ISSUES FOR HEARING
INVENTORY OF NEW MEXICO TAX EXPENDITURES

Prepared by
Elisa Walker-Moran Chief Economist

SUMMARY:

- Tax expenditures are government spending programs authorized through the tax code. Although tax expenditures are an important component of the state's annual budget, the state does not have a systematic means of reporting and analyzing their effects.

- Per Executive Order 2011-071 the Taxation and Revenue Department will be the lead agency in preparing an annual tax expenditure budget.

- Tax expenditures can be an efficient means of targeting selected populations for benefits, and also of influencing the decisions of private individuals to further the goals of public policy. New Mexico's tax code has hundreds of tax expenditures. Each of New Mexico's major tax programs contains numerous tax expenditures that affect virtually all NM taxpayers.

- These programs give people, groups and businesses special tax credits, deductions, exclusions, exemptions, deferrals, and preferential rates in support of various government policies. Tax expenditures are not limited to economic development incentives. Some of these programs help people save for retirement, buy a home, or pay for college; others encourage companies to invest in green energy technologies; they even subsidize corporations that drill for oil or purchase real estate; and much more.

- Tables 1 through 4 present tax expenditures presently contained in New Mexico statutes along with estimates of the revenue foregone due to each provision. Total general fund revenue foregone in FY13 is estimated at $922 million. Tax expenditures are identified under four categories: Economic development ($84 million); Poverty, Health, and Education ($367 million); Renewable Energy ($24 million); and All Other ($445 million).

- Tax expenditures can be difficult to define and identify. In preparing the tax expenditure budget the key is to properly define a "Tax Expenditure." Tax expenditures do not include provisions that define the proper scope of the tax base, prevent double taxation or avoid interference in interstate commerce.

- A good tax expenditure report is easily accessible by being published annually and on the Web, broad in scope and has all tax expenditures listed, detailed in that it includes current and future cost, description of, and who benefits from each tax expenditure and includes analysis of intended purpose and success in accomplishing that purpose.

LFC HEARING BRIEF

DATE: August 19, 2011

PURPOSE OF HEARING: Inventory of New Mexico's Tax Expenditures

WITNESS: Richard May, Cabinet Secretary, Department of Finance and Administration, Demesia Padilla, Cabinet Secretary, Taxation and Revenue Department; Tom Clifford, Policy and Research Director, TRD

PREPARED BY: Elisa Walker-Moran, Chief Economist, LFC

EXPECTED OUTCOME: Information and update on tax expenditure budget

BACKGROUND INFORMATION

Tax expenditures are government spending programs authorized through the tax code. Although tax expenditures are an important component of the state's annual budget, the state does not have a systematic means of reporting and analyzing their effects. Tax expenditures can be an efficient means of targeting selected populations for benefits, and also of influencing the decisions of private individuals to further the goals of public policy.

However, in the current fiscal environment, a particularly troubling aspect of tax expenditures is that they function like entitlement spending, i.e. anyone who meets the statutory criteria may claim tax benefits. Thus the only way to control the outflow of revenue is to amend the statutes, and the state typically lacks the information needed to craft the appropriate amendments. Although many tax expenditures appear to violate the LFC's principles of good tax policy (see sidebar on page 2), their supporters point to their advantages in meeting other public policy goals. This argument indicates the need to evaluate each of these programs to insure that the foregone public funds are meeting the intended goals with a minimum of waste.

WHAT ARE "TAX EXPENDITURES"?

Tax expenditures are defined in the Congressional Budget Act of 1974 as "revenue losses attributable to provisions of the Federal tax laws which allow a special exclusion, exemption, or deduction from gross income or which provide a special credit, a preferential rate of tax, or a deferral of tax liability."

The idea of "tax expenditures" - tax provisions that are presented as equivalent to governmental outlays - has evolved as part of the budget process in recent decades. Tax payments are viewed from the viewpoint of the government as opposed to the viewpoint of taxpayers. For example, if a taxpayer were asked if the amount of his or her IRA deduction or 401(k) deferral should be properly viewed as the taxpayer's property or as the property of the government, the practical problems of the tax expenditure budget would become even more evident. [1]

New Mexico's tax code has hundreds of tax expenditures. Each of New Mexico's major tax programs contains numerous tax expenditures that affect virtually all NM taxpayers. These programs give people, groups and businesses special tax credits, deductions, exclusions, exemptions, deferrals, and preferential rates in support of various government policies. Tax expenditures are not limited to economic development incentives. Some of these programs help people save for retirement, buy a home, or pay for college; others encourage companies to invest in green energy technologies; they even subsidize corporations that drill for oil or purchase real estate; and much more.

[1] From a 1999 'Tax Expenditures: A Review and Analysis" report by the Joint Economic Committee, US Congress.

LFC TAX POLICY PRINCIPLES:

Adequacy:
Revenue should be adequate to fund needed government services.
Efficiency:
Tax base should be as broad as possible and avoid excess reliance on one tax.
Equity:
Different taxpayers should be treated fairly.
Simplicity:
Collection should be simple and easily understood.
Accountability:
Preferences should be easy to monitor and evaluate.

The Film credit is the largest economic development expenditure.

Tables 1 through 4 present lists of tax expenditures presently contained in New Mexico statutes along with estimates of the revenue foregone due to each provision. The following table summarizes these provisions. Total general fund revenue foregone in FY13 is estimated at $922.8 million. As shown in Tables 1 through 4, local government revenues have been largely held harmless for these provisions, 92 percent of the total fiscal impact is felt by the general fund.

	Target of Expenditures	**Number of Provisions**	**FY13 General Fund Impact ($millions)**
Table 1	Economic Development	20	($84.6)
Table 2	Poverty, Health, Education	30	($367.5)
Table 3	Renewable Energy	13	($24.8)
Table 4	All Other	36	($445.9)
	Total	**99**	**($922.8)**

Source: LFC calculations, TRD.

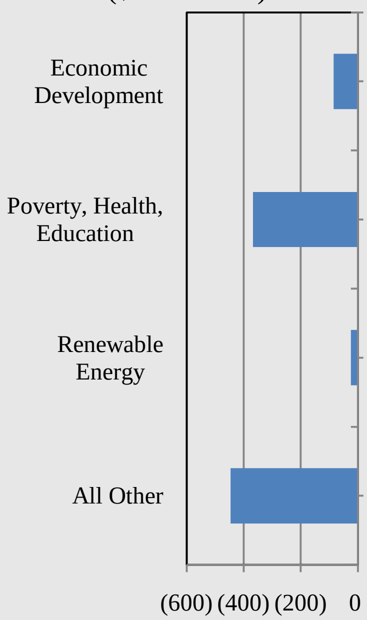
Economic development: Tax expenditures in this category reduce General Fund revenue by $84.6 million in FY13, with the Film credit accounting for largest impact of $50 million. The majority of the state's economic development tax expenditures have been created within the last 10 years. Many of the incentives have little impact.

Many states have increased their use of targeted economic development incentives in recent years. Such incentives may provide a relatively low-cost means of making the state a more attractive place for new investment. However, the state is seldom privy to all the information needed to determine how much incentive should be offered. In addition, targeted incentives create inequities within the tax code. States should be cautious in their use of economic development incentives, and require return on investment proof from those who propose new incentives.

Anti-poverty, health care and education: Health care is targeted with $220.7 million of the total $367.5 million in tax expenditures in this category. The largest components are the Insurance Premiums tax credit for New Mexico Medical Insurance Pool (NMMIP) assessments, and the gross receipts tax (GRT) deduction for managed care medical services. The largest anti-poverty tax expenditures are the working families' tax credit, the low/middle income personal exemption, low income comprehensive tax rebate (LICTR) and the food stamp GRT exemption.

One concern raised by health care tax expenditures is that they deprive the state of funds that could be spent on health care and generate matching

Tax Expenditures
($ in millions)



FY13 General Fund Impacts

To calculate the exact cost of GRT deductions and exemptions requires them to be listed on tax returns. This is burdensome for taxpayers and TRD.

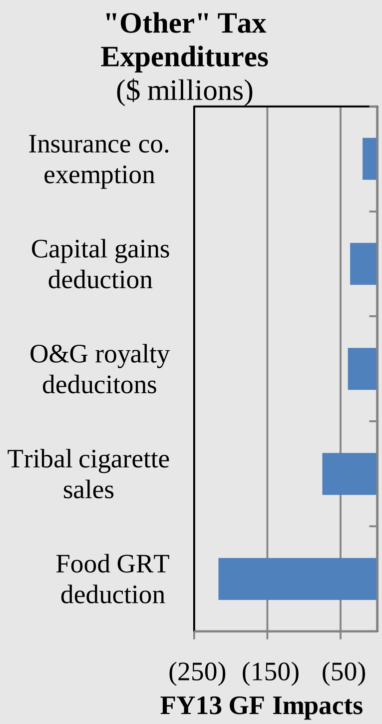
federal funds. Thus, the health care sector may not even be a net beneficiary from the tax breaks. Meanwhile, a "patchwork" of varying tax treatment has been created in which some providers and payments are given preferred treatment, and the fairness of the tax system is called into question.

