New Mexico Tax Policy

PRESENTED BY:

ISMAEL TORRES, CHIEF ECONOMIST, LFC

RICHARD ANKLAM, DIRECTOR,
NM TAX RESEARCH INSTITUTE

STEPHANIE SCHARDIN CLARKE, SECRETARY,
TAXATION AND REVENUE DEPARTMENT

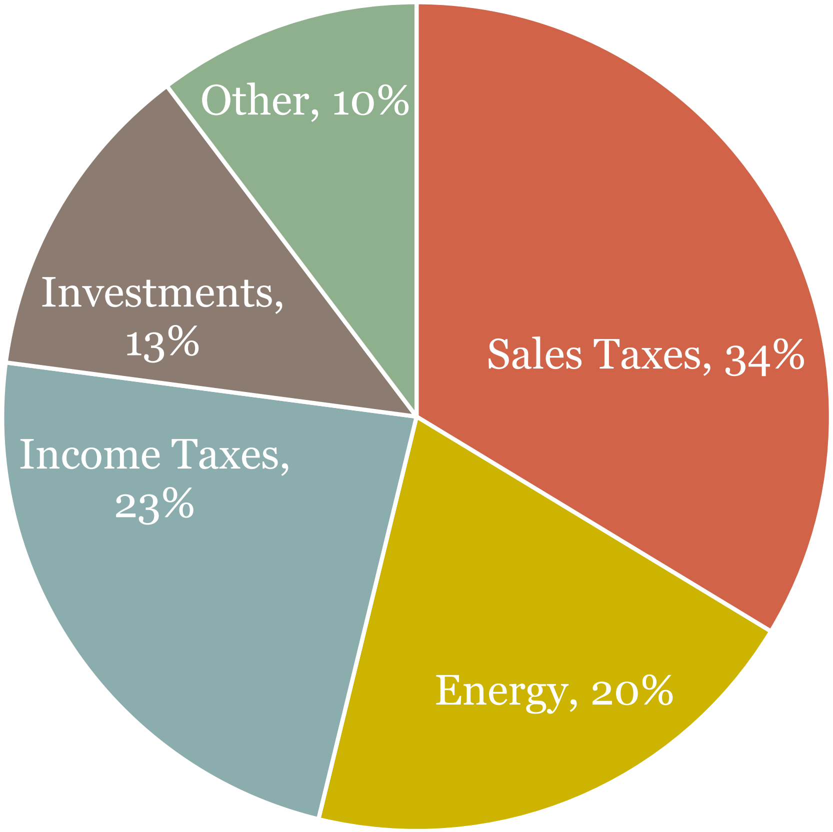
JULY 5, 2022

Outline

- New Mexico's Revenue Structure
- Tax Policy Principles
- Tax Expenditure Reporting and Evaluation
- Tax Reform
- Tax Burden

New Mexico Revenue Structure

FY 2023 General Fund Revenue: $9.05 Billion



- High reliance on general sales taxes
- Low reliance on property taxes
- High reliance on severance taxes and rents/royalty payments

General Fund Revenue Sources – Gross Receipts and Compensating Tax

- NM's largest source of revenue
- Broad-based (but less broad over time)
  - Seller imposed "sales" tax
  - Includes services and intangibles
  - Allows indirect tax on federal government (see *U.S. v. NM*)
- Rate includes "local option" taxes imposed by counties, municipalities, and others (i.e. train and spaceport districts)

General Fund Revenue Sources – Gross Receipts and Compensating Tax – Cont'd

- State's share = 3.775% (incorporated); 5.0%
- GRT rate range: 5.0% (base state GRT rate); 5.375 to 9.4375%* sourced locally
- Seller's location determined rate until 6/30/21

  Customer location determines rate since 7/1/21
- Pyramiding problem: Business-to-Business transactions; "every other sale" taxation of services
- "Hold-harmless" features for local government (being phased out)
  - Remainder of County – Lea and Lincoln; Taos Ski Valley through 12/22, respectively. Source: NMTRD
  - Effective 7/1/22, the statewide rate was reduced from 5.125% to 5%, and will reduce to 4.875% on 7/1/23

General Fund Revenue Sources – Gross Receipts and Compensating Tax – Cont'd

- Compensating Tax
  - Companion tax ("use" tax) – imposed on purchaser
  - Local option compensating tax began 7/1/21
- Municipal and county taxes
  - Local revenues tightly controlled by Legislature
  - Local option GRT and compensating taxes
  - GRT provides 75% of municipal general revenue
  - Bases are identical – so locals piggyback on state base
- Tribal taxes
  - Tribal governments are sovereign. They have taxing power of their own.
  - They do not have to align their general excise tax with New Mexico's. It is a matter of mutual convenience that they do.
  - Currently 20 tribal entities impose a GRT administered by the state under cooperative agreements.

General Fund Revenue Sources – Personal Income Tax

- NM imposes a personal income tax on residents, and non-residents deriving income from New Mexico sources
- The starting point is federal adjusted gross income (AGI) followed by additions and subtractions:

  \+ NM additions (e.g., interest on federally tax-exempt bonds; itemized state income tax)

  \- Federal standard or itemized deductions (changed by federal tax reform)

  \- Federal personal exemption amount (now zero from federal tax reform)

  \- NM low- and middle-income exemption

  \- NM subtractions (e.g., interest on NM state and local bonds, capital gains)

  \- NM uncompensated medical care deduction

  = NM taxable income

General Fund Revenue Sources – Personal Income Tax – Cont'd

- Graduated marginal rates that range from 1.7% to 5.9%.
- Tax credits and rebates may reduce tax due.
- Credits may be refundable, credit in excess of liability may be carried forward, or credits may be transferrable.
- Refundable rebates and credits (except the Working Families Tax Credit) are based on "Modified Gross Income" (MGI).
- Withholding and estimated payments are applied throughout the year to offset expected tax liability.
- Taxpayers compute their tax due/refund in tax returns typically due April 15
- Taxpayers may request extensions to file to October 15 from State or IRS

General Fund Revenue Sources – Corporate Income Tax

- <u>Entities Subject to Tax</u>
  - Corporations
  - Other entities taxed as corporations under federal income tax
    - Certain partnerships, LLCs, Non-profits (i.e. UBI), trusts

- <u>Nexus</u>
  - To be subject to tax by New Mexico, entity must:
    - Be employed or engaged in the transaction of business in, into or from New Mexico, or
    - Derive any income from any property or employment within New Mexico
  - Must have more than "the slightest physical presence" for constitutional nexus
    - Can be established by agents

Oil and Natural Gas Taxes

- Tax rates – Oil

Taxes on Oil	Net Price of Oil ($/bbl)		
	Under $15	$15 to $18	Over $18
Oil and Gas Emergency SchoolTax[1]	1.58%	2.36%	3.15%
Oil and Gas Severance Tax[2]	1.88%	2.81%	3.75%
Subtotal	**3.46%**	**5.17%**	**6.90%**
Oil and Gas Conservation Tax	0.19%	0.19%	0.19%
Production Ad Valorem Tax	1.04%	1.04%	1.04%
Production Equipment Ad Valorem Tax	0.14%	0.14%	0.14%
Total	**4.83%**	**6.54%**	**8.27%**

(1) 2.36% for stripper wells if taxable value of oil is between $15 and $18/barrel; 1.58% if less than $15/barrel.

