HISTORICAL OVERVIEW OF NEW MEXICO'S TAX SYSTEM
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The NM tax system consists of many taxes, but the most important taxes from a revenue standpoint are:

- Gross Receipts and Compensating Taxes
- Personal and Corporate Income Taxes
- Severance Taxes

These three taxes provide about 78% of all NM general revenues.

The fourth largest source of tax revenues is the Property Tax, which provides a large part of local government operating and capital funds, especially for counties.

In delving into the NM tax system, it is important to have a little information on how the tax system evolved. The following is an outline of key events, influences and litigation shaping our present tax system:

I. Gross Receipts and Compensating Tax.

- Had its roots in 1935, in the depths of the great depression.
    - NM had extreme financial problems like most states.
    - Property tax revenues had vanished.
    - The legislature enacted the "emergency school tax" imposed on goods and services at varying rates at around 2%.
        - Taxed mineral severance.
        - All retail sales.
        - Virtually all services.
    - During this same period, most states chose to primarily tax all retail sales of tangibles and severance of natural resources.
    - NM was somewhat unique in taxing services—most states saw taxing of tangibles as primarily taxing non-resident manufacturers of goods, while taxing services was viewed as being primarily borne by state residents.
    - NM was such a sparsely populated state with no industry, therefore by necessity, had to tax virtually every bit of commerce of all types to have any revenue base at all.
    - NM has continued to be unique among the states, along with Hawaii and South Dakota in taxing nearly all services and leases, in addition to tangibles in a very broad based gross receipts tax.

- 1959 saw a major revision of the Emergency School Tax Code.
    - Oil and gas was subjected to a separate law.
    - Major rewrite of the Code.

- 1966 and subsequent years saw other major revisions in the Code.
    - The "emergency sales tax" replaced with the Gross Receipts and Compensating Tax Act.[1]
    - Municipalities, to a less extent, counties were permitted to impose their own local option taxes.

- 1969 was the year the Governor appointed Franklin Jones as Commissioner of Revenue of the then Bureau of Revenue. Franklin worked tirelessly to improve the administration of taxes, with emphasis on the Gross Receipts and Compensating Tax Act. In that year the Act was extensively rewritten.

- 1981-83, in the *ERDA* case, the US Supreme Court upheld the application of the NM Gross Receipts Tax on US government contractors. This was a landmark case that helped shape NM revenues.
    - Under Federal law, states are prohibited from imposing a sales tax directly on the Federal government.
    - With a Gross Receipts Tax, a state imposes the tax on the contractor providing services to the Federal government, irrespective of whether or not the contractor passes the tax on to the Federal government.
    - As a practical matter, the contractor usually passes the tax on.
    - In this manner, the state of NM receives many millions in tax revenues it would not receive under a traditional sales tax.

- 1991, saw the enactment of the Governmental Gross Receipts Tax. This was to level the playing field for sales of good and services by governmental bodies in competition with regular businesses.

II. Severance Tax.

- These taxes are imposed on the volume or value of mineral production of sales.

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[1] Difference between a "sales tax" and a "gross receipts tax"-a sales tax is a tax imposed on the "buyer" and the "seller" just acts as a collection agent; while the gross receipts tax is imposed on the "seller" on gross their receipts for the privilege of doing business in NM, even if the seller doesn't pass the tax on to the buyer.

- 1933 saw the enactment of the severance tax.

- In 1959, a separate Oil and Gas Severance Tax was passed.

- Over subsequent years, each resource was covered under a separate code with varying rates.

- In 1973, the legislature created the Severance Tax Permanent Fund as the repository for taxes not required for repayment of severance tax bonds.

III. Income Tax.

- Corporate Income Tax.
    - Originally enacted in 1919.
    - In 1961, NM joined other states is passing the Uniform Division of Income for Tax Purposes Act (UDITPA).
    - In 1993, the legislature made a major change to UDITPA by allowing manufacturers the option of double-weighting their sales income.
    - The Corporate Income Tax is highly volatile, in part because of the volatile nature of corporate profits.

- Personal Income Tax.
    - Originally enacted in 1919.
    - 1961 saw the enactment of withholding of the income tax by employers. That year, NM established its present concept of "piggy-backing" onto the Federal income tax.
    - 1972 saw enactment of the Low Income Comprehensive Tax Rebate (LICTR).
    - 1997, quarterly estimated payments on state income tax required.
    - 2003 saw the enactment of a major reduction in the top rates of the personal income tax, phased over several years.