Through its LICTR, New Mexico has been an innovator in the use of the personal income tax to re-distribute income. These policies have been enhanced in recent years with the addition of the working families' tax credit and the low/middle income personal exemption. These policies play an important role in reducing the "regressivity" of the state's GRT. Although the income tax is a relatively efficient means of delivering these benefits, they do impose an administrative burden on the tax department, which, if not addressed through staffing, could result in funds going to unintended beneficiaries.

Renewable energy and energy conservation: The renewable energy production tax credit at $20 million per year is the largest tax expenditure in this category, followed by the wind-energy equipment deduction at $2 million. The remaining eleven have less than a $3 million impact combined. Actual claims have been lower than this amount in recent years because some taxpayers have failed to utilize all of their credits. However, taxpayers can carry unused credits forward to future years, so $20 million is the total amount of credits the state could end up paying. Also, new projects are eligible for refundable tax credits so no liability is needed to utilize these credits.

Two concerns are raised by these tax expenditures. One is the lack of detailed information and analysis on the "rate of return" the state is receiving. Second, information is lacking on the interaction of these benefits with other subsidies and mandates. In addition to state tax benefits, renewable power investors may benefit from property tax relief, federal income tax relief and from subsidies paid by regulated utilities. In addition, regulated utilities may subsidize these investments through their regulated rate setting because they are mandated to generate specific portions of their power generation from renewable sources.

Other tax expenditures: The tax expenditures that cannot be categorized have grown. Of the total $445.8 million in tax expenditures in this category, $217 million, or 46 percent, is due to the GRT deduction for food sold for home consumption. Some provisions in this category have been in place longer, dating back decades in some cases. Since the provisions in this category address varying purposes, it is difficult to generalize about their effects.



LFC has included a list of tax expenditures in volume 1 of the annual budget recommendation and plans to continue this practice until a formal tax expenditure budget is prepared by TRD.

WHAT PREFERENCES[2] ARE <u>NOT</u> TAX EXPENDITURES?

Tax expenditures can be difficult to identify. They do not include provisions that define the proper scope of the tax base, prevent double taxation or avoid interference in interstate commerce. It is difficult in some cases to make these distinctions. For example, the 50 percent deduction for net capital gain income can be viewed as an incentive to invest in New Mexico or as an attempt to reduce the taxation of inflationary gains, i.e. to define the proper tax base. Another example is the food GRT deduction, which has been excluded from the sales tax base in many states. Developing a tax expenditure list involves subjective judgments.

The broad-based nature of New Mexico's gross receipts tax (GRT) means that many exemptions and deductions are needed just to limit the tax base to something closer to the retail sales taxes imposed in most other states. These are not tax expenditures. Examples include deductions for goods and services sold to governments and non-profit organizations. In addition, the broad base definition of the GRT would have the effect of creating double taxation either within the GRT or when combined with income taxes and other sales taxes. Many exemptions and deductions are needed to prevent such double taxation. Examples include the exemptions for wages, dividends and interest. These are not tax expenditures. Similar issues arise in other tax programs.

Table 5 attached presents a list of 65 tax preference items that do not fit the definition of tax expenditure.

TAX RATE DIFFERENCES

The concept of tax expenditure is not easily applied to differences in tax rates. In part this is because there is no generally accepted definition of the "correct" tax rate for a particular program. The usual approach is to compare to tax rates in other states. This raises two problems: (1) Differences in the tax base definition; and (2) Different taxes play different roles in each state's overall tax system. Comparing tax rates between tax programs – for example the motor vehicle excise tax rate vs. the GRT rate – must also be adjusted for tax base differences. Within a given tax program, different rates are sometimes applied to different industry segments, for example the oil and gas school tax rate on natural gas is 4 percent while the rate on crude oil is 3.15 percent. However, since there is no generally accepted definition of the correct rate, it isn't clear whether oil is taxed too low or gas is taxed too high. Finally, some goods – e.g. liquor and cigarettes -- are taxed at both the wholesale and retail level, so the combined effective tax on these items is larger than suggested by the wholesale tax rate alone.

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[2] The general term "preferences" is used to refer to all types of tax relief including credits, exemptions and deductions.

Average Tax Rate
(% of retail price)

Gross receipts tax	7%
Motor vehicle excise	3%
Oil and gas taxes	8.5%
Hard minerals taxes	1% - 3%
Insurance premiums	3% - 4%
Liquor excise	7.5%
Cigarette	30%
Fuels taxes	6.6%

Source: LFC estimates

The process of appropriating should include a side by side analysis of line item expenditures and a comparison of foregone revenue.

Model Tax Expenditure Reporting States:
1. Louisiana
2. Minnesota
3. Connecticut
4. Oregon

TAX EXPENDITURE ACCOUNTABILITY

Spending through the tax code should be considered the same, or nearly the same as program expenditures. The difference between the two is that tax expenditures reduce revenues and generally bypass the annual legislative review process. Most often, tax expenditures are open-ended with respect to tenure and the amount of foregone revenue. Any review of tax expenditures is generally accomplished as a process toward generating a revenue projection.

For the most part, most tax expenditures start out with a specific public-policy goal – such as poverty reduction, tax payer equity, or job creation; however, once tax expenditures are enacted there is generally no agency held accountable, other than the revenue collecting agency, for the effectiveness of the program. A tax expenditure budget allows policy makers to compare tax incentives benefitting different industries and income levels and to indicate publicly whether they support or oppose certain tax expenditures.

New Mexico, as part of the Accountability in Government Act (AGA), adopted performance based budgeting; however, tax expenditures were not a part of the AGA. Annual review of tax expenditures is necessary to ensure that they are effective, equitable, and accomplishing their intended purpose. Measuring revenue that is foregone alongside an agency's performance goals could improve statewide resource allocation, allowing for re-prioritization during difficult economic times.

Transparency of the tax code improves accountability by providing a complete picture of government spending and subsidies. Tax payers regularly want to know and participate in how their tax dollars are spent. In many cases, it is unclear who actually benefited from a given tax break and what unintended consequences many have occurred. Transparency also helps to avoid cross-agency or governmental subsidies to the same beneficiary – often characterized as corporate welfare.

Elements of a Good Tax Expenditure Report. Although the best practice would be to incorporate tax expenditures into the annual budgetary process, or appropriation bill; most states publish a separate tax expenditure budget report. A good tax expenditure report is a difficult undertaking. Calculating foregone revenue is only the first step. To answer questions like whether the expenditure is achieving its goals requires detailed analysis. Objectivity is required. Agencies or individuals with a vested interest in promoting a program may not provide a reliable assessment of program effectiveness.

To achieve its goals of improving transparency, encouraging accountability, and saving money, a tax expenditure report should have the features listed below:

1. Accessibility. The report should be:
    a. Published regularly.
    b. Incorporated into the budget process.
    c. Available on the Web.

Seven states do not regularly report tax expenditures:

1. Alabama
2. Alaska
3. Indiana
4. Nevada,
5. New Mexico
6. South Dakota
7. Wyoming

August 9, 2011 – Governor Susana Martinez issues Executive Order 2011-071 "Requiring Preparation of an Annual Tax Expenditure Budget"

2. Scope. The report should include:
    a. Tax expenditures related to all taxes.
    b. Explicit and implicit tax expenditures.
    c. Tax expenditures enacted by the state that affect local government.
3. Detail. The report should include:
    a. The cost of the tax expenditure, using current data.
    b. The cost in future years, to allow comparison with other proposed expenditures.
    c. A description of the tax expenditure.
    d. The relevant legal citation and year of enactment.
    e. Detail on the taxpayers who benefit from the tax expenditure.
    f. Separate reporting for the state and local revenue losses, where applicable.
4. Analysis. The report should:
    a. Classify tax expenditures using the same categories as direct spending.
    b. State the intended purpose of the tax expenditure.
    c. Evaluate the extent to which that intended purpose has been accomplished.
    d. Analyze the distribution of benefits by income level and size of business.

Developing such a report will require that taxpayer beneficiaries provide more information than they do now, and the TRD be authorized to release the information. A balance will have to be struck between the need for public information and the taxpayer's need for confidentiality.

Action Steps. On August 9, 2011 Governor Susana Martinez signed an executive order requiring preparation of an annual tax expenditure budget. As ordered by the Governor, the annual tax expenditure budget will be prepared as a joint product of the executive branch agencies. The Taxation and Revenue Department will lead this effort and coordinate with other agencies to develop the budget.

STAFF RECOMMENDATIONS

1. TRD will coordinate with other agencies to define which tax provisions are tax expenditures.
2. TRD will lead other agencies to develop a tax expenditure report to review and analyze the effects of all of its major tax expenditures.
3. New tax expenditure proposals should be subject to thorough review, including detailed information on all major costs and benefits of the proposal.
4. The need for caps and/or sunset provisions should be examined to enable the state to manage the fiscal impacts of tax expenditures in times of falling revenues.

