

**OPTIONS FOR REDUCING  
HORIZONTAL INEQUITIES, BALANCING  
RATES AND MAKING OTHER CHANGES IN  
SELECTED EXCISE AND OTHER TAXES**

**BLUE RIBBON TAX REFORM COMMISSION  
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## MOTOR VEHICLE EXCISE TAX

From testimony presented and committee discussions, it appears that tax rates for motor vehicles do not meet the tax principal of equity. There is little tax policy justification to argue that vehicles should be taxed at lower rates than other tangibles purchased in New Mexico. New Mexico's vehicle excise tax is generally lower than surrounding states, except for Colorado.

If it is determined that current motor vehicle excise tax rates should be raised, the following options are presented. Revenue impacts are in the Revenue Impact Table, and additional background information on the various options is in the report to the commission from the Selective Excise Tax Committee.

Arguments for and against increasing motor vehicle excise tax follows the discussion of the options.

### *OPTIONS*

#### **OPTION 1. Increase Motor Vehicle Excise Tax Rates**

This option proposes to increase the motor vehicle excise tax from three percent to four or five percent. The three percent motor vehicle excise tax is estimated to generate approximately \$117 million in FY2004. Each one percent increase would generate approximately \$39 million. A four to five percent rate would be closer to equity with gross receipts tax rates that apply to sales of other tangibles purchased in New Mexico.

### *ISSUES*

Will the increased revenue be directed to the general fund as is currently the case?

### *PROS*

- There is little tax policy justification to argue that vehicles should be taxed at lower rates than other tangibles purchased in New Mexico, including homes.

### *CONS*

- Auto dealers argue that a vehicle is taxed each time it is sold at the used car price, and the total tax imposed on a vehicle over its life span approximates the general gross receipts tax rate, thereby, justifying the lower rate assessed on initial sale.

#### **OPTION 2. Place Motor Vehicles Under Gross Receipts Tax.**

This option would repeal the Motor Vehicle Excise Tax Act and the gross receipts and compensating tax exemptions under Sections 7-9-22 and 7-9-23 NMSA 1978 for sale of motor vehicles. Motor vehicles would then be subject to gross receipts tax instead of motor vehicle

excise tax. A minor amendment to Section 7-9-71 NMSA 1978 (deduction for trade-in allowances) would also be required.

*PROS*

- Motor vehicles will be treated in the same manner as most other commodities.
- Larger municipalities and counties at least will receive a significant share of the revenue derived from motor vehicle sales. They currently get nothing from this activity.
- Simplifies the tax system by discarding a significant tax.

*CONS*

- Will raise the price of motor vehicles to customers.
- Tax receipts from vehicle sales will reach the state treasury later than they do now because they will be due by the twenty-fifth of the month following the month of the sale instead of with the application for certificate of title.
- Disconnecting payment of tax from the application for certificate of title may weaken enforcement.

**OPTION 3. Repeal Motor Vehicle Excise Tax and Replace It with a New Tax on All Vehicles.**

The idea is to treat all vehicles (motor vehicles, boats, certain aircraft, tractors and off-road vehicles) in the same manner. Currently, motor vehicles are taxed under the motor vehicle excise tax, boats under the boat excise tax and under the gross receipts tax, aircraft not registered under the Aircraft Registration Act, tractors and off-road vehicles. Although the vehicles are used in different environments, they are all vehicles.

Under the proposal, the tax rate would be the same for all. The administrative requirements would also be uniform. It involves repealing the Motor Vehicle Excise Tax Act, the boat excise tax and repealing or modifying some gross receipts tax provisions.

*PROS*

- Vehicles of different types are treated in the same manner. This may permit more efficient administration down the road.
- Since it is a new tax, the distribution of revenues between the state and local governments can be revisited.
- The structure of this tax will not be limited by the Streamlined Sales Tax Agreement.

*CONS*

- Existing taxes and their registration systems have been fine-tuned over the years. This advantage will be lost by forcing a new tax to cover all these disparate products.
- This proposal could be just a fancy way of raising taxes on these products.

**OPTION 4. Adopt a Progressive Motor Vehicle Excise Tax Rate Table.**

As in most western states, private transportation is essential for successful participation in the economic and cultural life of the state. The price of even used vehicles can strain the budgets of low-income New Mexicans. Therefore, the state should make it easier for its low-income citizens to acquire motor vehicles by taxing low-priced vehicles at a low rate and high-priced vehicles at a higher rate.