(2) 2.81% from stripper wells if taxable value of oil is between $15 and $18/barrel; 2.45% removed from well workover projects if average annual price of WTI is less than $24/barrel; 1.88% if WTI less than $15/barrel.

Note: Deductions allowed for state, federal and Indian royalties and trucking expenses - In FY 2020, oil deductions averaged 12%.

Oil and Natural Gas Taxes

- Tax rates – Natural Gas

Taxes on Natural Gas	Net Price of Natural Gas ($/mcf)		
	Under $1.15	**$1.15 to $1.35**	**Over $1.35**
Oil and Gas Emergency School Tax[1]	2.00%	3.00%	4.00%
Oil and Gas Severance Tax[2]	1.88%	2.81%	3.75%
Subtotal	**3.88%**	**5.81%**	**7.75%**
Oil and Gas Conservation Tax	0.19%	0.19%	0.19%
Production Ad Valorem Tax	0.88%	0.88%	0.88%
Production Equipment Ad Valorem Tax	0.15%	0.15%	0.15%
Total	**5.10%**	**7.03%**	**8.97%**

(1) 3% for stripper wells if taxable value is between $1.15 and $1.35/mcf; 2% if average annual price of WTI is less than $24/barrel.

(2) 2.81% for stripper wells if taxable value is between $1.15 and $1.35/mcf; 2.45% if average annual price of WTI is less than $24/barrel; 1.88% if taxable value is less than $1.15.

Note: Deductions allowed for state, federal and Indian royalties and trucking expenses - In FY 2020, natural gas deductions averaged 43%.

Other Tax Issues – Unemployment Insurance (UI) Tax

- The unemployment trust fund receives revenue through UI tax rates on employers.
  - The amount of tax an employer pays depends on: (1) the number of its employees, (2) the state-determined taxable wage base per employee, (3) the contribution rate assigned to the employer based on number of former employees claiming UI, and (4) a multiplier based on the balance of the fund.
- Prior to the pandemic, the unemployment trust fund had a balance $459 million; however, by September 2020 the fund had reached insolvency due to elevated unemployment claims.
- The state used $656.6 million of ARPA funds to repay federal loans and replenish the unemployment trust fund.
- The state now faces the possibility of a tax hike despite replenishing the fund. Because the balance in the fund is insufficient to withstand another pandemic, and the pandemic year is included in tax calculations, taxes are set to increase unless balances rise or the formula is changed. Balances are likely to dip in 2022 further raising rates in future years.

Tax Policy Principles

NMTRI Tax Policy Principles

N.M. Tax Research Institute is a non-profit, non-partisan member-supported organization dedicated to advancing the following principles of good tax policy in New Mexico:

Adequacy

Revenues should be sufficient to fund needed services

Efficiency

Interference with the private economy should be minimized

Equity

Taxpayers should be treated fairly

Simplicity

Laws, regulations, forms and procedures should be as simple as possible

Comprehensiveness

All taxes should be considered when evaluating the system

Accountability

Exceptions should be rare and should be carefully evaluated and justified

Tax Expenditure Evaluation and Reporting

What is a Tax Expenditure Report?

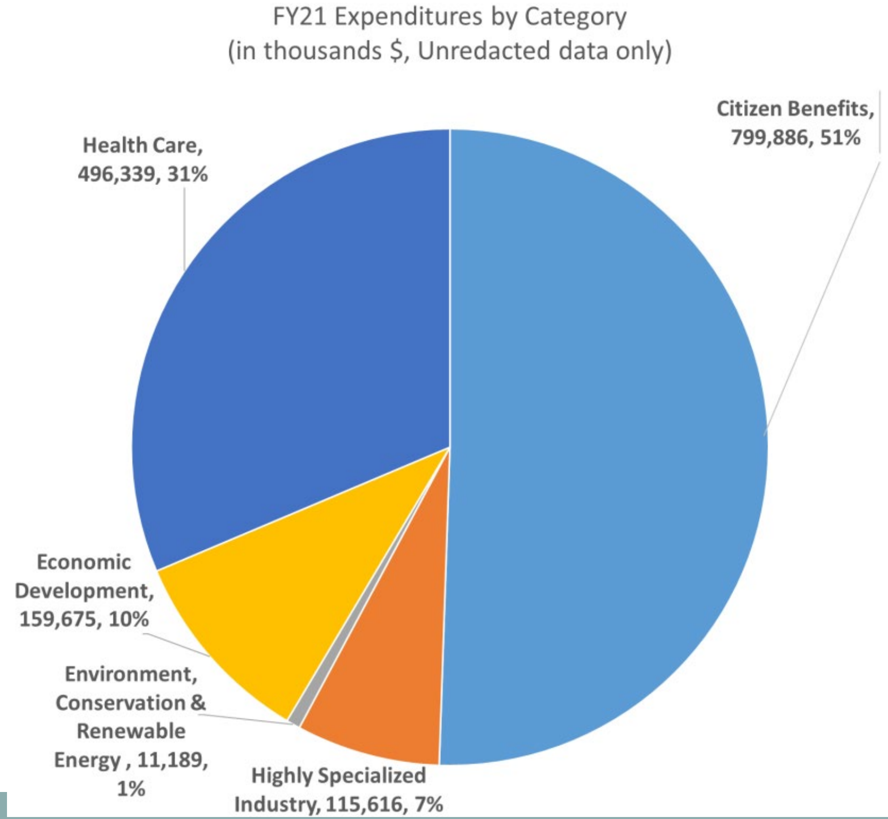
- Tax expenditure reports (TER) describe areas where the tax code provides for preferential tax treatment of a certain activity
- TRD has produced a TER yearly since 2012. Find them at www.tax.newmexico.gov, then under Forms & Publications, Publications, Tax Expenditure Reports
- TER is presented to Revenue Stabilization and Tax Policy Committee each fall
- The TER includes an estimate of revenue foregone because of the preferential tax treatment due to:
  - Credits
  - Deductions
  - Exemptions
  - Preferential tax rates
- Every dollar of revenue foregone is a dollar that cannot be appropriated or added to reserves
- State appropriations are rigorously evaluated and reprioritized annually; tax expenditures should be similarly revisited
- TER are important transparency tools that allow State policymakers, advocacy groups, and the public an opportunity to regularly evaluate the State's tax code

Exclusions, Exemptions, Credits, and Deductions (Oh My!)