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Table 1: Economic Development Tax Expenditures

Item	NMSA section	Description	Tax Program	Created	Estimated FY13 Fiscal Impacts [1] ($ millions) General Fund	Local gov'ts	Total
1	7-2F	Film production credit	PIT, CIT	2002	(50.0)	-	(50.0)
2	7-9A	Investment credit	CRS	1979	(7.0)	-	(7.0)
3	7-9F	Technology jobs credit	PIT, CIT, CRS	2000	(6.6)	-	(6.6)
4	7-9G-1	High-wage jobs credit	CRS [2]	2004	(5.6)	-	(5.6)
5	7-4-10	Double-weighted sales	CIT	1993	(5.0)	-	(5.0)
6	7-9E	Laboratory small business credit	GRT & Comp.	2000	(3.0)	-	(3.0)
7	7-9-40	Racetrack exemption	GRT & Comp.	1970	(2.0)	-	(2.0)
8	5-15	Tax increment districts	GRT & Comp.	2006	(2.0)	(1.6)	(3.6)
9	7-9-86	Sales to film companies	GRT & Comp.	1995	(1.0)	(0.8)	(1.8)
10	7-2E	Rural jobs credit	PIT, CIT, CRS	1999	(0.7)	-	(0.7)
11	7-9-106	Military construction	GRT & Comp.	2007	(0.5)	(0.3)	(0.8)
12	7-9H	R&D small business credit	CRS	2005	(0.2)	-	(0.2)
13	7-9-13.3	Baseball stadium exemption	GRT & Comp.	2001	(0.2)	(0.2)	(0.4)
14	7-9-94	Military transformation programs	GRT & Comp.	2005	(0.2)	(0.1)	(0.3)
15	7-2-18.17	Angel investment credit	PIT	2007	(0.1)	-	(0.1)
16	7-9-54.2	Spaceport deduction	GRT & Comp.	2001	(0.1)	(0.0)	(0.1)
17	7-9-54.4, -54.5	Space test articles	GRT & Comp.	2003, 2004	(0.1)	(0.1)	(0.2)
18	7-9-26.1	Space vehicle fuel deduction	GRT & Comp.	2003	(0.1)	(0.1)	(0.2)
19	7-9-57.2	Software services in rural areas	GRT & Comp.	2002	(0.1)	(0.1)	(0.2)
20	7-9-107	Boxing promotion	GRT & Comp.	2007	(0.1)	(0.1)	(0.2)
21		Industrial Revenue Bonds [3]	Property Tax		-	na	na
		Total			**(84.6)**	**(3.4)**	**(88.0)**

Notes: 1. Estimates are preliminary and subject to revision.
2. Credits can be applied against Withholding, GRT, Compensating and other CRS taxes.
3. Estimates are not available at this time.

Table 2: Tax Expenditures to Relieve Poverty, Improve Health and Education

Item	NMSA section	Description	Tax Program	Created	Estimated FY13 Fiscal Impacts [1] ($ millions)		
					General Fund	Local gov'ts	Total
		Premiums tax credit for NMMIP assessments	Ins. Premiums		(77.0)	-	(77.0)
1	7-9-93	Managed care medical services deduction	GRT & Comp.	2004	(75.0)	-	(75.0)
2	7-2-18.15	Working families credit	PIT	2007	(45.0)	-	(45.0)
3	7-2-5.8	Low-/middle income exemption	PIT	2005	(30.0)	-	(30.0)
4	7-2-14	LICTR	PIT	1972	(24.0)	-	(24.0)
5	7-9-18.1	Food stamp exemption	GRT & Comp.	1987	(20.0)	(17.0)	(37.0)
6	7-2-5.2	Over-65 or blind exemption	PIT	1985	(19.0)	-	(19.0)
7	7-9-73.2	Prescription drugs deduction	GRT & Comp.	1998	(19.0)	(16.0)	(35.0)
8	7-9-96.1	Hospital receipts credit	GRT & Comp.	2007	(12.5)	-	(12.5)
9	7-9-77.1	Medicare medical services deduction	GRT & Comp.	1998	(12.0)	(10.0)	(22.0)
10	7-9-73.1	50% of for-profit hospital receipts deduction	GRT & Comp.	1991	(11.0)	(9.0)	(20.0)
11	7-2-18.22	Rural health practitioner credit	PIT	2007	(5.0)	-	(5.0)
12	7-2-35	Uncompensated care deduction	PIT	2000	(3.5)	-	(3.5)
13	7-2-18	Over-65 property tax rebate	PIT	1977	(3.5)	-	(3.5)
14	7-2-32	Education trust deduction	PIT	1997	(2.0)	-	(2.0)
15	7-9-96.2	Unreimbursed services credit	GRT & Comp.	2007	(2.0)	-	(2.0)
16	7-2-18.1	Child care expense credit	PIT	1981	(1.5)	-	(1.5)
17	7-2-18.16	Special needs child adoption	PIT	2007	(1.0)	-	(1.0)
18	7-9-16	Non-profit nursing home exemption	GRT & Comp.	1970	(1.0)		(1.0)
19	7-9-73	Prosthetic device deduction	GRT & Comp.	1970	(1.0)	-	(1.0)
20	7-9-111	Hearing and vision aids deduction	GRT & Comp.	2007	(0.9)	(0.7)	(1.6)
21	7-9-99, -100	Hospital construction deduction	GRT & Comp.	2006	(0.4)	(0.3)	(0.7)
22	7-2-5.6	Medical savings accounts	PIT	1995	(0.2)	-	(0.2)
23	7-2-5.9, 7-2-18.13	Over-65 uncompensated medical care	PIT	2005	(0.2)	-	(0.2)
24	7-9-41	Religious organization exemption	GRT & Comp.	1972	(0.2)	(0.1)	(0.3)
25	7-2-36	Organ donor expenses	PIT	2005	(0.1)	-	(0.1)
26	7-2-18.5, 7-2A-8.8	Welfare-to-work credit	PIT, CIT	1998	(0.1)	-	(0.1)
27	7-2-14.3	Low-income property tax rebate	PIT	1994	(0.1)	-	(0.1)
28	7-2A-14	Corporate child care deduction	CIT	1983	(0.1)	-	(0.1)
29	7-9I	Affordable housing credit	CRS, PIT, CIT	2005	(0.1)	-	(0.1)
30	7-2A-17.1, 7-2-18.11	Job mentorship credit	CIT. PIT	2003	(0.1)	-	(0.1)
		Total			**(367.5)**	**(53.1)**	**(420.6)**

Notes: 1. Estimates are preliminary and subject to revision.
2. Credits can be applied against Withholding, GRT, Compensating and other CRS taxes.

Table 3: Renewable Energy and Energy Conservation Tax Expenditures

Item	NMSA section	Description	Tax Program	Created	Estimated FY13 Fiscal Impacts [1] ($ millions) General Fund	Local gov'ts	Total
1	7-2-18.8, 7-2A-19	Renewable energy production credit	PIT, CIT	2002	(20.0)	-	(20.0)
2	7-9-54.3	Wind energy equipment deduction	GRT & Comp.	2002	(2.0)	(1.0)	(3.0)
3	Laws 2010, Ch. 78	Solar generating facility deduction	GRT & Comp.	2010	(0.8)	(0.3)	(1.1)
4	7-2-18.14	Solar market development credit	PIT	2006	(0.6)	-	(0.6)
5	7-2-18.19, 7-2A-21	Sustainable building credit	PIT, CIT	2007	(0.4)	-	(0.4)
6	7-9G-2, 7-2A-25, 7-2-18.25	Advanced energy credit	CRS, PIT, CIT	2007	(0.1)	(0.1)	*
7	7-9J	Altern. Energy manufacturer's credit	CRS	2007	(0.1)	(0.1)	*
8	7-2-18.21, 7-2A-23	Blended biodiesel fuel credit	PIT, CIT	2007	(0.1)	-	(0.1)
9	7-9-98	Biomass deductions	GRT & Comp.	2005	(0.1)	(0.1)	(0.2)
10	7-9-101, -102, -103	Renewable energy transmission authority	GRT & Comp.	2007	(0.1)	(0.1)	(0.2)
11	7-9-112	Solar energy systems deduction	GRT & Comp.	2007	(0.1)	(0.1)	(0.2)
12	7-9-113	Vegetable oil for special fuels	GRT & Comp.	2009	(0.1)	(0.1)	(0.2)
13	Laws 2011, Ch 108	Plant photosynthesis as alternative energy	GRT & Comp.	2011	(0.3)	-	(0.3)
		Total			**(24.8)**	**(1.9)**	**(26.3)**

Notes: 1. Estimates are preliminary and subject to revision.
2. Credits can be applied against Withholding, GRT, Compensating and other CRS taxes.