As an example, consider the following as a replacement for the present three percent rate.

<u>If the price paid is</u>		<u>The tax shall be</u>
<u>At Least</u>	<u>But Not More Than</u>	
\$0	\$2,500	1% of the price paid
\$2,500	\$5,000	\$25.00 plus 2% of excess over \$2,500
\$5,000	\$10,000	\$75.00 plus 3% of excess over \$5,000
\$10,000	\$20,000	\$225 plus 4% of excess over \$10,000
\$20,000		\$625 plus 5% of excess over \$20,000.

*PROS*

- Although not all low-priced vehicles are purchased by low-income people, a progressive rate table will ease the relative burden on low-income purchasers.

*CONS*

- This is a lot more complicated than a flat rate without a great deal of benefit.
- Automobile sales are cyclical. A progressive rate table will exaggerate the swings in revenue.

**OPTION 5. Use Standard Values For Sales of Used Vehicles.**

Implement legislation to provide for a firm, statutorily specified value for used vehicles, including passenger vehicles, RVs and trucks for taxation purposes. The specified value could be derived from a standard nationally recognized source similar to NADA book values, or could be a percentage schedule tied to manufacturer's suggested retail price (MSRP) on all vehicles.

*PROS*

- This would eliminate the present "honor system" of declaring the value of used vehicles.
- Provisions should address the transfer of automobiles between family members and automobiles with salvage value only.

*CONS*

- The practice of using stated values could penalize those purchasing cars at less than book value.

**OPTION 6. Implement MVD Software Systems That Cannot Be Overridden When Computing the Motor Vehicle Excise Tax on Trucks.**

The Motor Vehicle Division should be required to implement software in its system that does not allow clerks to override the system in regard to registration of vehicles in excess of 26,000 GVW.

*PROS*

- This will stop the practice of "shopping" for motor vehicle offices that will give the lowest amount for motor vehicle excise tax.

## TOBACCO TAXES

From testimony presented, the effect of the large increase in cigarette taxes enacted from the 2003 regular legislative session is not yet known. The legislature may want to assess the effects of this tax increase before making other changes to the cigarette tax. Issues continue to rise because of cigarettes and tobacco products sold to non-Indians on tribal land. Additionally, the commission may consider equalizing the tax on tobacco products with the cigarette increase for equity purposes.

The following options are presented addressing these issues. The revenue impacts are presented in the Revenue Impact Table and additional background information on the various options is in the report to the commission from the Selective Excise Tax Committee.

### CIGARETTE TAX

#### *OPTIONS*

#### **OPTION 1. Implementing Government-to-Government Negotiations to Capture Tax on Sales of Tobacco to Non-Indians on Tribal Land.**

The Supreme Court has ruled that states may not tax the sale of tobacco products sold to tribal members on an Indian reservation. However, sales on reservations to non-Indian customers are taxable. One difficulty for states is requiring Indian retailers to segregate sales to Indian and non-Indian customers. Some states, such as Arizona and Montana, have reached cooperative agreements with tribes that respect the legal exemptions for sales to tribal members and provide for voluntary tax collections from non-Indian customers. This would also require the repeal of the exemption under the cigarette tax for cigarettes sold "to the governing body or to any tribal member licenses by the governing body of any Indian nation, tribe or pueblo for use or sale on that reservation or pueblo grant". Sales by tribal entities have been approximately 20 million packs per year, or about 20 percent of the cigarette taxable base of about 98 million packs.

#### **OPTION 2. Combine Local Government Cigarette and Recreation Fund Distributions.**

The commission may choose to combine the separate distributions to county and municipal recreation uses with the distributions to city and county general funds. The amount of revenue distributed to cities and counties each month is often so small as to be less than useful to the recipient and further imposes an unnecessary burden on state revenue distribution processes.

#### **OPTION 3. Repeal Tax Stamp Discount Allowance.**

Current "tax stamp discount" allowance provided to taxpayers to defray the cost of affixing tax stamps is no longer appropriate and should be eliminated. The archaic provision has outlived its usefulness in the contemporary era of increased mechanization, concentration among fewer distributors and a public policy of punitive taxation of tobacco products. Elimination of the tax stamp discount would increase total cigarette revenue by about \$900,000 per year (preliminary staff estimate).