- **Exclusions** – amounts of gross receipts, gross income, or other amount that is removed to define the tax base
  - Taxpayers exclude certain amounts of their "base income" to derive "net income" on which tax is imposed. § 7-2-2(N)
  - The property tax excludes personal property and has a 3% limit on annual value growth on residential property
- **Exemptions** – often eliminate a taxpayer's obligation to register, report, and/or pay
- TRD does not have visibility into income or receipts that are exempt because they are not reported on a tax return
- **Deductions** - reduce liability by eliminating certain transactions or income from amounts taxpayers are required to report on returns
- Deductions and Exemptions have the same effect on a taxpayer's tax liability, but differ in taxpayer reporting obligations
- **Credits** – are dollar for dollar credits against the taxpayer's tax liability due

Tax Expenditures Categories

- Citizen Benefits: benefit all taxpayers or specific population (low-income, disabled, etc.), lessen the burden of taxation
- Economic Development: stimulate investment, job creation or job retention, attract industries
  - Environment, Conservation, and Renewable Energy: support environmental health, promote conservation and renewable energy
  - Health Care: increase access to or lower costs of health care
  - Highly Specialized Industries: target specific or highly specialized industries



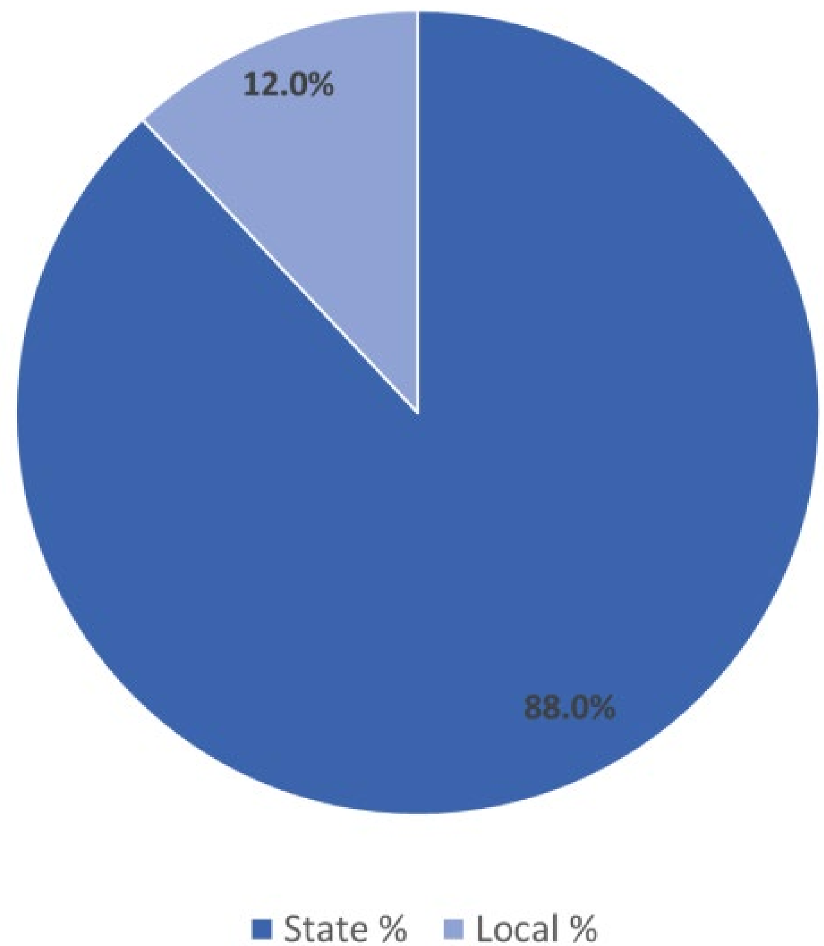
Top Ten Expenditures by Cost: 2020 and 2021

Name	2020 ($000's State & Local)	2020 Rank	2021 ($000's State & Local)	2021 Rank	
Sale of Food at Retail Food Stores GRT Deduction and Hold Harmless Distribution	599,700	1	442,464	1	Green
DOH-Licensed Hospitals 60 Percent GRT Deduction	219,789	2	227,147	2	Yellow
Prescription Drugs and Oxygen GRT and GGRT Deduction	173,600	3	183,000	3	Red
Income Tax Rebate 2020 tax year filing	NA	NA	98,766	4	Green
Working Families Credit against PIT	83,408	5	75,863	5	Green
Health Care Practitioner Services GRT Deduction and Hold Harmless Distribution	84,500	4	71,662	6	Green
Restaurant and Bar Temporary GRT Deduction	NA	NA	51,065	7	Green
Nonprofit Organizations Exemption from GRT	49,118	7	50,600	8	Red
Apportionment Election for CIT Manufacturers	34,643	9	42,876	9	Yellow
Film and Television Credit against PIT and CIT	55,596	6	39,824	10	Green
Capital Gain Deduction From PIT	41,226	8	31,587	12	Green
Low- and Middle-Income Taxpayers Exemption from PIT	18,872	10	20,170	14	Green

State vs. Local Tax Expenditure Incidence

- GRT incidence for deductions and exemptions is shared between the State General Fund and local governments in most cases
- Tax expenditures for CIT, PIT, etc., generally impact only State General Fund directly

FISCAL YEAR 2021 EXPENDITURES BY STATE AND LOCAL TAX INCIDENCE



LFC Tax Expenditure Policy Principles

- **Vetted**: The proposed new or expanded tax expenditure was vetted through interim legislative committees, such as LFC and the Revenue Stabilization and Tax Policy Committee, to review fiscal, legal, and general policy parameters.
- **Targeted**: The tax expenditure has a clearly stated purpose, long-term goals, and measurable annual targets designed to mark progress toward the goals.
- **Transparent**: The tax expenditure requires at least annual reporting by the recipients, the Taxation and Revenue Department, and other relevant agencies.
- **Accountable**: The required reporting allows for analysis by members of the public to determine progress toward annual targets and determination of effectiveness and efficiency. The tax expenditure is set to expire unless legislative action is taken to review the tax expenditure and extend the expiration date.
- **Effective:** The tax expenditure fulfills the stated purpose. If the tax expenditure is designed to alter behavior – for example, economic development incentives intended to increase economic growth – there are indicators the recipients would not have performed the desired actions "but for" the existence of the tax expenditure.
- **Efficient:** The tax expenditure is the most cost-effective way to achieve the desired results.

LFC Tax Expenditure Policy Principles

LFC Tax Expenditure Policy Principle	Met?	Comments
Vetted	✓	
Targeted		
Clearly stated purpose	✓	
Long-term goals	✓	
Measurable targets	✘	
Transparent	✓	
Accountable		
Public analysis	✘	
Expiration date	✓	
Effective		
Fulfills stated purpose	✓	
Passes "but for" test	?	
Efficient	✘	
Key: ✓ Met ✘ Not Met ? Unclear		

Tax Reform

Recent Steps Towards Tax Reform: 2019

- Subjected online sales to GRT
- Created local option compensating tax, de-earmarked local option GRT
- Moved NM to destination based sourcing 7/1/21
- New 5.9% top rate affecting top 3% of filers
- Hospital GRT reform to level playing field
- CIT mandatory combined filing and market sourcing
- Increased motor vehicle excise tax from 3 to 4%
- Expanded Working Families Tax Credit
- Reduced capital gain deduction from 50% to 40%
- Began to tax e-cigarettes and increased cigarette tax from $1.66 to $2.00 per pack
- Restored dependent deduction eliminated by feds

Recent Steps Towards Tax Reform: 2020

- Create tax credits for solar and technology transfer from national labs
- Penalty and interest grace period for pandemic relief

Recent Steps Towards Tax Reform: 2021

- Imposed the Cannabis Tax Act (eff. 4/1/22)
- Ensured grocery GRT deduction applies to deliveries
- Expanded Working Families Tax Credit and included ITIN filers, younger childless workers
- Expanded Low-Income Comprehensive Tax Rebate and provided for future inflation adjustment
- Extensive tax code cleanup
- Conformance with federal partnership audit rules

