

REPORT

PROFESSIONAL TAX STUDY COMMITTEE

NOVEMBER 21, 1996

The legislature and the governor authorized the creation of a Tax Study Committee, otherwise known as the Professional Tax Study Committee (PTSC) in House Bill 900, Laws of 1994. A copy of House Bill 900 appears in Appendix A. In relevant part, the house bill states:

A. The co-chairmen of the Legislative council, in consultation with the governor, shall appoint a tax study committee. The tax study committee shall be composed of five public members who are experts in the field of tax policy and tax law.

B. The committee shall examine the manner and subjects of taxation and the foundations and goals of current and recommended tax policy. The committee . . . shall report its findings and recommendations, including proposed bill drafts, to the members of the appropriate interim or special legislative committee, the legislative council and the governor prior to the commencement of the forty-third legislature.

As required by House Bill 900, PTSC submits this report of its findings and recommendations, including a proposed bill draft. A summary of PTSC's actions can be found in Appendix B. The Committee emphasizes that the bill draft is not final and is intended only to illustrate, in legislative form, the concepts discussed in this report. The bill may contain technical inaccuracies that the Committee will eliminate as it continues its deliberations.

1. Overview

The members of PTSC are: Janice M. Ahern, a Santa Fe attorney with Gerber, Ahern & Aikin, P.A., Robert J. Desiderio, Committee Chair, Professor of Law, University of New Mexico, James W. Francis, a Hobbs certified public accountant with Johnson, Miller & Co, Brian McDonald, Director, Bureau of

Business and Economic Research, University of New Mexico, and Benjamin C. Roybal, an Albuquerque attorney with Rodey, Dickason, Sloan, Akin, Robb, P.A. PTSC has been served ably by the Legislative Council Service; Jessica Sutin provided support from the PTSC's creation to August 1996, at which time Cleo Griffith began assisting the Committee.

Gail Reese, Taxation and Revenue Department (TRD) Deputy Secretary, attended many of PTSC meetings and shared her knowledge and insight into New Mexico tax law, particularly in the areas of the Motor Vehicles and Leased Vehicles Excise Taxes as well as rule and regulations regarding nontaxable transaction certificates. Laird Graeser, Director of Tax Research and Statistics, also provided the Committee with invaluable research, discussion papers for Committee deliberation and recommendations for possible amendments to current tax law.

The first meeting of PTSC was in May, 1994. Franklin Jones, the late tax attorney and former Commissioner of Taxation, was an important asset during the Committee's initial meetings. Franklin gave Committee members a context in which to understand the current tax structure by providing a full history of New Mexico tax law. In addition, Franklin directed the Committee's initial tax policy discussion by preparing a section by section review of the Gross Receipts and Compensating Tax Act and enumerated, from his perspective, important issues for Committee review.

Since May, 1994, PTSC held regular, monthly meetings that were open to the public. Each meeting was conducted in a fashion that provided for open discussion between Committee members, state agency representatives and interested parties representing individual taxpayers, organizations, associations and business. In this context, the debate between the Committee and the public was unassuming and straightforward. Interested persons who attended committee meetings had ample opportunity on a regular basis to participate in committee discussion, engage committee members in questions and comment on any topic presented on PTSC's agenda.

In addition, committee members responded to written letters and statements presented by interested parties at those meetings where the topic of the letter or statement was on the agenda. In most instances, the Chair gave concerned individuals the occasion to speak on behalf of their particular topic and allowed enough time for a question and answer period. Finally, each committee member took it upon himself and herself to speak with individuals, community organizations

and businesses on the purpose and work of the Committee to educate the public about the progression of committee discussions, review and consideration of tax laws that has ultimately lead to these proposed findings and recommendations of PTSC.

Each PTSC meeting produced technical and well thought deliberations regarding why changes and modifications are necessary for New Mexico's tax system. Committee members have reviewed and discussed scores of issue papers, tax policy articles and reports concerning tax issues in New Mexico and has compiled an extensive library of local, regional and national tax and related fiscal policy materials. The following report is a compilation of committee discussions and debates, issue papers and bill drafts that represent the outcome of the Committee's two year commitment to review New Mexico tax policy. It is important to note, however, that two years was not enough time for the Committee to address each New Mexico tax. This report does not address the Individual Income Tax Act, Severance Taxes and the Property Tax. Because the committee decided to give the gross receipts and compensating taxes, the crux of New Mexico's tax base, long and arduous review, it did not have sufficient time to review these other taxes. In addition, the Committee was only able to begin its deliberations on the Investment Credit Act, Industrial Revenue Bonds and the Corporate Income and Franchise Tax. In order to continue its review of these taxes as well as beginning to examine the taxes that received no consideration, PTSC is requesting an additional two years to extend the important work already initiated by Committee members.

