NEW MEXICO TAXES AND ECONOMIC DEVELOPMENT

Brian McDonald
Lee Reynis
Jim Peach
Chuck Wellborn

THE GROSS RECEIPTS TAX

The State's tax system has a major structural problem and it relates to the gross receipts tax.

New Mexico enacted an Emergency School Tax in 1935 to fund public schools with a state-level sales tax. In most states, public education is funded with local property taxes but in 1935 a statewide sales tax was chosen because it was the only tax capable of raising the revenue required. Later, New Mexico instituted a public school funding formula to deal with the inequalities in public school funding capacity across the State. Together, these actions firmly fixed the responsibility for funding public schools on the State's General Fund.

The revenues from the sales tax (which later became the gross receipts tax) are not dedicated to public schools. So the schools, along with the State's higher education system, are forced to compete for funding with a myriad of state spending needs, plus appropriations dictated by political agendas.

Before the 1935 school tax, public schools had been funded from local property taxes. Once property values recovered from the Depression, New Mexico could have changed course and used the State's unused property tax authority (10 mils or so) to provide a stable source of public school funding long term. Instead, this taxing authority was given away permanently to counties and municipalities.

So, unlike other states which primarily fund their public schools from local property taxes, New Mexico’s schools get the lion's share of their operational funding from the State's General Fund. Public schools have no operational revenue source of their own. The only contribution that local property tax revenues make toward public school operations is the 0.5 mill levy each district is required to impose. However, the State’s school funding formula takes credit for much of this property tax revenue and essentially neutralizes it as an additional local revenue source for schools.

Until recently, local property taxes were the only source of funding for school capital projects. But in the last decade, state funding of school capital needs has become a more pressing need. These needs have been addressed utilizing severance tax revenue bonds and general fund surpluses. In contrast to other states, local property taxes in New Mexico remain largely untapped except to repay General Obligation bonds approved by the voters.

Is New Mexico's gross receipts tax really the oddity it is said to be? Yes, it is: in two ways.

The first is that it is a very broad tax, even covering services. Does that mean it is bad? Not necessarily, because this broad coverage of the gross receipts tax brings in sufficient revenue that it allows property taxes to be extraordinarily low compared to other states.

The second unique feature of the gross receipts tax is not so good. That is that services are often taxed in business-to-business transactions with the result that more than one tax is paid on the ultimate product or service. More needs to be done to avoid that.

It should also be noted that the gross receipts tax is a regressive tax. As a percentage of household income, it imposes a greater burden on the poor than the rich because of the lesser ability of the poor to pay the tax.

Previously, this regressivity was offset to a greater degree by New Mexico's progressive income tax. But when income tax rates were lowered from 8.2% to 4.9% during the Richardson administration, much of the progressivity of the income tax was lost. Now the top marginal rate of income tax kicks in at the relatively low level of $24,000 in taxable income for couples. Such a couple now pays the same marginal rate of tax as those with taxable income that is 2, 5, or even 10 times higher.

THE DIMINISHED GROSS RECEIPTS TAX

The reductions in personal income tax rates during the Richardson administration, coupled with corporate income tax reductions during the Martinez administration, have had the effect of placing more and more of the burden for funding state government operations on the gross receipts tax and, until recently, the volatile taxes on the oil and gas industry.

At the same time, revenues from gross receipts tax have gone down in recent years even though gross receipts tax rates have risen. The reason is the once broad base of the gross receipts tax has been whittled away. Most regrettable were the food, prescription drug and medical deductions from gross receipts tax passed under the Richardson administration. Just these exclusions currently reduce the State’s revenues by hundreds of millions of dollars each year.

Despite this revenue loss, each legislative session sees dozens of bills introduced and often passed to carve out more and more exclusions from the gross receipts tax. Worse, these tax exclusion measures typically have no sunset provision offering the Legislature the opportunity to end them if the intended benefits are not being realized.

As a result, many such gross receipts tax exclusions on the books serve no current benefit to the State. Further, cities and counties impose gross receipts taxes themselves and so these exclusions from gross receipts tax at the state level have caused cities and counties serious declines in tax revenues. As a consequence, many have raised their gross receipts tax rates to make up for the decline.

FIXING THE GROSS RECEIPTS TAX

The choices are obvious: eliminate most of the gross receipts tax deductions, exemptions and credits and reduce the gross receipts tax rate sufficiently that its adoption becomes sufficiently politically appealing to overcome the complaints about the elimination of all the sacred cows. In addition, there should be at least some reduction in tax pyramiding in fairness to industries impacted by this now and to improve its chances for adoption. Consideration could be given to adding another income tax bracket for high earners as a means of replacing some of the lost gross receipts tax revenue and adding a little more progressivity to the income tax.

TAX BURDENS

At this point, some discussion of state and local tax burdens is appropriate.

Most New Mexicans don't realize that overall state and local tax burdens vary less from state to state than it might seem. The measurement of a state's tax burden is complex and requires careful analysis. Each state has its own mix of taxes such as sales, income, property taxes, and others. As noted above, New Mexico funds public education with state-level taxes, whereas in other states local government property taxes are used to fund public schools.

