GAO
Government Accountability Office
New Mexico Office of the State Auditor
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Transparency Report
Understanding Tax Choices

Compiled Data Sheds Light on Consequences of Tax Policy

The data regarding New Mexico's tax programs reveals a complex picture. About half of all revenue that the State does not collect as a result of tax breaks comes from three sources: multiple extractive industry tax breaks (comprising 27% of all tax breaks); two broad gross receipts tax breaks that benefit all New Mexicans (17%); and nonprofit organizations' exemption from gross receipts tax (8%). The remaining one-half of all tax breaks span multiple industries, sizes, and types of programs.

In compiling this report, the OSA was faced with a lack of transparency on tax break data that stems in part from privacy provisions in the Tax Administration Act. For example, in the uranium industry, little information was shared because fewer than three taxpayers avail themselves of these tax breaks. The OSA relied on 2015 data for the uranium hexafluoride deduction, but we have no other data for the uranium industry. The Legislature should consider whether the beneficiaries of such generous tax incentives should provide appropriate exceptions to some of their privacy rights so that the public can assess their fiscal impact and return on investment.

In addition, the structure of some tax breaks require assumptions in order to calculate impact. Tax breaks based on adjustments to taxable value are particularly opaque. For example, the extractive industries reported well over half a billion dollars in various adjustments to taxable value, but the impact of these adjustments to revenue could only be estimated. As part of a comprehensive review of tax policy, the Legislature should require additional reporting that brings transparency to these incentives.

A thoughtful examination of tax programs and their relative returns on investment is the best practice followed by most states, and strongly recommended by the U.S. Government Accountability Office. The OSA is aware that New Mexico may not have all of the data necessary to develop detailed economic models for all of the 180 tax breaks that the OSA has identified, 23 of which have no data at all. That said, the Legislature should not let the perfect be the enemy of the good. Legislators deserve thorough information and time to consider it before making major changes to the tax code, and New Mexicans deserve no less.

Tax Terms
in a nutshell

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At the most basic level, the amount of tax due is calculated by defining a "taxable event," and then applying a "rate" to a "taxable value" to determine a "tax liability." Over years of tax policy development, lawmakers may adjust each of these components in literally hundreds of different ways. All of these decisions occur against the backdrop of a government's effort to raise adequate and predictable revenue for government to function.

The term "tax expenditure" generally means the amount of revenue that the government does not receive when a tax policy decision deviates in some way from a "normal" situation. Experts and decision-makers have a range of different opinions about what types of tax policy establish what is "normal," in contrast to deviating from what is "normal." This is why developing a budget of tax expenditures can get bogged down in technical disputes.