- Because of the ease of adjusting income tax rates:
    - This tax source as played the role of a revenue stabilizer, tending to offset fluctuations in other taxes.
    - Has been used in NM to take the regressive edge off of the rest of the tax structure, for example, with the Low Income Comprehensive Tax Rebate (LICTR).

IV. Property Taxes.

- The Property Tax predates statehood and in early years was a primary revenue source.

- The Depression saw property values fall and the property tax fell dramatically.

- New Mexicans have a historical and deeply felt aversion to property taxes. In territorial days many people lost their property because they could not pay their property taxes.

- In 1973, there was a re-codification of the property tax code.

- Local assessors value residential and small business property, while the state handles large businesses such as utilities, railroads, pipelines, etc.

- In 1981, two separate classes of property were adopted: residential and non-residential.

- Property taxes continue to be the major source of revenues for local governments.

V. Other Taxes. There are a host of other taxes, but time does not allow me to cover those. The Tax Department (TRD) and the Department of Finance and Administration (DFA) will cover all of the taxes in detail.

VI. In looking at all tax programs, there are four tax policy criteria that should be considered in looking at each program:

- "Adequacy"
  - Gauges the ability of a particular tax program to raise the revenues necessary to fund governmental spending.
  - A tax is adequate not only if it generates the requisite revenues in the current year, but also if the tax is sufficiently elastic to react to changes in the economy.

- "Equity"
  - This is the most important criterion for a tax program.
  - Equity generally means fairness and the fairness of a tax is measured in two ways:
    - Taxpayers with the same tax base pay the same amount of tax (horizontal equity).
    - Taxpayers with a larger tax base are often viewed as being able to pay a larger percentage of that base in taxes (vertical equity or a progressive tax).

- "Efficiency"
  - Measures the effect of the tax on economic activity within the jurisdiction.

        - Under ideal conditions, a tax should be "neutral" and not cause taxpayers to alter their activity to produce more favorable tax treatment.

    - "Simplicity"
        - Weighs compliance concerns from both the taxpayers' and the tax departments' different perspectives.
        - For taxpayers, the tax should be as simple as possible with which to comply.
        - For the tax collector, administration and enforcement should not be so costly as to hinder enforcement.

VII. All in all, the NM tax system provides the lion's share of the total funding of state government, schools, universities and local government.

- There are a number of features that distinguish NM public finances from most other states:
    - High reliance on revenues from the extractive industries, primarily oil and gas.
    - High reliance on the gross receipts tax that broadly taxes services.
    - High degree of centralization of collection of certain local option revenues for local governments.
    - High degree of state participation in and funding of public schools and universities.
    - Low dependence on property taxes at the state level. Primarily utilized by local governments.
    - Existence of substantial, income producing permanent funds.

- Many surrounding states that are facing huge shortfalls in revenue would gladly trade places with us---example is California, which is facing a $30 billion deficit on a $100 billion budget!

VIII. Conclusion: In looking a changes in the NM tax system, there are a number of constraints or models the Commission will have to consider:

- NM Experience-Have to consider what is "saleable" to the citizens of NM for the long haul. For example, increasing reliance on the property tax is a poor choice, in view of NM past problems, deep-rooted dislike, and problems of administration.

- Inter-state Tax Competition-State tax systems are competitive for economic development initiatives.
    - States need to be attractive to mobile capital and labor to survive. An important element of the competition between

    - states is the appearance of being attractive to economic development projects.
    - People and capital can move easily into or out of NM, to other states or even other countries.

- Constitutional Restrictions-The US constitution/laws and NM constitution sets limits on what we do with our tax system.
    - The US constitution disallows taxes that interfere with interstate commerce; taxes that discriminate between state residents and residents of other states; taxes which conflict with laws passed by Congress.
    - No taxes directly on the US government.
    - The NM constitution sets broad standards for valuing property for property tax purposes.
    - The NM constitution requires that a portion of severance taxes be placed in a permanent fund.
    - Consideration of the anti-donation clause.

- The "Three Legged Stool" Theory-Many tax experts and economists believe that states must try to achieve balance similar to a "three legged stool":
    - They suggest that the legs of the stool are income taxes, property taxes and sales taxes.
    - They suggest that the legs of the stool should be of equal length in order to achieve a stable, productive and predictable revenue stream over time.
    - By decreasing the reliance on any one tax and maintaining a balance, revenues are more predictable.
    - As an interesting exercise if you apply this theory to NM, you have for the '03 FY, dollars in millions:
        - General and Selective Sales Taxes $1,654.80
        - Income Taxes 1,258.90
        - (In Lieu Of Property Taxes) Investment Income, Mining Taxes, Rents, Royalties & Other 1,107.50

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