Table 4: Other Tax Expenditures

Item	NMSA section	Description	Tax Program	Created	Estimated FY13 Fiscal Impacts [1] ($ millions)		
					General Fund	Local gov'ts	Total
1	7-9-92	Food for home consumption deduction	GRT & Comp.	2004	(217.0)	-	(217.0)
2	7-12-4	Tribal sales exemption	Cigarette	1992	(75.0)	-	(75.0)
3	7-31-5	Royalty deductions	O&G School	1959	(40.0)	-	(40.0)
4	7-2-34	Exclusion of 50% of capital gains	PIT	2003	(37.0)	-	(37.0)
5	59A-6-6	Insurance company exemption	CIT	1984	(20.0)	-	(20.0)
6	7-2-5.1	Armed forces salary exemption	PIT	2007	(12.0)	-	(12.0)
7	7-9-56	Intrastate transportation	GRT & Comp.	1994	(12.0)	(2.0)	(14.0)
8	7-9-24	Insurance not subject to premiums tax	GRT & Comp.	1969	(6.0)	(5.0)	(11.0)
9	7-9-30	Railroad, aircraft, space vehicle deduction	Comp.	1969	(6.0)	(1.5)	(7.5)
10	7-9-87	Lottery tickets and commissions deduction	GRT & Comp.	1995	(6.0)	(4.0)	(10.0)
11	7-9-95	Back-to-school sales tax "holiday"	GRT & Comp.	2005	(2.7)	(2.2)	(4.9)
12	7-2-18.10, 7-2A-8.9	Open space land donation credit	PIT, CIT	2003	(2.5)	-	(2.5)
13	7-9-7.1	Compensating tax estoppel on households	Comp.	1993	(2.0)	(0.4)	(2.4)
14	7-9-63, -64	Newspapers, magazines deduction	GRT & Comp.	1969	(2.0)	(1.6)	(3.6)
15	7-9-61.2	Sals to credit unions deduction	GRT & Comp.	2000	(1.0)	(0.8)	(1.8)
16	7-9-20, -39	Fees of social organizations	GRT & Comp.	1988	(1.0)	(0.8)	(1.8)
17	7-2-18.20	Ag. Water conservation credit	PIT	2007	(0.5)	(0.3)	(0.8)
18	7-25-3	Royalty deductions	Resources	1966	(0.5)	-	(0.5)
19	7-12-7	Cigarette stamp discount	Cigarette	1943	(0.3)	-	(0.3)
20	7-2-18.2, 7-2A-8.6	Cultural property preservation credit	PIT, CIT	1984	(0.2)	-	(0.2)
21	7-9-13.4	Textbook exemption	GRT & Comp.	2002	(0.2)	(0.2)	(0.4)
22	7-2-18.8, 7-2A-18	Electronic I.D, equipment deduction	PIT, CIT	2001	(0.1)	(0.1)	(0.2)
23	7-2-5.10	Nat'l guard insurance exemption	PIT	2006	(0.1)	(0.1)	(0.2)
24	7-2-5.7	Over age 100 exemption	PIT	2002	(0.1)	-	(0.1)
25	7-9-97	Mining reclamation bond deduction	GRT & Comp.	2005	(0.1)	(0.1)	(0.2)
26	7-9-13.5	Municipal event center charges	GRT & Comp.	2005	(0.1)	(0.1)	(0.2)
27	7-9-41.3	Disabled street vendor deduction	GRT & Comp.	2007	(0.1)	(0.1)	(0.2)
28	7-9-41.1	University athletic event deduction	GRT & Comp.	2007	(0.1)	(0.1)	(0.2)
29	7-9-56.3	Border trade companies deduction	GRT & Comp.	2003	(0.1)	(0.1)	(0.2)
30	7-9-89	Sales to diplomats	GRT & Comp.	1998	(0.1)	(0.1)	*
31	7-9-83	Jet fuel deduction	GRT & Comp.	1993	-	(1.0)	(1.0)
32	7-29B-3	Reduced O&G tax rate for stripper wells	O&G School	1995	-	-	-
33	7-2-18.4, 7-2A-15	Business facility rehabilitation credit	PIT, CIT	1994	*	*	*
34	Laws 2010, Ch 31	Gaming tax credit (counties reimbursed)	GRT	2010	(0.3)	-	(0.3)
35	Laws 2010, Ch 84	Transport of dairy waste	PIT, CIT	2010	(0.7)	-	(0.7)
		Total			**(445.8)**	**(20.6)**	**(466.2)**

Notes: 1. Estimates are preliminary and subject to revision.
2. Credits can be applied against Withholding, GRT, Compensating and other CRS taxes.

Table 5: Deductions and Exemptions that are not Tax Expenditures

Item	NMSA Section	Description	Tax Program	Explanation
1	7-9-18	Agricultural products exemption	GRT & Comp.	Anti-pyramiding
2	7-9-3.3	Third-party call center operations	GRT & Comp.	Anti-pyramiding
3	7-9-3.5	Interest income	GRT & Comp.	Avoids double-taxation
4	7-9-3.5	Agents' income	GRT & Comp.	Anti-pyramiding
5	7-9-3.5	Florists' receipts on out-of-state sales	GRT & Comp.	Avoids double-taxation
6	7-9-3.5	Government receipts	GRT & Comp.	Not in typical retail sales tax base
7	7-9-13.1	Imported services	GRT & Comp.	Not in typical retail sales tax base
8	7-9-15, -60	Non-profit purchases	GRT & Comp.	Not in typical retail sales tax base
9	7-9-29, -85	Non-profit sales	GRT & Comp.	Not in typical retail sales tax base
10	7-9-17	Wages	GRT & Comp.	Avoids double-taxation
11	7-9-25	Dividends & interest	GRT & Comp.	Avoids double-taxation
12	7-9-18	Livestock, unprocessed ag. Products	GRT & Comp.	Anti-pyramiding
13	7-9-19	Livestock services	GRT & Comp.	Anti-pyramiding
14	7-9-109	Veterinary services for livestock	GRT & Comp.	Anti-pyramiding
15	7-9-22, -23	Motor vehicles	GRT & Comp.	Avoids double-taxation
16	7-9-22.1, -23.1	Boats	GRT & Comp.	Avoids double-taxation
17	7-9-24	Insurance receipts subject to premiums tax	GRT & Comp.	Avoids double-taxation
18	7-9-26	Fuels subject to other taxes	GRT & Comp.	Avoids double-taxation
19	7-9-28	Occasional sales	GRT & Comp.	Reduced administrative/compliance burden
20	7-9-47, -48, -96	Sales for re-sale	GRT & Comp.	Anti-pyramiding
21	7-9-32	O&G mineral interests	GRT & Comp.	Avoids double-taxation
22	7-9-33	O&G products subject to other taxes	GRT & Comp.	Avoids double-taxation
23	7-9-34	Gas processing subject to NGPT	GRT & Comp.	Avoids double-taxation
24	7-9-35	Resources subject to resource excise tax	GRT & Comp.	Avoids double-taxation
25	7-9-36, -37	O&G used in pipeline transportation	GRT & Comp.	Anti-pyramiding
26	7-9-38	Electricity used in production & transportation	GRT & Comp.	Anti-pyramiding
27	7-33	Gas products used in production	NGPT	Anti-pyramiding
28	7-9-46	Manufacturers' ingredients	GRT & Comp.	Anti-pyramiding
29	7-9-49, -50, -78	Sale/leasing for re-leasing	GRT & Comp.	Anti-pyramiding
30	7-9-51, -52	Construction materials/services for re-sale	GRT & Comp.	Anti-pyramiding
31	7-9-53	Sale/lease of real property	GRT & Comp.	Avoids double-taxation
32	7-9-14, -54	Sales to governments	GRT & Comp.	Not in typical retail sales tax base
33	7-9-54.1	Aerospace services to the USAF	GRT & Comp.	Not in typical retail sales tax base
34	7-9-55	Interstate commerce	GRT & Comp.	Not in typical retail sales tax base
35	7-9-56.1	Internet services for re-sale	GRT & Comp.	Anti-pyramiding
36	7-9-56.2	Website hosting	GRT & Comp.	Anti-pyramiding
37	7-9-57	Services for export	GRT & Comp.	Not in typical retail sales tax base
38	7-9-57.1	Internet sales for export	GRT & Comp.	Not in typical retail sales tax base
39	7-9-58	Feed, fertilizer	GRT & Comp.	Anti-pyramiding