## **NON-CIGARETTE TOBACCO PRODUCTS TAX**

### *OPTION*

#### **OPTION 1. Tax Rate Equity on Non-Cigarette Tobacco Products**

This option proposes that the tax rate on non-cigarette tobacco products should be increased to a level equivalent to the current tax on cigarettes, even though the equivalency will not necessarily be maintained overtime since one tax is unit-based and one tax is value-based. A tax increase on tobacco products other than cigarettes from 25 percent of product value to 45 percent of product value would equalize the taxes at this point in time.

### *PROS*

- A tax increase on tobacco products is appropriate because it helps recoup some of the social costs for the sale of tobacco.
- Proponents contend that increasing taxes leads to a more economically efficient market outcome by reducing consumption levels below the level they would be without higher taxes.
- Proponents of tax increases argue the state needs the increased revenues for needed services.

### *CONS*

- Opponents argue that smokers and tobacco users already pay their fair share of these costs in excise taxes and gross receipts taxes, and that excise taxes are a highly regressive form of taxation that singles out one class of citizens for punitive taxation.
- Opponents say increases in the state tax would increase lost business to interstate competition, tribal sales and bootlegging. Tax increases punish wholesalers that have made large investments in New Mexico and employ many employees statewide.

## LIQUOR TAXES

In New Mexico, revenues from liquor excise taxes are approximately \$38.8 million. Funds from liquor excise taxes are distributed 34.57 percent to the local DWI grant fund, and 65.43 percent to the state general fund. Distributions to the general fund accounted for .6 percent of total general fund revenue in FY 2002, down from 1.1 percent in 1994. Per capita, New Mexicans had approximately 50 "drinks" of wine, 140 "drinks" of spirits and 300 "drinks" of beer in FY 2002.

Unlike sales taxes, per-unit taxes fail to generate additional revenue when prices increase. Rates must be increased legislatively simply to keep revenues on par with inflation and economic growth. Second, nationally per capita consumption of alcoholic beverages has been stable or declining for the last two decades. This declining consumption further erodes the productivity of the tax.

If it is determined that current revenues are insufficient to meet New Mexico's need for administration and to pay for related health and social costs, the following are options for consideration. Revenue impacts are in the Revenue Impact Table, and additional background information on the various options is in the report to the commission from the Selective Excise Tax Committee. Arguments for and against the proposals follow the listed options.

### LIQUOR EXCISE TAX

#### *OPTIONS*

##### **OPTION 1. Increase the Current Liquor Excise Tax.**

Each 10 percent increase in liquor excise tax raises about \$3.7 million on a full-year basis.

#### *ISSUES*

- The commission may choose to increase the taxes proportionately between beverages of differing alcohol content or may choose to increase taxes on higher volume sales, such as beer.
- Will the increased revenue be directed 100 percent to the state general fund, or shared with local governments through the local DWI grant fund?
- What is the effective date of the tax rate increase?

##### **OPTION 2. Increase the Current Liquor Excise Tax and Eliminate the Current Differential Treatment Between Types of Alcoholic Beverages (Tax "By the Drink").**

Two options were presented to the committee proposing revenue increases while equalizing the tax on different types of beverages based on alcohol content. These "tax by the drink" proposals assumed that equivalent alcohol content can be found in a 12-ounce beer, a five-ounce glass of wine and 1.5 ounces of spirits.



*ISSUES*

- Will the increased revenue be directed 100 percent to the state general fund, or shared with local governments through the local DWI grant fund?
- What is the effective date of the tax rate increase?

**OPTION 3. Expansion of the Local Option Liquor Excise Tax to All Counties.**

The local option liquor excise tax is currently authorized and imposed only in McKinley County. Legislative initiatives to expand the tax to all counties have been introduced in recent years, but have been unsuccessful. The Taxation and Revenue Department reports that expansion of this tax to all counties would impose an extreme administrative burden on the department, and argues that similar results could be obtained in a much more efficient manner through an increase in the state liquor excise tax, and a formula distribution to the counties.

A five percent local option imposed by all counties would raise about \$21.2 million (in addition to the \$800,000 currently raised in McKinley County).

*ISSUES*

- More strict limitations on allowed implementation dates would probably be required to make the tax administrable.