Recent Steps Towards Tax Reform: 2022

- Reduced the state GRT rate from 5.125% to 4.875% (in FY24 and thereafter)
- Anti-pyramiding GRT deductions for certain consumed services by manufacturers only
- PIT exemption for Social Security income for those with under $100K in gross income
- Partial PIT exemption for military retirement pay (3 year delayed repeal)
- Child tax credit
- Election for pass through entities to pay tax directly
- Motor vehicle excise credit for tribal excise tax paid
- Clarify disclosed agency in GRT

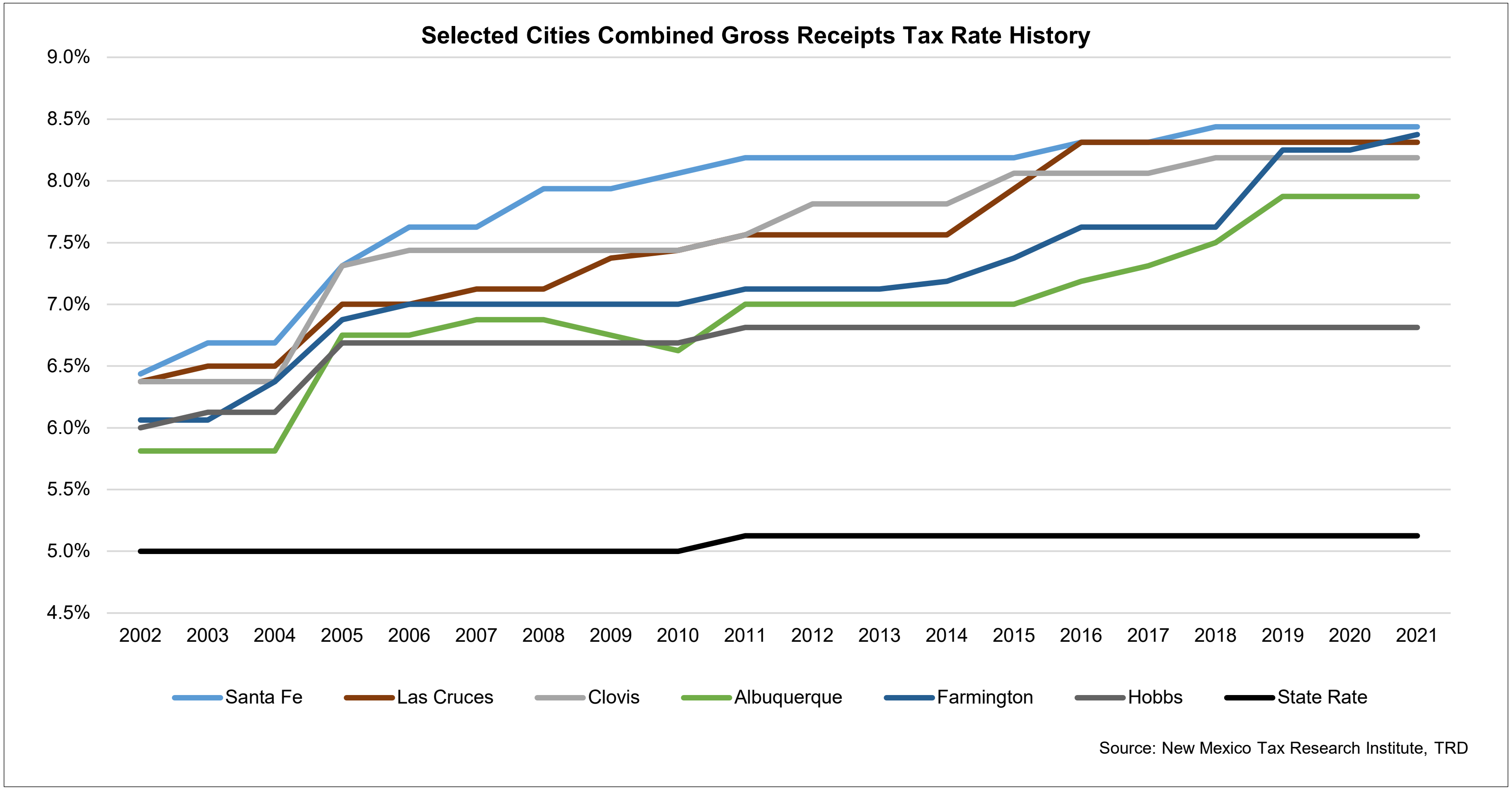
Recent Steps Towards Tax Reform: Personal Income Tax Reforms

Legislative Changes to Personal Income Tax
(in millions)

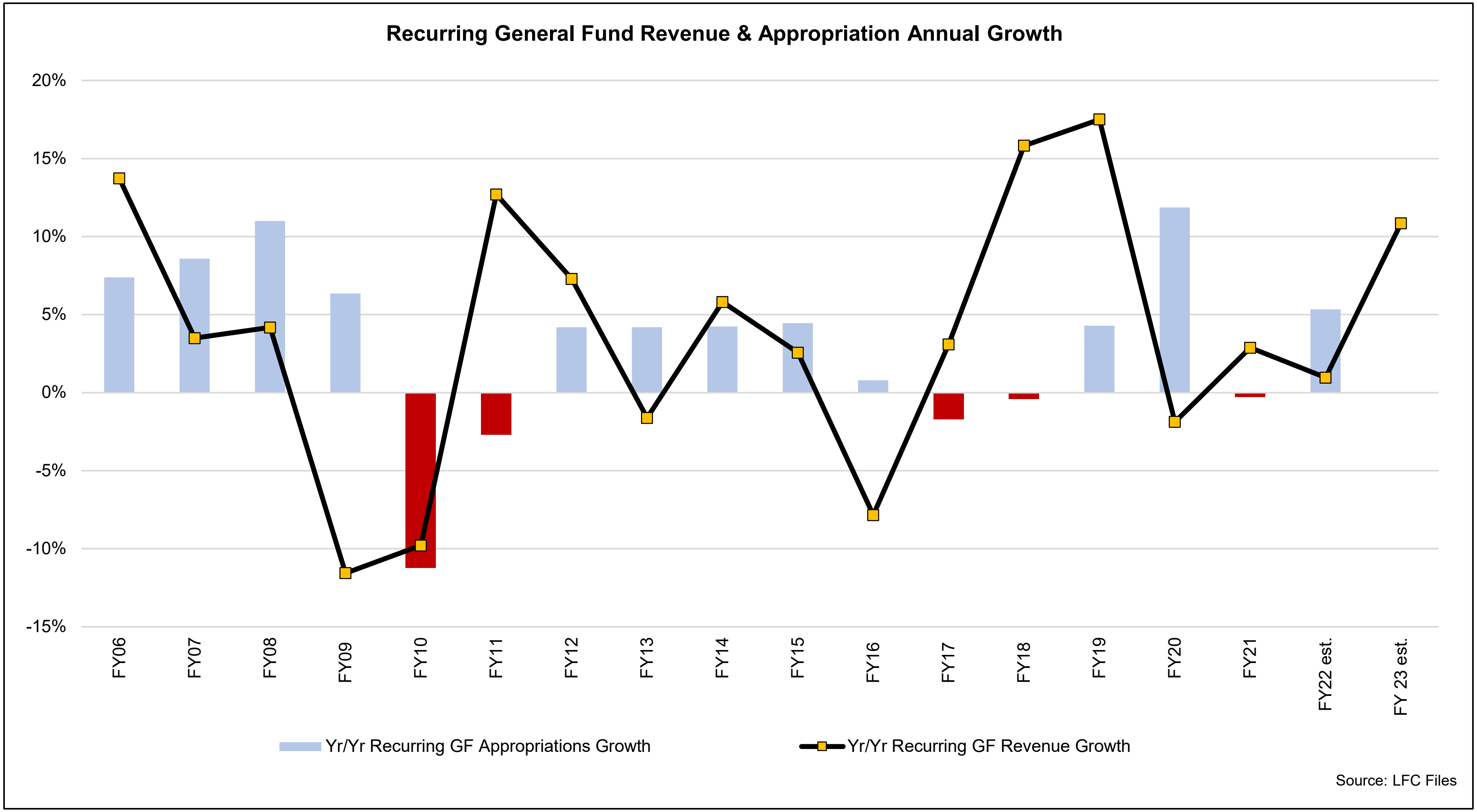
	FY21	FY22	FY23	FY24	FY25
New top rate of 5.9% (HB 6, 2019)	$20	$40	$41	$41	$41
Increase working families tax credit from 10% to 17% (HB 6, 2019)	($39)	($39)	($41)	($41)	($41)
Create dependent deduction (HB 6, 2019)	($27)	($28)	($28)	($28)	($28)
Deduction for capital gains from 50% to 40% (HB 6, 2019)	$10	$10	$10	$10	$10
Increase working families tax credit to 25%, add ITIN and under 25 (HB 291, 2021)	-	($25)	($23)	($49)	($49)
Low income comprehensive tax rebate expansion (HB 291, 2021)	-	($49)	($50)	($51)	($52)
Credit for liquor license holders (HB 255, 2021)	-	($2)	($2)	-	-
Income Tax Rebates (HB 163, 2022 Regular and HB 2 2022 Special Session)	-	($339)	($651)	-	-
Certain social security income exempted tax (HB 163, 2022)	-	-	($84)	($89)	($94)
Military Pension Exemption (HB 163, 2022)	-	-	($7)	($14)	($18)
Created the child tax credit (HB 163, 2022)	-	-	-	($74)	($75)
Total PIT Revenue Change	($36)	($432)	($835)	($295)	($306)

