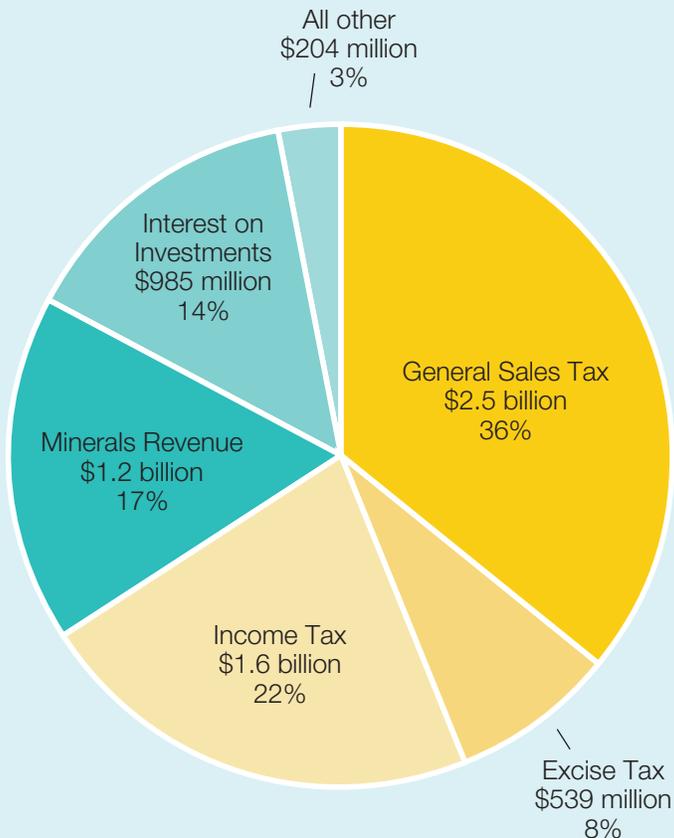
HOW THE STATE COLLECTS MONEY

The taxes we all pay are how we fund the state's programs and public services that benefit us collectively. They are how we build our roads, bridges, waterlines, electrical grids, and how we educate our children, advance public health, and uphold our laws. These programs and services form the foundation of our economy, enhance our quality of life, and pay dividends far into the future.

Most of the taxes we pay are deposited into the general fund, which is the state's main pot of money for programs and services laid out in our state budget (see our budget guide for more on that). Not all of the money in the state general fund comes from taxes. The state also collects rents and royalties from the sale or lease of state lands for oil and gas production, and it earns income on the investments it makes in the stock market. Other common revenue sources for the state include fuel taxes, some fees, federal funds, and a share of property taxes, but those do not go into the state general fund.



STATE REVENUE SOURCES (FY21)



Source: Post-Session Review, Legislative Finance Committee, 2020

WHERE THE MONEY COMES FROM

General sales taxes include gross receipts taxes (GRT) and compensating taxes. GRT is levied on most goods and services and is often passed along to the consumer.

Excise taxes are also sales taxes, but they are reserved for things like tobacco, liquor, motor vehicles, and telecommunications services.

Income taxes include personal income taxes (PIT) and corporate income taxes (CIT). Corporate income taxes are levied on a corporation's net profits.

Mineral revenues are collected 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.

Interest on investments is primarily income derived from investing permanent fund revenue in the stock and bond markets.

All other 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.

WHO PAYS?

Besides deciding how to spend this money, the lawmakers we elect and send to Santa Fe are charged with determining how our tax money is collected for important investments like education, infrastructure, public safety, and more. In other words, they have to decide who pays taxes and how much, in order to advance our collective priorities.

Most tax systems are either regressive or progressive. A regressive tax system is one in which those with the lowest incomes pay the highest share of their income in taxes. Sales and excise taxes tend to be regressive. In contrast, a progressive tax system is one in which those who earn the least pay the lowest rates, with rates increasing as income increases. The federal income tax is progressive, and was designed as such to help make up for the fact that state and local taxes tend to be regressive.