**OPTION 4. Approximate a Local Option Liquor Excise Tax by Means of a Formula-Driven Distribution to All Counties.**

Presumably, a liquor excise tax increase (see Options 1, 2 and 3 above) would be required to provide the funding for a formula distribution to counties.

Approximation of a five percent local option tax imposed by all counties would require about \$21.2 million (in addition to the \$800,000 currently raised in McKinley County).

*ISSUES*

- The current McKinley County local option tax might be repealed and replaced with the formula-driven distribution. McKinley County realizes about \$805,000 from the tax. The computation of a formula distribution to McKinley County amounts to \$834,000.

*PROS*

- Increases in price of alcohol through high taxes may discourage consumption.
- Proponents argue that alcoholic beverage excise taxes improve the efficiency of the free market by including the social costs of drinking in the price of the product.
- Proponents of higher taxes believe the taxes can be viewed as "user fees" that should be dedicated to alcoholism treatment and anti-DWI initiatives.

- Price elasticity estimates show that beer consumption is the least responsive to price changes, while wine consumption is most responsive, thereby indicating that beer could sustain a tax increase.

*CONS*

- Alcoholic beverage taxes are a regressive form of taxation.
- Since alcoholic beverage excise taxes and markups are embedded in the price of products sold at retail, most taxpayers do not know the exact amount of the sales price that represents taxes. Therefore, alcoholic beverage taxes do not score well on the principle of accountability.

## INSURANCE PREMIUM TAX

Insurance premium taxes have been adopted by a majority of states as a surrogate for other forms of taxation. Raising the tax, in whatever way, or converting it to a gross receipts tax has a host of issues associated with such ideas.

Specific arguments for and against the various options proposed may follow some options. General arguments for and against the various proposals are at the end of the list of options.

### *OPTIONS*

#### **OPTION 1. Reduce Insurance Premium Tax for Insurers with a Regional or Home Office in New Mexico.**

This proposal would offer reduced insurance premium tax rates to companies that either locate a home office or regional office in New Mexico and that invest a certain percentage of their assets in New Mexico. The proposal is for a one percent tax rate for companies that establish a home office in the state and a rate of two percent for those that establish a regional office here. All other companies would be subject to the current three percent insurance premium tax.

### *ISSUES*

- Defining a "home office" or "regional office" may turn out to be a difficult proposition.

### *PROS*

- This option provides an excellent incentive for insurers to locate offices here in New Mexico. As an economic development tool, this tax rate incentive could be very effective in bringing companies with very good jobs into the state.
- Some other states have provided this differential rate incentive with success and without litigation.

### *CONS*

- Revenues to the general fund will be reduced. The fire protection fund distributions could also experience some reductions.
- This three-tiered tax rate scheme is vulnerable to litigation. The state abandoned a two-tier tax rate years ago, much like this proposal, because of court challenges.
- The Insurance Division has not been able to determine what the fiscal impact of this proposal might be. Several "guesses" about the impact have covered a very wide range. This is an idea that probably needs more research or study to determine whether it is advisable.

**OPTION 2. Repeal Insurance Premium Tax and Impose Gross Receipts Tax and Corporate Income Tax.**

Repeal the insurance premium tax and impose the full gross receipts tax and the corporate income tax.

*ISSUE*

- Should the gross receipts tax revenue be distributed to local governments under the existing distribution percentages?

*PROS*

- If insurance premiums were subject to the gross receipts tax, this would raise revenues for local governments at a time when many of them may need additional revenue. The state would also be held harmless and probably gain some revenue.

*CONS*

- Raises the overall cost of insurance to consumers.

**OPTION 3. Increase Insurance Premium Tax on Health Insurance Only.**

Implement an insurance premium tax for those companies that provide health insurance coverage and leave other insurance companies at the current three percent level. At the same time, consideration could be given to eliminating the gross receipts tax on health care.

*PROS*

- The additional revenue from this increase could be used to offset the cost of the repeal of gross receipts taxes on medical services or other health care.

*CONS*

- Increasing the premium tax on health insurance will increase the cost of health care.
- This two-tiered tax rate scheme is vulnerable to litigation. The state abandoned a two-tier tax rate years ago, much like this proposal, because of court challenges.