A credible tax burden analysis must consider both state and local taxes. Comparing only state-level taxes is a common tactic by those advocating lower taxes. In a recent presentation at the New Mexico Tax Research Institute's Annual Conference, DFA Secretary Tom Clifford indicated that the state and local tax burden in New Mexico as a percentage of personal income is slightly below the national average. That aligns with the general nonpartisan opinion. Even then, New Mexico's state-level taxes include severance taxes on minerals and oil and gas extraction and are always included in the tax burden analyses. But few New Mexico consumers pay these severance taxes and that favorably improves the overall tax burden in New Mexico. The mantra that New Mexico taxes overall are too high is a myth.

The varying mixes of taxes from state to state account for the complaints that a certain tax in another state is lower than a similar tax in New Mexico. But when all of the taxes imposed by that state are taken into consideration, it becomes clear that there are no free lunches.

TAXES AND ECONOMIC DEVELOPMENT

Employment levels in the State are still not yet back to the levels achieved in 2007 before the Great Recession. New Mexico has been hit hard by the federal sequestration, the bust in construction activity and now the decline in energy prices. Despite claims that recent job gains signal economic recovery, these new jobs continue to be largely healthcare jobs and are due, not to the State economic development initiatives but to enactment of the federal Affordable Care Act and the resulting increase in medical care for State residents. Albuquerque Business First reported on April 29th that though the South and West offer the best climates for small-business growth, Albuquerque ranks 93rd in business vitality out of 106 metro areas with a population of at least 500,000.

A three-step course of action is recommended.

First, fix the gross receipts tax as described above. Retain the gross receipts tax breaks that make a demonstrated contribution to our economic development efforts. But also do this overhaul in a way that will raise gross receipts tax revenues modestly so that New Mexico has the resources to invest in its future. And don’t let anyone tell you that a modest tax increase will kill our chances to attract new business activity to New Mexico.

Second, make a periodic review and refinement of the existing inducements that the State offers to job creators, including tax breaks, subsidies for job training and infrastructure, and their effectiveness.

Third, rather than relying solely on these job creation inducements, the State should implement strong measures to stimulate the State's economy, including meaningful fiscal stimulus.

As just some examples, the State could use increased tax revenues, capital outlay money and severance tax and general obligation bonds to pay for state infrastructure projects that will materially improve the long term health of the State's economy: roads, airports, internet connections, innovation districts, university science and engineering laboratories, tenured faculty positions, plus equipment and facilities for public schools and other improvements to New Mexico's education system that enhance educational and training opportunities for the State's young people.

Good examples of this type of action are recent efforts by the City of Albuquerque. It recently built the new interchange at Paseo del Norte and I-25, not by waiting for federal spending to someday arrive, but instead by largely using City bond money to pay for it. The work created many construction jobs and improved the commuting life of citizens.

The City is doing much the same thing with its Albuquerque Rapid Transit project (except that the federal government is providing tens of millions in funding). Similarly, the City, County and UNM are funding development at the Innovate ABQ project on Broadway and Central.

There will always be those who complain that the City or State is doing too little to address important challenges and then find fault with whatever action is taken. Yes, some will worry that improving roadways will lead to urban sprawl or more cars on the road. Some will not believe that the bus rapid transit will lead to increased investment in properties along Central Ave. Others will not be convinced that an innovation district will be a meaningful job creator.

But isn't decisive but thoughtful action better than doing nothing but wringing our hands over the State's and City's uncertain economic future?

EXPLORING CRITICISMS OF NEW MEXICO TAX POLICY

There always seem to be a fair number of misstatements about New Mexico's tax system, including a few recently, and this might be a good time to review them.

Claim: *The Rio Grande Foundation claimed (Op-ed Paul Gessing April 10, 2016) that New Mexico's tax burden as a percent of personal income is ninth-heaviest in the nation, citing Federation of Tax Administrators data.*

Analysis: Wrong. *The Rio Grande Foundation compared only taxes levied at the state level. New Mexico funds public education with state-level taxes. Other states fund public schools with local government taxes and so the Foundation is comparing apples and oranges.*

Because it utilizes state-level taxes, almost half of New Mexico's annual state budget is devoted to its public elementary and secondary schools. So comparing New Mexico's state-level taxes to the state-level taxes of states that fund education with local property taxes simply makes no sense.

In addition, New Mexico's state-level taxes include a substantial amount of severance taxes that most other states do not receive. Severance taxes are paid by mining and oil and gas companies (typically out of state), not individual taxpayers. This further distorts this comparison of state-level taxes.

It might be noted that the Federation of Tax Administrators specifically warns readers not to use its comparative data to judge whether a state is a high tax or low tax state because “no single measure generally tells the whole story.”

Claim: *The Rio Grande Foundation claimed in the same Op-Ed that New Mexico state and local workers make 20 percent more than their private sector counterparts if retirement and other benefits are included. It cited data from a website called “Key Policy Data”. The disparity between public and private workers is claimed to be the 12th highest in the country.*

Analysis: Wrong. *State and local government employees appear to be overpaid because the comparison ignored entirely the compensation of the thousands of federal employees (military, federal agencies, national labs) who reside in the State.*

Again, the large federal New Mexico presence means the proportion of private sector employees is smaller than in other states.