Potential for Tax Reform – GRT Rate Trends

- The first statewide GRT rate cut in 40 years was enacted in 2022. 1/8% cut took effect July 1, 2022 and another 1/8% cut is scheduled for July 1, 2023

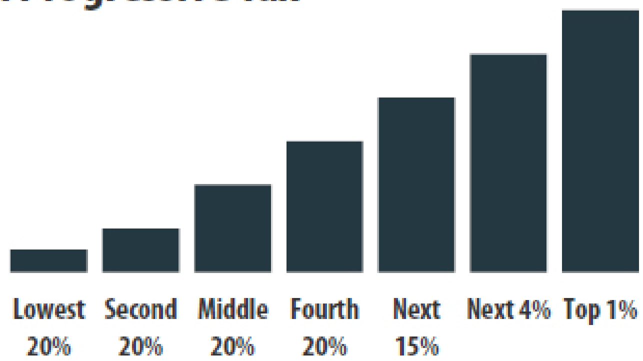


Potential for Tax Reform – Revenue Stability

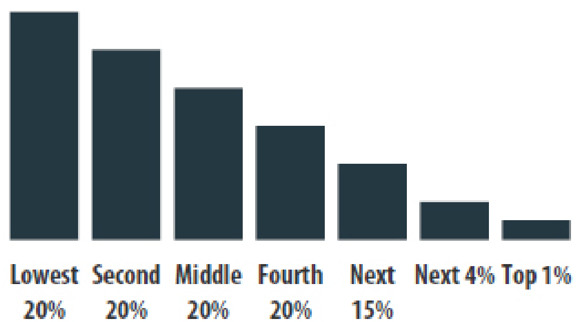


Tax Burden

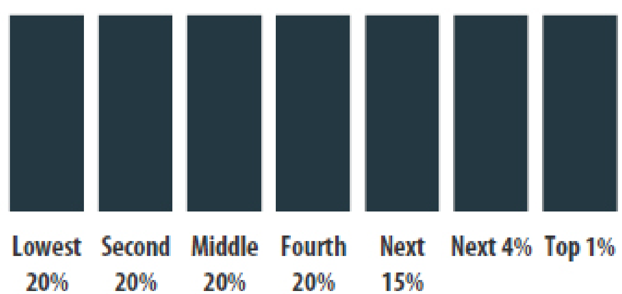
A Progressive Tax



A Regressive Tax



A Proportional Tax



A **progressive tax** is one in which upper-income families pay a larger share of their incomes in tax than do those with lower incomes

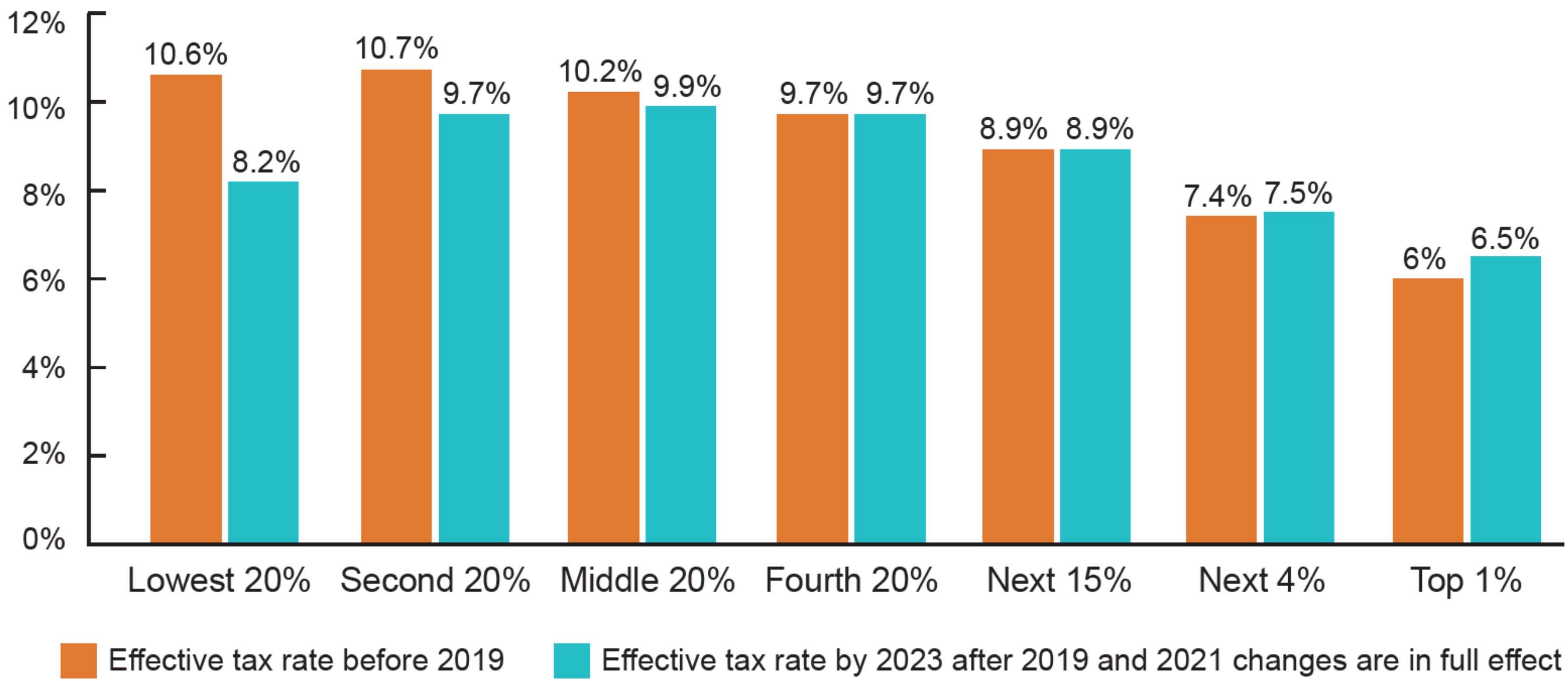
A **regressive tax** requires the poor and middle-income to pay a larger share of their incomes in taxes than the rich