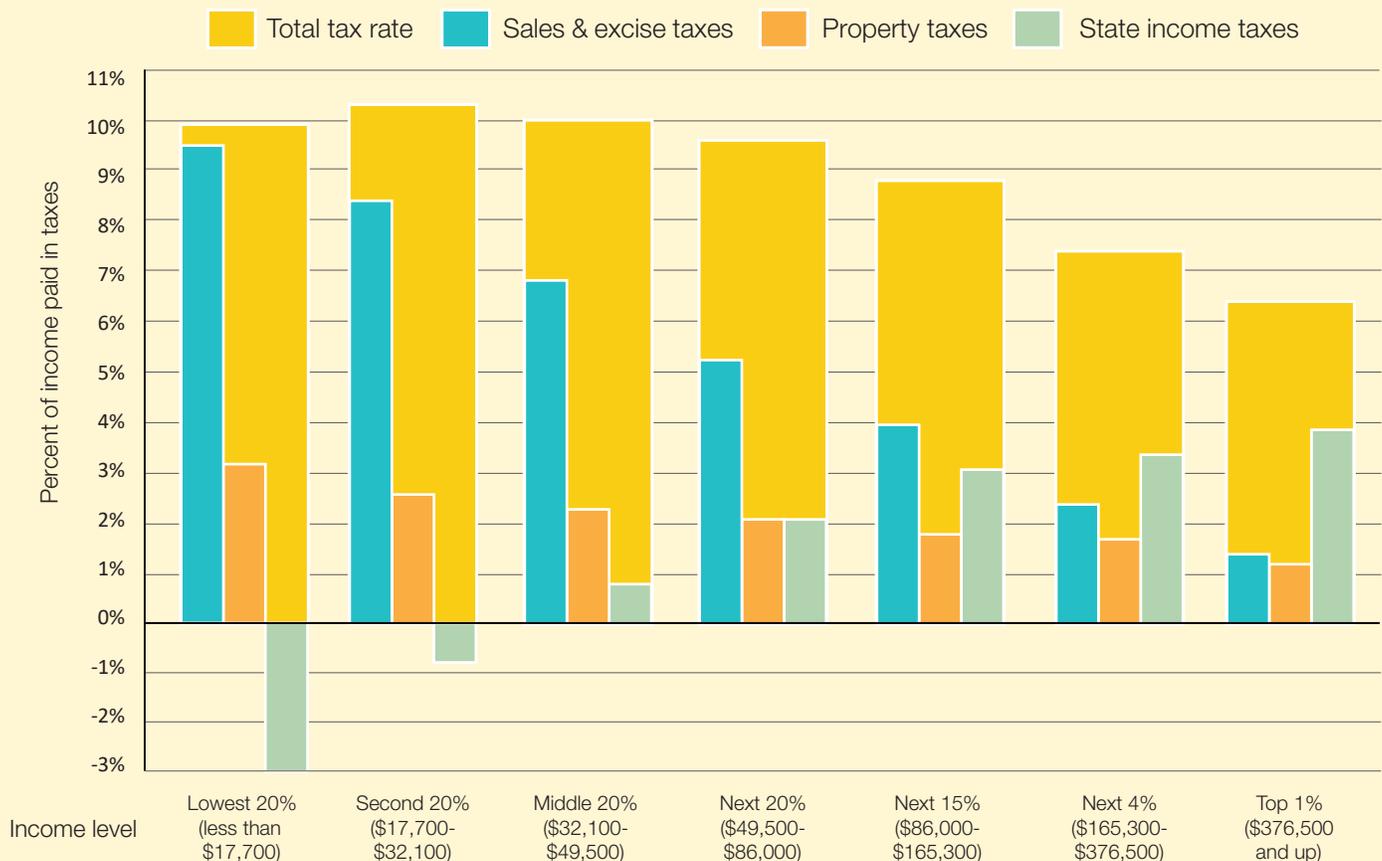
Most people agree that those with the lowest incomes shouldn't pay a higher percentage of their income in taxes than do the wealthiest. But in New Mexico, people earning the lowest incomes pay around 10% of their income in state and local taxes, while the wealthiest pay less than 7%. This is largely due to our high reliance on the gross receipts tax (the blue bars) – which is regressive – and our underutilization of our personal income tax (the green bars) – which should be more progressive to counteract it.