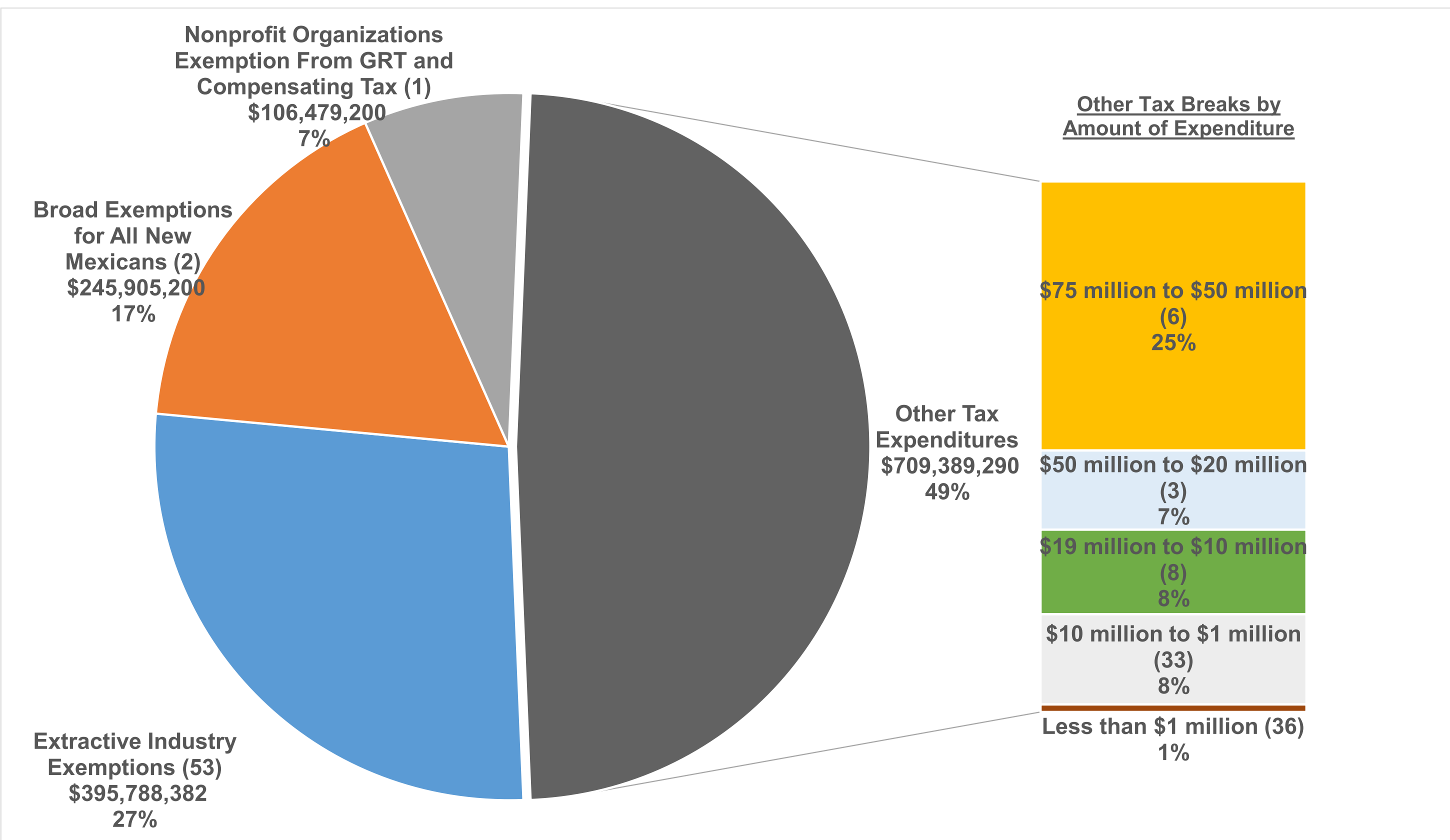
"Financial reporting plays a major role in fulfilling government's duty to be publicly accountable in a democratic society."
– Governmental Accounting Standards Board, Concept Statement No. 1.

