Impacts of Revenue Raising Options on Good Tax Policy Principles

Presentation to the
Revenue Stabilization and Tax Policy Committee
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N.M. Legislative Finance Committee
Overview

• List of revenue-raising options (last slide)

• Impacts of recently-enacted statutes on tax policy

• Implications of revenue-raising options for tax policy principles

• Summary of FY10 budget actions in other states
Effects of Recently Enacted Statutes on Adequacy

• General Fund revenue growth from FY03 to FY11 = 31%
  (3.4%/year)
• GF expenditure growth FY03-FY10 including temporary federal & other funds = 47% (5.7%/yr)
• FY10 gap = $910 million
• GF revenue measures since 2003 = -$600 million/year
  – 2003 PIT cuts: -$400 million/year
  – Food & Medical GRT Deduction + 0.5% credit: -$130 million/year
  – Tax incentives: -$100 million
  – Low-income relief: -$70 million
Even after two rounds of solvency cuts, FY10 spending including temporary federal and other funds is over $900 million higher than revenue.
Effects of Recently Enacted Statutes on Efficiency

- **Positive:** PIT cuts improve NM’s competitive position
- **Negative:** Food GRT deduction narrowed base, raised rate
- **Economic theory** predicts that state taxes can affect economic performance; Evidence is mixed
- **Recent comparison (COST)** suggest that NM’s tax burden on businesses is about average among neighboring states
  - Businesses that purchase a lot of services are at a disadvantage while those with a lot of property are at an advantage
- **NM’s tax burden on households** is above average among neighboring states (D.C. Government)
  - Taxes on low income households are below average
  - Taxes on high income households are above average
    - Sales (GRT) tax above average, other taxes about average
**Tax Policy Principles: Effects of Recently Enacted Statutes on Equity**

- **Equity—Horizontal:**
  - Tax incentives create economic distortion, shift tax burden
  - Narrower GRT base and higher rate creates distortions
  - Higher GRT rate favors out-of-state vendors without nexus

- **Equity—Vertical:**
  - Food/WFTC/Low-income exemption increased progressivity
  - Decreased PIT reduced progressivity
  - DC study found NM’s system to be less regressive than other states in the region
    - Least regressive = Idaho
    - Most regressive = Nevada
Summary: Tax Policy Context

- Large gap between spending and revenue comes from a reduced rate of revenue growth not accompanied by a reduced rate of spending growth.

- NM is about average in tax burden on businesses, slightly above average in burden on households: Thus any significant tax increase is likely to push the NM burden above average.

- Although somewhat regressive, NM’s system is relatively fair in the distribution of tax burdens between high-income and low-income households.
Implications of Income Tax Increase Proposals

• Raising taxes on high-income taxpayers improves vertical equity—the goal of adjusting tax burdens to ability to pay: Over 80% of 2003 rate change benefits went to households over $100,000 gross income

• Raising high-income taxes creates a narrower tax base with higher rates, thus impairing efficiency: 60% of tax is currently paid by 9% of households; Caution against raising tax rate too high

• Reliance on PIT has fallen to less than 1/3 of GRT

• PIT elasticity with personal income has fallen from 1.4 to 1.1
Implications of Income Tax Proposals (continued)

• Since State PIT payments are deductible for federal income tax purposes, net liability will increase by \((1 \text{ – tax rate})\) for taxpayers who itemize deductions. 80% - 95% of taxpayers over $100,000 itemize, their average federal tax rate is approximately 30%.

• Most of capital gains deduction does not directly target NM investments

• NCSL Survey of 2010 budget actions:
  – 9 states have raised income tax rates on high-income households
  – 5 states have reduced itemized deductions
  – 4 states have raised tax on capital gains
Implications of Corporate Income Tax Increase Proposals

• CIT is a highly concentrated tax:
  – Applies to a minority of businesses
  – Top 250 taxpayers pay 90%

• NM’s tax rate one of highest in region

• Combined reporting revenue yield is uncertain

• NCSL Survey of 2010 budget actions:
  – 5 states have raised CIT rates
  – 6 states have expanded the base
  – 2 states have decoupled from federal tax law provisions
  – 1 state has limited the use of tax credits
  – 1 state (WI) has required combined reporting
**Implications of GRT Options**