2. Tax Policy Criteria

The charge to PTSC was to review New Mexico's tax laws from a tax policy perspective. In this regard, the Committee's first task was to establish the tax policy criteria necessary to review New Mexico tax law. This criteria was then used as the foundation for determining if a certain tax law was in need of modification or alteration. PTSC adopted the most universally accepted criteria for assessing tax systems: adequacy, equity, efficiency and simplicity.

"Adequacy" gauges the ability of a tax to raise the revenues necessary to fund government spending. It looks more to quantity of revenues produced by the tax system, while the other criteria address the quality of the tax system. A tax,

however, is adequate not only if it generates the requisite revenues in the current year, but also if it is sufficiently elastic to react to changes in the economy.

“Equity” generally means fairness. Fairness is measured in two ways: First, a tax is equitable if taxpayers with the same tax base pay the same amount of tax. This equity measurement is known as “horizontal equity.” Second, fairness is assessed by determining whether taxpayers who have a larger tax base, pay a larger percentage of that base in taxes. This evaluation of a tax is termed “vertical equity.” Vertical equity is the basis for a progressive tax. A progressive tax is one in which taxpayers with larger tax bases are better able to pay the tax otherwise known as the “ability to pay” standard.

“Efficiency” measures the effect of the tax on economic activity within a jurisdiction. Ideally, a tax should be “neutral;” the tax should not cause taxpayers to alter their activity to produce a more favorable tax treatment.

It is well recognized that tax neutrality is impossible. Therefore, the primary goal is to strive for a tax that has the least impact on economic decisions. Indeed, occasions arise when a legislature decides to stimulate certain activity, to aid the economy as a whole or to grant incentives to particular segments of the economy. Investment tax credits are examples of such decisions. Extending favorable tax treatment to selective taxpayers, however, necessarily results in inequitable tax treatment and interferes with the private economy. As such, wise tax policy suggests that tax incentives should be adopted sparingly.

“Simplicity” concerns compliance by both taxpayers and tax collectors. For taxpayers, the tax should be as simple as possible so that they may comply without undue cost and effort. A complex tax system will cause avoidance or incorrect reporting. For tax collectors, administration and enforcement of the tax should not be so costly as to prevent enforcement.

The Committee reviewed other criteria, such as the use of taxation to foster economic development and the exportability of a tax, but opted against their adoption. The use of taxation for economic development creates serious inequities. The Committee concluded that a comprehensive tax, with lower tax rates, would advance more lasting economic development. The Committee also determined that whether or not a tax can be exported is not a valid determinative of a good tax. A tax system that applies the same principles to all taxpayers, no matter who bears the

incidence of the tax, will result in a fair tax and thus advance economic development in New Mexico.

PTSC used these tax policy criteria to test each tax law and make a determination on whether that particular tax is adequate, equitable, efficient and simple. At the same time, Committee members took into consideration how changes to specific tax laws will affect New Mexico's tax system as a whole. In its final determinations, the Committee based its recommendations and findings first on changes made to each tax law under the scrutiny of the above mentioned tax policy criteria, and second on how that change will impact the overall structure of the New Mexico tax system. The overall goal of PTSC is to strike a revenue neutral tax base for the state. PTSC does not advocate an increase or decrease in taxes. In fact, an example of the Committee's goal is its recommendation to decrease the general gross receipts tax rate due to the increase in taxes resulting from other PTSC recommendations that will expand the gross receipts tax base

HOUSE BILL 900

Section 5. TAX STUDY COMMITTEE--CREATION--DUTIES.--

15 A. The co-chairmen of the legislative council, in
16 consultation with the governor, shall appoint a tax study
17 committee. The tax study committee shall be composed of five
18 public members who are experts in the field of tax policy and
19 tax law.
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21 B. The committee shall examine the manner and
22 subjects of taxation and the foundations and goals of current
23 and recommended tax policy. The committee shall review the
24 long-term, strategic planning considerations of the New
25 Mexico horizons task force and shall report its findings and

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1 recommendations, including proposed bill drafts, to the
2 members of the appropriate interim or special legislative
3 committee, the legislative council and the governor prior to
4 the commencement of the forty-third legislature.

5 C. To assist the members of the tax study
6 committee, upon their request, the director of the
7 legislative council service is authorized to contract for the
8 services of a draftsman to perform drafting and research
9 services for the committee.

10 D. Members of the committee may receive per diem
11 and mileage in the manner provided for non-elected public
12 officers in the Per Diem and Mileage Act.