Analysis

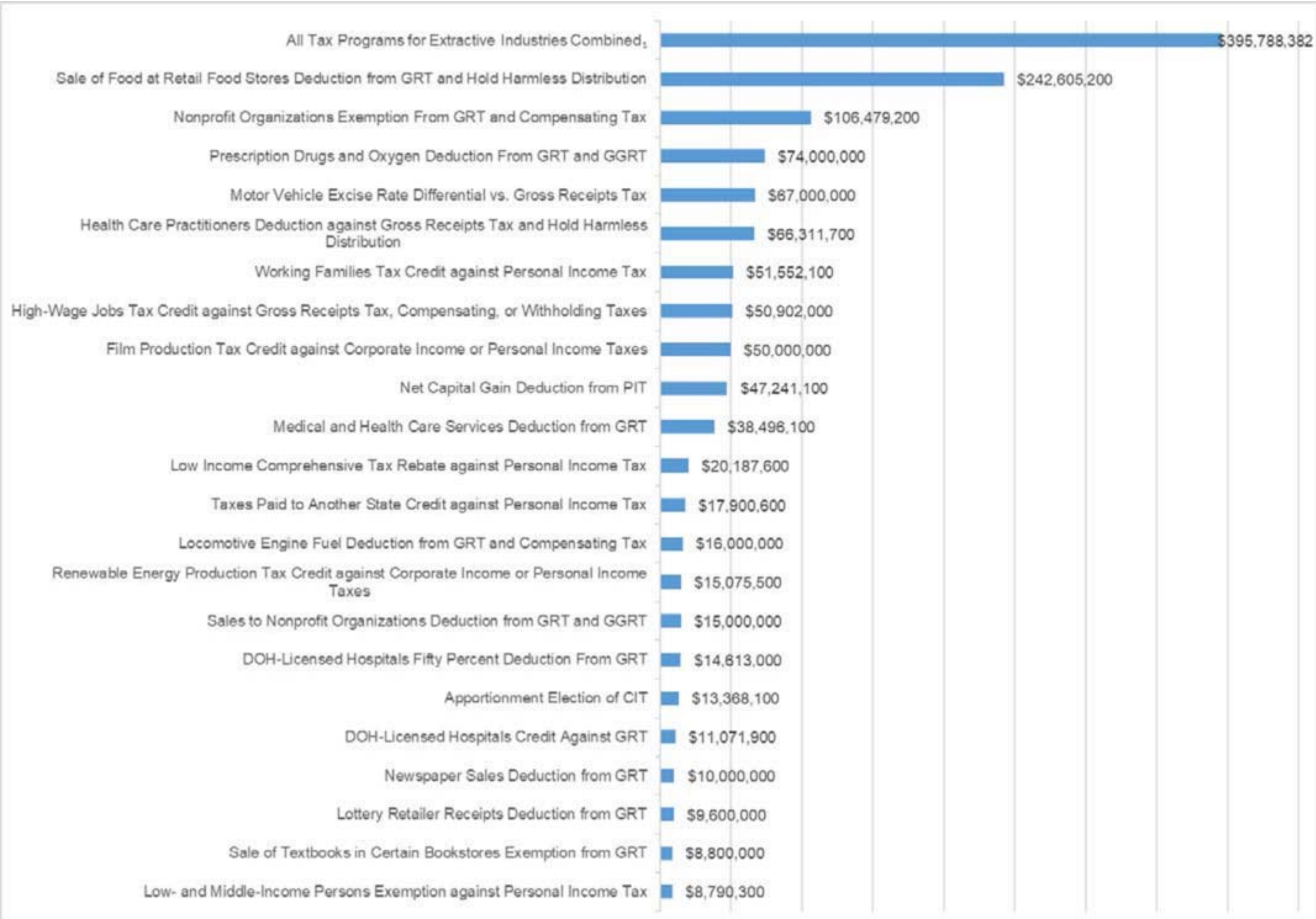
Tax policy defines what is taxable (property, revenue, income, or inheritance). A "taxable event" is the trigger that makes tax due, and is generally when something is transferred or received. Decisions makers may incentivize certain activities by making them "exempt" from taxation. Tax policy also defines who is liable for the tax, for example, the buyer or the seller in a sale. Again, some classes of taxpayers may be "exempt" in some situations. Of the many ways to value something, policy makers may decide to use an actual number, a fair market value or some other base value calculation, tax policy may provide "deductions" and "exclusions" that reduce the amount subject to tax. There are many ways to calculate a tax rate, and again, to make a rate lower for activities we want to encourage, higher for riskier activity. Once the "rate times taxable value" equation occurs, "credits" reduce tax liability dollar for dollar for the amount of credit. The law may also provide ways to "defer" when a tax is due.

With helpful collaboration from the TRD, the OSA was able to gain clarity regarding extractive industry tax programs and other areas not covered in TRD's Tax Expenditure Report. Executive Order 2011-071, issued in response to the 2011 veto of SB 47 (Tax and Revenue Department Tax Expenditure Budget), limits the scope of that report. From the OSA's perspective of examining all financial affairs of the State, our work encompassed certain rate differentials, adjustments to value and other types of programs not discussed in the TRD report.

Summary of Major Tax Programs
(see Methodology Section for details)



Largest Tax Programs
(see Methodology Section for details)



Learn More

Tax Expenditure Budgets and Reports: Best Practices, National Conference of State Legislatures

Tax Expenditure Reports: A Vital Tool with Room for Improvement, Institute on Taxation and Economic Policy