THE BACKWARD STATE OF TAXES

New Mexicans with the lowest incomes pay the highest rates in state and local taxes

The majority of New Mexicans (those earning less than \$49,500 or 60%) pay about 10% of their incomes in state and local taxes, while a tiny minority (making more than \$376,500) pay less than 7%.



Source: *Who Pays?*, The Institute on Taxation and Economic Policy, 2020
 Note: Table shows permanent law in New Mexico enacted through 2019

NOT ALL TAX CODES ARE CREATED EQUAL

PRINCIPLES OF A GOOD TAX SYSTEM

Besides the issue of fairness (see equity, below), there are several other characteristics that should be built in to a state's tax code.

Accountable: Tax credits, exemptions and deductions are easy to monitor and evaluate.

Adequate: Collects enough revenue to meet all of the state's needs.

Consistent: Tax revenues grow at the same rate as state personal income.

Efficient: Has a broad enough base to avoid dependence on any one tax.

Equitable: Has everyone pay taxes according to their ability to pay.

Simple: Is easily understood and collection efforts are minimal.

Stable: Has more revenue sources that are predictable than sources that fluctuate.

Transparent: Information about the tax system is clear and readily available.

In general, when viewed through the lens of these principles, New Mexico's tax system needs improvement. Given the myriad of tax credits, exemptions and deductions to the state's tax code, it would be hard to argue that it is **accountable**. Hundreds of exceptions have been made to the gross receipts tax (GRT) in particular.

These exceptions to the GRT, along with corporate and personal income tax cuts enacted within the past 15 years, have reduced important streams of revenue. Due to these giveaways, which mostly benefitted the biggest corporations and wealthiest earners, the state was left without **adequate** funding for crucial programs and services when revenues plummeted during the Great Recession. Over the past decade, many programs that support the health, education, and well-being of New Mexico's children were cut or severely underfunded as a result. The post-recession boom in oil and gas production changed that, but only until prices dropped

again due to a global price war and the pandemic. Placing too much reliance on these industries is problematic for other reasons (see stability).

Sales and personal income taxes are the most **consistent** types of taxes and these make up the two largest shares of the state's revenue pie. However, the state's over-reliance on revenues from the oil and gas industry, which are volatile and susceptible to external economic shocks, keeps the tax system from being **efficient**.

As we have seen, **equity** is a major concern, with our high reliance on the gross receipts tax being the main problem because those on the lowest end of the income scale have to spend the largest share of their income on the day-to-day necessities that are taxed. State lawmakers have enacted tax credits that are targeted to low-income New Mexicans, but even with these the overall tax code is still not equitable. Personal income tax cuts for those in the top income brackets nearly flattened the one area of the tax code that can be progressive. Besides making the tax system less equitable, every time a tax cut is enacted the tax code becomes less **simple** to understand and implement.

Although mineral revenue makes up just 17% of the state revenue pie, oil and gas extraction also brings in significant GRT, making the industry's contribution worth about a third of the whole. When oil and gas prices fall, the state takes a big hit. This unpredictability makes the tax code less stable. To make the tax system more **stable** and efficient, New Mexico must diversify its revenue sources. Stabilizing revenue streams would also help improve adequacy.

If our tax code was more **transparent** lawmakers and taxpayers alike would be able to hold it more accountable. Unlike most states, New Mexico lacks a comprehensive tax expenditure budget (TEB). This is an annual accounting of all of the money that the state has chosen to forgo by way of tax breaks, along with an evaluation of their benefits. While the state does produce a TEB, it lacks the kind of analysis that would make it useful for determining where our tax code needs improvement. After all, spending on the budget side is analyzed every year and lawmakers expect to be given information on how the money was spent and whether the spending produced the desired outcomes. But once an expenditure is written into the tax code it is almost never revisited and we rarely learn if it worked as intended.

While our tax code determines how much revenue the state will bring in every year, our budget determines how that money will be spent. Much in the same way that our tax decisions reflect our values and priorities, so too do the decisions we make when crafting the budget. Our state budget is about more than addressing our current needs. It also mirrors our hopes for the future. For more information on how the state budget it crafted, see *A Guide to New Mexico's State Budget*.