It is true, however, that retirement benefits for state and local government employees are substantial if an employee stays in the job long enough to earn them. But many do not and therefore it shouldn’t be assumed that all government workers will receive government retirement benefits. It is a long-standing practice for government employees to be offered good retirement benefits as an inducement to remain in government service.

The measurement Key Policy Data made of the compensation of state and local government employees is somewhat skewed because employees of New Mexico Indian Tribes and their casinos are considered government employees in the data it used.

It may be noted that Key Policy Data is staffed by persons who previously worked for the American Conservative Union Foundation, the Tax Foundation and the Heritage Foundation.

Speaking generally about whether New Mexico state and local employees are or are not overpaid, there are plenty of indications that state and local government employees are not overpaid. The average salaries of New Mexico’s school teachers are 45th in the nation. The average salary for an assistant district attorney in Bernalillo County is around $42,000 (for someone who has had three years of law school and who has passed the bar exam). it’s clear that Albuquerque is not paying enough to keep or attract police officers. The same is true for Bernalillo County's Metro Detention Center, the state police and case workers for the State’s Human Services Department.

The Rio Grande Foundation argues in its Op-Ed that in setting salaries, the government should recognize the present high unemployment rate in New Mexico and pay no more than local labor market conditions would warrant. This is not a sound strategy. Teachers, police officers and other government employees are mobile and will go where pay is higher. Paying rock bottom salaries to government workers would diminish the quality of government services. If the public wants good government services, good employees must be attracted to government service. That is how the private sector operates, using wage levels to attract sufficient, high quality human resources.

Claim: *The Rio Grande Foundation Op-Ed also claimed that New Mexico's state and local government workforce is bloated, based on The Key Policy Data report referred to above. It says that New Mexico has the second-most state and local government employees relative to private-sector workers.*

Analysis: Wrong Again. *The Key Policy Data report compares the number of state and local government workers to the number of the State's private sector workers only, ignoring again the large federal presence in the State.*

New Mexico's private sector employment is relatively than in other states because of the large federal presence at our state's military installations, federal agencies and national laboratories. The thousands of federal government workers in New Mexico require and are entitled to state and local government services too. So the Key Policy Data makes little sense.

Also, the number of state and local employment employees is overstated because the data for government workers includes employees of tribes and their many casinos.

Claim: *The Albuquerque Journal editorialized on April 2, 2016 that New Mexico state government does a bad job of delivering return on investment for the tax dollars it spends. It also says New Mexico has the 17th highest level of state and local taxes per capita based on those 18 and older at 10.65%*

Analysis: *The Journal may be correct about the quality of state services. But WalletHub's calculation of a 10.65% tax burden was based on U.S. median household incomes, not New Mexico median household incomes, and therefore came up with the wrong answer.*

The first question one might ask is: who is WalletHub? It is not a research organization. It is web-based seller of financial services. It says it is a "one-stop destination for the tools and information consumers and small business owners need to make better financial decisions". WalletHub does not appear to be ideological. It likely puts out its reports in order to get news coverage that drives consumers to its website.

The WalletHub study the Journal apparently relied upon that rated the quality of state services is “2016’s States With the Best & Worst Taxpayer ROI (https://wallethub.com/edu/state-taxpayer-roi-report/3283/.

The stated purpose of this study was to contrast state and local tax rates with the quality of services provided by each state within certain categories: Education, Health, Safety, Economy and Infrastructure & Pollution.

WalletHub gave New Mexico poor rankings in each of these categories (except for infrastructure and pollution). But that came as no great surprise. On the other hand, is it fair to suggest all of the fault lies with government employees, rather than the State’s political leadership?

However, it was not the same WalletHub study but another that came up with the 10.65% tax rate calculation. This other WalletHub study is entitled “2016’s States with the Highest & Lowest Tax Rates” (https://wallethub.com/edu/best-worst-states-to-be-a-taxpayer/2416/).

First, this other WalletHub surveyed effective total state and local tax rates and it stated that the effective rate of New Mexico’s state and local taxes was 10.65% and it said that 10.65% was the level of state and local taxes on households, not per capita as the Journal said.

However, WalletHub came up with the 10.65% tax rate by applying New Mexico's total state and local tax rates to the median income of U.S. households, not to the median income of New Mexico households. Using this method, WalletHub calculated the annual New Mexico tax bill at $5,741and gave New Mexico taxes an "Overall Ranking" of 26th lowest.

But when Wallethub applied New Mexico's total state and local tax rates to New Mexico's median household income, WalletHub came up with annual taxes of $4,912 rather than $5,741. It further ranked New Mexico state and local taxes as 20th lowest when it applied the cost of living index.

What is demonstrated by all this is that there are all kinds of comparisons and it's important to know just what is being compared and whether the comparison being made by an unbiased and reputable research organization.