Tax Expenditure Database, The Pew Charitable Trusts

Tax Expenditure Resource Page, United States Government Accountability Office

Local Tax Expenditures: The Rest of the Story

This Report and the TRD Tax Expenditure Report examine tax programs at the state level. Historically, no agency has been in a position to compile a comprehensive picture of tax programs at the local level. These programs include industrial revenue bonds (IRBs) and tax increment development districts (TIDDs) that are implemented primarily by municipal and county governments. For the first time ever, the OSA will be able to compile this information through the new auditing standard known as Government Accounting Standards Board Standard No. 77 (GASB 77). GASB 77 requires all audited agencies to disclose any tax abatement agreements and a variety of information about each such agreement, including the identity of the recipient, the amount of taxes abated, and the potential impact on revenue due to other government agencies. New Mexico has been recognized as a national leader in GASB 77 implementation because of the OSA's approach to disclosure. The OSA will begin to receive tax abatement agreement data in October 2017 and will compile it on an ongoing basis.

Methodology

All data is from 2016, or 2015 when that was the most recent data provided in TRD's Tax Expenditure Report, with the following exceptions:

a. Data from LFC's 2015 tax expenditure report was used for: the molybdenum, potash and timber rate differentials against the resource component of the resource excise tax, the aircraft sales or services deduction from GRT, and the uranium and uranium hexafluoride enrichment deduction from GRT.

b. Most recent data available, which was dated as early as 2009, for 15 tax programs (updated information was not included in TRD's Tax Expenditure Report) was used for: unpaid charges for hospital services credit against GRT; taxes paid to another state credit against PIT; Native Americans' income exemption against PIT; motor vehicle excise rate differential against GRT; sales to tax-exempt entities deductions against resources and processors components of resources excise tax; molybdenum, potash and timber rate differentials from processors component of resource excise tax; royalty deduction from severance tax for natural resources except coal and uranium; royalties paid or due to the U.S., State of New Mexico or any Indian Tribe, pueblo, or ward of the U.S. deduction from severance, conservation, emergency school and ad valorem taxes; oil and other liquid hydrocarbons intergovernmental production tax credit against the severance, emergency school, conservation and ad valorem taxes; the coal intergovernmental production tax credit against severance tax; the intergovernmental business credit against CIT; disabled street vendors exemption from GRT; nonprofit elderly care facility exemption from GRT; electric transmission and storage facilities deduction from GRT and compensating tax.

The category of tax programs for extractive industries covers a wide array of materials, tax break types, and purposes. They include the following (by material):

Coal: Tax-exempt sales, service charges and royalty deductions from the Oil & Gas Conservation Tax, exemption from the severance surtax, Intergovernmental Production Credit against severance tax, and rate differentials against the severance tax and severance surtax.

Copper: Rate differential on severance tax.

Gold & Silver: Rate differential on severance tax and hoisting, loading, crushing and processing or beneficiation costs deductions from severance tax.

Molybdenum: Tax-exempt sales, service charges and royalty deductions from the resources, processors and severance tax components of the resources excise tax; hoisting, loading, crushing and processing or beneficiation costs deductions from severance tax; rate differentials on the resources and processors tax components of the resource excise tax.

Natural Gas: Deductions from the gas processors tax for gas returned to lease, force majeure and gas flared; already taxed exemptions from gas processors tax and oil & gas severance tax; rate differentials on oil & gas severance and emergency school taxes.

Natural Resources (other than coal, copper, gold & silver, molybdenum, potash, timber & uranium): Hoisting, loading, crushing and processing or beneficiation costs deductions from severance tax, royalty deductions from severance tax.

Oil, Natural Gas or Liquid Hydrocarbons, Carbon Dioxide, and Helium and Non-Hydrocarbon Gases: Processing and transportation costs deductions from the oil & gas severance, conservation, emergency school, ad valorem and processors taxes; credit against emergency school tax for products located in Jicarilla Apache Tribal lands; intergovernmental production credits against the oil and gas severance, conservation, emergency school, ad valorem and processors taxes; rate differentials on the severance and emergency school tax rates.

Potash: Tax-exempt sales, service charges and royalty deductions from the resources, processors and service tax components of the resources excise tax; hoisting, loading, crushing and processing or beneficiation costs deductions from severance tax; rate differential on the severance tax rate.

Timber: Tax-exempt sales, service charges and royalty deductions from the processors tax component of resources excise tax, and rate differential from severance tax rate.

Uranium: Deductions from gross receipts, severance, compensating, and oil & gas conservation taxes.