A **proportional tax** takes the same percentage of income from everyone, regardless of how much or how little they earn.

Source: ITEP

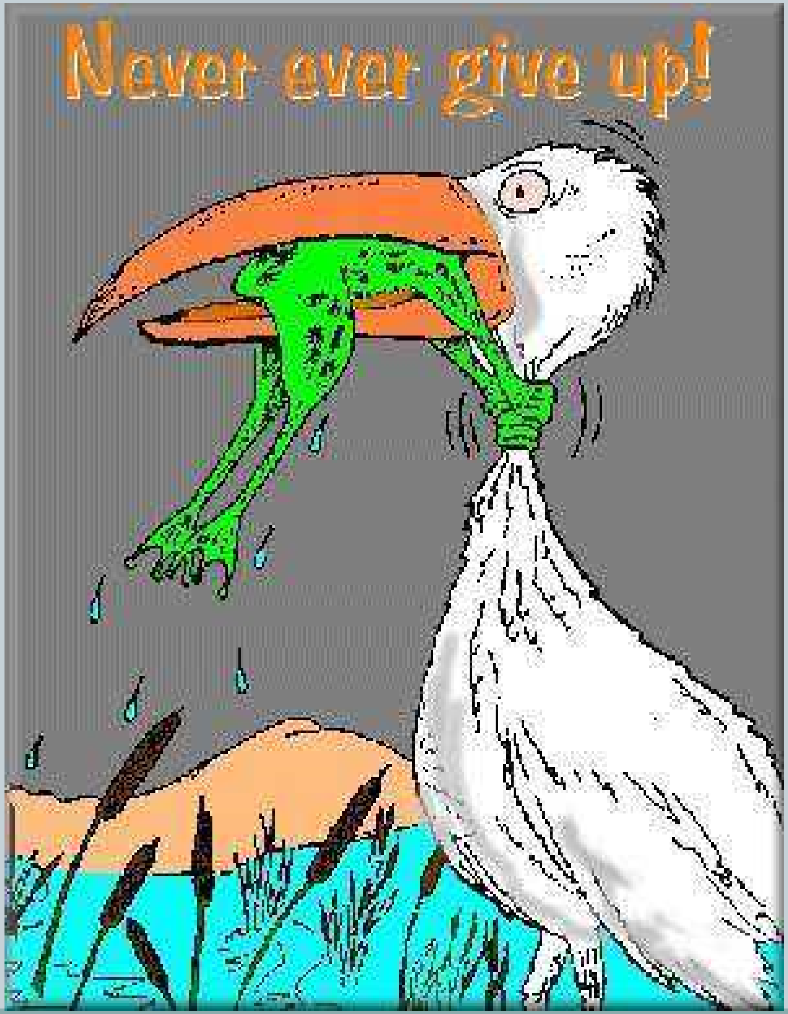
Taxation in New Mexico

THE SHARE OF INCOME PAID IN STATE AND LOCAL TAXES (INCOME, SALES, EXCISE, AND PROPERTY) BY INCOME QUINTILE (2018-2023)



Source: Institute on Taxation and Economic Policy, July 2021

Questions



General Fund Revenue Sources – Gross Receipts and Compensating Tax – Cont'd

- Compensating tax
  - Imposed on the value of property
    - manufactured in the state by the person using it
    - acquired outside NM that would have been subject to the GRT had it been acquired in NM
    - that becomes taxable because of subsequent use of the property or service (i.e. using something acquired for resale)
  - Product of services used in the state
  - Credit for tax (sales) paid to other state up to 5.125%
  - Exemptions & Deduction mirror GRT where applicable
  - Applies to Individuals as of 7/1/20

General Fund Revenue Sources – Corporate Income Tax – Cont'd

- Taxable Income
  - Taxable income as defined for federal income tax purposes, with certain additions and subtractions
  - Additions:
    - Interest on non-New Mexico state and local bonds
    - Federal NOLs (3 year carryback, 20 year carryforward)
  - Subtractions:
    - Interest on federal bonds and New Mexico state and local bonds subject to federal income tax
    - State NOLs (no carryback, now 20 year carryforward (was 5)
    - Dividends from foreign corporations (not combined filers, and including "gross-up"; percentage based on ownership)

General Fund Revenue Sources – Corporate Income Tax – Cont'd

- <u>Reporting Methods</u>

  OLD (until TYB o/a 1/1/19)

  - Separate Corporate Entity (SCE)
    - Default reporting method, unless taxpayer elects combined or consolidated
  - Combined
    - Can be elected by "unitary" corporations (determined by inter-relations)
    - Once elected, cannot go back to SCE without permission of TRD Secretary
  - Consolidated
    - Follows federal rules (requires 80% ownership by common parent)
    - Once elected, cannot go back to combined or SCE without permission of TRD Secretary

General Fund Revenue Sources – Corporate Income Tax – Cont'd

- <u>Reporting Methods</u>

  NEW (TYB o/a 1/1/20)

  - Worlwide Combined
    - Default reporting method, unless taxpayer elects combined or consolidated
  - Water's Edge Combined
    - Can be elected by "unitary" corporations (determined by inter-relations)
    - Once elected, cannot elect to other methods for seven years
  - Consolidated
    - Follows federal rules (requires 80% ownership by common parent)
    - Once elected, cannot elect another method for seven years

General Fund Revenue Sources – Corporate Income Tax – Cont'd

- <u>Allocation and Apportionment</u>
  - Corporations with income from outside New Mexico must allocate and apportion their income to New Mexico
  - NM follows Uniform Division of Income for Tax Purposes Act (UDITPA)
  - "Non-business" income is "allocated" to one state (source state)
  - "Business income" is "apportioned" between states by formula
  - Apportionment formula uses 3- "factors" - property, payroll, and sales
  - Each factor is the percentage of the New Mexico amount to the "everywhere" amount, and the three percentages are then added and divided by 3 to get the average apportionment percentage
  - Manufacturers and corporate HQs (or some ops) can elect to use a single sales factor formula (which may benefit those who have property and payroll here but sell mostly outside the state).