Table 5: Deductions and Exemptions that are not Tax Expenditures

Item	NMSA Section	Description	Tax Program	Explanation
40	7-9-59	Warehousing agricultural products	GRT & Comp.	Anti-pyramiding
41	7-9-61.1	Loan origination fees	GRT & Comp.	
42	7-9-62, -77	Agricultural implements, aircraft	GRT & Comp.	Anti-pyramiding
43	7-9-62.1	Aircraft services	GRT & Comp.	Anti-pyramiding
44	7-9-65	Chemicals to mining industry	GRT & Comp.	Anti-pyramiding
45	7-9-66	Sales commissions on tangible property	GRT & Comp.	Anti-pyramiding
46	7-9-66.1	Sales commissions on real property	GRT & Comp.	Anti-pyramiding
47	7-9-67	Bad debt	GRT & Comp.	Avoids taxation of non-existent receipts
48	7-9-68	Warranty services	GRT & Comp.	Anti-pyramiding
49	7-9-69	Admin, & accounting services for affiliate	GRT & Comp.	Anti-pyramiding
50	7-9-70	Lease of vehicles for interstate travel	GRT & Comp.	Not in typical retail sales tax base
51	7-9-71	Trade-in allowances	GRT & Comp.	Avoids double-taxation
52	7-9-74	Property in jewelry manufacturing	GRT & Comp.	Anti-pyramiding
53	7-9-75	Certain services to manufacturers	GRT & Comp.	Anti-pyramiding
54	7-9-76	Certain travel agents' commissions	GRT & Comp.	Anti-pyramiding
55	7-9-76.1	Manufactured homes	GRT & Comp.	Avoids double-taxation
56	7-9-76.2	Leasing films for re-lease	GRT & Comp.	Anti-pyramiding
57	7-9-78.1	Uranium plant equipment	GRT & Comp.	Anti-pyramiding
58	7-2-13, -79, -79.1	Credit for taxes to another state	GRT & Comp.	Avoids double-taxation
59	7-2A-16, 7-29C, 7-9-88.1, -88.2	Credit for taxes to a tribe	GRT & Comp.	Avoids double-taxation
60	7-9-90	Uranium enrichment services	GRT & Comp.	Anti-pyramiding
61	7-9-108	Mutual fund services	GRT & Comp.	Anti-pyramiding
62	7-9-96	Credit for certain services for re-sale	GRT & Comp.	Anti-pyramiding
63	7-25, 7-31	Processing cost deductions	O&G school, Resources	Anti-pyramiding
64	7-29, 7-30, 7-31, 7-32	Trucking cost deductions	O&G taxes	Avoids double-taxation
65	7-2-2.3	Interest on U.S. debt issues	PIT	Federal pre-emption

ISSUES FOR HEARING

Tax Expenditures: Best Practices in Other States

Prepared by
Leila Burrows, Economist with assistance from the Taxation and Revenue Department

LFC staff with assistance from TRD researched state reports to determine best practices in preparing and publishing a tax expenditure budget. This research uncovered variety in when, how, and by whom states' tax expenditure budgets are published.

- During the 2011 legislative session, House Bill 161 and Senate Bill 47 were passed requiring the Taxation and Revenue Department (TRD) to report annually on tax expenditures and dedicated revenue budgets.

- The governor vetoed both bills. In her veto message, the governor stated she wants a thorough review of all tax credits and will issue an executive order requiring the TRD to compile all expenditure information.

- On August 12, 2011, Governor Martinez issued an executive order requiring the preparation of an annual tax expenditure budget by the TRD in conjunction with other executive agencies.

- If properly designed and implemented, a tax expenditure report adds transparency and accountability to the taxation and spending processes. Proper monitoring of tax expenditures combined with revision of poorly targeted incentives could lead to increased revenues.

- Of the 50 states and Washington, D.C., 44 states regularly publish some sort of tax expenditure report, and 35 states have statutory requirements that a tax expenditure budget be prepared on a regular basis (see Table 1). Four other states, including New Mexico, have published a one-time or irregularly released report.

- Most states included analysis of tax expenditures affecting personal income taxes, corporate income taxes, and sales/use taxes. Excise taxes were also commonly reported. Other types of taxes that were included less frequently were property tax, severance tax, estate tax, and other taxes.

LFC HEARING BRIEF

DATE: August 19, 2011

PURPOSE OF HEARING: Tax Expenditures: Best Practices in Other States

WITNESS: Leila Burrows, Economist, LFC

PREPARED BY: Leila Burrows, Economist with assistance from TRD

EXPECTED OUTCOME: Information and update on tax expenditure report best practices.

BACKGROUND INFORMATION

During the 2011 legislative session, several bills were passed requiring examination of the effectiveness of tax credits and other revenue measures, including House Bill 161 and Senate Bill 47. The governor vetoed both bills, which would have required the Taxation and Revenue Department (TRD) to report annually on tax expenditures and dedicated revenue budgets. In her veto message, the governor stated she wants a thorough review of all tax credits and will issue an executive order requiring the TRD to compile all expenditure information.

On August 12, 2011, Governor Martinez issued an executive order requiring the preparation of an annual tax expenditure budget by the TRD in conjunction with other executive agencies. If properly designed and implemented, a tax expenditure report adds transparency and accountability to the taxation and spending processes. Proper monitoring of tax expenditures combined with revision of poorly targeted incentives could lead to increased revenues.

SUMMARY OF STATE TAX EXPENDITURE REPORTS

The TRD in collaboration with LFC staff researched state reports to determine best practices in preparing and publishing a tax expenditure budget. This research uncovered variety in when, how, and by whom states' tax expenditure budgets are published. The results of this research, which are summarized in Table 1, gauge the feasibility of publishing a tax expenditure budget for New Mexico and suggest a breadth of topics that might be included.

Of the 50 states and Washington, D.C., 44 states regularly produce tax expenditure reports. 35 states have statutory requirements that a tax expenditure budget be prepared on a regular basis, typically coinciding with the preparation of the executive budget recommendation. In those states without statutory requirements, tax expenditure budgets were produced due to a department's initiative or some other unknown reason. Four other states, including New Mexico, have published a one-time or irregularly released report.

Of the tax expenditure budgets reviewed, reports were predominantly produced by Departments of Revenue or Finance. One was published by a legislative agency, one was published by a governor's office, and one by a third-party agency (the University of Missouri). Other executive publishing agencies included Department of Treasury, Office of the Comptroller, or a research division.

Tax expenditure budgets vary greatly by the types of taxes reported. Most states included analysis of tax expenditures affecting personal income taxes, corporate income taxes, and sales/use taxes. Excise taxes on items such as liquor, tobacco, fuel, and motor vehicles were also commonly reported. Other types of taxes that were included less frequently were property tax,

Why Review Tax Expenditures?
- Transparency/Simplicity
- Fiscal Discipline
- Political Accountability

severance tax, estate tax, and other taxes. In general, tax expenditure reports contain a listing of various tax expenditures but do not include holistic analysis of economic development incentives.

Appendix 1 summarizes a partial list of state reports and the respective methodology.

In addition to these state reports, Congress' Joint Committee on Taxation and the Department of Treasury each include estimates of tax expenditures in their annual budget.

TAX EXPENDITURE BUDGET HIGHLIGHTS FROM STATES USING BEST PRACTICES
To determine the criteria necessary for an effective analysis of New Mexico tax expenditures, TRD and LFC staff selected two states thought to be using best practices for further analysis: Louisiana and Minnesota. For comparison, TRD and LFC staff also analyzed one of the least useful reports to illustrate the wrong approach to tax expenditure reporting: Maryland. The findings from this research are below.

Louisiana (Model Approach). The Louisiana Department of Revenue is required by statute to prepare an annual tax exemption budget. This report must include the following information:

- List of each exclusion, exemption, credit, refund, preferential tax rate, and deferred tax liability;
- Legal citation for each tax expenditure;
- Purpose of each tax expenditure;
- Estimate of the revenues lost for the preceding three, current and ensuing fiscal years;
- Estimated cost of administering and implementing each tax expenditure for the five years reflected in the report;
- Determination of each tax expenditure's effectiveness in fulfilling its intended purpose;
- Assessment of whether the tax expenditure is the most effective means to achieve its intended purpose, whether it has any inadvertent consequences or legal conflicts, and whether it simplifies or complicates the tax system.

Louisiana officials use tax returns to calculate the cost of tax expenditures whenever possible. When tax return data is not available, other sources must be found to estimate the cost, and they caution that estimates are only as good as their assumptions. The Louisiana tax expenditure budget also allows use costs to be described with terms such as "negligible" for costs less than $10 thousand, and "unable to anticipate" when no reasonable estimate can be made.

Of particular note, the Louisiana tax expenditure report includes a comparison of major tax exemptions for sales, personal income and corporate income taxes with exemptions in other southeastern states.

Model Tax Expenditure Reporting States:

1. Louisiana
2. Minnesota
3. Connecticut
4. Oregon

Seven states do not regularly report tax expenditures:

1. Alabama
2. Alaska
3. Indiana
4. Nevada
5. New Mexico
6. South Dakota
7. Wyoming

While a tax expenditure considered in isolation may appear to have minimal costs, the cumulative total of revenue foregone due to tax expenditures is significant. For example, Louisiana estimates that in FY10 about $7.1 billion of its revenue base was foregone due to tax expenditures – almost equaling the $7.7 billion state general fund appropriation.[1] These numbers should be used with caution, however, as they are estimates of foregone revenue in many cases and do not take into account any economic impacts caused by the preferential treatment.

Even though it is tempting to aggregate individual estimates, doing so will not provide a realistic amount of revenue that could be gained from repealing multiple expenditures simultaneously. Each individual estimate must be made with the assumption that the rest of the tax code stays the same. If even two expenditures were eliminated at the same time their aggregate impact would be much less than the sum of each by itself.

Minnesota (Model Approach). The Minnesota Department of Revenue is required by statute to produce an annual tax expenditure budget by February 1 of each even-numbered year. The report must contain data for at least three fiscal years and must include every tax provision that meets the criteria listed below.