Others: Sales to tax-exempt entities deductions from processors and resources components of the resources excise tax; royalties paid or due to the U.S., State of New Mexico, or any Indian Tribe, Pueblo, or ward of the U.S., deductions from the oil and gas severance, conservation, emergency school and ad valorem taxes.

Certain information was not available in disaggregated form because of concerns about taxpayer confidentiality. These programs are: the hoisting, loading, crushing and processing or beneficiation costs deductions from severance tax for potash, molybdenum, gold and silver; potash and coal tax-exempt sales, service charges and royalty deductions from processors component of resources excise tax; potash and gold and silver rate differentials against severance tax rate; coal rate differential against severance surtax.

Estimates were necessary to quantify selected tax expenditures. The data utilizes three estimates:

a. For tax programs for which TRD estimated an amount of forgone revenue, OSA used TRD's figures. They include the Natural Gas exemption from processors tax for gas already taxed and deductions for gas returned to lease, force majeure and gas flared; Oil and Other Liquid Hydrocarbons, Natural Gas, and Carbon Dioxide: Jicarilla Apache Tribal Capital Improvement Tax Credit against Oil and Gas Emergency School Tax; Oil, Natural Gas or Liquid Hydrocarbons, Carbon Dioxide, and Helium and Non- Hydrocarbon Gases: Processing Costs Deductions from Natural Gas Processors Tax; Unreimbursed or Uncompensated Medical Expenses for Persons 65 Years of Age or Older Credit from PIT; Unreimbursed or Uncompensated Medical Expenses for Persons 65 Years of Age or Older Exemption from PIT; and Unreimbursed or Uncompensated Medical Care Expenses Deduction from PIT.

b. For certain programs that result in an adjust to taxable value, TRD was able to provide the amount by which taxpayers decreased the taxable value. OSA then estimated lost revenue by applying the applicable tax rate to the decrease in value. In cases where multiple rates may have been applicable, OSA used the lowest rate or an average rate. These included the oil and gas processing and transportation costs deductions from the severance, emergency school, ad valorem, conservation and processors taxes; hoisting, loading, crushing and processing or beneficiation costs deductions from the severance tax for all materials; royalty deductions from the oil and gas conservation tax and the resources excise tax.

c. In the extractive industries, some rate differentials are expressed without reference to a standard rate. To calculate the figures for these differentials, TRD provided actual revenue figures. OSA then used these figures to determine taxable value, and then applied the rate one tier higher to come up with a hypothetical revenue figure. OSA then subtracted the actual revenue from the hypothetical revenue figure to estimate forgone revenue. These rate differentials were as follows: the copper, gold and silver, potash and timber rate differentials against the severance tax rate; the natural gas rate differentials against the severance and emergency school tax rates; and the oil and other liquid hydrocarbons rate differentials against the severance and emergency school tax rates.

The category of “broad exemptions for all New Mexicans” covers non-specialized tax breaks that can be utilized by all taxpayers. They include the sale of food (approximately $133 million) and hold harmless deduction (approximately $108 million) from gross receipts tax, as well as the back-to-school tax free weekend deduction from gross receipts tax.

Not included in this data is the insurance premium tax, which is adjusted by certain credits that could be considered tax breaks. As of the release date of this Report, the OSA had designated the Office of the Superintendent of Insurance (OSI) for a special audit of premium tax collection that is currently underway. The audit is designed to bring transparency to the dollar value of credits against premium tax. Because previous audits suggested large discrepancies in premium tax calculations, which amounted to potential underpayments of hundreds of millions of dollars to the state, the OSA did not believe it was appropriate to include historical premium tax numbers. The OSA is working together with DFA, LFC, and OSI to bring closure to this issue and determine the extent to which underpayments may be due from the most significant filers. The outcome of the special audit, which will be available in the fall, could have a very significant impact on potential revenue for the State. Additionally, systemic management and financial challenges were identified in the OSI’s annual financial audit for Fiscal Year 2016 resulting in a “disclaimer of opinion” and 31 findings. These issues also impact the reliability of the agency’s tax collection efforts.

The data used in this study is available at the OSA website:
http://www.saonm.org/government_accountability_office