**OPTION 4. Amend Statutes to Make It Clear That Third Party Administrators Are Subject to Gross Receipts Tax.**

Clarify statutes to make fees received by third party administrators subject to the gross receipts tax and income tax.

*PROS*

- Third party administrators are apparently not subject to the gross receipts tax. Yet, they are not insurers and are engaging in business in New Mexico. The principle of equity would certainly seem to support making it clear that they are subject to the gross receipts tax like other businesses in the state.

*CONS*

- This will raise the cost of health insurance, primarily for businesses that are self-insured.

**OPTION 5. Impose a "Head Tax" on Third Party Administrators.**

Implement a "head tax" that applies to each employee covered for a year or portion of a year under a self-insured program administered by a third party administrator in lieu of the gross receipts tax. The head tax concept could also apply as a way to collect various assessments for risk pools and other fees regular insurance companies must pay.

*PROS*

- This proposal may offer the best way to ensure equity in health insurance taxation by taxing the third party administrators of self-insured plans that are not subject to New Mexico's insurance premium tax.

*CONS*

- It is almost certain that adoption of this proposal would lead to litigation under ERISA, the federal law governing self-insured plans nationwide.

**OPTION 6. Implement a Pilot Project to Enhance Insurance Division Funding.**

Implement legislation to provide for a dedicated funding pilot program for the Insurance Division to be able to enhance administration and enforcement of the New Mexico Insurance Code. Any earmarked funding would continue to be subject to the annual appropriations process and to sunset after three years.

*PROS*

- In New Mexico, the three percent premium tax is well below the amount that would be collected if insurance premiums were subject to the gross receipts tax.
- The insurance industry receives an unfair economic incentive not available to other industries because of the differential in the insurance premium tax and the gross receipts tax.
- Other businesses are discriminated against because the insurance industry is not subject to corporate income tax.

*CONS*

- The insurance industry is one the most highly regulated industries in the country. The insurance product is unlike any other.
- The product is a promise to pay the insured person if something bad happens to them, which is unlike the purchase of goods or services.
- All costs associated with insurance are rolled into rate determinations and passed on to the consumers in New Mexico.

- Assessment of gross receipts tax would entail a study of revenue sharing with local governments and a thorough look at double taxation of certain services.
- A complication of taxation is the existence in almost all states of "retaliatory taxes" on insurance companies. Such statutes could lead to an increase in taxes on New Mexico-based companies on their operations in other states.
- The primary advantage of premium taxes appears to be administrative simplicity.
- Income taxation of insurance companies is a notoriously complex area of federal tax law.

## PARI-MUTUEL TAX OPTIONS

### *OPTIONS*

#### **OPTION 1. Strike the Capital Improvements Deduction.**

Current law (Section 60-1-15 NMSA 1978) allows horse racing tracks to retain part of the pari-mutuel tax collected at the track to offset the cost of capital improvements made at the track. This proposal would eliminate the deduction.

#### *PROS*

- This ends a possibly unconstitutional subsidy to an industry. Given its limited resources, New Mexico should not try to prop up faltering industries.
- By granting this industry the privilege of conducting simulcast meets and gaming, the legislature has granted it sufficient tools to find economic success.

#### *CONS*

- The commission's purpose is to find policies to improve the development of the state's economy, not to deliberately throw people out of work.
- This would arbitrarily end a successful program without any real debate or demonstration that the program should be terminated.

#### **OPTION 2. Extend Hours of Operation at Racetracks for Gaming Operations.**

Racetracks licensed as gaming operators may operate gaming for no more than 12 hours a day (Section 60-2E-27 NMSA 1978). It is proposed to allow tracks to open their gaming operations for 16 hours each day.

#### *PROS*

- Gaming is the most profitable part of track operations. Increased activity will lead to greater revenues for the state as well as to additional economic development opportunities.
- By strengthening the tracks' profitability, New Mexico will be able to play a bigger role in the horse racing world.

#### *CONS*

- It expands gambling.
- Any measure that expands off-reservation gaming risks a tribal determination that the state-tribal compacts have been breached.