General Fund Revenue Sources – Corporate Income Tax – Cont'd

Tax Liability

- Corporate income tax is imposed at two rates:
  - 4.8% for net income of $500,000 or less;
  - 5.9% of net income above $500,000

- Applicable credits may reduce tax liability

- Corporate franchise tax also applies - $50 per year per corporation

Selective Sales Taxes – Tobacco

- Tobacco Taxes
  - Cigarette
    - 10 cents/$2.00 per pack of 20 cigarettes
    - Tax raised from $.21 to $.91/pack of 20 on July 1, 2003, to 1.66/pack in 2010, and again to the present rate on July 1, 2019
    - Requires stamps
    - Exemptions
      - U.S. or any agency thereof
      - governing body or enrolled member of any tribe for sale or use on that tribe or pueblo
      - sales prohibited by N.M. or U.S. constitution
  - Tobacco Products Tax (snuff, cigars, etc.)
    - 25% of product value (not to exceed 50 cents/cigar)
    - 12.5% of wholesale for e-liquids and 50 cents/closed system cartridge
    - Exemptions
      - Products sold to or by the U.S. or N.M., or any of their agents or instrumentalities
    - Deductions
      - Interstate sales

Selective Excise Taxes - Liquor

- Liquor Excise Tax
  - Rates vary by type
    - Spirituous Liquor - $1.60/liter
    - Beer - $0.41/gallon
    - Wine - $1.50/liter
    - Fortified Wine - $1.50/liter
    - Microbrewer beer- $0.08/liter
    - Cider - $0.41/gallon
    - Preferential rates for certain small winery or winegrower , craft beer brewers and craft distillers
  - Exemptions
    - Sales to or by instrumentality of the armed forces engaged in resale
  - Deductions
    - Interstate sales

Selective Sales Taxes - Insurance

- Insurance Taxes
  - Administered Office of Superintendent of Insurance
  - Tax on Premiums
    - Tax rate – 3.003%
  - Imposed in lieu of all other state taxes except property taxes
  - Health Insurance Premiums Surtax
    - Imposed on health insurance premiums
    - Tax rate –3.75%
  - Other issues – Retaliatory taxes
    - Many states, to include NM, have provisions impose a retaliatory tax on foreign insurers if that insurer's home state's rates are higher than their own rates.

Selective Sales Taxes - Gaming

- Gaming Taxes
  - Gaming Tax
    - Administered by the Gaming Control Board
    - 10% of receipts from sale or lease or other transfer of gamine devices
      - Exception for transfer from manufacturers to distributors
    - 10% of the net take of a gaming operator that is a not-for-profit
    - 26% of the net take of other gaming operators
    - In lieu of other state and local gross receipts taxes
  - Gaming operator that is a racetrack
    - Administered by the Racing Commission
    - 26% of net take to purses (in addition to gaming tax)

Gross Receipts Tax

- GRT system includes "Special" state taxes
  - Governmental GRT
    - Justified by competition between governments and businesses
    - Revenue benefits NMFA public project revolving fund and capital outlay projects of select state agencies
  - Interstate telecommunications GRT
    - Long-distance service was taxed under the gross receipts tax until 1992
    - This separate tax was created, mainly as a convenience to the long-distance companies
    - The FCC would not permit passing on the tax unless local rates were part of a special tax.
    - ITGRT's rate of 4.25% determined as an average of the actual effective gross receipts tax rate.
  - Lease vehicle GRT & surtax
    - At the behest of auto rental companies, this 5% tax on top of regular GRT replaced the motor vehicle excise tax on the same vehicles.
    - Effectively reduced interest paid on financed vehicle purchases.
    - Tax is targeted at tourists.
  - Telecommunications relay service surcharge
    - Rate = 0.33% - charged on receipts from intrastate telephone services.
    - It funds TTY/TDD services.
    - It is a special excise tax that happens to be collected through the gross receipts tax system.

Exclusions, Exemptions, Deductions and Credits

- **Exclusions** – amounts of gross receipts, gross income, or other amount that is removed in order to define the tax base.
  - Example: Taxpayers exclude certain amounts of their "base income" to derive "net income" on which tax is imposed. § 7-2-2(N).

- **Exemptions** - eliminate a legal obligation to register, report, and/or pay.
  - Exemptions can hinge on the nature or character of the taxpayer.
    - Insurance companies exempt from CIT because they pay premium tax; § 7-2A-4;
    - Nonprofits and disabled street vendors exempt from GRT. § 7-9-29.
  - Exemptions can hinge on the nature of the transaction.
    - Gross receipts from sales of livestock or unprocessed agricultural products exempt from GRT. § 7-9-18.
  - Exemptions can be full or partial.
  - Generally, if the exemption is full and applies to the nature of the taxpayer, or if a taxpayer solely engages in exempt transactions, there is no registration or filing obligation.
  - For GRT, if a taxpayer is required to register and file returns, but some of its transactions are exempt, the exempt amounts are not included anywhere on the return.

Exclusions, Exemptions, Ded. and Credits (Cont.)

- **Deductions** - reduce liability by eliminating certain transactions or income from amounts taxpayers are required to report on returns.

- Deductions deviate from the normal tax base and lower the tax base before calculating tax due.
  - For GRT, taxpayers report a gross amount on the face of the return, then also show the amount of the subtraction.
  - Some deductions are "lumped" on a return; others are separately itemized by code.
  - Many GRT deductions statutorily require the seller to be in possession of a Nontaxable Transaction Certificate (NTTC) at the time the return is filed or within sixty days of a TRD audit request. Alternative evidence can now be used in lieu of NTTCs.

Exclusions, Exemptions, Ded. and Credits (Cont.)

- **Credits** – are dollar for dollar credits against the tax determined due.
  - Most credits are business activity credits that require an application for approval to either TRD or another certifying agency before the credit is allowed.

Earmarking

- Earmarking occurs when statute (or the New Mexico Constitution) **directs certain revenues to a specific fund or agency**, and it often is accompanied by language stating the purpose for which the revenues are to be used

Earmarking - Advantages

- If the revenue source is aligned with the benefits from the earmark, this fulfills the **benefit principle** – those benefiting from the government service should be financially responsible for it
  - However, some studies in other states indicate revenue sources are frequently not aligned with earmark benefits
- Helps ensure a **steady flow of funding** for a specific purpose; not as subject to changing funding desires of the Legislature
- Can be used to **gain support and commitment** from groups of taxpayers and stakeholders, in some cases creating situations where taxpayers are willing to support increased taxes if the revenues are used for a purpose that benefits them

Earmarking - Disadvantages

- **Reduces general fund revenues** available for discretionary appropriation
  - Increases difficulty to establish funding priorities and change those priorities over time as revenues and needs change
  - During tough economic and budget times, the reduced discretion is likely to lead to deeper cuts for agencies and programs not funded through earmarks
- The need for dedicated funding streams for a particular purpose can change over time, but it is **more difficult changing earmarks** than changing appropriation amounts or language
- An earmark to provide additional funding for a program **does not guarantee an increase in funding**, as non-earmarked funding may be reduced (a common national example is earmarked lottery revenue for education partially offset by general fund budget cuts to education)
- It can be **difficult to track** earmarked funds and ensure they are being expended effectively and efficiently
- Earmarked funds often **do not revert** to the general fund, creating an environment for funds to sit unused

Earmarking, cont.