A provision is a tax expenditure if it:

- has an impact on a tax that is applied statewide;
- confers preferential treatment;
- results in reduced tax revenue in the applicable fiscal years;
- is not included as an expenditure item in the state budget;
- is included in the defined tax base for that tax;
- is not subject to an alternative tax; and
- can be amended or repealed by a change in state law.

For individual tax expenditures, the report identifies statutory reference, the year enacted, and an estimate of foregone revenue. The report also contains a description of the intended purpose of each tax expenditure, effectiveness at achieving that purpose, its effect on distribution of the tax burden across the state, and any administrative implications.

The most recent version, which contains estimates for fiscal years 2010 through 2013, details tax expenditures in 16 different tax programs. Data sources for the report include state and federal tax returns, and federal tax expenditure estimates.

Statute requires that the tax expenditure budget must include its cost of production, which was $130 thousand in the most recent publication.

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[1] Louisiana 2010-2011 Tax Exemption Budget, http://www.rev.state.la.us/forms/publications/TEB(2010)WEB.pdf and Louisiana State Budget Fiscal Year 2010-2011, http://doa.louisiana.gov/opb/pub/FY11/FY10-11_StateBudget.pdf

Maryland (Poor Approach). The Maryland Department of Budget and Management is required by statute to prepare a biennial report estimating the revenue loss resulting from tax expenditures.

Maryland's report does include an important piece of analysis that is not included in many reports. The report distinguishes between structural exemptions, which are determined to be such an integral component of tax law that repeal would require complete overhaul of the tax system and categorical tax expenditures, which can be defined as narrowly-targeted provisions with more or less discernable policy goals. The report also isolates incidental expenditures, which are designed to solve administrative problems or to avoid double-taxation.

Some of the primary limitations of the Maryland tax expenditure include the following:

- The report fails to include any qualitative analysis of the tax expenditures that would determine whether the expenditures have achieved their intended purpose.
- Although in some cases, Maryland used data provided by those state agencies that administered the tax, in many instances, the agency relied only on estimates. Personal and corporate income tax returns were not consulted.
- The report contains dozens of cost estimate omissions.

Brief descriptions of 14 tax expenditure reports are included in Appendix 1. Appendix 2 includes a recommended list of criteria necessary for an effective tax expenditure report.

LB/svb

Table 1: Tax Expenditure Budget Features in All States

State	Reporting Agency	Published	Most Recent FY	Personal Income	Corporate Income	Fiduciary Income	Corporate Franchise	Sales and Use	Property	Severance	Estate	Excise	Gift	Insurance Premium	Description	Estimate Cost	Estimate Benefit
AL	None																
AK	Dept. of Revenue	One-time release	2010-12		X				X	X	X	X		X	X		
AR	Dept. of Finance and Administration	Annual	2011	X	X			X							X		
	Dept. of Finance and Administration	Ad hoc	2008					X							X	X	
AZ	Dept. of Revenue	Annual	2009/10	X	X	X	NA		X	X	X	X	NA	X	X	X	
CA	Dept. of Finance	Annual	2010	X	X			X	X		NA	X	NA	X	X	X	X
	Franchise Tax Board	Annual	2010-12	X	X		X								X	X	X
CO	Dept. of Revenue	Annual	CY 2009					X							X	X	
CT	Legis: Fiscal Analysis	Biennial	2011	X	X			X	X		X	X	X	X	X	X	
DC	Office of the Chief Financial Officer	Biennial	2010-13	X	X		X	X	X					X	X	X	
DE	Dept. of Finance	Biennial	2010	X	X				NA			X			X	X	X
FL	Office of Economic and Demographic Research	Annual	2011	NA	X			X		X		X		X	X	X	
GA	Fiscal Research Center	Annual	2012	X	X			X	X			X		X	X	X	
HI	Dept. of Taxation	Rare	TY 2005	X	X	X						X		X	X	X	
IA	Dept. of Revenue	Pentannual release	TY 2005	X	X			X					NA		X	X	
	Dept. of Revenue	Annual	2007	X	X	X	X						NA	X	X	X	
ID	Dept. of Financial Management	Annual	2011	X	X			X							X	X	
IL	Office of the Comptroller	Annual	2009	X	X		X	X	X			X		X	X	X	
IN	Budget Agency	One-time release	TY 05-07	X											X	X	
KS	Dept. of Revenue	Annual	2010	X	X	X		X	X	X		X			X	X	
KY	Office of State Budget Director	Biennial	2010-12	X	X		X	X	X	X	X	X		X	X	X	
LA	Dept. of Revenue	Annual	2011	X	X		X	X		X		X	X		X	X	
ME	Dept. of Administrative and Financial Services	Biennial	2012-13	X	X			X	X			X			X	X	X
MD	Dept. of Budget and Management	Biennial	2010	X	X			X	X			X		X	X	X	
MA	Dept. of Revenue	Annual	2012	X	X			X					NA		X	X	
MI	Dept. of Treasury	Annual	2011	X	X			X	X	X		X		X	X	X	
MN	Dept. of Revenue	Biennial	2010-13	X			X	X	X		X	X	NA	X	X	X	
MS	Center for Policy Research and Planning	Annual	2011	X	X		X	X		X				X	X	X	
MO	Dept. of Economic Development	Annual	CY09						Examines economic incentives						X		
	Univ. of Missouri	Discontinued	2003-13	X	X		X	X			X	X	NA	X	X	X	
	Tax Credit Review Commission	One-time release	2010	X	X		X	X	X		X		NA	X	X	X	

Table 1: Tax Expenditure Budget Features in All States

State	Reporting Agency	Published	Most Recent FY	Personal Income	Corporate Income	Fiduciary Income	Corporate Franchise	Sales and Use	Property	Severance	Estate	Excise	Gift	Insurance Premium	Description	Estimate Cost	Estimate Benefit
MT	Dept. of Revenue	Biennial	2010	X	X		X	NA	X	X					X	X	
NE	Dept. of Revenue	Biennial	2010	X	X	X	X	X	X	X	X	X		X	X	X	
NV	None																
NH	Dept. of Revenue Administration	Annual	2011		X			X						X	X	X	
NJ	Department of the Treasury	Annual	2010-12		X			X	X		X	X			X	X	
NM	Taxation and Revenue Dept	One-time release	2004-10	X	X			X	X	X		X		X	X	X	
NY	Office of Taxation and Finance	Annual	2011-12	X	X		X	X	X	NA	X	X		X	X	X	
	Office of Taxation and Finance	Annual	2010						X						X	X	X
	Office of Taxation and Finance	Annual	CY 2006				X								X	X	X
NC	Policy Analysis and Statistics Division	Biennial	2010	X	X		X	X	X			X		X	X	X	X
ND	Office of State Tax Commissioner	Biennial	2011	X	X			X	X	X	X	X		X	X	X	
OH	Dept of Taxation	Biennial	2010-13	X			X	X			X	X		X	X	X	
OK	Tax Commission	Biennial	2010	X	X		X	X			X	X			X	X	
OR	Dept. of Revenue	Biennial	2011-13	X	X			NA	X	X		X		X	X	X	X
PA	Governor's Office of the Budget	Annual	2011/12	X	X		X	X	X		X	X		X	X	X	X
RI	Dept. of Revenue	Biennial	CY08 -11	X	X		X	X	X		X	X		X	X	X	
SC	Budget and Control Board	Irregular release	2009					X							X	X	
SD	None																
TN	Dept. of Finance and Administration	Annual	2012				X	X				X			X	X	
TX	Office of the Comptroller	Biennial	2011-16	NA	NA	NA	X	X	X			X			X	X	
UT	Tax Commission	Annual	2010	X			X	X	X						X		
VT	Dept. of Taxation	Biennial	2012	X	X		X	X	X					X	X	X	X
VA	Dept. of Taxation	Annual	2011					X							X	X	X
WA	Dept. of Revenue	Quadrennial	2011					X	X		X	X		X	X	X	X
WV	Dept. of Taxation	Different pieces released on a three-year rotation	2010	X	X		X				NA				X	X	
WI	Dept. of Revenue Dept. of Administration	Biennial	2010	X	X		X	X	X	X	X	X		X	X	X	
WY	None																

Source: NM Taxation and Revenue Dept and LFC Files

APPENDIX 1: Survey of State Tax Expenditure Studies

Neighboring States:

Arizona. The Arizona Department of Revenue prepares an annual expenditure report following statutory requirements. The report contains sections for all taxes imposed by the state; however, the individual income tax section of this report contains only tax credit data. A detailed explanation and approximate cost of the provision are analyzed if possible, and a summary is provided at the end of each with a total value of the tax expenditure. The report assumes no consideration of decreased demand as a result of higher taxes. As with other reports, the estimated costs should not be used as an exact representation of what would occur in later years.

Colorado. The Colorado Department of Revenue presents a table of sales tax exemptions by statute number every year. The table only includes statute, tax exemption areas, estimated cost, enacted date and sunset date.