## BOXING AND WRESTLING PRIVILEGE TAXES OPTIONS

Two privilege taxes are administered by the New Mexico Athletic Commission. The first (Section 60-2A-23 NMSA 1978) levies against the promoter a tax of four percent of the gross receipts derived from performance of a live contest in New Mexico. The second (Section 60-2A-26 NMSA 1978) levies a five percent tax on admissions to any live contest taking place outside New Mexico but shown in New Mexico on closed-circuit television or as a motion picture. The revenues support operations of the Athletic Commission. According the Athletic Commission, combined revenues from the two taxes are as follows:

FY 2000	\$147,401
FY 2001	80,120
FY 2002	43,839
FY 2003	111,077

In recent years, many of the live events and telecasts occurred in venues on tribal territory. Although the Athletic Commission is still obligated to carry out its regulatory duties and is often invited to do so when the venue is on tribal territory, it may not enforce its taxes at such locations.

### *OPTIONS*

#### **OPTION 1. Convert the Taxes to Fees Based on Costs of Services Performed and Authorize the Athletic Commission to Enter into Joint Administration and Enforcement Agreements with Tribal Governments.**

Limits could be placed on the fees and approval of the governor could be required on any agreements reached with tribal governments. The fiscal impact will be small, but perhaps positive.

#### *PROS*

- Recognizes the dual sovereignty situation facing the New Mexico Athletic Commission and provides a means of dealing with it.

#### *CONS*

- The stakes involved are small. The Athletic Commission seems to be coping on its own.

#### **OPTION 2. Exempt Receipts from Events Covered by the Two Privilege Taxes from Gross Receipts Tax.**

The events covered by the two privilege taxes are also subject to gross receipts tax.

#### *PROS*

- Relieving the double taxation will make New Mexico a much more attractive venue for such contests. The added economic activity will mitigate the revenue loss.
- New Mexico boxers and wrestlers will be able to perform more frequently here.



*CONS*

- The gross receipts family of taxes is imposed on services performed in New Mexico to support the general activities of state and local governments. The two privilege taxes reimburse the costs of regulating these particular activities. Since the two sets of taxes are levied for different purposes, there is no need to relieve these two sports from their obligation to contribute to the general welfare.
- This could be the start of a slide down a slippery slope to exempt all athletic events from gross receipts tax.

## OIL AND GAS EMERGENCY SCHOOL TAX

The oil and gas emergency school tax is levied on the production of oil, natural gas and carbon dioxide. The proceeds flow to the state general fund. Since 1993, the tax rate on natural gas has been four percent and the rate on oil and carbon dioxide has been 3.15 percent.

### *OPTION*

#### **OPTION 1. Equalize Oil and Gas Emergency School Tax Rates at Four Percent.**

This proposal would impose the same oil and gas emergency school tax rate on oil, natural gas and carbon dioxide. That rate would be four percent.

### *PROS*

- Oil and natural gas are close substitutes. They should be treated in the same manner for tax purposes.
- In all of the other New Mexico taxes on oil and natural gas, the rates are the same for both products. This proposal will provide that same equity with the oil and gas emergency school tax.

### *CONS*

- Increasing the tax on oil and carbon dioxide will marginally lower the marketability of New Mexico products.
- Rates can be equalized in two directions. Lowering the tax could spur activity — and jobs — in New Mexico.

## **"DECOUPLE" THE NEW MEXICO ESTATE TAX FROM THE FEDERAL CREDIT**

New Mexico, like 37 other states and the District of Columbia, has structured its estate tax based on the provisions of the federal state death tax credit. Section 7-7-3 NMSA 1978 provides that a tax equal to the federal credit is imposed on the transfer of the net estate of every resident and refers to Section 2011 of the United States Internal Revenue Code.

The Internal Revenue Code, until 2001, allowed a credit against federal estate taxes on a dollar-for-dollar basis for state death taxes paid. The state death tax credit was limited based on the size of the estate and a set of graduated rates specified in the federal law. In 2001, Congress passed and the president signed into law Public Law 107-16, The Economic Growth and Tax Relief Reconciliation Act of 2001 (2001 Act). The 2001 Act scales back the federal credit and substitutes a federal deduction for state taxes. The act provides that, for decedents dying in 2002, the federal credit is reduced to 75 percent of the amount originally specified in Section 2011, falls to 50 percent of that amount in 2003 and to 215 percent in 2004. For decedents dying after 2004, there is no federal credit. Thus, unless New Mexico acts, after 2004 there will be no revenues from the estate tax.