- GRT is largely a tax on services, 1/3 or more of the base is business-to-business transactions; 70% of household purchases are exempt or deductible

- Raising tax rate increases pyramiding

- Eliminating food deduction broadens the base; combined with reinstating the 0.5% credit, this improves efficiency; Food deduction is poorly targeted since most of benefit goes to non-poor households

- Increasing GRT may be regressive but evidence is limited

- NCSL survey of 2010 budget actions:
  - 5 states have increased tax rates
  - 13 states expanded their tax bases
  - 7 states tightened collection procedures
Implications of Excise Tax Options

- Most NM excise tax rates are relatively high compared with neighboring states; exception = Motor Vehicle Excise Tax

- Revenue yield from cigarette tax is sharply limited due to tribal exemption

- “Sin” taxes probably have a regressive incidence

- Significant rate increases can lead to increased use of internet for non-taxed transactions

- NCSL survey of 2010 budget actions:
  - 9 states have raised tax rates – several on insurance premiums
  - 4 states have expanded the tax base
  - 4 states have eliminated or limited tax credits
Effects of Shifting Severance Tax Revenue to the General Fund

• General fund revenue gain roughly equals bonding capacity loss over time but there may be a greater loss of capacity in the short run due to effect on the statutory test for bond issuance

• Investor confidence in the severance bond program would likely be negatively affected; lower ratings and higher interest rates are likely

• Reduced supplemental bond capacity may adversely affect the state’s ability to comply with the terms of the Zuni lawsuit
Other Options

• NCSL survey of 2010 budget actions:
  – 5 states have implemented some form of medical service provider tax
  – 3 states have imposed or expanded their estate tax
  – 9 states have approved a tax amnesty
### General Fund Revenue Impacts of Various Revenue Raising Options

(Dollar amounts in millions)

<table>
<thead>
<tr>
<th>Income tax options:</th>
<th>Effect. Date</th>
<th>FY10</th>
<th>FY11</th>
<th>FY12</th>
</tr>
</thead>
<tbody>
<tr>
<td>1% income tax increase on current top bracket (married $24,000/single $16,000)</td>
<td>Tyba 1/1/2010</td>
<td>25.5</td>
<td>170.0</td>
<td>179.4</td>
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<tr>
<td>1% income tax increase over $100,000 (single), $150,000 (married)</td>
<td>Tyba 1/1/2010</td>
<td>5.0</td>
<td>56.1</td>
<td>59.4</td>
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<tr>
<td>Addback income tax deduction for state &amp; local taxes</td>
<td>Tyba 1/1/2010</td>
<td>-</td>
<td>40.0</td>
<td>42.0</td>
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<tr>
<td>Reduce deduction for capital gains from 50% to 25%</td>
<td>Tyba 1/1/2010</td>
<td>-</td>
<td>18.0</td>
<td>20.0</td>
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</tbody>
</table>

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<thead>
<tr>
<th>Corporate income tax options:</th>
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<tbody>
<tr>
<td>Require combined reporting for corporate income tax</td>
<td>Tyba 1/1/2011</td>
<td>-</td>
<td>12.0</td>
<td>30.0</td>
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<tr>
<td>Increase corporate franchise tax from $50 to $250 per year</td>
<td>Tyba 1/1/2010</td>
<td>-</td>
<td>7.5</td>
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</tbody>
</table>