Oklahoma. The Oklahoma Tax Commission has recently issued the 10th biennial expenditure report for FY2010. This report includes as many statutory tax expenditures and revenue estimates for provisions as possible by tax programs. The estimates are based on information from actual tax returns and secondary data sources. The four levels of reliability are determined by the accuracy of the data and the estimation procedure. Each provision is summarized with statutory citation, description, estimated cost, data source, and reliability level.

Utah. The Tax Commission of Utah includes an analysis of tax exemptions with its annual tax report. This report primarily provides information on revenue collection and distributions. Exemptions from state sales tax are listed by fiscal impact, however, the report does not include a qualitative assessment of the efficiency of the exemptions. The fiscal impact of other exemptions or tax expenditures is not estimated.

Texas. As required by statute, the Texas Office of Comptroller prepares a biennial tax expenditure report. This report estimates the revenue loss of each exemption, exclusion, discount, deduction, special accounting method, credit, refund, and special appraisal available under major taxes for a six-year period (FY2011-16). The revenue impact of tax expenditures is listed by income class, industry or business class. Each estimate is based on the best information available from public and private sources. The report contains no recommendations related to the exemptions estimated.

Other States:

California. By statute, the California Department of Finance is required to report on tax expenditures annually. Since 2006, this report has included a comprehensive list of tax expenditures exceeding $5 million, a description of the legislative intent of each expenditure, the sunset date and beneficiaries of each provision, and the estimated revenue loss for the current and two subsequent fiscal years. Other requirements include the number of businesses or taxpayers affected by corporate or personal income tax expenditures. The California report separates the tax expenditure by major tax and includes personal income tax credits and deductions.

Connecticut. The Office of Fiscal Analysis of the Connecticut General Assembly is required to provide a tax expenditure report on a biennial basis. The report includes a summary of major identifiable tax expenditures by revenue source for the most recent fiscal year and provides considerable detail for each tax expenditure. One of the unique features of this report is the assignment of rationale for the existence of each tax expenditure: Perceived Equity, Efficiency, Incentive, Redundancy, Cascading (or pyramiding) Clarification, Conformity, and Expediency.

Delaware. The Delaware Division of Revenue is required to report every other year on all newly created and existing tax *preferences*. Each preference is detailed as follows: statutory authority, description and purpose, revenue impact in current and previous fiscal years, assessment of the efficiency of the expenditure in achieving its purpose, and inadvertent impact. The most recent report (FY09) includes a discussion of the cumulative impact of multiple expenditures through the example of personal income tax credits and deductions targeted at seniors.

Iowa. The Iowa Department of Revenue published tax expenditure reports in 2000 and 2005. The department has also conducted independent evaluation of five key tax credits and a jobs training program. Iowa defines a base level tax structure and then considers any that deviates from that base and negatively impacts revenues a tax expenditure.

Louisiana. The Louisiana Department of Revenue is required to prepare an annual tax exemption budget report. This report must include the following information pertaining to the state's tax exemptions: a listing of each exclusion, exemption, credit, refund, preferential tax rate, or deferred tax liability; legal citation; purpose; an estimate of the revenues lost for the preceding three years and for the current and ensuing fiscal year; and estimated cost of administering and implementing each exemption. The department has been unable to provide an estimate of the administration cost of each tax expenditure.

Massachusetts. Massachusetts provides a tax report that includes the cost and description of each tax spending program, including historical data. The Executive Office for Administration and Finance calculates a base tax structure for each of the major taxes and then defines tax expenditures as deviations from that base. The detail for each tax expenditure is limited to statute, description and revenue estimate.

Minnesota. As required under Minnesota statutes, the Minnesota Department of Revenue has just issued the 12th biennial tax expenditure report which reflects Minnesota law after changes enacted in 2009. It contains an explanation and history for each provision, as well as the fiscal cost impact for fiscal years 2010 through 2013. The most recent version details 296 tax expenditures in 16 different tax programs. Each tax program is summarized followed by federal and state provisions.

Montana. Montana's Department of Revenue produces a tax expenditure report along with each biennial budget report. It identifies special provisions in the tax code that either reward or discourage private activities, and measures the cost of these special provisions in terms of reduced tax revenue.

Oregon. With the assistance of the Department of Revenue and the Department of Administrative Services, Oregon's governor is required by statute to release a tax expenditure report with each biennial budget recommendation. This report describes 378 tax expenditures in 17 Oregon tax programs evaluated by 28 agencies. The report includes a summary of each program's tax base, and an assessment of the efficiency of the tax expenditure in achieving its intended purpose. This report includes all provisions related to tax relief, and identifies tax expenditures that are scheduled to sunset in the next biennium. In addition, the report provides information about the beneficiaries of tax expenditures, if possible.

APPENDIX 2: Recommended Tax Expenditure Criteria

To achieve its goals of improving transparency, encouraging accountability, and saving money, a tax expenditure report should have the features listed below:

1. Accessibility. The report should be:
    a. Published regularly.
    b. Incorporated into the budget process.
    c. Available on the Web.
2. Scope. The report should include:
    a. Tax expenditures related to all taxes.
    b. Explicit and implicit tax expenditures.
    c. Tax expenditures enacted by the state that affect local government.
3. Detail. The report should include:
    a. The cost of the tax expenditure, using current data.
    b. The cost in future years, to allow comparison with other proposed expenditures.
    c. A description of the tax expenditure.
    d. The relevant legal citation and year of enactment.
    e. Detail on the taxpayers who benefit from the tax expenditure.
    f. Separate reporting for the state and local revenue losses, where applicable.
4. Analysis. The report should:
    a. Classify tax expenditures using the same categories as direct spending.
    b. State the intended purpose of the tax expenditure.
    c. Evaluate the extent to which that intended purpose has been accomplished.
    d. Analyze the distribution of benefits by income level and size of business.

Case Study: Oil & Natural Gas Royalty Deduction

Leila Burrows, Economist
Legislative Finance Committee

August 19, 2011

What are royalties?

Royalties are paid to oil and natural gas owners by producers for the right to extract resources. In this arrangement, risks and profits are shared between the owner and producer. Royalties are typically paid as a percentage of total production value.

How is the royalty deduction calculated?

New Mexico oil and natural gas producers can deduct the amount paid for state, federal and tribal royalties from the taxable value of production.

- Federal royalty rate – 1/8 of taxable value (12.5%)
- State royalty rates – 1/8 to 1/5 of taxable value (12.5% - 20%)

New Mexico receives 100% of royalties on state land and 48% of royalties on federal land.

Percent of production by land ownership:

Ownership	Oil	Gas
Federal	42%	62%
State	38%	18%
Tribal	1%	3%
Private	19%	17%
Total	100%	100%

LFC Tax Principles

The Legislative Finance Committee has adopted the following principles to guide responsible and effective tax policy decisions:

- ***Adequacy:*** *revenue should be adequate to fund government services.*
- ***Efficiency:*** *tax base should be as broad as possible to minimize rates and the structure should minimize economic distortion and avoid excessive reliance on any single tax.*
- ***Equity****: taxes should be fairly applied across similarly situated taxpayers and across taxpayers with different income levels.*
- ***Simplicity***: *taxes should be as simple as possible to encourage compliance and minimize administrative and audit costs.*
- ***Accountability/Transparency:*** *Deductions, credits and exemptions should be easy to monitor and evaluate and be subject to periodic review.*

Equity

•The royalty deduction creates an uneven playing field for producers. Producers on private land are unable to benefit from the deduction.

•On the other hand, the higher rate of deduction on state land could provide incentive to produce on state land, which could lead to increases in bonus lease payments and rental revenue.

•The higher royalty rate on state land could offset the lease gains.

Avg Royalty Rate - ONGARD FY10

	Oil	Gas
Federal	11.8%	10.5%
State	12.9%	11.8%
Tribal	14.9%	13.6%

Taxable value per MMbbls/mcf (millions)*

	Oil	Gas
Federal	$75.41	$4.65
State	$74.47	$4.59
Tribal	$72.76	$4.49
Private	$85.50	$5.20

*Calculated using July 2011 consensus price and volume forecasts for FY11 applied to FY10 effective royalty rate for each type of land ownership. Excludes deductions for transportation and processing

Efficiency

- While it can be argued that royalties are a type of revenue-sharing arrangement, some claim that royalties are another form of taxation. From this perspective, removing the deduction would result in multiple levies on the same dollar of income.
- Since such a large portion of NM production is on public land (80 percent) compared to other states, this deduction substantially reduces our tax base, lowering the revenue that can be generated by a given tax rate.
- However, this type of tax expenditure may encourage growth in the oil and gas industry, which could lead to high-skilled jobs or increased tax revenue.

Direct and Indirect Revenue from Oil & Gas

Approximately 29 percent of general fund revenue is generated directly or indirectly from oil and gas production.