As of June 2003, 12 states had acted to "decouple" from recently enacted federal changes. Most have enacted legislation linking their estate taxes to the federal estate tax in effect before the 2001 tax bill. Several have elected to decouple through 2004 or 2007 and one, Nebraska, decoupled by creating a separate state estate tax based on the federal law before the 2001 changes.

New Mexico clearly has the same options. The estimate of revenue that would be realized from decoupling is in the attached Revenue Impact Table. If New Mexico takes no action, there will be no revenue from its estate tax after 2004. If the state wishes to retain an estate tax, the following options may be considered.

### *OPTIONS*

#### **OPTION 1. Enact a New Mexico Estate Tax Based on the Federal Tax Code Prior to the 2001 Change.**

This option, chosen by a number of states, would propose enacting legislation creating a New Mexico estate tax based on the federal tax code as it existed prior to the 2001 Act. The revenues produced by the current estate tax when the full federal credit was in place should theoretically be restored.

#### **OPTION 2. Enact a "New" New Mexico Estate Tax.**

Under this option, legislation creating a New Mexico estate tax would be based on definitions, rates and principles totally separate from the federal code and make no reference to it. The revenue flow would be dependent on the rates and base contained in the new law.

### *PROS*

- New Mexico badly needs the revenues from the estate tax, so it would be prudent to decouple from the federal credit now. There are already reduced revenues from the phase-out of the federal credit.
- Because of the uncertainty of what may happen at the federal level, it would be wise for New Mexico to go its own way, as many other states have chosen to do.
- To maintain progressivity and balance in the state tax system, it is important to maintain this tax on wealth, whether or not the federal government chooses to do so. Despite the fears of many, very few persons will die with sufficient assets to be subject to the estate tax.

### *CONS*

- Most taxpayers wholeheartedly support the phase-out and repeal of the federal estate tax. They will feel it is very unfair for the state to impose its own estate tax in the face of a very popular federal tax policy change.
- Reinstating a New Mexico estate tax, after repeal of the federal tax, will not be in line with the state policy of lowering personal income tax rates for wealthier individuals to attract businesses and their executives into the state. And once again, New Mexico will be outside the mainstream, as the majority of states will probably not be imposing estate or other death taxes.
- It would take a significant administrative effort to impose a New Mexico estate tax. In the past the state has "piggy-backed" on the federal system. With the federal law being repealed, New Mexico would have to develop its own regulations and administrative procedures.

## PUNITIVE DAMAGES TAX

Punitive damages are awarded by courts in certain instances in which a defendant or defendants have been shown to damage plaintiffs egregiously. Punitive damages are a sanction against bad behavior. Attorneys taking cases in which punitive damages may be awarded often charge a contingency fee, such as 20 or 33 percent of the total amount awarded the plaintiff(s).

### *OPTION*

#### **OPTION 1. Impose a Tax of 33.3 Percent of the Punitive Damages Awarded.**

At this time there is no data available on the cost of this option. The fiscal impact would depend on the number and amounts of punitive damages awarded.

### *PROS*

- Punitive damages are court-enforced penalties for bad behavior. In this they are no different than state-imposed monetary criminal and civil penalties. Like the state-imposed penalties, penalties secured through private action should inure to the benefit of society as a whole, not to private parties and their attorneys. The damages and court costs obtained are sufficient to make whole the prevailing private party.
- The oft-lamented willingness of Americans to sue is encouraged by attorneys seeking a big share of the potential punitive damages rather than, as officers of the court, seeing justice done.
- Although it is statistically rare, juries sometimes grant outrageously sized awards to express anger or frustration with a defendant. There is no reason the plaintiff or the plaintiff's attorneys should be enriched by such awards.

### *CONS*

- The bugaboo of out-of-control juries is a phantasm created by those who have engaged in meretricious behavior and their apologists. The system actually works quite well. There is no need to interfere with it by inserting a tax.
- Governments are limited in their resources. They may not — and as a free society we may not want them to — pursue every instance in which one person injures another. Our system works best when private parties sort out these issues themselves.
- Contingency cases, like most of those involving punitive damages, can be expensive to prosecute. The attorney is taking a risk. The attorney's expected share of the punitive damages awarded has to be large enough to cover the attorney's costs. Cutting into the net punitive damages available will affect the attorney's perception of the relative risks and rewards. Thus, some number of worthy actions will not be pursued, in effect rewarding at least some parties for behavior believed to be reprehensible.