- LFC budget guidelines instruct analysts to identify opportunities to eliminate earmarks
- Examples of earmarks:
  - petroleum products loading fee to the corrective action fund at NMED
  - fire protection fund revenues to fire districts, fire departments, and the fire protection grant fund
  - a portion of liquor excise taxes to the local DWI grant fund and a temporary earmark for the lottery scholarship fund
  - cigarette tax earmarks to a variety of sources, including a distribution where the excess has sat, nearly unchanged in value, for the last three years (SB113 sweeps this fund balance)
- No system-wide analysis in New Mexico of earmarked funds
- A 2014 study in Michigan found nearly two-thirds of the state's taxes were earmarked for distributions other than to the general fund

New Mexico State & Local Taxes

TOTAL TAX

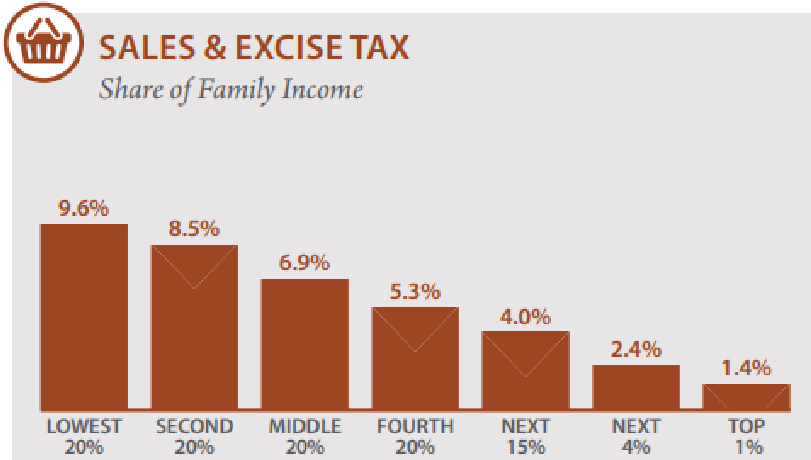
Share of Family Income

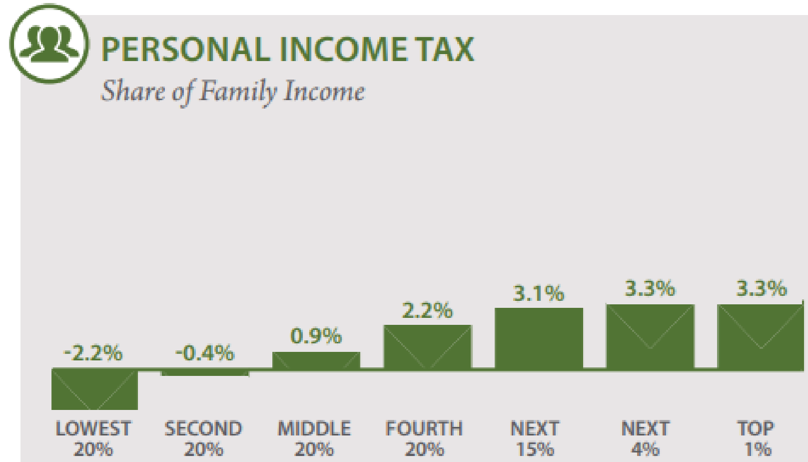
INCOME GROUP	LOWEST 20%	SECOND 20%	MIDDLE 20%	FOURTH 20%	TOP 20%: NEXT 15%	TOP 20%: NEXT 4%	TOP 20%: TOP 1%
INCOME RANGE	Less than $17,700	$17,700 to $32,100	$32,100 to $49,500	$49,500 to $86,000	$86,000 to $165,300	$165,300 to $376,500	over $376,500
AVERAGE INCOME IN GROUP	$11,500	$25,100	$39,400	$65,400	$116,400	$229,700	$845,400
SALES & EXCISE TAXES	**9.6%**	**8.5%**	**6.9%**	**5.3%**	**4.0%**	**2.4%**	**1.4%**
General Sales—Individuals	5.3%	5.1%	4.2%	3.3%	2.5%	1.5%	0.9%
Other Sales & Excise—Ind.	1.0%	0.7%	0.5%	0.3%	0.2%	0.1%	0.0%
Sales & Excise on Business	3.2%	2.8%	2.3%	1.7%	1.2%	0.7%	0.4%
PROPERTY TAXES	**3.2%**	**2.6%**	**2.3%**	**2.1%**	**1.8%**	**1.7%**	**1.2%**
Home, Rent, Car—Individuals	3.2%	2.5%	2.2%	2.0%	1.6%	1.4%	0.4%
Other Property Taxes	0.0%	0.0%	0.1%	0.1%	0.1%	0.3%	0.8%
INCOME TAXES	**-2.2%**	**-0.4%**	**0.9%**	**2.2%**	**3.2%**	**3.4%**	**3.5%**
Personal Income Tax	-2.2%	-0.4%	0.9%	2.2%	3.1%	3.3%	3.3%
Corporate Income Tax	0.0%	0.0%	0.0%	0.0%	0.0%	0.1%	0.1%
TOTAL TAXES	**10.6%**	**10.7%**	**10.2%**	**9.7%**	**8.9%**	**7.4%**	**6.0%**

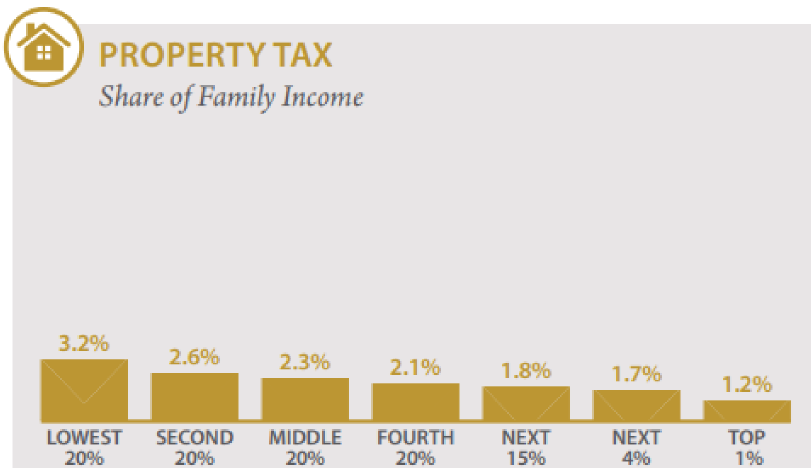
Individual figures may not sum to totals due to rounding.

Source: Institute on Taxation and Economic Policy, October 2018

New Mexico State & Local Taxes







NOTE:

Figures show permanent law in New Mexico enacted through September 10, 2018 at 2015 income levels. Top figure represents total state and local taxes as a share of income. The 6th edition of Who Pays does not include the impact of the federal deduction for state and local taxes (SALT) because policy changes in the 2017 federal Tax Cuts and Jobs Act temporarily limited the extent to which the SALT deduction functions as a generalized offset of state and local taxes.

Source: “Who Pays? A Distributional Analysis of the Tax Systems in all 50 States,” Institute on Taxation and Economic Policy, October 2018