Revenue generated from oil and gas production:

Tax Type	FY11 Estimate	Use	Estimated Revenue Loss from Deduction
80 percent of Federal Mineral Leasing	Approx $329 million	Dedicated to public school spending	$0
90 percent of State Land Office Revenue	Approx $79 million	Dedicated to schools, higher education institutions, and other state institutions	$0
Oil and Gas School and Conservation taxes	Estimated to be $374 million	General fund	$41.5 million
Natural Gas Processors and Resources Excise taxes	Estimated to be $28 million	General fund	$3 million
Oil and Gas Severance Tax	Approx $350 million	Capital Outlay	$40.4 million
Corporate Income Tax	Estimated to be $32 million	General fund	$0

Other Sources and Uses of Oil and Gas Revenue

- State royalties are distributed to the Land Grant Permanent Fund (LGPF), which provides funding for schools, higher education institutions and other state institutions.
- Severance tax revenue that has not been authorized for capital projects reverts to the Severance Tax Permanent Fund (STPF), a percentage of which is distributed to the general fund.
- Approximately $900 million in oil and gas generated revenue is dedicated to public schools.
- The royalty deduction resulted in an estimated loss of revenue of $85 million dollars in FY10.

Accountability

The amount paid in royalties is tracked and available through the ONGARD tax system.

FY10 Royalty Payments from Oil and Natural Gas:

- Federal $708.8 million
- State $332.2 million
- Tribal $37 million
- Private $180 thousand

State Comparison

	Production Taxes - Oil	Production Taxes - Gas	Royalty Taxes	Deduction	Land Type
CO	Severance tax - 2-5% (tiered) Conservation levy - 0.7-1.5% Ad valorem - 8.75%	Severance tax - 2-5% (tiered) Conservation levy - 0.7-1.5% Ad valorem - 8.75%	Federal - 12.5% State - 12.5%	Yes	Federal - 35.5% State - 4.4% Other - 60.1% Total Public - 39.9%
LA	Full rate oil - 12.5%	Full rate gas - $0.164/mcf	Federal - 12.5% State - 23%	Federal only	Federal - 5.0% State - 2.7% Other - 92.3% Total Public - 7.7%
NM	Severance - 3.75% Oil School Tax - 3.15% Oil Conservation - 0.24% Ad valorem - 1.5%	Severance - 3.75% Gas School Tax - 4% Gas Conservation - 0.19% Ad valorem - 1.5%	Federal - 12.5% State - 11.8%	Yes	Federal - 29.4% State - 11.2% Other - 59.4% Total Public - 40.6%
OK	Production Tax - 7% Petroleum Excise - 0.095%	Production Tax - 7%	Federal - 12.5% State - N/A	Yes	Federal - 1.3% State - 1.0% Other - 97.7% Total Public - 2.3%
TX	Severance - 4.6%	Severance - 7.5%	Federal - 12.5% State - 20-25%	Yes	Federal - 1.4% State - 0.5% Other - 98.1% Total Public - 1.9%
WY	Severance - 6% Ad valorem - avg 7.5%	Severance - 6% Ad valorem - avg 7.5%	Federal - 12.5% State - 16.7%	Yes	Federal - 48.4% State - 6.2% Other - 45.4% Total Public - 54.6%

Source: Data were compiled from state revenue depts, state land offices, state oil and gas commissions, federal publications and LFC files.

Constitutionality of Removing Deduction

- The doctrine of intergovernmental immunity precludes the United States from taxing states and vice versa.
- This doctrine also bars states from taxing the activities of Indian tribes, including royalty payments, absent express authority from Congress.
- A private party's interest in severed products cannot be taxed if calculated on the gross value of the severed products without first reserving the government's royalty interest (see Montana v. Blackfeet Tribe, 471 U.S. at 768, 1985).
- An attempt to repeal the royalty deduction from taxable value for severance tax purposes could be challenged as unconstitutional.

Potential Legislative Changes

- Statutory requirement to produce an annual report on total royalty deduction claimed.

- Raise royalty rate on state land, if federal government raises onshore royalty rates to match offshore rate (18.75 percent).

LFC HEARING BRIEF

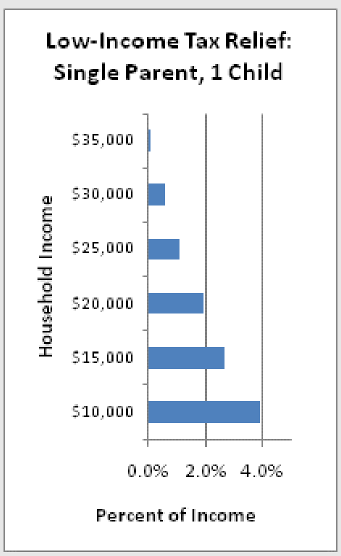
DATE: August 19, 2011

PURPOSE OF HEARING: Inventory of New Mexico's Tax Expenditures – Food Deduction

WITNESS: Richard May, Cabinet Secretary, Department of Finance and Administration, Demesia Padilla, Cabinet Secretary, Taxation and Revenue Department; Tom Clifford, Policy and Research Director, TRD, Elisa Walker-Moran, Chief Economist, LFC.

PREPARED BY: Charles Kassicieh, Economist, LFC

EXPECTED OUTCOME: Information and update on Food Deduction



BACKGROUND INFORMATION ON FOOD DEDUCTION

Food deductions reduce the gross receipts tax (GRT) that would otherwise be due on sales of food for home consumption. The United States Supplemental Nutrition Assistance Program (SNAP), historically and commonly known as the Food Stamp Program, is a service provided by the government that assists low-income or no-income households to purchase food. They are coupons that can be used to buy food. These are distributed by the state government to people without money to purchase food, even though the program is administered by the US Department of Agriculture.

In 2004 HB 625 removed the gross receipts tax on food for home consumption. Beginning January 1, 2005 food meeting the qualifications for the federal Supplemental Nutritional Assistance Program[1] (SNAP) became deductible. Only retail food stores qualifying to participate in SNAP are able to use the deduction; these stores must sell a variety of food (including breads/cereals, dairy, meat, fruit and vegetables) or specialize in one staple group such as a bakery or a butcher shop. Excluded are alcoholic beverages, tobacco, and prepared hot foods sold for immediate consumption. Unlike almost all other exemptions and deduction the food deduction must be separately stated in order to calculate hold harmless distributions to counties and municipalities. The food deduction costs the General Fund about $200 million per year.

ARE THERE RULES OF ELIGIBILITY

Food Stamps

There are several rules that must be met prior to becoming eligible for food stamps. They include having proper identification and a U.S. citizen. One must be able to supply information regarding how much money your household receives as well as how much one owns in property and in bank accounts.

Food Tax Deduction

Under the provisions of HB 625, businesses selling food for home consumption do not owe GRT on those sales. However there is a separate sin tax in place that taxes items such as liquor at a higher sales tax as compared to other taxable items.

FISCAL IMPACTS

With a continued high unemployment rate, more and more people are turning to SNAP. In May of 2010, there were over 361 thousand people that used food stamps. However, in May 2011 that number had jumped by more than 15% to 417 thousand participants. The total benefits paid out totaled nearly $542 million in FY 2010, with the average participant receiving $126.54 each month. The national average is $133.79.

[1] The Supplemental Nutritional Assistance Program was formerly known as the food stamp program.

As of FY11, the food GRT deduction reduced taxable gross receipts by a total of $3.1 billion. This reduced state GRT collections by $3,053,424,613 million. In addition, based on this deduction amount, the state made $98,808,038 million in hold harmless payments to local governments.

EVALUATING EFFECTIVENESS

Costs/Benefits

The food stamp program clearly provides very significant benefits to needy New Mexico households. With the Federal government covering most of the fiscal impacts, there is a clear net benefit to New Mexico from this program. One potential concern with the program may be that there are people that use the food stamps that don't need it or who take more than they really need.

The net benefits of the food GRT deduction are more difficult to determine. Benefits to low income families are limited, because their food purchases using food stamps were already exempt. Thus, most of the benefits of the measure go to middle class and upper class households. In addition, because the entire cost is funded by the State General Fund, the forgone revenue is not available for education, health care, public safety and other state needs. If the goal of the program is to lower the costs of meeting basic needs of New Mexico households, it would seem a more targeted approach would be through some kind of income tax relief such as the Working Families Tax Credit.

Program:	FY11 Fiscal Impacts
Working Families Tax Credit	$45 million
Low & Middle Income Exemption	$30 million
Low-Income Comprehensive Tax Rebate (LICTR)	$24 million

Alternatives

Food Pantries

Most communities have food pantries where area residents can go to get assistance. Each food pantry has its own rules about who can get food based on residency in the area, income and other requirements. Some are open only certain days of the week and during limited hours as they are volunteer-staffed.

Community Feeding Centers

Soup kitchen facilities are also available in many communities. They often serve meals five days a week, and may be open for all three meals of the day, depending on the facility. Balanced meals are served in a communal room where people can eat together.

Income Tax Credit

A handful of states tax food at their regular sales tax rate but provide a refundable income tax credit to offset the tax on food paid by low-income households. This allows the expenditure to be targeted only to low-income NM residents. Unlike NM's current food deduction, this would not subsidize the purchase of imported cheese by a high income European tourist.