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<thead>
<tr>
<th>Gross receipts tax options:</th>
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</thead>
<tbody>
<tr>
<td>Repeal GRT deduction for food</td>
<td>7/1/2010</td>
<td>-</td>
<td>228.0</td>
<td>238.9</td>
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<tr>
<td>Repeal GRT food deduction and reinstate 0.5% GRT credit in muni areas</td>
<td>7/1/2010</td>
<td>-</td>
<td>48.0</td>
<td>48.0</td>
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<tr>
<td>Repeal GRT deduction for medical services</td>
<td>7/1/2010</td>
<td>-</td>
<td>65.0</td>
<td>69.9</td>
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<tr>
<td>Apply compensating tax to in-state sales currently exempt from all tax</td>
<td>7/1/2010</td>
<td>-</td>
<td>13.2</td>
<td>13.8</td>
</tr>
<tr>
<td>Increase statewide GRT rate by 0.25%</td>
<td>7/1/2010</td>
<td>-</td>
<td>126.0</td>
<td>132.0</td>
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</tbody>
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<thead>
<tr>
<th>Excise tax options:</th>
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</thead>
<tbody>
<tr>
<td>Increase motor vehicle excise tax by 1.0%</td>
<td>4/1/2010</td>
<td>7.7</td>
<td>34.3</td>
<td>37.7</td>
</tr>
<tr>
<td>Increase O&amp;G Emergency School Tax on oil by 1%</td>
<td>4/1/2010</td>
<td>10.1</td>
<td>40.4</td>
<td>41.8</td>
</tr>
<tr>
<td>Increase O&amp;G Emergency School Tax on gas by 1%</td>
<td>4/1/2010</td>
<td>10.8</td>
<td>52.8</td>
<td>53.8</td>
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<tr>
<td>Increase liquor excise tax by 5 cents per drink</td>
<td>4/1/2010</td>
<td>10.0</td>
<td>40.0</td>
<td>40.7</td>
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<tr>
<td>Increase insurance premiums tax on health insurance by 1%</td>
<td>1/1/2011</td>
<td>-</td>
<td>22.0</td>
<td>47.0</td>
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<tr>
<td>Increase cigarette tax by $1 per pack from $0.91 to $1.91 per pack</td>
<td>4/1/2010</td>
<td>7.5</td>
<td>30.0</td>
<td>30.0</td>
</tr>
<tr>
<td>Increase cigarette tax by $1 with no exemption for tribal sellers for increase</td>
<td>4/1/2010</td>
<td>24.8</td>
<td>99.0</td>
<td>99.0</td>
</tr>
<tr>
<td>Increase tobacco products tax from 25% to 40%</td>
<td>4/1/2010</td>
<td>0.8</td>
<td>3.0</td>
<td>3.0</td>
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</tbody>
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<tr>
<th>Options to reduce tax expenditures:</th>
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</tr>
</thead>
<tbody>
<tr>
<td>Repeal angel investor tax credit</td>
<td>Tyba 1/1/2010</td>
<td>-</td>
<td>0.8</td>
<td>0.8</td>
</tr>
<tr>
<td>Reduce film production credit rate from 25% to 15% of expenditures</td>
<td>Tyba 1/1/2010</td>
<td>6.5</td>
<td>26.0</td>
<td>28.6</td>
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<tr>
<td>Reduce rate of high wage jobs tax credit from 10% to 7% of wages</td>
<td>7/1/2010</td>
<td>-</td>
<td>5.0</td>
<td>5.5</td>
</tr>
<tr>
<td>Reduce rate of technology jobs tax credit from 8% to 6% of expenditures</td>
<td>7/1/2010</td>
<td>-</td>
<td>1.5</td>
<td>1.7</td>
</tr>
<tr>
<td>Reduce rate of investment credit from 5% to 4% of expenditures</td>
<td>7/1/2010</td>
<td>-</td>
<td>1.6</td>
<td>1.8</td>
</tr>
<tr>
<td>Reduce renewable energy production credit by 20%</td>
<td></td>
<td></td>
<td>1.0</td>
<td>1.1</td>
</tr>
<tr>
<td>Freeze hospital GRT credit at FY10 level</td>
<td>7/1/2010</td>
<td>-</td>
<td>4.0</td>
<td>8.0</td>
</tr>
<tr>
<td>Reduce rate of credit for NMMIP assessments by 20%</td>
<td>7/1/2010</td>
<td>-</td>
<td>10.0</td>
<td>14.0</td>
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<tr>
<td>Eliminate GRT back to school tax holiday</td>
<td>7/1/2010</td>
<td>-</td>
<td>2.7</td>
<td>2.7</td>
</tr>
<tr>
<td>Reduce lab small business partnership credit by 50%</td>
<td>7/1/2010</td>
<td>-</td>
<td>2.0</td>
<td>2.1</td>
</tr>
</tbody>
</table>

*Tyba* = Tax years beginning on or after.